

The Impact of Investor-State Arbitration on Global Climate Protection

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Abstract. The climate change requires global climate protection measures, which means that developed countries should contribute to climate finance and capital export to increase the technological and funds. However, the implementation of such climate-friendly investments can sometimes lead to conflicts between the state's investment protection and climate change measures. Therefore, it is necessary to promote Investor-State arbitration that reasonably to reconcile the protection of the rights and interests between investors and host countries, which could contribute to the development of global climate protection and sustainable development.

Keywords: Investor-State Arbitration; Global Climate Protection; Sustainable Development.

1. Introduction

With the development of economic globalization, international investment promotes the best combination of production factors, which realizes the division of labor and cooperation in the international community. However, while international investment reduces economic costs and promotes economic development, it also brings negative impacts, the most notable of which is climate change. Currently, climate change caused by greenhouse gas emissions is considered to be one of the world's greatest concerns. To effectively address the issue of climate change, the international community has signed a series of international agreements by previous climate negotiations, which includes the 1992 United Nations Framework Convention on Climate Change (UNFCCC), the 1997 Kyoto Protocol, the 2016 Paris Agreement and the 2021 Glasgow Climate Pact Agreement. Article 2(1) and Article 2(3) of the Paris Agreement respectively states that: "The Parties are committed to limit the increase in global average temperature to below 2°C above pre-industrial levels and to endeavour to limit the temperature increase to within 1.5°C above pre-industrial levels" and "Align financial flows with low greenhouse gas emissions and climate-resilient development". In addition, the Glasgow Climate Pact reaffirmed the climate protection goals of Article 2(1) of the Paris Agreement and called on all countries to present stronger national action plans. Therefore, in order to fulfill the commitments of international climate agreements, countries encourage foreign investors to invest in low-carbon areas and limit or eliminate the international investment in high greenhouse emissions areas.

It can be seen that the development of international climate agreements has prompted countries to formulate more carbon emissions, carbon trading plans or other carbon adaptation measures. Countries are also promoted to formulate climate and environmental legislation and implement stricter climate protection measures. The climate protection policies and measures formulated by the host countries that conflict with the signed investment agreements, which has increased the number of international investment disputes between investors and the host country. Therefore, international investment disputes related to climate protection have emerged in the field of international investment arbitration. The fundamental function of traditional international investment treaties is to protect the foreign investment, including protecting the investment rights and interests of investors and stipulating the host country's obligations to fairly protect and treat foreign investors, and limit the host country's regulatory powers. However, there are almost no provisions related to sustainable development or climate change. In addition, International investment arbitration mechanisms are organized under international investment agreements, so as to their inherent propensity to protect traditional investors has limited host countries' efforts to mitigate climate change. Therefore,

improving international investment agreements and international investment arbitration mechanisms is crucial for climate protection.

This paper will focus on the impact of Investor-State arbitration on the global climate protection. In order to analyze this argument, the second part will introduce the relationship between the Investor-State arbitration and climate protection. The third part will analyze the challenges of reconciling climate investment and host country climate protection conflicts in Investor-State arbitration. Mainly includes analysis of inconsistent standards for interpretation of national treatment, fair and equitable treatment and indirect expropriation and the issue of the legal choice between investment protection regulations and climate protection regulations. The fourth part will analyze how to improve the Investor-State arbitration to promote climate protection. It mainly includes clearly specifying the judgment criteria for the application of the national treatment clause, interpreting fair and equitable treatment conducive to the climate protection, determining the criteria for indirect expropriation based on the principle of proportionality and exception clauses, and clarifying the prioritization between investment protection regulations and climate protection regulations. The final section will provide conclusions.

2. Relationship between Investor-State arbitration and climate protection

Global climate governance is a lengthy and arduous planning project that requires all parties to effectively translate their climate responsibilities into collective climate governance actions. By the continuous negotiations of different countries, the issue of climate change is being globalized in the global climate governance treaty system represented by the “United Nations Framework Convention on Climate Change”, the “Kyoto Protocol” and the “Paris Agreement”, which could promote the participation of countries in global climate governance. The main cause of climate change is the emission of a large amount of greenhouse gases, which are mainly generated by the modern industry's reliance on fossil fuels. Therefore, the most important method to mitigate climate change is to reduce reliance on and investment in fossil fuels and transition to renewable energy and sustainable development. In this context, the “Paris Agreement” Article 2(1) proposes the governance objectives. In addition, the 26th UNFCCC Conference of the Parties, which concluded in Glasgow, agreed on a historic Glasgow Climate Pact, which commits countries to accelerate the “phasing out” of coal use and “mobilize climate finance from all sources to reach the required level for the goals of the Paris Agreement”. This is the first time that the UN has explicitly mentioned the phasing out of coal use in the Glasgow Climate Pact, while also emphasizing the continuation of investment goals consistent with the principles of the Paris Agreement.

To achieve reduction in greenhouse gas emissions, climate protection measures must be combined with climate protection investments. Climate financing is the basic logical premise of climate governance, which is the investment and financing for the realization of nationally determined contributions and low-carbon development goals, so as to guide and encourage more funds to be invested in climate protection. Climate financing can promote the industrial structure, optimize the energy structure, reduce the greenhouse gas emissions and accelerate the construction of infrastructure that promotes sustainable development. In addition, the traditional climate financing model is dominated by the voluntary contributions of sovereign countries, with funds coming mainly from developed countries. The Green Climate Fund (GCF), established in 2010, is a major fundraising program under the UNFCCC for climate change mitigation and adaptation. GCF launched its initial funding efforts in 2014 and quickly raised \$10.3 billion in funding. However, when the United States announced its withdrawal from the “Paris Agreement” and the unwillingness of other countries to raise funds, the source of funding for global climate policy was challenged. It can be seen that, with the sovereign-state-dominated diplomatic model of climate governance stalled, subsequent negotiations of the “Paris Agreement” focused on the transformation of climate governance from a “regulatory” model to a “facilitated” model. A key part of this shift is the acceptance of climate action by non-state actors in intergovernmental mechanisms. Climate financing by non-state actors has

become an important channel for climate financing to fill gaps in the readiness and capacity of sovereign countries for climate financing and to promote the participation of non-state actors in transnational green investment. It can be seen that climate financing cannot only rely on government power, but also requires private investors and foreign capital to enter the climate investment and finance field.

While the private climate investments promote the global climate governance, they also reflect the conflict between climate investments protection of foreign investors and climate regulation of host country. Firstly, the implementation of climate policies by host countries will change the investment policy environment and affect the reasonable expectations and interests of climate investors. In order to attract foreign investment, developing countries as host countries often grant investors various advantages in international investment agreements, and they do not conclude an agreement on climate and environmental protection or the agreement is ambiguous and difficult to implement. However, with the development of the host country, the original economic priority development strategy has been gradually changed and new climate protection measures have been formulated, which may change the previous investment policy environment. This means that the policies centered on protecting the environment may damage the investors' reasonable expectations and interests. Furthermore, differences between investment rules and climate rules exacerbate conflicts between climate investors and host country climate protection. It can be seen that climate protection Investments is within a complex framework of contradictory public and private, economic development and climate protection goals. The protective purpose of most bilateral investment agreements (BITs) and multilateral investment agreements is to protect the interests of investors, while the purpose of international climate agreements is to mitigate climate change. The different basic purpose and interests of international investment agreements and climate protection policies determines the conflict between them. Pursuant to Article 14 of the "United Nations Framework Convention on Climate Change" and Article 24 of the "Paris Agreement", in the circumstances of the dispute between the investor and the host country parties, it is recommended that arbitration be used as a method of dispute settlement. It can be seen that it is crucial for foreign investors and host countries to resolve the conflict between climate protection investment and climate regulation of the host country by international investment arbitration.

3. Challenges of Investor-State Arbitration Reconciliation of climate investments and host country climate protection conflicts

In the process of global climate governance by climate investments, it is crucial to balance countries' commitments to mitigate climate change and their responsibility to protect foreign investors. International investment agreements allow individual investor in the Investor-State Arbitration mechanism to challenge capital-importing country standards of treatments, therefore, the Investor-State Arbitration in resolving climate investment disputes is necessary. As an investment protection mechanism that investors can initiate instead of relying on the government, Investor-State Arbitration has become a powerful method to compel countries to take effective measures to avoid greenhouse gas emissions and implement climate policies, thereby promoting investor protection and climate governance development. While most international investment agreements provide safeguards for private investment, they are meaningless without a well-established dispute resolution mechanism. This is because Investor-State Arbitration awards have different effects on host countries and investors. For example, if the arbitral tribunal awards to protect investor on the basis of an investment treaty, this will discourage the host country's efforts to mitigate climate change, which is not conducive to the implementation of climate protection. This section will analyze the challenges of Investor-State Arbitration in resolving the conflict between climate investment and host country climate protection based on the following points.

3.1 Inconsistent standards for interpretation of national treatment

The standard of national treatment is that the standard of treatment offered by the host country to foreign investors cannot be lower than that offered to its own nationals, unless such a distinction is justified in the public interest. In international investment agreements, the host country ensures that the application of national treatment standards to investors. National treatment clauses generally apply to actions by a state with respect to the establishment, acquisition, expansion, regulation, operation and sale of investments and other conduct relating to investments in that state. For example, if the host country implements relevant climate policy measures that restrict fossil fuels and pollution, or facilitate the import and export of domestic renewable energy to reduce greenhouse gas emissions, the investor will use the national treatment standard to blame the host country discriminate and violate the promised standard of national treatment. In the case of *Nykomb v. Latvian*, Nykomb claimed that Latvia violated the national treatment standard in the Energy Charter Treaty because Latvia supported low-carbon projects by domestic operators and rejected foreign companies as investors. The arbitral tribunal awarded that Latvia should compensate Nykomb for its economic losses. It can be seen that the national treatment clause can be a useful method for investors to challenge climate change policies but it will attack the host country's enthusiasm for climate protection.

3.2 The judgment standard on the fair and equitable treatment is vague

Fair and equitable treatment clauses are the substantive clauses most commonly invoked to protect investors' legitimate expectations. Almost all international investment agreements provide for fair and equitable treatment, but the criteria for determining the meaning of the clause are quite controversial. The fuzzy judgment standard of fair and equitable treatment includes vague interpretation of fair and equitable treatment and vague interpretation of investors' reasonable expectations of interests. Firstly, the interpretation of fair and equitable treatment is too broad. When interpreting the fair and equitable treatment, there is still disagreement as to whether the term should be interpreted in a general sense or related to the minimum treatment standard in international customary law. For example, the traditional legal norm is that bilateral investment treaties only generally state that the parties shall treat the foreign investment fairly and equitably in all circumstances. This model means that the arbitral tribunal has greater discretion and, in practice, it is easy to interpret fair and equitable terms broadly. Furthermore, the issue of interpreting international customary law is how to assess the minimum standard of international customary law. Due to the different interpretations of the status of international customary law by arbitral tribunals, it is controversial whether specific principles can be applied as the minimum standard of international customary law. For example, reasonable expectation is one of the most frequently cited specific standards, and there is still disagreement as to whether it is customary international law or not.

In addition, the arbitral tribunal also has different points of interpretation with the investor's reasonable expectations of interests. One view is that if the host country grants an objectively expected benefit to attract investment but then cancels this expected benefit, which can be considered a breach of fair and equitable treatment. Another view is that investors cannot expect existing regulatory systems to remain unchanged, except for specific obligations of host country, and that regulatory reforms should be unreasonably predictable at the time of investment. Reasonable expectations that an existing policy will not be changed should be analyzed objectively but not from the subjective thinking of investors when making investments. It can be seen that the judgment standard on the fair and equitable treatment is vague. The vagueness of the judgment standard means that the arbitral tribunal's discretionary power is further expanded and the judgment results cannot be consistent. There are no clear regulations and clear explanations, which is not conducive to the coordination of climate investments and climate protection in the host country.

3.3 Conflicting criteria for determining whether climate regulation policy constitutes indirect expropriation

For foreign investors, the most important issue is that host government occupies investor property. Indirect expropriation is an act that does not directly involve the formal transfer of property, but the legal policy or relevant decisions promulgated by the host country that damage to the investment rights and interests of foreign investors. For example, if a host country takes climate protection measures, such as setting and implementing greenhouse gas emission standards and raising taxes on high-carbon industries, it will have an impact on investors. This can be viewed as indirect expropriation and the investor can resort to Investor-State Arbitration. In the current practice of Investor-State Arbitration, there are the following viewpoints. Firstly, as long as the measures taken by the host country to deal with climate change affect the business activities of investors, it constitutes indirect expropriation. Secondly, so long as the measures taken to protect the environment and other public interests do not constitute expropriation, non-discriminatory injunctions lawfully made for public purposes are excluded from the scope of the expropriation determination. Thirdly, the relationship between host country's public policy objectives and the investor's responsibilities should be measured, and an appropriate proportional relationship should be used to make judgments. As the above views have been supported by the arbitral tribunal in arbitration practice, all parties are subject to significant uncertainties.

3.4 The issue of the legal choice between investment protection regulations and climate protection regulations

Most existing investment treaties hardly contain any environmental protection clauses represented by climate change, and host country's climate protection laws and international climate agreements also do not provide protection clauses for private investments. For example, the Kyoto Protocol does not include the mechanism to protect low-carbon investments from potential regulatory changes and policy uncertainty. This makes it difficult for investment arbitration tribunal to choose the priority of the application of law. On the one hand, there is the issue of the priority order of treaty application between the clauses of the climate protection agreement and the clauses of the investment protection agreement. On the other hand, it is the issue of the priority order between the host country's domestic laws and climate protection clauses in host countries stipulated in the International Investment Agreement. In existing arbitration practice, there are different applicable legal norms and different arbitration awards. For example, in the case of *AGIP SaP v. Republic of the Congo*, the arbitral tribunal decided that the host country's law of the Congolese is to be applied firstly and, if necessary, the principles of international law can be supplemented. In the case of *Asia Agriculture Products Limited v. Republic of Sri Lanka*, the Arbitral Tribunal awarded that the rules of international law that the parties chose to apply should prevail, with the domestic law of Sri Lanka as a supplement. It can be seen that the unclear application regulations of the law choice has led to different arbitration awards in the process of reconciling climate investments and climate protection in the host country.

In conclusion, there are still many challenges in the process of reconciling climate investment and climate protection conflicts in Investor-State arbitration. The substantive clauses in international investment treaties protecting investors and their investments can be used by investors as a basis for filing arbitration claims, and they are also the main basis for investors to challenge the host country's climate policies. Among them, the limitation of the national treatment clause, the ambiguity of the judgment standard of the fair and equitable treatment clause, and the conflict of the judgment standard on whether the climate regulation policy constitutes indirect expropriation, all of which make the Investor-State arbitration unclear in the process of reconciling climate investment and host country climate protection conflicts. In addition, the uncertainty of the legal choice of investment protection regulations and climate protection regulations also leads to the Investor-State arbitration tribunal issuing different arbitral awards, which is not conducive to the protection of investors and the implementation of climate protection measures by the host country. It can be seen that improving the

international investment arbitration mechanism is crucial to reconcile the conflict between climate investment protection and climate protection measures of the host country.

4. Countermeasures to Reconcile the Conflict between Climate Investment and Host Country Climate Protection

4.1 Clearly define the criteria for determining the application of the national treatment clause

To resolve the conflict between climate investment protection and host country climate protection measures caused by the national treatment clause, two points can be considered. Firstly, the conditions of the investment access that foreign investors must abide by the host country's laws, including the climate protection policies formulated by the host country and the international climate protection obligations stipulated by international environmental law, should be stipulated in the international investment agreements. An investment is only eligible for international investment agreements protection if the investor is willing to comply with relevant climate protection laws. This measure can effectively solve the issues of investors to evade the implementation of the host country's climate protection measures by claiming the national treatment clauses.

In addition, the arbitral tribunal should improve the criteria for assessing "similar circumstances". When the arbitral tribunal decides whether the host country has breached national treatment, the usual standard of assessment is to consider whether the foreign investment and the domestic investment have "similar circumstances". However, the definition of the "similar circumstances" standard is often limited to commercial considerations, with the assessment being made within the same company or economic sector and ignoring environmental and social factors. Therefore, when identifying "similar circumstances" in national treatment, public interests such as climate protection should be prioritized. For example, when the arbitration tribunal compares domestic investors in the host country with foreign investors, it should distinguish whether these are low-carbon and environmentally friendly investments and pay attention to the impact of foreign investment on the host country's greenhouse gas emissions. When the policy adopted by the host country is for the purpose of climate protection, it should not be regarded as a violation of the "similar circumstances" in the national treatment, so as to increase the enthusiasm and initiative of the host country to take climate measures. It can be seen that, by improving the judgment standard of the arbitral tribunal for "similar circumstances", it could provide a measure for host countries to treat international investments differently based on the greenhouse gas emission characteristics of similar investments. This can reduce unreasonable arbitration of investors by national treatment clauses and promote the development of climate investments and climate protection.

4.2 The judgment of fair and equitable treatment clauses should be beneficial to climate protection

For the judgment of the fair and equitable treatment clause, the arbitral tribunal should make an interpretation in favor of climate protection. Protecting investors' legitimate expectations does not mean that domestic legal frameworks cannot be changed or that compensation claims should be accepted for any change. To resolve the conflict of interests between investors and host countries in protecting the environment, it is necessary to improve the judgment criteria of the arbitral tribunal for assessing reasonable expectation interests. By making explanations in favor of climate protection, the arbitral tribunal can reduce the inappropriate arbitration of investors and strengthen the climate protection behavior of the host country. Therefore, the arbitral tribunal should make an interpretation in favor of climate protection according to Article 31(1) of the Vienna Convention on the Law of Treaties (VCLT). Article 31(1) of the VCLT stipulates that contracts must be interpreted in good faith based on the ordinary meaning of the articles and the purpose of the treaty. On the one hand, the arbitral tribunal should accept the condition that the host country's national policies have changed due to climate protection measures and should not issue an award on the basis that any legal changes

constitute a violation of an investment treaty. The arbitral tribunal should issue an award of compensation by the host country only when the host country is exercising its legislative power in an unjust, unreasonable and unequal situation. On the other hand, if the host country provided information before taking action to mitigate climate change and investors continue to act without taking countermeasures, it can also be assumed that investors agree to the implementation of such measures. Investors can then no longer invoke fair and equitable treatment clauses to claim that the host country is detrimental to their reasonable interests. It can be seen that the arbitral tribunal not only broadly interprets the purpose of the contract by climate protection friendly interpretations, but also interprets the obligations of the host country and the investors in accordance with its responsibility for climate protection. In this method, the relationship between climate investment protection and climate protection can be effectively coordinated and sustainable development can be promoted.

4.3 Judgment criteria for indirect expropriations should be conducive to climate protection

Judgment criteria for indirect expropriations should be determined based on the principle of proportionality and exception clauses. Judgment criteria based on the effect of actually protecting investors can largely protect the confidential interests of private investors. Firstly, the conflict between climate investments protection and climate protection arises from the conflict between private interests and public interests. The application of the principle of proportionality could serve to balance private interests and public interests. When applying the principle of proportionality to determine indirect expropriation, the arbitral tribunal takes into account the following two aspects. On the one hand, arbitral tribunal should assess whether the host country's climate protection measures are so intensive that they are considered constitute indirect expropriation and should be compensated. On the other hand, the arbitral tribunal should judge whether the host country constitutes indirect expropriation from the perspective of the impact and purpose of the host country's climate protection measures. For example, if the host country's climate protection measures pretend to pursue the public interests and abuse unilateral measures to achieve other political and economic goals, the legitimacy of such climate protection measures should be denied. The climate protection measure should be based on a legitimate objective in the public interest and be appropriate for the achievement of the objective, which means climate protection measure should have an appropriate proportional relationship between the effect and the objective. According to this view, a measure should be deemed to violate proportionality if its consequences or adverse effects impose an unfairly disproportionate burden on investors. It shows that the impact of the climate protection measures implemented by the host country on investors should be proportionate to the goals they are striving for. This is advantageous for solving the conflict between climate investment and climate protection.

In addition, the establishment of exception clauses can protect the public interest of the host country. The effect of the exception clause is that if the climate and environmental laws and regulations formulated by the host country affect the interests of investors, investors shall not initiate international investment arbitration based on this investment agreement. For example, Article 1114(1) of North American Free Trade Agreement (NAFTA) states that nothing in this Chapter shall be construed to prevent Party from adopting, maintaining or implementing any climate protection measure that integrates environmental concerns into investment activities. Adequate exception clauses can reduce the risk of climate protection action being challenged by an investment arbitration claim and give host countries more policy scope to address environmental and climate change issues. This can promote the development of the climate protection and international investment.

4.4 Clarify the prioritization between investment protection regulations and climate protection regulations

When a country's international commitments to protect the environment and climate change conflict with its international commitments to protect foreign investment, it needs to clarify the prioritization between investment protection regulations and climate protection regulations.

According to Article 53 of the Vienna Convention on the Law of Treaties, a treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm of general international law. For the purposes of the present Convention, a peremptory norm of general international law is a norm accepted and recognized by the international community of States as a whole as a norm from which no derogation is permitted and which can be modified only by a subsequent norm of general international law having the same character. From the perspective of international compulsory law, climate change is an important field of environmental protection, and environmental protection is a legal interest that is accepted and recognized by the international community and cannot be compromised. For example, in the two United Nations declarations on the environment, the Stockholm Declaration and the Rio Declaration, many principles have become part of international customary law. International regulations on the environment and climate protection can be regarded as *jus cogens* in safeguarding the public interest of the state in international law. Therefore, the legal effect of the international compulsory law related to climate change should be superior to the provisions of international investment law.

In addition, the international investment agreements should contain international obligations clauses to determine the legal effect of the domestic law of the host country and the international investment agreement. The international obligation clause can reduce the risk of the host country being sued to an arbitral tribunal, and ensure that host country can continue to comply with the obligations of climate change or greenhouse gas reduction by the provisions of the obligation clause. For example, the obligations clauses of the US Model BIT of 2012 are more instructive. Article 12(3) of the Model states that the Parties recognize that each Party reserves the right in the enforcement of regulations, compliance, investigations and prosecutions, and in the making decisions about the allocation of resources related to the implementation of other environmental issues shall have priority for each Party. Therefore, if obligations clauses had been made in investment treaties, the arbitral tribunal would have awarded that environmental and climate change issues should take priority consideration over investment commitments.

5. Conclusion

In conclusion, due to the need for global climate protection, climate-friendly investments have become important. The implementation of climate-friendly investment sometimes leads to conflicts between the state's investment protection obligations and climate change obligations. As the main form of dispute settlement, Investor-State arbitration should also be improved accordingly to balance the protection of the rights and interests between investors and host countries. Inconsistent standards for interpretation of national treatment, vague judgment standard on the fair and equitable treatment, conflicting criteria for determining indirect expropriation and the issue of the legal choice between investment protection regulations and climate protection regulations are the main challenge for the arbitral tribunal to resolve conflicts of interest between climate investors and host countries in climate protection. Therefore, in order to better promote the implementation of climate protection measures, Investor-State arbitration should be improved. These include define the criteria clearly for determining the application of the national treatment clause, the judgment of fair and equitable treatment clauses should be beneficial to climate protection, the judgment criteria for indirect expropriations should be conducive to climate protection and clarify the prioritization between investment protection regulations and climate protection.

It can be seen that global climate protection has become an important part of the framework of the international dispute settlement mechanism. International investment regulations are an effective method to protect private property from climate governance measures, which can promote the development of global climate protection. The improvement of the Investor-State arbitration mechanism can not only resolve the conflict between the investment protection and climate protection, but also promote global climate protection and the development of international climate-friendly investment, so as to achieve the environmental sustainable development.

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