

Relationship between Climate Change and International Investment Law. Lack of precision in BITs and its impact on further dispute settlements



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Relationship between Climate Change and International Investment Law. Lack of precision in BITs and its impact on further dispute settlements.

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Abstract

The interaction between Climate Change and International Investment Law is considered a crucial study due to the rising periodicity and complexity of disputes where environmental protection and investor rights interfere. The lack of precision in Bilateral Investment Treaties (BITs) covering environmental provisions and sustainable development objectives specifically gives rise to this issue. This uncertainty created by the legal gap causes arbitral tribunals to act in the restricted guidance on how to set the impartiality between investor protection in compliance with the host state's regulations as an obligation under International Environmental Law and Multilateral Climate Agreements, such as the Paris Agreement. There is an urge in harmonized treaty languages concerning climate change. This study explores the climate change legislation in the first chapter. In the second chapter of the thesis, aspects such as dispute settlement according to BITs, and related to the topic, BIT provisions, are covered broadly. Besides the legal research, this study includes the analysis of two different cases, those are discussed in the last chapter. Finally, this study concludes by recommending the alignment of BITs with climate goals.

Keywords: Climate change, Investment Law, Paris Agreement, Arbitration, BITs, investor rights.

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Acknowledgement

I dedicate my work to my grandmother Leyli Jalilova, the woman who inspired me to become an independent and educated version of myself.

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Introduction

This paper investigates the intersection between climate change as a part of Environmental Law and BITs as a pivotal tool of International Investment Law. The principal objective of this paper is the impact of uncertainties accrued due to the poorly drafted environmental provision in BITs. The first chapter introduces climate change as an actual question and covers deeply the legal framework of climate change. Additionally, Chapter 1 provides introductory data regarding ICSID and BITs related to the environmental provisions. Consequently, the literature review is mainly covered in the first Chapter. Findings start from the second chapter, which combines both theoretical and the transition to practical part of the thesis. This chapter integrates the critical reflection on how the investment treaty design and interpretation need to evolve to align with the global agenda. Moreover, this chapter reflects the paragraph that reflects how states can set the fairness between protecting foreign investors and safeguarding environmental interests. The third chapter concludes the paper with the practical and contrasting ICSID cases in the beginning, leading to the discussions of the paper with recommendations highlighted in the second chapter and analysis of the literature review of the first chapter. The conclusion of the paper includes the main idea and covers the study's limitations. The research methodology of this paper is mixed qualitative, which consists of doctrinal research and a practical case study.

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Chapter 1

Climate change as an actual problem.

Climate change is not only an environmental issue but also a legal, ethical, and human rights concern in the frame of international environmental law. It poses as a clear danger to global welfare with visible impacts such as extreme weather events, rising sea levels, and disrupted ecosystems across regions. Climate change is already observed from flooded homes in Spain to forest fires in Australia, from rising oceans in the Pacific to barren plains in East Africa.¹ The resolving climate change problem is our moral duty and a part of the common responsibility of all citizens in the World. Nothing has a greater impact on the security, prosperity, and well-being of all nations such as climate change². As COP29 President Mukhtar Babayev mentioned at the UN Climate Change Conference, to save “tomorrow,” people need to invest in “today”.³ Before diving into the topic, it is suggested to get to know the problem better.

As quoted in the article of the United Nations: “*Climate change refers to long-term shifts in temperatures and weather patterns. Such shifts can be natural, due to changes in the sun’s activity or large volcanic eruptions. But since the 1800s, human activities have been the main driver of climate change, primarily due to the burning of fossil fuels like coal, oil, and gas.*

*Burning fossil fuels generates greenhouse gas emissions that act like a blanket wrapped around the Earth, trapping the sun’s heat and raising temperatures. The main greenhouse gases that are causing climate change include carbon dioxide and methane. These come from using gasoline for driving a car or coal for heating a building, for example. Clearing land and cutting down forests can also release carbon dioxide. Agriculture, oil, and gas operations are major sources of methane emissions. Energy, industry, transport, buildings, agriculture, and land use are among the main sectors causing greenhouse gases”.*⁴

The Intergovernmental Panel on Climate Change (IPCC) is the international authority for assessing the science linked to climate change. The IPCC was set up in 1988 by the World

¹ UN. (2023). Climate Change-induced Sea-Level Rise Direct Threat to Millions around World, Secretary-General Tells Security Council.

² Buhaug, H., Benjaminsen, T. A., Gilmore, E. A., & Hendrix, C. S. (2022). Climate-driven risks to peace over the 21st century. *Climate Risk Management*, 39.

³ Babayev, M. (2024) Opening Speech at the UN Climate Change Conference. COP29 Proceedings.

⁴ United Nations. (n.d.). What is climate change?

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Meteorological Organization (WMO) and United Nations Environment Programme (UNEP) to provide policy writers with regular assessments of the scientific foundation of climate change, its impacts and possible, arising risks, and options for adaptation and mitigation.⁵ According to the IPCC report: *“Human activities, principally through emissions of greenhouse gases, have unequivocally caused global warming, with global surface temperature reaching 1.1°C above 1850-1900 in 2011-2020. Global greenhouse gas emissions have continued to increase, with unequal historical and ongoing contributions arising from unsustainable energy use, land use and land-use change, lifestyles and patterns of consumption and production across regions, between and within countries, and among individuals.” “Widespread and rapid changes in the atmosphere, ocean, cryosphere, and biosphere have occurred. Human-caused climate change is already affecting many weather and climate extremes in every region across the globe. This has led to widespread adverse impacts and related losses and damages to nature and people (high confidence). Vulnerable communities who have historically contributed the least to current climate change are disproportionately affected”*⁶.

Climate change is deemed as an actual problem since it results in breach of right and a potential breach of the rights of the next generations. All people have the right to a clean, healthy, and sustainable environment. As human rights and the environment are interdependent, a clean, healthy, and sustainable environment is necessary for the full enjoyment of a wide range of human rights, such as the rights to life, health, food, water, sanitation, and development, among others.⁷ Moreover, the concept of intergenerational justice also causes the potential breach of the upper-mentioned right of the descendants. Besides this, climate change is a critical and growing threat to national and international security.⁸ Mostly influenced by climate change will be people living in financially restricted conditions, in underdeveloped and unstable countries, and under poor governance. Furthermore, the effect of the physical consequences – such as more frequent extreme weather, melting glaciers, and shorter growing seasons – will add to the pressures under which those societies already live. The background of the lack of resources and weak governance lead these communities to have a low capacity to adapt to climate change

⁵ Intergovernmental Panel on Climate Change. (2024). What is the IPCC?

⁶ Intergovernmental Panel on Climate Change. (2023). Climate change 2023: Synthesis report. Summary for policymakers. Contribution of Working Groups I, II and III to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change.

⁷ United Nations Development Programme, United Nations Environment Programme, & United Nations High Commissioner for Human Rights. (2023) What is the right to a healthy environment?

⁸ Council on Foreign Relations. (2024). National security and climate change.

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and be challenged by a extreme risk of violence⁹. In this context, Russia's thawing permafrost is an obvious example. Permafrost is warming much faster than scientists had once thought. That's dangerous for Russia because two-thirds of the country rests on permafrost. When it melts, the ground is less solid, and that could be disastrous for cities and critical infrastructure like buildings and oil pipelines.¹⁰

As the global community seeks to respond to climate change through international cooperation and legal frameworks, it has become significant to examine how environmental protection overlaps with other areas of international law. Considering inter-state relations, this has become especially important in the framework of international investment law.¹¹ While climate and environmental regulations are essential for sustainable development they might sometimes be conflicting for the economic interests of foreign investors. This tension is particularly relevant for large-scale projects that might create environmental risks while bringing economic growth. Thus, understanding this relation is critical for measuring how states can balance environmental obligations with responsibilities under bilateral investment treaties and how disputes from such conflicts are addressed through international mechanisms like ICSID. The following section explores the overlapping principles, tensions, and dispute resolution mechanisms at the crossroad of international investment law and international environmental law.

1.1 International investment law and international environmental law. The role of ICSID.

Climate law has continually been described as a component of environmental law. In the frame of this concept, environmental law and climate law are jointly supportive endeavours towards sustainable development.¹² Since the BITs consider investments, it is crucial to comprehend the roles of both international investment law and environmental law. Thus, in the case of environmental measures' impact on foreign investments, elements of international investment law act as a guide for investors.¹³ There exist several common features between International investment law and International environmental law. Starting with, they both have a role in

⁹ International Alert (2007), A climate of conflict: The links between climate change, peace and war

¹⁰ Vinnall, F. (2022). Why Russia's thawing permafrost is a global problem. NPR.

¹¹ Popa Tache, C. (2025). Normative grey areas in international investment law the dynamics of regions, technologies, dispute resolution, and the environment. *International Investment Law Journal*, 5(1), 4-10.

¹² Woolley, O. (2021). *Climate Law and Environmental Law: Is Conflict Between Them Inevitable?*

¹³ Viñuales, J. (2017). *Foreign Investment and the Environment in International Law*. Cambridge University Press.

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regulation in the usage of natural resources. Environmental law sets regulations and restrictions on the usage of natural resources. As Article 15.1 of the Convention on Biological Diversity mentions: “Admitting the national rights of Governments over their natural resources, the power to determine access to genetic resources rests with the national governments and is subject to domestic legislation.”¹⁴ On the other side, from the perspective of International investment law, natural resources are regulated as economic assets through investment treaties and agreements between states and investors. Another common ground is having sustainable development as a objective. Referring to the article on “*International investment law and sustainable development. The role of international law in development*” by Ursula Kriebaum where author refers to “K Gordon, J Pohl, M Bouchard, Investment Treaty Law, Sustainable Development and Responsible Business Conduct: A Fact Finding Survey, OECD Working Papers on International Investment, 2014/01” : “*State parties concluding investment protection treaties always aim to foster economic development. Only more recently, concerns for sustainable development have led to the inclusion of language into investment protection treaties that aims to integrate goals of investment protection and sustainable development*”¹⁵ While sustainability is among the leading principles of Environmental law (through the protection of natural resources), the investment law is trying to reach this goal through “green” investments. Green investment supports business that contributes natural environment. Green investments focus on projects or company initiatives linked to the conservation of natural resources, pollution reduction based on criteria such as socially responsible investing (SRI) or environmental, social, and governance (ESG).¹⁶

Also, investments may influence the environment as before executing the start of the big projects, such as plant construction, electricity stations, roads, mines, pipelines, resorts and others, the land needs ecological expertise. Environmental impact assessment of (foreign or non) investment projects is carried out before construction starts. In comparison, while international investment law promotes investments, States maintain their right to protect the environment. Such an outcome forms a conflict where investors claim compensation for restrictions caused by the States. Consequently, dispute solutions are regulated by means of

¹⁴ Article 15.1; Convention on Biological Diversity (1993)

¹⁵ Kriebaum, U. (2022). International investment law and sustainable development. The role of international law in development. SSRN.

¹⁶ Chen, J. (2022). Green Investing; Investopedia

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investment arbitration, namely in the International Centre for Settlement of Investment Disputes (ICSID).

Dispute methods in international investment law and international environmental law.

In International investment law and International environmental law, dispute methods divide into traditional and alternative.

Arbitration is a common traditional method of dispute resolution that has a binding decision. Mainly referring to the BITs, multilateral treaties, and Free Trade Agreements (FTAs) in its decisions, arbitration commonly has 3 forms: ICSID, UNCITRAL, and ICC.

On the other side, alternative dispute methods divide into Negotiation and Mediation. Negotiation and mediation are procedures for resolving disputes of conflicting positions of the parties. Negotiation is a stage that involves dialogue between the parties in order to reach a consensus.¹⁷ Mediation is a flexible process that involves a third person (the “mediator”) who supports the parties to negotiate a friendly and peaceful settlement of the issues in dispute. It is considered an effective tool to resolve disputes, with the mediator organizing and assisting dialogue between the parties.¹⁸

The role of ICSID.

In today's global economy, cross-border investment has reached unprecedented levels, leading to a corresponding increase in investment disputes between investors and host states. Resolving related cases objectively and optimally is significant for keeping investors' confidence and promoting international economic partnership. In this context, arbitration has emerged as an important means of settling investment disputes, providing a flexible and effective alternative to traditional courts.

Arbitration has made great strides in its role for resolving investment disputes.

At first stages, arbitration was used for commercial disputes, attracting private investors and host countries. However, with the occurrence of BITs in the 1960s and 1970s, arbitration

¹⁷ Carnevale, P. J. D., & Choi, D. W. (2000). Negotiation and mediation. In M. Deutsch & P. T. Coleman (Eds.), *The handbook of conflict resolution: Theory and practice* (pp. 534–559). Jossey-Bass.

¹⁸ United Nations Commission on International Trade Law. (2024). *UNCITRAL guidelines on mediation*

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became a main mechanism for resolving investment disputes. BIT became a foundation for the Investor-State Dispute Settlement (ISDS) mechanism by stimulating investors to file claims against the host country. The establishment of relevant arbitral institutions, such as ICSID, has provided a qualified forum for resolving investment disputes.

Investment arbitration is a procedure for resolving disputes between overseas investors and host countries. The opportunity for overseas investors to sue the host country ensures that overseas investors have access to impartial and experienced arbitrators who will resolve the dispute and render a binding decision. Foreign investors who make direct investments usually stay in the host country for an extended period and obtain governmental support. Negotiations of such cases favour dispute resolution but are generally ineffective. In such cases, foreign investors usually rely on national courts, which is not always an efficient method to resolve disputes. These risks are particularly present in non-developed countries generally for the reasons such as: inefficient qualifications of local judges in such scope of disputes, processes with over long durations, and less familiarity of investors with host country procedural steps. Governmental immunity in the proceedings of judges, investors, or enforcement proceedings in investment disputes between investors. To avoid the previously mentioned risks, arbitration is considered one of the most flexible and convenient mechanisms for resolving international business disputes. Therefore, almost all investment treaties today provide a mechanism for disputes through arbitration between investors and States.

Consequently, ICSID has advantages such as confidentiality, qualified arbitrators, and enforceability. Arbitration is a widely used mechanism for resolving investment disputes, but it has disadvantages as well. These are some of the disadvantages forming the limitation of ICSID. Starting with the lack of Appeal Mechanism, opposite to the local court, arbitration generally lacks an appeal process. Arbitration award is usually final and binding, with limited opportunity for appeal. Furthermore, there is limited disclosure liability. Arbitration proceedings are generally conducted in private, and the confidentiality of the process may limit public scrutiny and liability. A lack of transparency can be seen as a disadvantage, especially where public interest and policy considerations are highlighted. Another disadvantage is high costs. Arbitration is costly due to the fees associated with hiring arbitrators, legal representation, expert witnesses, and administrative costs. It creates difficulties for small investors or developing countries with limited resources. Moreover, limited state participation is an issue. States may sometimes be unmotivated to participate in arbitration proceedings or

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to recognize the authority of an arbitral tribunal. This may form investment disputes more challenging to resolve and decrease arbitration as a method of dispute resolution. However, these challenges and limitations repeat the urge to continuously assess and develop the arbitration process to guarantee the efficiency of investment dispute resolution.

1.2 Climate change from a legal perspective. Legal framework.

The world is facing a climate emergency since the Earth's temperature has already increased by 1 degree Celsius, which directly impacts water supplies, biodiversity, oceans, food production, and extreme climate events. Consequently, the urge to regulate this issue became an agenda at the 21st COP event.¹⁹

Signed in 1992, the United Nations Framework Convention on Climate Change (UNFCCC) is the foundational treaty that has provided a primary and significant milestone basis for international climate discussions starting from the day of its establishment, including landmark agreements such as the Kyoto Protocol and the Paris Agreement. The Convention has been ratified by 197 states that have committed to act on climate change and regularly report on their progress.²⁰

Principle of common but differentiated responsibilities, right to sustainable development, precautionary principle, promotion of open international economic system, and support for vulnerable developing countries expressed in article 3 of the UNFCCC structured the foundation for designing further legal acts in relevant field.²¹

Common features between UNFCCC, Kyoto Protocol, and Paris Agreement.

Shared significant features between the UNFCCC, Kyoto Protocol, and Paris Agreement are directly linked to the significance of the threats caused by climate change and urge for the sustainable future. These similarities involve the rise of scientific data about climate change, collective financial obligations, emerging urge for international legal regulation, and political and economic risks. To begin with data regarding the issue, following several overseas scientific meetings in 1985-1987, states concluded to establish the IPCC, under the auspices of

¹⁹ Shivanna K. R. (2022). Climate change and its impact on biodiversity and human welfare.

²⁰ Grantham Research Institute on Climate Change and the Environment. (2022). *What is the UN Framework Convention on Climate Change (UNFCCC)?* London School of Economics and Political Science.

²¹ Article 3, United Nations Framework Convention on Climate Change (1994) UNFCCC

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the United Nations Environment Programme and the World Meteorological Organization, to provide them with assessments of climate change science, projected social and economic impacts, and potential response strategies. In addition, the Parties to the Paris Agreement agreed to recent instructions on how to report nationally determined contributions (NDCs). NDCs are to be updated every five years and "will" represent progress in ambition to abate GHG emissions beyond the previous NDC. Moving to collective financial duties, the Paris Agreement reiterates the collective obligation in the UNFCCC for developed country Parties to provide financial resources—public and private—to assist developing country Parties with mitigation and adaptation efforts. It urges scaling up from past financing.

The domestic GHG emissions of some Parties to the Kyoto Protocol were prevailing their targets, but as envisioned under the Kyoto Protocol, Parties could execute their obligations by purchasing emission reduction credits through the three market mechanisms of the treaty: the Clean Development Mechanism, Joint Implementation, and emissions trading.²² The historical responsibility of non-developing countries in climate change made them actively invest into climate change projects. Another overlapping feature is the increasing urge for international legal regulation. As mentioned in the UNFCCC : “the developed country Parties should pioneer in combating climate change and the adverse effects thereof” is also reiterated in the last preambular part of the Paris Agreement. According to the article 3.2 of the UNFCCC: “The specific needs and special circumstances of developing country Parties ... should be given full consideration” is also reflected in several parts of the Paris Agreement; and Article 3.3, “Efforts to address climate change may be carried out cooperatively by interested Parties” also recognized in the Paris Agreement’s trading mechanisms, among other places.²³ Moreover, the social pressure for the urge for international cooperation and legal framework is observed between social eco-activists. As an example, “Friday for Future” is an international movement initiated by students (also called School Strike for Climate) who skip Friday classes to participate in strikes where they demand politicians care about climate change.²⁴ Lastly, for political and economic risks, starting from the period of the Industrial Revolution, there has been a strong connection between economic development and burning fossil fuels. The

²² CRS. (2020). *The United Nations Framework Convention on Climate Change, the Kyoto Protocol, and the Paris Agreement: A summary* (CRS Report No. R46204). Congressional Research Service.

²³ Legal Response International. (n.d.).(The Financial Times European Innovative Lawyer Award winner) *Relationship between the Convention and the Paris Agreement*.

²⁴ United Nations Environment Programme. (2019). *Fridays for Future Movement*. Champions of the Earth.

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challenge for both developed and developing countries is how to build a healthy economy for the future while still lowering greenhouse gas emissions. Another significant challenge is how to share the burden of cutting emissions equitably.²⁵

1.2.1 Kyoto Protocol.

On 11 December 1997, 160 nations representatives assembled in Kyoto, Japan, for the Third Conference of the Parties (COP) to sign a historic agreement: the Kyoto Protocol. In an unprecedented moment of international consensus making, the Protocol strove to address global warming by cutting GHG emissions in 38 industrialized countries by 5.2% between 2008 and 2012 compared to the levels registered in 1990.²⁶

It was for the initial time when legally binding objectives and commitments were set and key economic players such as Japan, the US, and the European Union pledged to cut their emissions by 7%, 8%, and 9% respectively.²⁷

There are several reasons for the failure of the Kyoto Protocol. First of all, the biggest GHG issuer refused to participate in the agreement. Though the United States (US) signed the document in 1998, Congress failed to ratify the agreement which led to the fact that the US never officially signed the pact.²⁸ The main reason was the “unequal commitment”. According to Kyoto, only developed countries should contribute, the US did not agree with this condition. Next, the Protocol had a limited scope which had several side effects. The feature of Kyoto being binding for the developed countries only made its effect less impressive. Such an outcome led to crucial points in the scope and effectiveness of the Protocol. Although in 1997, the US and EU were the world’s largest emitters, by 2006, the second largest GHG issuer-China surpassed the US in annual emissions, and India’s emissions were almost equal to the EU indicators in 2022. Furthermore, by 2012, the year after the first commitment period (2008-2012), as stated in the Kyoto Protocol, instead of reducing emissions by an average of 5.2% below 1990 levels, global emissions had risen 44% from 1997 levels, driven predominantly by emissions growth in non-developed countries. The Kyoto Protocol could not stem the flow of

²⁵Griffin K. (2022). *The Kyoto Protocol and the Paris Agreement: Effects on the global economy*. Green Economy Journal.

²⁶ Bassetti, F. (2022). Success or failure? The Kyoto Protocol’s troubled legacy.

²⁷ Chen, J. (2022). Green Investing; Investopedia

²⁸ William J. Clinton Presidential Library & Museum (n.d.). Signing the Kyoto Protocol.

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global emissions.²⁹ Another issue was the Protocol being a weak control mechanism and sanctions insufficiency. After the US Senate refused to ratify the Kyoto Protocol by referring to the unequal commitment and potential damage to the US economy, the US set a precedent for countries such as Canada and Japan to pull out of the deal without penalty in 2011 and providing a serious setback on the effectiveness of the agreement right from the starting point.³⁰ Finally, economic and political reasons acted as a hindrance. In this lens, the Global Financial Crisis (2008-2009) also had a negative effect on the Kyoto Protocol. According to the IMF Staff Position Note: “Negotiations towards a successor to the Kyoto Protocol on climate change have come to a critical point, and domestic climate policies are being developed, as the world seeks to recover from the deepest economic crisis for decades and looks for new sources of sustainable growth. This position note considers the challenge posed by these two policy imperatives: how to exit from the crisis while developing an effective response to climate change.”³¹

The Kyoto Protocol became a significant stage in developing international climate law, however, its effectiveness was limited due to lack of global scope (not only developed countries), refusal of key countries in active participation, and weak execution mechanism. These key points were considered in designing the Paris Agreement which has more adjustable and all-comprehending character.

1.2.2 The Paris Agreement.

The Paris Agreement is a legally binding international treaty on climate change. The Paris Agreement was adopted by 196 countries during the Conference of the Parties COP 21 in Paris in December 2015. It aims to reduce global warming to 1.5-2°C compared to pre-industrial levels.

According to the article published in 2025 by the Environmental Defense Fund: “Despite the fact that the progress has been slow, and the climate is still warming, which is leading to worsening flooding, wildfires and hurricanes, the models clearly reflect that without the Paris

²⁹ Bassetti, F. (2022). Success or failure? The Kyoto Protocol’s troubled legacy.

³⁰ Bassetti, F. (2022). Success or failure? The Kyoto Protocol’s troubled legacy.

³¹ Jones, B., Keen, M. (2009). *Climate policy and the recovery* (IMF Staff Position Note No SPN/09/28). International Monetary Fund.

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agreement, global temperature rise would be much worse and that the Paris agreement has made a positive difference.”³²

Besides innovative aims, the focus on adaptation, sustainability, and the financing of the climate, the Paris Agreement is considered more effective and innovative than the Kyoto Protocol for several reasons. First, the global participation for Paris Agreement is higher with 197 countries than that for Kyoto Protocol. ³³ In the article 4.4 of the Paris Agreement, it is written that: *“Developed country Parties should continue taking the lead by undertaking economywide absolute emission reduction targets. Developing country Parties should continue enhancing their mitigation efforts, and are encouraged to move over time towards economy-wide emission reduction or limitation targets in the light of different national circumstances.”*³⁴

Moreover, from the point of international environmental law, the Paris Agreement is unlike top-down structure of the Kyoto Protocol and reflects an evolution toward more inclusive and dynamic legal frameworks. The Kyoto Protocol imposed legally binding emission reduction targets exclusively on countries, relying on the principle of "common but differentiated responsibilities and respective capabilities". ³⁵ Also, its legal design is similar to a traditional treaty law, with enforceable obligations and a compliance mechanism which limited its effectiveness, as key emitters like the US or Canada did not participate or later withdrew, and developing countries remained outside the scope of binding commitments. In contrast, the Paris Agreement has a more adjustable and universal strategy in the same principle but applies it dynamically.³⁶ The agreement requires all parties to submit nationally determined contributions which are not legally binding but are accompanied by procedural obligations, like transparency, monitoring, and frequent reviews. This shift implies international environmental law preference for soft law instruments and mutual accountability, emphasizing cooperation rather than formal sanctions.

³² Environmental Defense Fund. (2025). *What is the Paris Climate Agreement and why does it matter?*

³³ Voigt, C. (2023). The power of the Paris Agreement in international climate litigation. *RECIEL*. 2023; 32(2): 237-249.

³⁴ Article 4.4. (2015) United Nations Framework Convention. The Paris Agreement

³⁵ Nguyen, D., Doan, H., Nguyen, C. P., & Nguyen, B. Q. (2024). From Kyoto to Paris and beyond: A deep dive into the green shift. *Renewable Energy*, 228, 120675.

³⁶ Mor, S., Aneja, R., Madan, S., & Ghimire, M. (2023). Kyoto Protocol and Paris Agreement: Transition from Bindings to Pledges – A Review. *Millennial Asia*, 15(4), 690-711.

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Next, Paris Agreement offers more flexibility and voluntariness of goals. The Kyoto Protocol had strict aims solely for developed countries without considering their economic specifications. Regarding the Paris Agreement, the situation is more stimulating. According to Article 4.2 of the Paris Agreement: *“Each Party shall prepare, communicate and maintain successive nationally determined contributions that it intends to achieve. Parties shall pursue domestic mitigation measures, with the aim of achieving the objectives of such contributions.”*³⁷ As cited in *UNDP NDC Global Outlook Report 2021*: *“The number of countries that have enhanced their Nationally Determined Contributions (NDCs) rose from 75 countries in 2019 to 178 in 2021. And most countries have abided by the key principle to submit increasingly ambitious NDCs every five years. The Paris Agreement’s “ratchet mechanism” is working.”*³⁸ Another reason for the preference of Paris Agreement lies in its transparency and accountability. As mentioned before, the Kyoto Protocol had a weak control mechanism and a lack of sanctions. On the other hand, the unified transparency of the Paris Agreement is reflected in article 94 (C): *“Parties report information on adaptation action and planning including, if appropriate, their national adaptation plans, with a view to collectively exchanging information and sharing lessons learned”*³⁹ Also, financial assistance of Paris agreement is significant. While the financing mechanism in the Kyoto Protocol was not precisely regulated, the Paris Agreement set the target of minimum 100 billion USD per year, considering the need of developing countries (Article 53 of the Paris Agreement). Taking into consideration all the above-mentioned, undoubtedly the Paris Agreement is more inclusive and transparent. It does not divide the world into “developed” and “developing” countries, instead considers the capacity of each country, which makes the Paris Agreement more innovative and realistic.

From a legal perspective, climate change is not only an ecological issue anymore as it immediately influences economic, trade, and investment policies. Currently, International law is facing a great challenge in balancing state sovereignty, investor rights, and climate obligations.

³⁷ Article 4.2. (2015) United Nations Framework Convention. The Paris Agreement

³⁸ United Nations Development Programme (UNDP). (2021). *The State of Climate Ambition: UNDP NDC Global Outlook Report 2021*.

³⁹ Article 94. C. (2015) United Nations Framework Convention. The Paris Agreement

1.3 BITs from the perspective of climate change. The gaps in environmental provisions.

One of the most significant advancements in international law is the exponential rise of International Investment Agreements (IIAs). An IIA is an international agreement focused on security, promotion, and liberalizing measures of transnational investments. The most widespread categories of IIAs are standalone Bilateral Investment Treaties (BITs) and Free Trade Agreements (FTAs) that incorporate investment provisions. Double Taxation Treaties (DTTs) are also perceived as IIAs, given the notable connection between taxation and foreign investment.⁴⁰

The evolution of international investment law after the Second World War on the foundation of bilateral treaties differ remarkably with the multilateral development in other scopes of international economic law, specifically international trade and international monetary law. During the period multilateralism controlled international relations in these areas through the formation of international institutions, such as General Agreement on Tariffs and Trade (GATT) and later the WTO, as well as IMF, several methods to found a multilateral investment mechanism stated on a multilateral treaty malfunctioned. Instead international investment law has advanced on the foundation of a multitude of bilateral, regional and sectoral investment treaties.

Both bilateralism and multilateralism are categories of international partnership. The main contrast between both categories relate to the amount of parties to an international agreement and the complexion of the directives governing inter-State behavior.

On a procedural perspective, bilateralism implements the dyadic relationship between States, while multilateralism concerns “the practice of coordinating national policies in sort of three or more States”.⁴¹

While foreign investment can utilize the economic and industrial resources to advance environmental protection through different methods, such as energy efficiency, minimization of GHG emissions, waste treatment, and other ‘clean’ innovations. Oppose this, foreign investment may unfavorably influence the environment of the host State. It can be reflected

⁴⁰ Singh K, Ilge B, ((2015). *Rethinking bilateral investment treaties: Critical issues and policy choices*, Both ENDS, Madhyam, & SOMO

⁴¹ Schill S., (2009) *The Multilateralization of International Investment Law*

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through the destruction of biodiversity, pollution of water resources, improper disposal of hazardous waste, and commercialisation of harmful chemicals banned/restricted in developed countries.⁴²

The insufficiency of the conventional international legal order in responding to environmental challenges led to the advancement of new, “greener” rules of international law.

In the first phases of the advancement of international environmental law, the field had a shortage of integrated legal and administrative system.⁴³

According to the second edition of the *Global Environment Institutions, Law, and Policy* by R.S. Axelrod, D. L. Downie, and N. J. Vig where referred on Krasner’s book (1983) about International Regime “*The first distinct period in the greening process began with nineteenth-century bilateral fisheries treaties and the Pacific Fur Seal Arbitration*”.⁴⁴

The period after 1945 is described as one in the process of industrialization and the quick, effective expansion of economic activities based on natural resources, demanding the placing of limits on the exploitation of flora and fauna and the adoption of appropriate legal instruments.⁴⁵

Later most of the international institutions with competence in environmental issues were established and legal tools were adopted to focus on specific sources of pollution and the maintaining of common and specific environmental resources such as oil pollution, nuclear testing, wetlands, the marine environment and its living resources, freshwaters, and the dumping of waste at sea.⁴⁶

Before the Rio Convention, in the 1990s, a solid body of regulations of international environmental law existed. States participated as subjects to restrictions on the right to allow or carry out actions that mistreating the environment. Environmental issues started to interconnect with economic affairs, specifically with trade and development lending.⁴⁷

⁴² Dupuy P., & Vinuales, J. (2018). *International Environmental Law*

⁴³ Axelrod R.S., Downie D. L., Vig N. J. (2005), *Global Environment Institutions, Law, and Policy*

⁴⁴ Axelrod R.S., Downie D. L., Vig N. J. (2005), *Global Environment Institutions, Law, and Policy*

⁴⁵ Axelrod R.S., Downie D. L., Vig N. J. (2005), *Global Environment Institutions, Law, and Policy*

⁴⁶ Axelrod R.S., Downie D. L., Vig N. J. (2005), *Global Environment Institutions, Law, and Policy*

⁴⁷ Axelrod R.S., Downie D. L., Vig N. J. (2005), *Global Environment Institutions, Law, and Policy*

The gaps in environmental provisions.

There are several gaps in BITs regarding environmental protection. These include environmental protection provisions not being explicitly included and not exist in older BITs. According to a 2011 study, the Organisation for Economic Co-operation and Development (OECD) suggested that environmental language had peaked in 2008, when 89% of newly concluded BITs and relevant trade agreements contained environmental references.⁴⁸

Moreover, “Fair and equitable treatment” (FET) and “Legitimate expectations” are often invoked to challenge States and protect Investors. The link between the FET standard in investment treaties and the protection of investors’ legal expectations is reflected in the 2003 case of *Tecmed v. Mexico*. In that case, the tribunal held that the FET clause in the Spain-Mexico BIT obliged the state to safeguard the ‘basic expectations that were taken into account by the foreign investor to invest’. This finding was circulated by successive tribunals, and, by 2006, lawful expectations were already being highlighted as the ‘dominant element’ of the FET standard. Since then, investors have ‘constantly invoked’ the doctrine of legitimate expectations in investment treaty proceedings, leading to numerous awards of compensation. To illustrate, in 2019, a tribunal in *RREEF Infrastructure v. Spain* ordered the State to pay almost €60 million for violation of the legal expectations of a renewable energy investor.⁴⁹ In addition, there exists unpredictability between Investment Law and Environmental Law. Very often, BITs proceed individually from environmental law, which may cause conflicting obligations. Similar to the previous case, the host State may be caught between protecting biodiversity and paying compensation to foreign investors. As cited in *Columbia Journal on Environmental Law*, “*The nature of environmental problems and the difficulties of international cooperation on global commons contribute to a bottom-up trend of environmental governance with polycentric, participatory, and adaptive features. However, foreign investment governance in the past half-century has developed a strong treaty system that is implemented in sovereign states in an integrated way. This leads to tension in governance between foreign investment and environmental protection*”.⁵⁰ In comparison with environmental governance, foreign investment governance has a stronger international regulatory mechanism in terms of

⁴⁸ Hailes, O. (2024). Environmental clauses in investment arbitration: Deep roots, green shoots, and dead wood. *ICSID Review – Foreign Investment Law Journal*.

⁴⁹ Hepburn J., (2025), The Legal Justification for the Doctrine of Legitimate Expectations in International Investment Law, *European Journal of International Law*

⁵⁰ Zhu Y., (2022), “A bottom-up dilemma” *Columbia Journal of Environmental Law* vol. 48 №1, pages 108-109.

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policy writing and implementation⁵¹. Lastly, the issue of limited state participation persists. As previously mentioned in paragraph 1.3 of Chapter 1, the State's participation restricted by the investment Law negatively affects its interest, so the regulation of public interest is not clearly affirmed in most BITs.

Chapter 2

2.1. Dispute Settlement Regulation according to the BIT. BITs analysis from a legal perspective.

In the case of dispute arousal between the parties of the long-term agreements, it is not preferred to be highlighted in the public forum of the litigation. Generally, a non-host country or its investor hesitates about the objectivity and accessibility of the host state's domestic court. Moreover, the host state is not eager for submission of the disputes to the courts of another state⁵².

Due to the fact that arbitration is a private mode of dispute settlement in international commerce in which parties themselves coordinate the terms, it implements independence from the domestic courts. There is a "global adjudication system"⁵³ where international investment and other commercial disputes are "resolved by binding and final arbitration, as regulated, but by national legislation and judiciaries". Owing to the New York Convention⁵⁴, 143 Contracting Parties agreed to recognize the arbitration awards as binding and enforceable through the local courts. However, Parties should consider Article V of the Convention, where the list of limited grounds on which recognition and enforcement of an award may be refused upon the claim of the party against whom it was invoked. Consequently, that Party is obliged to provide relevant proof to the authorities where the recognition and the enforcement of the arbitration award is sought. Notwithstanding the evidence that the State is a Contracting Party to the New York Convention, domestic courts contribute significantly while implementing the enforcement and sometimes challenge the proceedings.⁵⁵

⁵¹ Zhu Y., (2022), "A bottom-up dilemma" *Columbia Journal of Environmental Law*

⁵² Cameron P.D., (2010) *International Energy Investment Law. The Pursuit of Stability*

⁵³ Soave, T. (2023). The social field of international adjudication: Structures and practices of a conflictive professional universe. *Leiden Journal of International Law*, 36(3), 565–591.

⁵⁴ United Nations. (1958). *Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention")*

⁵⁵ Cameron P.D., (2010) *International Energy Investment Law. The Pursuit of Stability*

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Parties are free in selecting the arbitration proceedings through international arbitral institutions or on an ad hoc basis, known as administered and non-administered arbitration. An institutional type of arbitration sets up the regulations and schedules during the establishment of the arbitral tribunal for the conduct of the arbitration. Moreover, arbitration is characterized by the expanding range of institutional forms such as International Centre for Dispute Resolution of the American Arbitration Association (ICDR); ICSID; ICC; the London Court of International Arbitration (LCIA); the Singapore International Arbitration Centre (SIAC); and the Arbitration Centre of the Stockholm Chamber of Commerce (SCC).⁵⁶

These arbitral institutions are preferable due to rich experience in arbitration, including deals with various challenges to arbitrators, terms of a known quantity, specifically beneficial when parties come from different cultures and speak different languages. Even though the advantages of the ICSID procedure are more evident concerning enforcement, since arbitration under UNCITRAL involves enforcement by national courts.⁵⁷

An *ad hoc* arbitration has a feature of simplified procedures since litigations are not administered by arbitral institutions, and parties are free in determining all aspects of the arbitration, starting from the schedule, number of arbitrators, their qualifications, their appointment procedures, selection of applicable law, and other related provisions.⁵⁸ Consequently, *ad hoc* provides flexibility, disputing parties save all costs related to the administration procedures, and save their time. Moreover, if the parties are experienced in arbitration, they can adopt the terms of UNCITRAL. In case they are not, the *ad hoc* arbitration conducted according to the rules of UNCITRAL will be considered as the misallocation of both financial and time resources.⁵⁹

It is widely recognized that mediation and negotiation are alternative methods of dispute settlement. By referring to such methods, the parties recover power over the future of the conflict in the primary stages, simultaneously assuring themselves with the fact that if the negotiations do not result in expected outcomes, a third party provides a binding decision.⁶⁰

⁵⁶ Kaufmann-Kohler, G., Potestà, M. (2020). Why Investment Arbitration and Not Domestic Courts? The Origins of the Modern Investment Dispute Resolution System, Criticism, and Future Outlook.

⁵⁷ Cameron P.D., (2010) International Energy Investment Law. The Pursuit of Stability

⁵⁸ Born, G. B. (2021). International Commercial Arbitration (3rd ed.). Kluwer Law International.

⁵⁹ Thailand Arbitration Center (2021) The difference between Ad Hoc arbitration and Institutional Arbitration

⁶⁰ Cameron P.D., (2010) International Energy Investment Law. The Pursuit of Stability

States and investors are concerned regarding the costs of arbitration, certain governments refuse to comply with arbitral awards, while others hesitate to sign new BITs. Moreover, citizens have started to participate in popular turbulence at the prospect of investment treaty arbitration. Consequently, investors as well as states support the use of mediation to supplement investor-state arbitration.⁶¹ Consultation is additionally considered an alternative type of dispute settlement; however, alternative methods are not effective if one of the parties is not willing to compromise. Generally, alternative methods are considered a precursor to arbitration.⁶²

Moreover, alternative dispute settlement provisions became increasingly demanded by contracting parties over the past 25-30 years. What repeatedly denotes that Parties are looking for a process with lower transactional costs, which provides procedures for focusing on the resolution.⁶³

BITs generally differentiate in two types of dispute settlement regarding the parties' composition: State-State Dispute Settlement (SSDS) and Investor-State Dispute Settlement (ISDS). While Bilateral Investment Treaties exhibit variation in their specific provisions, they initiate a framework of substantive protections—namely, fair and equitable treatment (FET), non-discrimination (MFN), national treatment and full security—for foreign investors within host jurisdictions.⁶⁴ These protections are reinforced by robust investor-state dispute-settlement provisions, which permit investors to invoke arbitration unambiguously against host States in the absence of bilateral consent at the domestic level.⁶⁵ This capacity for investors to vindicate their treaty-based rights through international adjudication highlights the impressive achievement of the BIT regime's innovation, securing both the predictability of investment protections and the enforceability of legal commitments across borders. Consequently, ISDS cases often take place in comparison to SSDS ones.⁶⁶

⁶¹ Welsh N. & Schneider A, (2012) *Becoming "Investor-State Mediation"*, 1 Penn. St. J.L. & Int'l Aff. Page 86

⁶² Chapter 3, EU-Vietnam Investment Protection Agreement (2019)

⁶³ ICSID (2021) *Overview of Investment Treaty Clauses on Mediation*

⁶⁴ Dolzer, R., & Schreuer, C. (2012). *Principles of International Investment Law* (2nd ed.). Oxford University Press

⁶⁵ Schreuer, C. H. (2009). *The ICSID Convention: A Commentary* (2nd ed.). Cambridge University Press

⁶⁶ Dewi, Y. K., & Afriansyah, A. (2019). *Dispute settlement mechanism in bilateral investment treaties (BITs)*. *Yuridika: Fakultas Hukum Universitas Airlangga*, 34(1), 151–157.

BITs analysis from a legal perspective.

Historically, the initial BIT was signed in 1959 between West Germany and Pakistan.⁶⁷ By 1989, the rapid growth of BITs over 300 concluded had established a global legal framework for protecting foreign investments, particularly between developed and developing states. Emerging in response to the lack of customary international norms in investment law, BITs were driven by investor apprehensions over regulatory instability and unpredictability, arbitrary treatment, and limited legal protections in host states. Originally formulated by European countries and later adopted by the United States and other capital-exporting nations, BITs evolved to provide standardized rules on expropriation, dispute settlement, and rights of investors, forming a bedrock for international investment law.⁶⁸

Drafting Substantial provisions in BITs.

BITs, as IIA, in the process of design, consist of provisions and issues chosen by the parties. Parties decide whether they would add some issues or keep them outside. Such agreements differ in the variations of contained substantive provisions. The drafting process of BITs provides states with a capacity of selected provisions, which reflects their relevant economic, developmental, and regulatory priorities.⁶⁹ Substantial provisions start from the scope and definition of the investment. Previous IIAs tend to use extensive and non-restrictive definitions of "investment", which significantly influence a country's development policy. Investment definitions divide into broad and narrow. An extensive definition includes various categories of assets mentioned in the treaty. Its side effects may limit a country's flexibility in regulating its investments according to the time when they become current. Moreover, a country is almost obligated to protect and promote investments that were not intended to be included in the context upon the signature of the agreement.⁷⁰ A broad definition may limit a state's regulatory autonomy, since they can subject a wide scope of governmental measures to ISDS. Oppose to this perspective, some modern treaties, such as the Canada-EU Comprehensive Economic and

⁶⁷ Federal Republic of Germany & Islamic Republic of Pakistan. (1959). Treaty for the promotion and protection of investments.

⁶⁸ Salacuse, J. W. (1990). BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries. *The International Lawyer*, 24(3), 655–675.

⁶⁹ Dolzer, R., & Schreuer, C. (2012). *Principles of International Investment Law* (2nd ed.). Oxford University Press.

⁷⁰ United Nations Conference on Trade and Development. (2004). *International investment agreements: Key issues* (Vol. I). 76-77

Trade Agreement (CETA), develop in the direction of more restrictive definitions to better balance investment protection with the state's right to regulate.⁷¹

As an example, in the BIT signed between Ecuador and the United Kingdom, the definition of investment is sufficiently broad: “*for the purpose of this Agreement, ‘investment’ means every kind of asset and in particular, though not exclusively...*”⁷². In the narrowed definitions to “investment”, Parties consider a better alignment with development goals.⁷³ In the BIT between Azerbaijan and the United Arab Emirates, it is expressed by excluding certain categories: “*Notwithstanding the provisions of the preceding sentence, the provisions of this Agreement shall not cover the hydrocarbons and natural resources.*”⁷⁴ Another type of narrower is expressed by excluding portfolio since it offers fewer development benefits and is considered more volatile. NAFTA (replaced by USMCA) included portfolio investment in its definition of investment; however excluded particular categories of debt securities and loans, and also sought to omit ordinary commercial agreements. Another specification is excluding investments made before the BIT entered into force to avoid the retroactive conferral of advantages.⁷⁵ According to the BIT between Germany and Sri Lanka, only investments made on or after November 8, 1963, were subject to that BIT.⁷⁶ From the legal perspective it is recommended to narrow the scope in order to escape uncertainties.

The next substantial provision is the admission and establishment of foreign direct investments (FDI). This matter is specifically important for developing countries, since FDI provides an opportunity for potential influence on national development prospects. Regulatory frameworks of such areas are based on strategic goals such as protection of emerging industries, national security, employment generation, technology transfer, and preservation of environmental and cultural values. The result of regulatory approach selection is formed by a country's specific

⁷¹ Article 8.1. CETA (2016). Canada–European Union Comprehensive Economic and Trade Agreement.

⁷² Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Ecuador for the Promotion and Protection of Investments (1994) (terminated on 28.05.2018) Article 1

⁷³ United Nations Conference on Trade and Development. (2004). International investment agreements: Key issues (Vol. I). 77

⁷⁴ Agreement between the Government of the United Arab Emirates and the Government of the Republic of Azerbaijan on the Promotion and Reciprocal Protection of Investments (2006) Article 1

⁷⁵ United Nations Conference on Trade and Development. (2004). International investment agreements: Key issues (Vol. I). 77-80

⁷⁶ Article 9 (1963) Treaty – between the Federal Republic of Germany and Ceylon for the Promotion and Reciprocal Protection of Investments (Replaced by new treaty)

political and economic context and reflects a combination of policy preferences.⁷⁷ One of the regulatory approaches is state discretion, which is implemented through the government's screening of FDI before the entry. From a positive perspective, this action may protect the strategic sectors and save the state from undesirable investments. From a negative perspective, such action by the state may discourage FDI and create negative perceptions.⁷⁸ In the Switzerland-Estonia BIT, the admission of investments is made in accordance with the laws and regulations of the host country. If the admission process has been finalized successfully, the host country is obliged to provide the investor party with required permissions.⁷⁹ An alternative to the state discretion in BITs is the national and most favoured nation (MFN) treatment approach, with a list of specific sectors and activities that are excluded from general commitments of national and MFN treatments. This approach promotes liberalized investment by granting extensive market access, restricting entry limits, and allowing commercial decisions to drive investment. It used to exist in NAFTA, U.S and Canadian BITs, and the ASEAN Investment Area. A mixed approach is also preferred between countries.⁸⁰ As BIT example from Agreement between Canada and Trinidad and Tobago: “ *Each Contracting Party shall permit establishment of a new business enterprise or acquisition of an existing business enterprise or a share of such enterprise by investors or prospective investors of the other Contracting Party on a basis no less favourable than that which, in like circumstances, it permits such acquisition or establishment by: Its investors or prospective investors; or Investors or prospective investors of any third state.* ”⁸¹ The next substantive provision of the BIT is the National Treatment. National treatment is one of the fundamental market access principles of the World Trade Organization (WTO). Whereas the MFN principle obligates parties with equal treatment among various jurisdictions, the national treatment obligation requires the treatment to be no worse than that for domestic investors.⁸² National treatment has

⁷⁷ United Nations Conference on Trade and Development. (2002). Admission and establishment (UNCTAD Series on Issues in International Investment Agreements, Vol. II). United Nations.

⁷⁸ United Nations Conference on Trade and Development. (2004). International investment agreements: Key issues (Vol. I). 81-82

⁷⁹ Article 2 (1992) Agreement between the Swiss Confederation and the Republic of Estonia on the Promotion and Reciprocal Protection of Investments

⁸⁰ United Nations Conference on Trade and Development. (2004). International investment agreements: Key issues (Vol. I). 83

⁸¹ 20 Article 2 (3) Canada - Trinidad and Tobago BIT (1995) Agreement between the Government of Canada and the Government of the Republic of Trinidad and Tobago for the Reciprocal Promotion and Protection of Investments

⁸² Jackson, J. H. (1989). National treatment obligations and non-tariff barriers. *Michigan Journal of International Law*, 10(2), 207–222.

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several categories: limited and full post-establishment of national treatment and limited and full pre-establishment of national treatment. Post-establishment categories of national treatment are more common for BITs. Limited post-establishment national treatment is applied only after the entry, which provides the host country with the maintaining of the strong regulatory control. Similar to the first category, the full post-establishment national treaty has a broader coverage and is linked to MFN treatment and Fair and Equitable Treatment (FET). Pre-establishment (full and limited) national treatment categories are applied to the investment before and after the entry of treatment into force. Due to possible financial risks, this category is not preferred in BITs, specifically nowadays, but in other IIAs.⁸³

As an example, Japan-Zambia BIT expresses a post-establishment category of national treatment obligating parties to grant investors of the other party treatment no less favorable than the one provided to local investors “in like circumstances” regarding investment activities. The phrase “in like circumstances” extends the rights of the host state to justify its different treatment based on legitimate policy aspects.⁸⁴

MFN treatment is also subject to the pre-entry and post-entry scope of application in the treaties. Governments with liberal economies perceive that foreign investments stimulate domestic competitiveness. By adopting the MFN treatment, the states express the absence of discrimination among foreign investors regardless of their nationality. However, these states may choose local investors over foreign ones. Consequently, the states prefer including MFN treatment rather than the national one. Another feature of MFN treatment by the states is expressed in a selective approach. As a result, some states may provide specific market access to their strategic partners and exclude other countries from this advantage. A selective strategy in working with a few chosen partners may be beneficial than providing MFN to all foreign investors. The last significant point to consider is the inclusion of the exceptions in MFN treatment. The more countries get involved in global trade and investment systems, the more they are obliged to consider exceptions to the MFN principle. These exceptions consist of common exceptions as bilateral tax treaties with strategic partners, mutual recognition arrangements of foreign countries’ professional qualifications and standards, and regional

⁸³ United Nations Conference on Trade and Development. (2004). International investment agreements: Key issues (Vol. I). 86-90

⁸⁴ Article 3 Japan-Zambia BIT (2025) Agreement between Japan and the Republic of Zambia for the Promotion and Protection of Investment

integration agreements of regional trade blocs. These benefits cannot be extended under the MFN to the other countries. There are also general exceptions to MFN based on public policy, national security, or health and morality concerns.⁸⁵ Example of the BIT Model of Germany excludes public security and order.⁸⁶

The last substantive provision to cover in this paragraph is the FET principle. Some parties do not include FET in BITs as Japan and Egypt⁸⁷, or early BITs signed by Pakistan⁸⁸. Rwanda, Saudi Arabia, and Singapore. In some BITs, the FET clause is formulated in a hortatory manner, meaning it expresses an advisory tone, rather than acting legally enforceable obligation. Such non-binding language limits the investors' ability to claim breaches under FET, reducing legal certainty. However, as investors prioritize strong and transparent protections against unfair treatment, it is more common for BITs to include a clearly strong FET standard. Although the terminology differs by using phrases like "fair and equitable," "just and equitable," simply "equitable" treatment, international tribunals generally treat these standards in a similar way. They require host states to maintain transparency and offer protection against arbitrary or discriminatory actions toward foreign investors. Thus, under the FET principle, the host state must ensure that foreign investors are not subject to arbitrary, discriminatory, or unfair treatment. This standard aims to design a stable, transparent, and predictable investment climate, reducing risks associated with sudden regulatory changes or unjust administrative issues.⁸⁹ A common example of these terms is the BIT between the Netherlands and the Philippines, which requires FET and full protection for investments throughout their lifecycle from entry to disposal.⁹⁰ Commonly, in BITs, there is a reference to FET in combination with related standards such as MFN or national treatment. Due to such a combination of granted

⁸⁵ United Nations Conference on Trade and Development. (2004). International investment agreements: Key issues (Vol. I). 90-92

⁸⁶ Article 3 (2) (2008) Model BIT of the Federal Republic of Germany concerning the Encouragement and Reciprocal Protection of Investments

⁸⁷ Government of Japan & Government of the Arab Republic of Egypt. (1977). Agreement between Japan and the Arab Republic of Egypt concerning the encouragement and reciprocal protection of investment.

⁸⁸ Government of the Islamic Republic of Pakistan & Government of the Republic of Turkey. (1995). Agreement between the Government of the Islamic Republic of Pakistan and the Government of the Republic of Turkey concerning the reciprocal promotion and protection of investments.

⁸⁹ United Nations Conference on Trade and Development. (2004). International investment agreements: Key issues (Vol. I). 93

⁹⁰ Article 3, Netherlands and Philippines BIT (1985) Agreement between the Kingdom of the Netherlands and the Republic of the Philippines for the Promotion and Protection of Investments

protections, investors tend to be more confident in the host country.⁹¹ Such an approach is exemplified in the BIT model of Chile.⁹² Another combination of a key protection formula is FET and the international minimum standard. Due to the variety of scope, FET does not automatically include the international minimum standard.⁹³ This approach is observed in the BIT between Mexico and Switzerland, where FET and full protection and security under international law are mentioned simultaneously with the prohibition of discriminatory treatment.⁹⁴ To conclude, being an important part of the BITs, dispute settlement mechanisms have evolved into key tools of international investment law. They offer foreign investors multiple options, including arbitration and ad hoc procedures, in the resolution of conflicts with host states. The legal foundations of BITs that cover FET, MFN, national treatment, definitions of investment, and pre-/post-establishment protections indicate the existing balance between investor rights and state sovereignty. As BITs keep expanding globally, their provisions have become more nuanced and shaped by the strategic priorities and developmental goals of states. This evolution has influenced not only how investment disputes are procedurally handled, such as through greater transparency or investor obligations, but also the way international investment is governed more broadly. In particular, it has begun to shift the focus from purely investor protection to incorporating issues of public interest, especially environmental and climate-related concerns.

The following section explores how climate change protection has gradually become more prominent in BITs over the years and analyzes the existing gaps in the current framework.

2.2. Improvement over the years. Analysis of the gaps in the current position.

Starting from the 1980s, institutional development and scientific discoveries, public awareness, and the rise of environmental activism alternately led to policy developments and international agreements on climate change.

⁹¹ United Nations Conference on Trade and Development. (2004). International investment agreements: Key issues (Vol. I). 93

⁹² Article 4, Chile BIT Model (1994) Agreement on the Reciprocal Promotion and Protection of Investments

⁹³ United Nations Conference on Trade and Development. (2004). International investment agreements: Key issues (Vol. I). 93

⁹⁴ Article 4, Mexico-Switzerland BIT (1995) Agreement between the Swiss Confederation and the United Mexican States on the Promotion and Reciprocal Protection of Investments

The 1980s evidenced key scientific progressions that emphasized the reality of climate change. In 1985, the Villach Conference brought together scientists who addressed the problem of global warming as a consequence of greenhouse gas emissions. This Conference caused an urge for an institutional foundation, namely the IPCC, in 1988 by the UNEP and the World Meteorological Organization, focusing on the evaluation of scientific information regarding climate change.⁹⁵ Public awareness was emphasized via the media in 1988 when NASA scientist James Hansen testified before the U.S. Congress, referring to global warming as a result of human activities.⁹⁶ Environmental activism became more popular in the 1980s, followed by the first Earth Day celebrated in 1970. Friends of the Earth were among the famous environmental activists.⁹⁷ The Montreal Protocol⁹⁸ and the mention in the Protocol of substances depleting the ozone layer, the Toronto Conference on the Changing Atmosphere⁹⁹, structured the foundation for UNFCCC. Starting from the day of establishment, the IPCC has released several comprehensive assessment reports (ARs) which shaped global climate policy:

By confirming that human activities caused atmospheric concentrations of GHG, which led to warming, the First AR in 1990 found a basis for the UNFCCC (1992).¹⁰⁰ The Second AR (1995) justified deeper the human influence on climate and contributed to the Kyoto Protocol (1997).¹⁰¹ The first AR of 20th century which was the third one took place in 2001. The Third AR reflected potential threats of abrupt and irreversible climate change by highlighting the role of climate models. General Circulation Models, Simple Climate Models, Earth System Models of Intermediate Complexity, and Regional Climate Models were the subjects of discussion.¹⁰² In 2007, the Fourth AR finalized with high confidence that global warming is resulted by

⁹⁵ Franz, W. E. (1997). The development of an international agenda for climate change: Connecting science to policy (ENRP Discussion Paper E97-07). Kennedy School of Government, Harvard University.

⁹⁶ McIntyre, D. R. (2009). James Hansen's 1988 Predictions Compared to Observations. *Energy & Environment*, 20(4), 587-594

⁹⁷ Thomson, J. (2017). Surviving the 1970s: The Case of Friends of the Earth. *Environmental History*, 22(2), 235–256.

⁹⁸ United Nations Environment Program (n.d.) About the Montreal Protocol

⁹⁹ United Nations. (1988). *Proceedings, World Conference, Toronto, Canada, June 27–30, 1988: The changing atmosphere: Implications for global security*

¹⁰⁰ Intergovernmental Panel on Climate Change (IPCC). (1990). *Climate Change: The IPCC Scientific Assessment (First Assessment Report - FAR)*. World Meteorological Organization / UNEP.

¹⁰¹ Intergovernmental Panel on Climate Change (IPCC). (1995). *Climate Change 1995: The Science of Climate Change (Second Assessment Report - SAR)*. Cambridge University Press.

¹⁰² Intergovernmental Panel on Climate Change (IPCC). (2001). *Climate Change 2001: The Scientific Basis (Third Assessment Report - TAR)*. Cambridge University Press.

human activities and earned the IPCC the Nobel Peace Prize jointly with Al Gore, who was a former president of the US.¹⁰³ The Fifth AR (2014) validated the urgency of mitigation and adaptation, leading to the Paris Agreement (2015).¹⁰⁴ The Sixth AR covered the years from 2021 to 2023 and declared that climate change is “unequivocally” caused by human actions and warned of tipping points by providing updated emissions pathways to limit warming to 1.5°C.¹⁰⁵ These Ars defined an essential contribution in shaping international climate governance, mobilizing national policy reforms under the UNFCCC framework.

Standards about the environment included in the BITs nowadays.

In recent years, Bilateral Investment Treaties have increasingly incorporated provisions that address environmental protection and sustainable development. This reflects a growing recognition among states of the need to align foreign investment with global environmental goals and responsible business conduct. These provisions aim to balance economic interests with ecological considerations by incorporating environmental language directly into the structure of the treaties.¹⁰⁶

One of the most common ways this is conducted is through preambular references. Many modern BITs now include preambular language that explicitly recognizes the importance of environmental protection, sustainable development, and responsible investment. While these references are not binding, they serve an interpretive function that can influence how tribunals understand the object and purpose of the treaty. To illustrate, the EU-Canada Comprehensive Economic and Trade Agreement preamble affirms the parties' commitment to sustainable development and high levels of environmental protection, setting a normative tone for the rest of the agreement.¹⁰⁷ Also, as an example, the Canada–Benin BIT includes points regarding

¹⁰³ Intergovernmental Panel on Climate Change (IPCC). (2007). Climate Change 2007: Synthesis Report (Fourth Assessment Report - AR4). IPCC.

¹⁰⁴ Intergovernmental Panel on Climate Change (IPCC). (2014). Climate Change 2014: Synthesis Report (Fifth Assessment Report - AR5). IPCC.

¹⁰⁵ Intergovernmental Panel on Climate Change (IPCC). (2021–2023). Sixth Assessment Report (AR6) – Climate Change 2021: The Physical Science Basis; 2022: Impacts, Adaptation and Vulnerability; 2023: Mitigation of Climate Change; Synthesis Report. IPCC.

¹⁰⁶ Dotzauer, M., & Biber-Freudenberger, L. (2024). The rise of sustainability provisions in international investment agreements. *Global Environmental Politics*, 24(4), 10–35.

¹⁰⁷ Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union, Canada–European Union, Oct. 30, 2016, Official Journal of the European Union, L 11, 14 January 2017.

sustainable development promotion¹⁰⁸, while the Brazil–Mozambique BIT focuses on the role of investment in promoting environmental protection.¹⁰⁹ Secondly, the right to regulate environmental objectives is another point of environmental issues. BITs confirm the the sovereign right of states to regulate in order to achieve legitimate public policy objectives, which also covers environmental protection. The *Canada–EU Comprehensive Economic and Trade Agreement* clearly mentions that parties have the right of regulation to attain achieve environmental objectives where this regulation is not viewed as a breach of the agreement¹¹⁰. Another provision concerns Environmental Impact Assessments (EIAs) and precautionary principles. Some BITs require investors to be aligned with domestic laws and international standards and thus conduct Environmental Impact Assessments accordingly. For example, the Nigeria–Morocco BIT requires that investors to conduct EIAs before investing and carefully assess precautionary principle¹¹¹. Moreover, in recent decades, legal provisions concerning following Corporate Social Responsibility (CSR)¹¹² have become more prevalent, especially the ones related to environmental standards. In this regard, the Canada–Benin BIT promotes the adoption of internationally recognized CSR standards by enterprises, including those related to environmental and other societal issues¹¹³.

Coming to non-derogation clauses, certain BITs contain provisions that restrict states from reducing environmental protections to lure foreign investment to avoid a "race to the bottom. For example, the Belgium–Luxembourg Economic Union–Mozambique BIT requires parties to try for the enhancement of environmental legislation and refrain from weakening such standards to gain investment advantages¹¹⁴. Finally, an increasing number of BITs have started

¹⁰⁸ Article 16, Government of Canada & Government of the Republic of Benin. (2013). Agreement between the Government of Canada and the Government of the Republic of Benin for the promotion and reciprocal protection of investments

¹⁰⁹ Article 10, Government of the Federative Republic of Brazil & Government of the Republic of Mozambique. (2015). Cooperation and Investment Facilitation Agreement.

¹¹⁰ Alistair L. (2024). Bilateral Investment Treaties as a Tool for Global Climate Governance?: Bridging the Tension Between International Investment Law and International Climate Change Law by Redesigning Bilateral Investment Treaties. *Völkerrechtsblog*.

¹¹¹ Mallya, M., & Turnbull, K. (2024). Bilateral Investment Treaties, Investor Obligations and Customary International Environmental Law. In P. Merkouris, A. Kulick, J. M. Álvarez-Zarate, & M. Żenkiewicz (Eds.), *Custom and its Interpretation in International Investment Law* (pp. 261–283). chapter, Cambridge: Cambridge University Press.

¹¹² Harvard Business School Online. (2021). Types of corporate social responsibility.

¹¹³ Dotzauer M., Biber-Freudenberger L., Dietz, T. (2024). The Rise of Sustainability Provisions in International Investment Agreements. *Global Environmental Politics* 24 (4): 10–36.

¹¹⁴ Article 7, Government of the Kingdom of Belgium, Government of the Grand Duchy of Luxembourg, & Government of the Republic of Mozambique. (2006). Agreement between the Belgium-Luxembourg Economic

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to refer to international environmental agreements, emphasizing the parties' obligation to maintain strong environmental protections. For instance, the Canada–Peru BIT contains clauses that require investors to comply with both national legislation and international environmental commitments¹¹⁵. Parties are often motivated to include such standards due to growing international pressure to address climate change, civil society advocacy, and the global emphasis on sustainable finance. In addition, incorporating environmental standards is increasingly viewed as a means to safeguard long-term investment stability and reduce reputational risk. However, not all treaties include such provisions which in their turn create significant normative and legal gaps. To compensate for these challenges, some states utilize domestic legislative frameworks that require treaty parties to incorporate environmental and sustainability standards into investment agreements. These internal regulations can serve as supporting mechanisms when treaty texts do not cover environmental obligations and helps to align investment policy with broader environmental goals. These trends imply a growing awareness of the importance of aligning investment protection with environmental sustainability. Nevertheless, the scope and legal force of such provisions differ significantly among treaties, and substantial challenges can be seen in guaranteeing that environmental safeguards are meaningfully implemented within the investment law regime.¹¹⁶

2.3. How should the governments balance the harmony between protecting the investor's interest and environmental safety while drafting the BIT.

To explore the potential of BITs as tools of global climate governance, it is needed to reconcile the traditional objectives of International Investment Law with the adaptive requirements of International Climate Change Law. Historically, BITs were designed to protect fossil fuel investments, unintentionally causing a legal foundation that could hinder to the climate action, particularly through the regulatory chill effect in which governments are not confident in adopting environmental provisions which may lead to the potential investor claim under the FET standard.¹¹⁷ Some methods are useful to consider for BITs to support climate policy. First

Union and the Government of the Republic of Mozambique on the reciprocal promotion and protection of investments.

¹¹⁵ World Jurisprudence. (2024). Integrating BITs and Environmental Standards in International Law.

¹¹⁶ World Jurisprudence. (2024). Integrating BITs and Environmental Standards in International Law

¹¹⁷ Lieser, A. (2024). Bilateral investment treaties as a tool for global climate governance?: Bridging the tension between international investment law and international climate change law by redesigning bilateral investment treaties. *Völkerrechtsblog*

comes the recognition of the right to regulate. BITs need to explicitly affirm the regulatory authority of states in environmental issues. Such provisions reduce the chilling effect and align investment protection with legitimate public policy goals.¹¹⁸ This method is expressed in treaties like CETA.¹¹⁹ Thus, by clearly stating that environmental measures taken in good faith will not be considered a breach of investor protections, states can create legal assurance for both sides. Secondly, it is proposed to include substantive environmental obligations where the investor is obliged to comply with environmental laws and international commitments, as in the BIT between Morocco and Nigeria, where the environmental and social impact assessment screening is applicable before the establishment of the investments according to the host country's regulations. Moreover, the post-establishment obligations will be imposed by the governments.¹²⁰ This approach shifts a part of the environmental responsibility to investors, encouraging sustainable business practices. Additionally, the requirement of timely environmental reporting by investors can enhance transparency and monitoring in host states. Preferential treatment for renewable energy investors is another effective approach. In case the BITs grant FET protection exclusively to renewable energy investors while excluding fossil fuel interests from the investor-state dispute mechanism.¹²¹ It is worth noting that this differentiation could be considered as an incentive for climate-friendly investments while discouraging carbon projects. Another preferential method is incorporating the Paris Agreement into BITs. According to the OECD Secretariat note in 2023, as a response to a survey on climate policies in investment treaties, the growing importance on this issue was highly supported by the majority of the governments.¹²² Incorporating references to nationally determined contributions under the Paris framework can further align foreign investment to each country's climate goals. The next method of balancing is the prevention of regulatory chill. By precisely defining the boundaries of investor protections and the host party's right to

¹¹⁸ Lieser, A. (2024). Bilateral investment treaties as a tool for global climate governance?: Bridging the tension between international investment law and international climate change law by redesigning bilateral investment treaties. *Völkerrechtsblog*

¹¹⁹ Article 8.9 & 24.3, Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union, Canada–European Union, Oct. 30, 2016, Official Journal of the European Union, L 11, 14 January 2017.

¹²⁰ Article 14&18, Morocco – Nigeria BIT (2016) Reciprocal Investment Promotion and Protection Agreement between the Government of the Kingdom of Morocco and the Government of the Federal Republic of Nigeria

¹²¹ Lieser, A. (2024). Bilateral investment treaties as a tool for global climate governance?: Bridging the tension between international investment law and international climate change law by redesigning bilateral investment treaties. *Völkerrechtsblog*

¹²² OECD. (2023). Investment treaties and climate change: Secretariat note for public consultation. Organisation for Economic Co-operation and Development, 13-14

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regulate, BITs may alleviate the “regulatory chill” effect, where states hesitate to legislate environmental regulations due to the claims of investors.¹²³ Treaty language should clarify that non-discriminatory environmental measures do not violate FET, national treatment, or other biased standards. The last suggestion in the concept of this paperwork is alignment with the Sustainable Development Goals. Integration of the related provisions into BITs ensures that investment activities stimulate the development of social and environmental goals by promoting them.¹²⁴

By following the mentioned methods, the BITs transformation in such fashion is significant for IIL to align with global climate objectives. Redesigning BITs can bring effective outcomes and exclude legal barriers in environmental regulation by promoting foreign sustainable investments.

2.4. Environmental exemptions and procedural protection.

Unlike early agreements, modern investment treaties specifically incorporate explicit phrasing to preserve regulatory autonomy of states with regard to environmental matters. These environmental “carve-outs” are legal clauses mentioning that non-discriminatory environmental measures will not constitute breaches of treaty obligations, regardless they affect foreign investors. Precise language of treaties gives states confidence to regulate in the public interest regarding especially environmental protection without the fear of triggering investor claims.¹²⁵

One significant example is Article 8.38 of the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada¹²⁶. This provision enforces that the tribunal cannot classify an agreement as preventing a Party from adopting or supporting immediate measures to protect legitimate public welfare objectives, such as the environment, in the case they are non-discriminatory. This clause sends a strong message that environmental regulations that are ratified in good faith will not automatically produce investment claims.

¹²³ Tienhaara, K. (2018). Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement. *Transnational Environmental Law*, 7(2), 229–250.

¹²⁴ Article 12 (2015) BIT Model of India

¹²⁵ Titi, C. (2022). The right to regulate in international investment law (revisited). *International and Comparative Law Research Center*

¹²⁶ Government of Canada. (2020). *Text of the Comprehensive Economic and Trade Agreement – Investment*.

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Similarly, the 2012 U.S. Model BIT includes a general exception in Article 13, which allows states to adopt suitable measures to protect public welfare, explicitly referencing the environment¹²⁷. Although these exceptions do not act as absolute shields, they provide guidance that might influence arbitral outcomes in favor of regulatory space.

The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) includes other similar measures¹²⁸. It references the legitimacy of “health, safety, or environmental measures,” stressing that treaty protections should not be interpreted in a way that restricts essential public policy actions. Despite these clauses often requiring that such measures be non-discriminatory and not disguised restrictions on investment, they reflect an evolving treaty practice that acknowledges climate change and concerns over biodiversity.

Procedural Innovations in ISDS Practice

In the broader view of treaties, changes in dispute resolution procedures also reshape the relations between investment protection and environmental policy. One such innovation is the acceptance of ‘ curiae briefs submitted by non-governmental organizations, especially NGOs concerned with the environment.¹²⁹ These submissions allow tribunals to consider external perspectives of experts, enhancing the understanding of concerning ecological consequences and societal interests.

In addition, some tribunals now appoint arbitrators or independent experts who have a background in environmental or climate law¹³⁰. This change helps to ensure proper evaluation of complex environmental regulations and provides scientific evidence by mitigating the risk of decisions being in favor of investors unfamiliar with ecological regulations.

Together, these procedural tools aim to balance investor rights and public interest, implying a gradual but meaningful departure from the pro-investor bias which is often associated with traditional ISDS mechanisms.

¹²⁷ United States Trade Representative. (2012). 2012 U.S. Model Bilateral Investment Treaty.

¹²⁸ Government of Canada. (2016). Consolidated TPP Text-Chapter 18- Intellectual Property.

¹²⁹ Baltag, C. (2020). The Role of Amici Curiae in Light of Recent Developments in Investment Treaty Arbitration: Legitimizing the System? ICSID Review - Foreign Investment Law Journal, Volume 35(1-2), 279-310.

¹³⁰ ICC Dispute Resolution Bulletin. (2019). Resolving Climate Change Related Disputes through Arbitration and ADR.

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Overall, these doctrinal and procedural innovations become the foundation for a dispute system that is able to accommodate urgent climate and biodiversity goals. They are known as practical evolution drivers within investment law, which recognizes and respects the regulatory means required for sustainable development. This balance will be further explored in Chapter 3 with the help of recent case studies that demonstrate how these principles should be tested and applied in practice.

Chapter 3

3.1. Scenario 1 -When investor interests predominate.

Occidental Petroleum v. Ecuador (ICSID Case No. ARB/06/11)

One of the cases as a result of the BIT breach in the FET standard related to environmental matters is the “Occidental Petroleum and Ecuador” ICSID case. Originally from the United States, the company Occidental Petroleum (“Oxy”) started its operations in Ecuador in the middle of 1980s, ultimately entering into a Participation Contract with the Republic of Ecuador in 1999 to explore and exploit hydrocarbons in Block 15 of the Amazon in Ecuador.¹³¹ A Participation Contract is an agreement arrangement generally used in the oil and gas industry, specifically in countries where the natural resources are owned by the state, but private and foreign companies are allowed in exploration, development, and production.¹³² In 2000, as a sequel to the Participation Contract, Oxy decided to enter into a Farmout Agreement with Alberta Energy Corporation (“AEC”) to transfer AEC 40% of interest in Block 15.¹³³ According to Ecuadorian law on Hydrocarbons¹³⁴ and the Participation Contract¹³⁵, Oxy had to obtain ministerial approval, and if the permission is not provided by the relevant authority,

¹³¹ UNCTAD. (2002). Occidental v. Ecuador (I). Investment Dispute Settlement Navigator. United Nations Conference on Trade and Development.

¹³² Bindemann, K. (1999). *Production-sharing agreements: An economic analysis* (WPM 25). Oxford Institute for Energy Studies

¹³³ International Centre for Settlement of Investment Disputes. (2012). Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Republic of Ecuador (ICSID Case No. ARB/06/11) Award, October 5, 2012. TDM IACL Case Report.

¹³⁴ Article 74 (n.d) Republic of Ecuador. Hydrocarbons Law of the Republic of atEcuador.

¹³⁵ Article 21 of the Participation Contract

the authority (the Ministry of Energy and Mines) may declare the forfeiture of the contract. Consequently, based on these provisions, the Ecuadorian government issued the “Caducidad” (forfeiture) Decree in May 2006, which terminated Oxy’s Participation Contract and seized its assets.¹³⁶ In response to the Termination Decree, Oxy henceforth initiated arbitration under the ICSID on May 17, 2006, referring to the breaches of the US-Ecuador BIT.¹³⁷ Initially, the dispute concerned the legality of Ecuador’s Decree outcomes. Oxy claimed that Ecuador’s unilateral termination was insufficient on a contractual and legal basis and led to the breach of the BIT. Afterwards, Oxy argued that regardless of the existence of the termination event, the measure was unfair, arbitrary, and disproportionate, contradicting the FET standard.¹³⁸ The majority of the Tribunal awarded that Ecuador breached Article II.3(a) of the BIT¹³⁹ since Ecuador failed to comply with the FET standard concerning the Claimant’s (Oxy’s) investments, moreover to comply with the principle of MFN standard in the BIT¹⁴⁰.

Tribunal also mentioned the fact that Ecuador breached Article III.1 of the Treaty¹⁴¹ by expropriating Oxy’s investment in Block 15 through “indirect expropriation”.¹⁴² Consequently, the “Caducidad” Decree was deemed a breach of FET and MFN standards, leading to tantamount expropriation.¹⁴³ Tribunal defined that Oxy breached Clause 16.1 of the Participation Contract since Oxy failed to provide the relevant ministerial authorization for the

¹³⁶ International Centre for Settlement of Investment Disputes. (2012, October 5). *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador (ICSID Case No. ARB/06/11)*, Award.

¹³⁷ United States and Ecuador BIT (1993). Agreement between the Government of the United States of America and the Government of the Republic of Ecuador concerning the encouragement and reciprocal protection of investment

¹³⁸ International Centre for Settlement of Investment Disputes. (2012). *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador (ICSID Case No. ARB/06/11)*, Award.

¹³⁹ United States and Ecuador BIT (1993). Agreement between the Government of the United States of America and the Government of the Republic of Ecuador concerning the encouragement and reciprocal protection of investment

¹⁴⁰ Article II (1) United States and Ecuador BIT (1993). Agreement between the Government of the United States of America and the Government of the Republic of Ecuador concerning the encouragement and reciprocal protection of investment

¹⁴¹ United States and Ecuador BIT (1993). Agreement between the Government of the United States of America and the Government of the Republic of Ecuador concerning the encouragement and reciprocal protection of investment

¹⁴² OECD. (2004). "Indirect expropriation" and the "right to regulate" in international investment law (OECD Working Papers on International Investment, No. 2004/4). OECD Publishing.

¹⁴³ International Centre for Settlement of Investment Disputes. (2012). *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Republic of Ecuador (ICSID Case No. ARB/06/11)* Award, October 5, 2012. TDM IACL Case Report.

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transfer of rights under the Farmout Agreement. According to the principle of inexistence and absolute nullity, the transfer of rights from Oxy to AEC was null and void with no legal effect since it was considered legally invalid without prior mandatory authorization. However, as a result of not obtaining authorization, leading to the illegal action by Oxy, the Tribunal reduced the award amount by 25%. In conclusion, Claimant was awarded the amount of US\$ 1,769,625,000 (US One billion, seven hundred sixty-nine million, six hundred twenty-five thousand dollars).¹⁴⁴

In the *Occidental Petroleum v. Ecuador* case, the tribunal acknowledged Ecuador breaching the BIT, however, the actions by Ecuador were caused due to the non-compliance of domestic law by the investor. Despite the investor being awarded the compensation, this case substantiated the host country's right to regulate in accordance with the national legislation. This award highlighted the importance of balance between the investor rights and the sovereign rights of the host countries to regulate activities in their territory.

3.2. Scenario 2- When environmental protection takes precedence.

Perenco Ecuador Ltd. v. Republic of Ecuador (ICSID Case No. ARB/08/6)

This case stands as a solid example of an investor-state arbitration where the host state successfully asserted counterclaims for environmental damage, demonstrating the increasing willingness of tribunals to sustain environmental obligations in the scope of investment treaties. The French oil company Perenco Ecuador Ltd. entered into a contract with the Republic of Ecuador to conduct hydrocarbon exploration and exploitation activities in Blocks 7 and 21 of the Ecuadorian Amazon¹⁴⁵. The investment was protected under the 1994 France–Ecuador BIT, which included the clauses for fair and equitable treatment, full protection and security, protection from expropriation without compensation, and the application of MFN and national treatment standards.

¹⁴⁴ UNCTAD. (2002). *Occidental v. Ecuador (I)*. Investment Dispute Settlement Navigator. United Nations Conference on Trade and Development.

¹⁴⁵ UNCTAD Investment Policy Hub. (2024). *Perenco v. Ecuador*.

In 2008, the dispute arose following the Ecuadorian government's implementation of Law 42, which raised a response to rising oil prices and significantly increased the state's share of oil revenues¹⁴⁶. Perenco challenged the issue, arguing that it was an unlawful expropriation and violated its legitimate expectations under the BIT. In response, Ecuador submitted a counterclaim, alleging that Perenco had caused severe environmental harm through its operations. The environmental counterclaims were based solely on Ecuadorian domestic legislation, including the Environmental Management Act, the Hydrocarbons Law, and constitutional provisions mandating the protection of nature¹⁴⁷. The alleged damage was on the issues that directly affected local ecosystems, including soil degradation, groundwater pollution, and the improper disposal of industrial waste.

The tribunal recognized the legitimacy of Ecuador's environmental counterclaim, but partially upheld Perenco's claim regarding the fiscal measures under Law 42¹⁴⁸. This was a significant development considering that historically, environmental counterclaims had been rare in ICSID proceedings. To evaluate the damage, the tribunal appointed independent environmental experts and conducted site inspections. Ultimately, Ecuador was awarded approximately \$54 million in compensation for the environmental harm, which was offset against the amount granted to Perenco in its investment claim¹⁴⁹.

Importantly, the tribunal emphasized that BIT cannot shield investors from liability for failing to comply with domestic environmental regulations. It also reaffirmed the sovereign right of the host state, despite investor-state disputes, to regulate to reach its public policy objectives, in this case, environmental protection. This case illustrates a shift in arbitral practice toward recognizing the significance of environmental obligations within international investment frameworks, even in the case without referencing multilateral environmental treaties. It also indicates a progressive development in balancing investor rights with environmental protection and calls for establishing strong domestic legal frameworks in supporting such claims.

¹⁴⁶ ICSID. (2024). *Perenco Ecuador Limited v. Republic of Ecuador*.

¹⁴⁷ *Global Arbitration Review*. (2014). Panel rules on Ecuador's windfall oil profits tax.

¹⁴⁸ Ketcheson, J., Lovells, H. (2015). The Law 42 Arbitrations: Ecuador's Efforts to Capture 'Extraordinary Profits' of Oil Companies. *the journal of world investment & trade* 16, 734-744.

¹⁴⁹ *In The United States District Court For The District Of Columbia*. (2023). Order and Final Judgment.

3.3 Discussion.

The case studies clearly indicate an enduring imbalance in investor-state arbitration outcomes when environmental concerns come into conflict with investor protections. In cases like *Occidental Petroleum v. Ecuador*, tribunals supported investor claims and even awarded \$1.77 billion to the investor, emphasizing treaty provisions such as expropriation and FET¹⁵⁰. These protections were established with sufficient clarity to guide the tribunal's decisions, although often not in favor of state environmental regulation. On the other hand, in cases like *Perencov. Ecuador*, tribunals acknowledged the regulatory interests of the state, especially about environmental protection. Yet, due to vague BIT language, Ecuador had to rely on its national environmental law, which implies the absence of structured environmental obligations in the BIT¹⁵¹. However, these examples are uncommon and rely on treaty-specific nuances rather than a consistent legal framework.

The contrast between these case outcomes can be attributed to the vagueness of binding environmental clauses in BITs. Although investor protections are specific and enforceable, environmental obligations remain general or even excluded altogether. This adds to an interpretive bias that favors investors, particularly for courtly cases when tribunals are left to balance competing goals.

Thus, BITs often lack precise and enforceable language on environmental obligations, which might produce several negative legal effects. Governments often face a difficult situation during BIT negotiations, between attracting foreign investment and preserving regulatory autonomy for environmental protection. This tendency might stem from political pressures or fears of deterring investors.¹⁵² However, this short-term ambiguity creates long-term legal uncertainty and litigation risks. Coming to negative effects, firstly, ambiguous language grants tribunals broad interpretive discretion, which can create unpredictability in rulings and lead to inconsistent outcomes. In the *Occidental Petroleum v. Ecuador* case, the lack of regulatory

¹⁵⁰ International Centre for Settlement of Investment Disputes. (2012). *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador* (ICSID Case No. ARB/06/11), Award.

¹⁵¹ UNCTAD Investment Policy Hub. (2024). *Perenco v. Ecuador*.

¹⁵² Bernasconi-Osterwalder, N., Cosby, A., Johnson, L., & Vis-Dunbar, D. (2011). *Investment treaties and why they matter to sustainable development: Questions and answers*. International Institute for Sustainable Development (IISD).

specifications left Ecuador unable to defend its environmental actions.¹⁵³ Moreover, as seen in the *Perenco v. Ecuador* case, states struggle to defend legitimate environmental measures when treaties lack references to international environmental law. This is especially more challenging when investors' claims pertain to standards like FET or indirect expropriation. Another issue is regulatory "chill", where governments hesitate to enact necessary but potentially contentious environmental laws, delaying policy interventions¹⁵⁴. Ecuador's experience in the first case sends a signal to other states considering environmental or sovereign interventions. Also, without operational clauses linking BITs to sustainability, treaties fail to encourage green investment despite verbal commitments to sustainable development. In the *Perenco* case, Ecuador had to rely on customary international law and ad hoc counterclaims rather than rights outlined in the treaty to enforce environmental protections. Overall, these deficiencies demonstrate that in their current states, BITs are structurally incompatible with the need for an environmentally focused measure. Furthermore, cases like *Occidental v. Ecuador* highlight how environmental protection is not prioritized when treaties do not include affirmative legal space for climate action. In the case and many other instances, there is no mention of climate goals, no Paris Agreement alignment, and no procedural safeguards like the right of NGOs to submit amicus curiae briefs or the appointment of environmental experts¹⁵⁵. In comparison, if procedural tools were available, tribunals would be able to be incorporated scientific evidence or third-party views to balance investor interests with public environmental goals. In the *Perenco v. Ecuador* case, the environmental counterclaim was a rare occasion of bridging this gap, which was also not by the BIT. The case serves as an example to institutionalize environmental protection mechanisms in future treaties.

The comparative analysis of the *Occidental* and *Perenco* case offers valuable insight into the differences in how investment tribunals handle disputes for state and investor sides. In *Occidental*, the tribunal prioritized the investor's rights under the BIT and accused Ecuador of revoking the investment contract, despite its justification supported by domestic law. Environmental considerations were not considered, which reflects BIT's stance on the

¹⁵³ International Centre for Settlement of Investment Disputes. (2012). *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Republic of Ecuador* (ICSID Case No. ARB/06/11) Award, October 5, 2012. TDM IACL Case Report.

¹⁵⁴ Bonnitcha, J., Poulsen, L. N. S., & Waibel, M. (2017). *The Political Economy of the Investment Treaty Regime*. Oxford University Press.

¹⁵⁵ International Centre for Settlement of Investment Disputes. (2012). *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Republic of Ecuador* (ICSID Case No. ARB/06/11) Award, October 5, 2012. TDM IACL Case Report.

regulatory power of states to protect public interests. On the other hand, a significant event was for Perenco case, with the tribunal recognizing Ecuador's environmental counterclaims. However, it should be noted that this recognition was based mainly on Ecuador's domestic environmental laws rather than treaty obligations, once again stressing that the BIT did not provide a clear framework to manage environmental responsibilities. This difference indicates how tribunals might offer varying results depending on the presence or absence of clear treaty language on environmental issues.

The comparative analysis of these cases stresses the critical need for investment treaties to integrate environmental clauses to ensure more balanced dispute outcomes. Reliance on tribunal interpretations results in unpredictability and inconsistent protection of environmental interests. Furthermore, including investor obligations to comply with environmental laws within BITs might encourage sustainable business practices and prevent environmental harm.¹⁵⁶ Another important lesson is that procedural innovations should be institutionalized to help tribunals better understand complex environmental issues. Such tools can help bridge the gap between investor protection and environmental regulation in the broader context of sustainable development. Overall, these cases imply that without fundamental treaty reforms, tribunals are left to deal with an ambiguous legal landscape, which might inadequately protect the environment. The cases of Occidental and Perenco would be beneficial for policymakers to design BITs that better balance economic interests and environmental imperatives.

Regarding policy gaps, these cases offer an approach to how policy changes may alter the outcomes of tribunal proceedings. For the Occidental case, if the BIT would include a clause like CETA's Article 8.9 which would affirm the state's right to regulate for public welfare, Ecuador might have avoided full liability¹⁵⁷. Also, in the Perenco case, if Ecuador's BIT had imposed obligations on investors to prevent environmental harm, the counterclaims of the state would have been supported directly by treaty law, not rely only on national statutes. Thus, these reforms would realign BITs with climate governance and reduce the investors from benefiting from ambiguous clauses in the tribunals regarding environmental issues. In this regard, it is necessary for BITs to evolve and accommodate environmental and climate clauses to overcome the mentioned challenges. Firstly, BITs should include a template regarding environmental

¹⁵⁶ Bonnitcha, J., Poulsen, L. N. S., & Waibel, M. (2017). *The Political Economy of the Investment Treaty Regime*. Oxford University Press.

¹⁵⁷ European Commission. (2016). *CETA Chapter 8: Investment*.

provisions. Adopting treaty templates like the EU Model BIT or CETA that support the state's right to regulate in the public interest for environmental protection might be a suitable step in this direction. Also, integrating clauses similar to Article XX of the GATT that mentions exemption of non-discriminatory and good faith environmental regulations from constituting treaty breaches¹⁵⁸. Besides this, it is crucial to include mandatory environmental impact assessments, environmental due diligence, and post-establishment obligations like the one established for the Morocco-Nigeria BIT¹⁵⁹. In addition, there should be mention of the shift to clean energy initiatives, if applicable. This should involve limiting protections to clean energy projects while discouraging fossil fuel investments through specific clauses. Moreover, BITs should pay special attention to aligning with the Paris Agreement and UN SDGs. Explicitly referencing international climate agreements and incorporating sustainable language would help to link investment obligations to global environmental goals. Lastly, the institutionalization of *amicus curiae* acceptance, ensuring the inclusion of environmental expertise in arbitration, and enhancing transparency would help to better reflect the public interest.

The future implications of these recommendations depend on their effective and committed implementation. Global attention toward sustainable development is changing investor expectations and government priorities in meeting climate targets. BIT reforms that contain this balance will likely to be used in future treaty negotiations. Thus, the governments that integrate environmental protections and procedural innovations in their BITs will be able to have better position in dispute management. The current main challenge of aligning BITs with environmental goals lies in surpassing the traditional bias toward investor protection and the complex structure of ISDS mechanisms. However, this also presents an opportunity to reform treaties in a way that reflects sustainable development and economic governance. Moreover, although environmental exceptions and procedural reforms look promising, their success depends on enforceability and consistency in treaties. Treaties like CETA provide a roadmap, but there is limited adoption with current innovations being insufficient without broader reforms. In this direction, procedural reforms like allowing environmental NGOs to contribute through *amicus curiae* and appointment of environmental law experts act as practical tools that

¹⁵⁸ World Trade Organization. (2012). GATT Article XX.

¹⁵⁹ UNCTAD. Morocco-Nigeria BIT. UN Trade & Development Investment Hub.

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would help to improve the quality and legitimacy of arbitral decisions. Beside investor claims, they serve to support public and scientific interest despite weak use.

Despite the efforts to conduct reforms, tensions remain. Investors demand legal certainty and strong protections, while states require policy space to meet climate obligations. Therefore, treaty reforms must balance these two demands and ensure that states can impose environmental laws without fear of disproportionate liability, while investors obtain protection against discriminatory treatment. As climate governance becomes central to international law, BIT reform is expected to turn into a central point of treaty negotiations¹⁶⁰. Countries might demand investment frameworks that are aligned with climate issues and even withdraw from older treaties that do not offer sustainability provisions. Further, new treaties will tend to include clearer language on environmental issues and arbitral tribunals might start to interpret existing provisions by integrating a perspective on climate issues. These trends stress the growing need to modify BITs to support sustainable investment. Without reforms, the international investment regime might continue to face challenges in addressing investor-state dispute cases related to environmental issues.

To conclude, the analysis of case studies clearly shows the complex and blurred relationship between investor protection and environmental regulation within the current international investment law regime. Designed primarily to protect investor interests, currently, BITs lack binding environmental provisions, which create significant legal uncertainty and help investors to benefit over host states' climate policies. This imbalance contributes to regulatory chill, where governments hesitate to adopt necessary environmental measures due to the fear of costly arbitration. However, recent treaty innovations offer a promising way forward to balance these competing interests. The comparison of cases like *Occidental* and *Perenco* implies the need for BITs to modify vague language and integrate sustainable development goals to their texts. This evolution is crucial not only for the protection of the environment but also for creating a stable investment climate that balances the interests of investors and states.

¹⁶⁰ Mazzei, I. (2025). Arbitrators of Environmental Disputes: The Guardians of Natural Resources. *Pace Environmental Law Review*, 42, p.278.

3.4 Conclusion

Despite aiming to provide a comprehensive analysis, this study has several limitations. Firstly, the research primarily focuses on two case studies, *Occidental v. Ecuador* and *Perenco v. Ecuador* which although are illustrative but may not fully represent the diversity of investment disputes regarding environmental issues. Secondly, due to restrictions on data accessibility and time, the study does not include interviews with legal practitioners, which could have offered practical insights into tribunal decisions. Furthermore, the constantly evolving nature of investment treaties and environmental norms implies that findings may become out of date as new treaty models are being drafted. Lastly, the analysis has a primarily legal nature and does not fully take into account for political, economic, or regional dynamics that may influence BIT drafting and enforcement in different regulatory systems.

In conclusion, this thesis explored the correlation of international investment law and environmental protection, focusing on how Bilateral Investment Treaties can both challenge and support global climate governance. The paper examined the evolving bond between international investment law and international environmental law, based on theoretical and legal foundations. The shared regulatory space over natural resources and the need to integrate sustainable development goals into investment frameworks has been one of the most essential topics recently. Moreover, the role of dispute resolution mechanisms, including ICSID arbitration, play an important part in balancing investor protection with environmental concerns. In addition, the paper provided a detailed legal analysis of BITs from a drafting perspective, emphasizing their traditional focus on investor rights. The practical implications of these theoretical and legal frameworks were analyzed in the cases of *Occidental Petroleum v. Ecuador* and *Perenco v. Ecuador*. They demonstrated how broad and vague BIT protections can change outcomes in favor of investors, often discouraging states from implementing environmental measures. However, the cases also provided an example that it is possible for the states to have regulatory autonomy when BITs include clearer environmental provisions and work in favor of the state. These case studies stressed the critical role of being precise in drafting treaties and the growing influence of procedural tools like *amicus curiae* submissions and expert appointments. Furthermore, the comparative analysis of both cases indicated how specific treaty language can significantly shift the direction of the outcomes of disputes. In the

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Perenco case, the presence of environmental counterclaims despite being based on domestic law imply a growing tendency for state defenses when climate concerns are being challenged.

Another key issue identified in this paper is about the effectiveness of procedural innovations and exemptions. Mechanisms such as environmental carve-outs, impact assessments, and stakeholder participation tools like *amicus curae* are gradually being introduced in modern treaties, however their enforcement and scope is still not sufficient.

The research identified significant challenges in aligning BITs with environmental goals, including regulatory chill, legal uncertainty, and tensions between investors and the state. These tensions stress the fragile balance that states must maintain between attracting foreign investment and complying with their international climate obligations. Without strong legal protection, states may become hesitant to implement necessary environmental regulations.

In this context, one major concern is whether BITs will be able to fully accommodate environmental imperatives without reducing investor trust. Nevertheless, the evolving global investment landscape, especially considering the rising importance of ESG standards, suggests that legal frameworks that ignore environmental risks may increasingly be seen as not suitable and commercially unfit. Despite this, the analysis also indicated that there exist opportunities through innovative treaty drafting and dispute resolution practices that can better integrate climate commitments and promote sustainable development. This includes incorporating references to the Paris Agreement, aligning with the UN Sustainable Development Goals, and redefining investor obligations to include environmental due diligence and responsibility.

Overall, this thesis argues for a thorough redesign of BITs to act as instruments that not only protect investors but also support global environmental and climate objectives. The future of international investment law depends on its capacity to evolve and include sustainability goals. Only through this evolution BITs may regain legitimacy in the eyes of the public and effectively balance private interests with public goods. By involving environmental clauses and embracing procedural innovations, BITs can facilitate a legal framework that balances economic development with ecological focus. This transformation is essential for ensuring that investment law contributes positively to the global climate agenda and sustainable development for future generations.

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