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# The Conflict Between Climate Policy and Investor-State Dispute Settlement

Assessing the Compatibility of ISDS with the EU's Climate Commitments

OT00BG79 Ympäristöoikeus murroksissa
Master's Thesis

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Tutkielmassa tarkastellaan sijoittajien ja valtioiden välistä riidanratkaisumenettelyä (Investor-State Dispute Settlement, ISDS) ja sen yhteensopivuutta Euroopan unionin (EU) ilmastotavoitteiden kanssa. Tutkielmassa analysoidaan ISDS:n sääntelykehikkoa ja nykytilaa EU:ssa sekä haasteita, joita ISDS aiheuttaa EU:n ilmastotavoitteiden toimeenpanolle. Tutkielmassa arvioidaan myös EU:n mahdollisuuksia uudistaa ISDS-menettelyä varmistaakseen paremman yhteensopivuuden ilmastopolitiikan kanssa. Tutkielman tavoitteena on osoittaa, että ISDS on ilmastopolitiikan näkökulmasta ajastaan jälkeen jäänyt menettely.

Tutkielman keskiössä on kaksi hyvin erilaista oikeudenalaa, investointisuoja ja ilmasto-oikeus, joita systematisoidaan ja analysoidaan lainopin keinoin. Oikeudenalojen välistä konfliktia arvioidaan ”law-in-context” -tutkimusmenetelmää hyödyntäen, joka mahdollistaa ISDS:n ongelmakohtien käsittelemisen laajemmassa yhteiskunnallisessa kontekstissa ja erityisesti suhteessa ilmastonmuutokseen. Lopuksi tutkielmassa annetaan ISDS:n tulevaisuutta EU:ssa koskevia kehitysehdotuksia.

Tutkielmassa havaittiin, että fossiilipolttoaineiden ja kaivosteollisuuden alalla toimivat sijoittajat nostavat suhteellisen paljon ISDS-kanteita EU-jäsenmaita vastaan verrattuna monien muiden sektorien sijoittajiin. Tutkielmassa osoitettiin, että ISDS:n prosessuaaliset ominaisuudet tekevät siitä epäsopivan menettelyn ilmastoon liittyvien kanteiden käsittelemiseksi muun muassa puutteellisen läpinäkyvyyden, johdonmukaisuuden ja objektiivisuuden takia. Tutkielmassa käsiteltiin myös niin kutsuttua ”regulatory chill” -ilmiötä, jonka osalta osoitettiin, että ISDS-kanteiden uhka on saattanut vaikuttaa joidenkin EU-jäsenmaiden ilmasto- ja ympäristösääntelyn kunnianhimon tasoon. Tutkielmassa nostettiin esille, että osa EU-jäsenmaista on aikoinaan ollut ensimmäisten investointisuojasopimuksia ja ISDS-menettelyä perustaneiden valtioiden joukossa, mutta nykyinen EU tiedostaa menettelyn moninaiset ongelmat ja on pyrkinyt uudistamaan sitä. ISDS:n ehkä perustavanlaatuisin ongelma on kuitenkin se, että se asettaa ulkomaiset sijoittajat erityiseen asemaan muihin kansainvälisen oikeuden toimijoihin verrattuna. Tutkielman kehitysehdotuksia koskeva keskeinen johtopäätös oli, että siinä missä toistaiseksi suunnitellut ja toimeenpannut uudistukset korjaavat joitakin ISDS:n ongelmista, ainoa keino perustavanlaatuisimman ongelman ratkaisemiseksi on lopettaa menettelyn hyödyntäminen.

**Avainsanat:** Ilmasto-oikeus, Euroopan unionin ilmastotavoitteet, investointisuoja, Investor-State Dispute Settlement

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This thesis examines the system of Investor-State Dispute Settlement (ISDS) and its compatibility with the European Union's (EU) climate commitments. The thesis analyses the legal framework and current status of ISDS in the EU, the challenges that ISDS causes to the implementation of the EU's climate policy, and possibilities of the EU to reform ISDS to ensure better consistency with its climate targets. The aim of the thesis is to demonstrate that, from the perspective of climate, ISDS is an outdated mechanism.

The method of doctrinal legal research is used to analyse and systemise the two very different areas of law in the focus of the thesis – investment protection and climate law. The conflict between them is assessed using the law-in-context approach, which enables discussing the problems of ISDS within the broader context of the contemporary society and especially in relation to climate change. Lastly, reform suggestions are presented based on the analysis.

It was found that investors in fossil fuels and mining are relatively active in bringing ISDS claims against the EU member states. It was demonstrated that the features of ISDS make it an unsuitable mechanism to handle climate-related claims for example due to the lack of transparency, consistency, and objectivity. The regulatory chill hypothesis was discussed, and it was shown that the threat of ISDS claims may have affected some member states' ambition in climate-related lawmaking. Though some of the EU member states have been among the first proponents of investment agreements and ISDS, today's EU has recognised the various problems of ISDS and attempted to reform the system. While the already planned and implemented reforms manage to address some key issues of ISDS, the thesis suggested that the only way to tackle perhaps the most fundamental problem of ISDS – the foreign investors' special position compared to other entities of international law – is to terminate the system.

**Key words:** Climate law, European Union's climate targets, investment protection, Investor-State Dispute Settlement

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## List of Abbreviations

| | |
|---|---|
| BIT | Bilateral Investment Treaty |
| CETA | Canada-EU Comprehensive Economic and Trade Agreement |
| CPTPP | Comprehensive and Progressive Agreement for Trans-Pacific Partnership |
| ECHR | European Court of Human Rights |
| ECJ | European Court of Justice |
| ECT | Energy Charter Treaty |
| ESR | Effort Sharing Regulation |
| ETS | Emissions Trading System |
| EU | European Union |
| EUR | Euro |
| FDI | Foreign Direct Investment |
| FET | Fair and Equitable Treatment |
| FTA | Free Trade Agreement |
| GDP | Gross Domestic Product |
| GHG | greenhouse gas |
| ICS | Investment Court System |
| ICSID | International Centre for the Settlement of Investment Disputes |
| ISDS | Investor-State Dispute Settlement |
| MIC | Multilateral Investment Court |
| TFEU | Treaty on the Functioning of the European Union |
| TPP | Trans-Pacific Partnership |
| TTIP | Transatlantic Trade and Investment Partnership |
| UN | United Nations |
| UNCITRAL | United Nations Commission on International Trade Law |
| UNCTAD | United Nations Conference on Trade and Development |
| UNFCCC | United Nations Framework Convention on Climate Change |
| USD | United States Dollar |

# 1 Introduction

## 1.1 Background

In the 2026 geopolitical situation the power relations between states are changing, and the European Union's (EU) long-time partners cannot be relied on in the same way as before. Some of the biggest economies in the world have grown fast, and in order not to fall behind the most influential global actors, the EU aims at improving its competitiveness. It is, for instance, promoting new partnerships through establishing trade agreements with countries such as Argentina, Brasil, Paraguay, and Uruguay (together Mercosur)[1] as well as India[2].

In addition to trade, economic growth and employment are also induced by investments. Objectives of the EU investment policy include making it "easier to invest by creating a predictable and transparent business environment" and attracting "international investment into the EU, while protecting the EU's essential interests". At the end of 2022, foreign direct investment (FDI) stocks held by foreign investors in the EU added up to EUR 7,715 billion.[3] Although the EU-Mercosur Interim Trade agreement, that entered into force in January 2026, aims at strengthening the parties' investment relations, it does not include a specific chapter on investment. Many EU and Mercosur states have, however, in the past concluded agreements that protect foreign investors, known as *international investment agreements*, which are still in force.[4]

Investment agreements are international instruments – concluded between two countries (*bilateral investment treaties, BITs*) or signed among a number of contracting states – that protect foreign investment. They stipulate certain standards for the treatment of foreign investors that governments should adhere to while enacting regulation that influences investments in their area. The first international investment agreements were established between developed and developing countries, largely to protect investment exported by the developed states to the developing nations after de-colonisation.[5] Many investment agreements provide for a mechanism called *Investor-State Arbitration* or *Investor-State Dispute Settlement (ISDS)* – a special form of dispute resolution enabling investors to bring a

[1] European Commission, EU-Mercosur agreement.
[2] European Commission, The EU-India trade agreement.
[3] European Commission, Investment.
[4] Duarte 2020, p. 198.
[5] Kofman 2018, p. 50

claim before an international arbitral tribunal in case the government of the investment's host country conducts measures disturbing the investment in a way that breaches the investment agreement.

The International Centre for Settlement of Investment Disputes (ICSID) and its arbitration rules provide one of the most commonly used forums for ISDS.[6] Until June 30 of 2024, the biggest economic sectors represented in the cases registered under the ICSID Convention were oil, gas, and mining as well as electric power and other energy – these areas making up 42 per cent of all ICSID cases registered by that date.[7] The statistics demonstrate that ISDS is to a great extent made use of by the industries contributing significantly to greenhouse gas (GHG) emissions. Notably, in recent years, an increasing number of ISDS cases has been initiated as a response to government regulations that set environmental protection and climate goals.[8]

Such goals have been set in particular by the EU. In 2019, the EU introduced the *European Green Deal* strategy of which goal is to accomplish climate neutrality within the EU by 2050 while maintaining economic competitiveness. The Green Deal transforms all policy areas of the EU, with the aim of achieving a green transition while creating growth.[9] One of the most central instruments of the strategy is the *European Climate Law*[10] from 2021, rendering the net-zero goal legally binding for all member states and setting up strategies to reach this target. To achieve climate neutrality by 2050 and negativity thereafter, the EU and its member states have to take measures to promote their carbon sinks and decrease their GHG emissions.[11] The Climate Law also introduces intermediate climate targets for 2030 and – as amended in 2026 – for 2040: the member states are to achieve a 55 per cent reduction in net GHG emissions by 2030 and a 90 per cent reduction by 2040, compared to 1990 levels.

Some foreign investors have considered the measures that member states have taken to achieve the EU's and domestic climate goals problematic and resorted to the protection standards provided by international investment agreements. One example involves energy

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[6] Dimopoulos 2016, p. 415.
[7] ICSID 2024, p. 11.
[8] Dimopoulos 2016, pp. 415–16.
[9] European Council and Council of the European Union 21 February 2025.
[10] Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law').
[11] Nouicer – Reif – Münchmeyer 2024, p. 11.

companies Uniper and RWE and the government of the Netherlands, the latter prohibiting the use of coal for the production of electricity in 2019 to achieve climate targets. As the companies' power plants were rendered useless after such a prohibition, the investors initiated ISDS proceedings.[12] Such cases have induced considerable criticism towards ISDS and the obstacles it has created for implementing climate measures. ISDS is not a way to change governmental regulations – its harmful effect is based on the monetary losses resulted from the arbitral tribunal having found a state liable for breaching an investment agreement. The significant damages may lead to what is referred as the *regulatory chill hypothesis*: in fear of monetary claims based on ISDS, governments are assumably disincentivised to regulate climate and environmental matters efficiently and ambitiously.[13]

Critics are not only concerned about the regulatory chill, but the criticism towards ISDS is also targeted towards its procedural features that make handling climate regulation based claims questionable. The ISDS system was established to protect investor rights, which still today materializes as rules and awards where investor rights override other interests, such as those related to the climate. One of the most often raised justifications for ISDS is that it assumably promotes the rule of law: foreign investors are protected from harmful host state actions in countries where the domestic legal system and political environment may be less stable. Investment agreements tend to stipulate investment protection standards that claim to guard "consistency, non-arbitrariness, due process and transparency", which can all be considered as rule of law characteristics.[14] Paradoxically, ISDS has been criticized for the lack of these exact principles, as the disputes are arbitrated behind closed doors and the agreement provisions allow for significant space for interpretation.

The EU has noted the criticism and aimed at taking steps to better accommodate for climate protection within the investment protection framework. The EU has initiated some relatively ambitious reform suggestions, such as a new court system to substitute individual tribunals and more precise language to protect public policies in its more recent trade agreements. Since implementation of the reforms takes time, it cannot yet be estimated whether or how effectively they are able to fix the problems of ISDS. The problems of ISDS are discussed to

[12] Putter 24 August 2021.
[13] Tienhaara 2018, pp. 232–33.
[14] Živković 2019, p. 551.

varied extent by media, the EU, and the member states. For example, the Finnish government has not really proactively discussed the challenges in public in the recent years.

The EU is the largest importer and exporter of foreign direct investment in the world,[15] at the same time making efforts to be the first climate-neutral continent in the world.[16] The ambitious climate targets on one hand and the need to attract investment and induce economic growth on the other are not easy to fit together. This thesis will not go deeper into addressing the frequent – and relevant – question of whether economic growth and climate protection can even co-exist but examines the more specific controversy between ISDS and climate commitments. The fundamental goal is to demonstrate that the dispute resolution mechanism is not fit for future.

This thesis focuses specifically on ISDS and the provisions of international investment agreements that deal with it, for the large part leaving broader considerations concerning the international investment protection regime outside its scope. This is because the criticism concerning investment protection is typically targeted specifically towards ISDS as the enforcement mechanism of investor rights. It is ISDS, in particular, that sets foreign investors in a unique position compared to other actors of international law.

ISDS has been criticised as especially harmful to developing countries[17] but this thesis will focus on assessing the damage that ISDS can cause to the EU member states, some of which have been among the first nations to establish investment agreements with developing states. A Finnish emeritus professor of international law, Martti Koskenniemi, has described that Finland is now drinking its own poison when the member state was in 2024 challenged to ISDS under an infamous investment agreement called the Energy Charter Treaty (ECT).[18] The same agreements that were once established to serve the member states in their pursuits in more unstable economies are now contradicting with efficient enforcement of the EU's current priorities, which makes studying ISDS in the EU context particularly appropriate and topical.

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[15] European Commission, Multilateral Investment Court project.
[16] European Commission, The European Green Deal: Striving to be the first climate-neutral continent.
[17] See for example Boyd 2023, para 18.
[18] Eskonen 13 October 2024.

## 1.2 Research Questions and Structure of the Thesis

The aim of this thesis is to analyse the relationship between ISDS and the EU's climate commitments, and based on the analysis to examine how ISDS should be developed in the EU to better take into account its current climate protection priorities. To attain these objectives, the following main questions are addressed:

1. What is the legal framework and current status of ISDS in the EU?
2. What kind of challenges does ISDS cause to the implementation of the EU's climate policy?
3. Considering these challenges, is it possible for the EU to reform ISDS to ensure consistency with its climate targets?

The first part of the thesis, comprising chapters two (2) and three (3), systemises the EU's climate policy and the regime of investment protection and ISDS as a part of it, respectively. These chapters frame the history and goals of both ISDS and the climate policy, setting up the context to analyse the contradictions in the second part of the thesis. In addition to providing background and context, the first part of the thesis starts answering the first research question by briefly exploring the relationship between ISDS and the EU legal order. The next chapters continue by examining the EU's stances on ISDS as well as recent ISDS cases against the member states.

The second part of the thesis consists of chapters four (4) and five (5). Chapter four moves on to analyse the relationship between ISDS and the EU's climate policy. The thesis premises that an inherent contradiction exists in the relationship between climate policy and ISDS, and hence focuses on examining what type of and how significant are the challenges posed by ISDS to the implementation of the climate commitments, answering the second research question.

Finally, in chapter five (5), the future of ISDS in the EU is considered and answers to the third research question provided. By examining the types of ISDS reforms that have been suggested and advanced, the chapter questions whether it even is possible to improve ISDS in a way that aligns with the climate concerns of today. As the question about ISDS' future is very broad, the answers will likewise be general in nature, offering some suggestions but not comprehensively exploring all possible solutions and their implications.

## 1.3 Research Methods

The three above-introduced research questions convey three different type of knowledge interests, respectively: 1) determining what the law is in the specific areas of research, EU climate policy and ISDS; 2) examining the compatibility of these areas; and 3) suggesting developments. The different type of knowledge interests require different methods of legal research.

*Doctrinal legal research* includes gathering materials, such as statutes, case law, preparatory works, and legal literature, and interpreting and analysing them in relation with each other.[19] Doctrinal research can be considered as a natural starting point of almost any legal discussion as it is used to systemise law; it is applied to find out what the law is in the particular area of study.[20]

Ian Dobinson and Francis Johns identify three methods of qualitative legal research in addition to doctrinal research: problem, policy, and law reform. According to them, all of the methods can be combined in a legal research for example by starting with a doctrinal analysis of the relevant area of law, followed by examination of the current problems of this area of law or policy, and finishing by suggesting reforms to develop the area of law or policy.[21] This is the 'template' of legal research methods followed in this thesis.

This thesis combines two very different areas of law: climate law and investment protection, including a specific form of dispute resolution. It is necessary to first assess the legal frameworks of each of these areas of law in order to move on to analyse their relationship. Doctrinal legal research is regarded as the suitable method to approach the first research question, *what is the legal framework and current status of ISDS in the EU?* This question is answered primarily by examining case law of the European Court of Justice (ECJ), ISDS cases, the EU's statements and actions regarding ISDS, and legal literature.

According to Dobinson and Johns, legal doctrinal research is not "simply textual analysis" or "merely a self-referential exercise" but a process in which the author "comes to understand the social context of decisions and draws inferences which need to be considered in a range of

[19] Taekema – van der Burg 2024, p. 10.
[20] Hutchinson 2013, p. 23, 28; Dobinson – Johns 2017, pp. 20–21.
[21] Dobinson – Johns 2017, p. 22.

real-world factual circumstances".[22] Some other researchers distinguish between doctrinal research and the *law-in-context* approach. According to them, where doctrinal research can be considered to focus on the legal material itself, law-in-context, as the name suggests, contextualises law by taking into account the surrounding society. Sanne Taekema and Wibren van der Burg see law-in-context as the type of research that is based on the doctrinal method but, to varying degrees, adds on it. According to them, "[c]ontextualisation is a process on a gradual scale and can be more or less extensive", differing from "inclusions of relevant facts to fully interdisciplinary research".[23] As may be characteristic of much environmental law research, this thesis takes on a law-in-context approach, particularly when answering the second research question, *what kind of challenges does ISDS cause to the implementation of the EU's climate policy?* Rather than treating ISDS as an isolated legal mechanism, its problems are discussed within the broader framework of contemporary society, with a specific focus on the urgency of climate protection. As the thesis deals with two different areas of law that are seen to 'compete' against each other, the law in context approach enables assessing them in relation to each other.

As a result of systematising a field of law, a researcher might discover conflicts or gaps in legislation or find that the law is not effective in achieving certain policy goals. It is hence logical that doctrinal legal research also involves making reform suggestions.[24] The first two research questions of the thesis establish the reasons behind and the significance of the contradictions between climate commitments and ISDS, whereas the third question looks into the future. Hence, answering the third question – *is it possible for the EU to reform ISDS to ensure consistency with its climate targets?* – involves making suggestions on how the mechanism should be reformed.

During the thesis process, generative artificial intelligence tools were used nonsystematically in ensuring the grammar and comprehensiveness of some individual sentences. In addition to language-related checks, AI was prompted to go through a table of global ISDS case statistics, from which it was asked to point out the number of cases involving the EU member states.[25] AI tools were not used to generate any analysis or other content in this thesis.

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[22] Dobinson – Johns 2017, p. 24.
[23] Taekema – van der Burg 2024, p. 93.
[24] Hutchinson 2013, p. 23.
[25] For these case statistics, see Chapter 4.1.

# 2 The EU's Climate Policy

## 2.1 The Right – and Duty – to Regulate for Climate

In climate-related ISDS disputes two interests go head-to-head: the financial interest of the investor and the broader interest of a nation's public. States' inability to regulate public policy without fear of being challenged is the fundamental problem of ISDS and its relationship with climate protection. As Helionor de Anzizu and Nikki Reisch conclude, fossil fuel companies' ISDS claims "[…] not only pit private investors against public authorities, they also pit State obligations to protect foreign investment against State obligations to protect human rights and the environment."[26]

Already in 2003, the United Nations (UN) expressed its concern about fragmentation of international law by setting up a study group to examine challenges related to it. The fragmentation is characterised by "the emergence of specialized and (relatively) autonomous rules or rule complexes, legal institutions and spheres of legal practice", of which investment law is a prime example. Fragmentation causes incoherence in the international system of law, with the different fragments having their own goals and principles. Because of this, the different rules of international law should be interpreted in relation to each other; some rules positioned higher in the hierarchy than others.[27]

In 2025, the International Court of Justice stated in its Advisory Opinion, titled *Obligations of States in respect of Climate Change*, that climate change treaties set "binding obligations" for states and that it is, in fact, part of customary international law that states must "[…] use all means at their disposal to prevent activities carried out within their jurisdiction or control from causing significant harm to the climate system […]".[28] In 2026, the Advisory Opinion was backed by the UN General Assembly.[29] Some authors go further than the UN, discussing the possibility and, importantly, the need to treat climate obligations as rules of *jus cogens* or *erga omnes* nature.[30] What has been made clear in many instruments of international law and in international case law is that climate measures are also human rights measures.[31] For

[26] De Anzizu – Reisch 2023, p. 181.
[27] United Nations 2006, pp. 176–78.
[28] International Court of Justice, Obligations of States in respect of Climate Change, Advisory Opinion of 23 July 2025, para 457.
[29] United Nations 20 May 2026.
[30] See for example Marmolejo Cervantes – Roeben – Solís 2022; Robinson 2018.
[31] De Anzizu – Reisch 2023, pp. 184–87.

example, the European Court of Human Rights ruled in 2024 that Switzerland was violating elderly women's human rights as it considered the government's climate measures to be insufficient.[32] The court held that climate change "poses a serious current and future threat to the enjoyment of human rights" and that "States are aware of it and capable of taking measures to effectively address it".[33] Given the severe consequences of climate change to human rights, the court found it "justified to consider that climate protection should carry considerable weight in the weighing-up of any competing considerations."[34]

States' *right to regulate* is a common question in ISDS disputes. More recent investment agreements contain carve-out clauses that leave certain public policy measures outside the scope of the agreement, allowing states to regulate these matters without having to worry about ISDS claims. While these clauses are a step to the right direction and may direct the tribunals' interpretation to side with the states, the line between legitimate public policy regulation and a breach of an investment agreement is thin: the question of what specifically is covered by the right to regulate remains.[35] This question will be returned to later in the thesis.

What has not been dealt with in the agreements or by tribunals is the states' *duty to regulate*. International climate agreements and EU law set obligations specifically for states. Ignoring these obligations, or merely approaching them from the perspective of right to regulate, undermines the gravity of climate change and equates states with private companies that carry entirely different obligations.[36] Therefore, duty to regulate should play a bigger role in international investment agreements. Aaron James talks about "an expectation of reciprocity" between states and investors: companies enjoy privileges just by operating in a country, so they should not expect compensation when a government is fulfilling its duty of protecting the public interest.[37]

States' right and duty to regulate are closely connected to the rather fundamental question of what a state's purpose or main duty even is – an explanation for its legitimacy. A government's duty can be considered to be advancing the 'common good', which requires

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[32] *Verein Klimaseniorinnen Schweiz and others v. Switzerland*, no. 53600/20, ECHR 2024.
[33] Ibid., para 436.
[34] Ibid., para 542.
[35] Paine 2021, p. 701.
[36] De Anzizu – Reisch 2023, pp. 183–84.
[37] James 2017, p. 220.

democratic decision-making. To achieve common good, a state must assist the economy to move to this direction, for example by taxing, spending, or prohibiting certain actions. Conversely, a so-called 'night watcher' state does not interfere in the markets in this way but serves them.[38] Its role is solely to maintain security and order, and to safeguard the infrastructure required for free enterprise.[39]

Markets alone would fail to address many current challenges such as climate change. They do not, for instance, protect third parties experiencing the negative impacts of emissions caused by business activities. Markets allow for free riding in terms of dealing with these negative impacts, which is why state intervention – climate and environmental regulation – is needed.[40] To eliminate the incentive for free riding, economists advocate for a *polluter pays* framework, which forces economic actors, instead of the public, to carry the financial burden of harming the environment and the climate.[41]

Hence, as the primary keeper of public authority, a state's ultimate purpose must be to protect and govern its citizens – the public.[42] In this capacity, states bear multiple obligations. In general, the EU member states are welfare states in which the scope of government's activities and duties has widened in the recent decades.[43] The EU member states' obligations to protect the climate arise from both EU law and international law. Pursuant to Article 4(2) of the Treaty on the Functioning of the European Union (TFEU), environmental policy and energy policy belong within the competences shared between the EU and its member states. Article 191(1) TFEU lists *promoting measures at international level to deal with regional or worldwide environmental problems, and in particular combating climate change* as one of the objectives of the EU's environmental policy. The most important international instruments of climate law are the Paris Agreement, the Kyoto Protocol, and the United Nations Framework Convention on Climate Change (UNFCCC). Human rights law also addresses the climate change crisis from its point of view.[44]

In light of the above, by enacting climate regulation, the EU and its member states are not only practicing their sovereign right or competence accorded to them but also fulfilling their

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[38] Mastromatteo – Solari 2014, p. 97.
[39] Tirole 2018, p. 156.
[40] Ibid., pp. 157–58.
[41] Ibid., p. 213.
[42] James 2017, p. 220.
[43] Borre – Goldsmith 1998, pp. 10–11.
[44] De Anzizu – Reisch 2023, p. 181.

duty under international law and as keepers of public authority. ISDS has hindered and prevented states from fulfilling this duty, particularly when it comes to protecting public policies such as climate regulation. Corporations have been provided with sufficient time to realise that investing in fossil fuels is not sustainable in the long run. For example, the European Commission recognised the need for an environmental protection programme for the first time already in 1970.[45] Ever since, climate and environmental concerns have gradually become a more important part of the EU lawmaking, as will be discussed next.

## 2.2 The EU's Climate Targets

The foundations of the EU's climate policy lie in energy regulation – initially a series of individual measures and later in 2007 a comprehensive energy policy. The policy was based on the principles of sustainable development, security of supply, and competitiveness. Since combating climate change was recognised as a significant challenge within the policy, the EU adopted the Climate & Energy Package in 2007, which included the 20-20-20 targets for the year 2020: a 20 per cent reduction in GHG emissions compared to the levels of 1990, 20 per cent of the EU's energy consumption consisting of renewable energy sources, and a 20 per cent improvement in the EU's energy efficiency.[46] These targets were unprecedented on a global scale and implemented for the most part with directives establishing rules for renewable energy, emissions trading, carbon capture, buildings' energy performance, and energy efficiency.[47] The EU went well beyond its first target by 2020, surpassing the other two as well, although the remarkably low GHG emissions and reduced energy consumption in 2020 were partly due to the special circumstances of the Covid-19 pandemic.[48]

After the Climate & Energy Package, multiple frameworks and strategies with regard to energy and climate have been adopted by the EU. A recent significant effort has been the European Green Deal introduced by the Commission in 2019. The Green Deal is more comprehensive than the previous policies and sets new targets with regard to climate protection. The Green Deal is part of the political guidelines – the *agenda for Europe* – of Ursula von der Leyen.[49] The goal of the Green Deal is to "[…] transform the EU into a fair and prosperous society, with a modern, resource-efficient and competitive economy where

[45] Van Calster – Reins 2017, p. 2.
[46] Nouicer – Reif – Münchmeyer 2024, pp. 4–5.
[47] Ibid., pp. 5–6; Piebalgs et al. 2020, p. 5.
[48] European Commission 2022, pp. 12–15.
[49] von der Leyen 2019.

there are no net emissions of greenhouse gases in 2050 and where economic growth is decoupled from resource use."[50]

The Green Deal cuts through all the EU's policy areas and at its core are the climate goals: the ultimate target of climate neutrality by 2050 and negative GHG emissions soon after, as well as the interim targets of a 55 per cent reduction in GHG emissions by 2030 and a 90 per cent reduction by 2040 compared to 1990 levels. These goals represent the world's most ambitious emission reduction strategy and have been put into legislation with the European Climate Law regulation of 2021.[51] The Climate Law turns political agreements into legal obligations, thereby also enhancing legal predictability for businesses investing in the member states.[52]

Putting a price on carbon to disincentivise pollution has been necessary in cutting emissions. Following the Kyoto Protocol in 2005, the EU adopted the Emissions Trading System (ETS), which puts a cap on the EU's total carbon emissions and creates a market for them, enabling market actors to trade allowances. The actors include certain energy and manufacturing installations, aviation operators, and maritime transport. The EU ETS has been successful in that the involved sectors have been able to decrease their carbon emissions significantly more than those excluded from the system. Auctioning the allowances has accumulated significant funds spent on promoting climate action.[53]

International climate cooperation has considerably influenced the EU's climate policy, and the EU has been active in these global forums, recognising its contributions to global GHG emissions. The EU's action has also pushed forward other global actors' climate policies. The legally binding net-zero goal of the EU was the first of its kind but has since encouraged other countries to set similar targets. In 2024, 169 countries had devised net-zero targets.[54] The EU's ability to influence global standards unilaterally, known as the *Brussels Effect*, has also been the EU's explicit target within climate policy, in particular with the ETS. The EU chose to adopt ETS to regulate GHG emissions over other possible instruments, such as carbon tax,

[50] European Commission 2019, p. 2.
[51] Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law').
[52] Hanoune 2024, p. 168.
[53] Delbeke 2024, pp. 36–37.
[54] Ibid., pp. 33–34.

as it considered it more likely to receive global support. Subsequently, countries such as South Korea, China, and Russia adopted similar mechanisms.[55]

## 2.3 The EU's Energy Policy

Action taken in the energy sector is crucial to reach net-zero as more than 80 per cent of the EU's GHG emissions constitute of carbon dioxide, released largely in the use of fossil fuels – coal, oil, and gas. The EU has hence been able to obtain significant reductions in GHG emissions by switching from fossil fuels to the less carbon intensive natural gas as well as renewables.[56] Geopolitical and energy security problems have caused variance in the EU's carbon dioxide emissions: natural gas has been imported from Russia but since its attack on Ukraine the EU has aimed at becoming less dependent on the country's imports, relying at times more on burning coal.[57]

Energy policy has been in the centre of European collaboration since the European Coal and Steel Community was founded in the 1950s. In 2009 a provision on energy was included in the EU Treaties.[58] Pursuant to Article 194 TFEU, the EU's energy policy aims at promoting *energy efficiency and energy saving and the development of new and renewable forms of energy.* It also aims at a functioning energy market, security of supply, and interconnection of energy networks. The provision leaves each member state the *right to determine the conditions for exploiting its energy sources, its choice between different energy sources and the general structure of its energy supply*.

Energy saving and phasing out fossil fuels is important from the perspective of both decreasing dependence on imported energy and reducing emissions. Targets related to energy savings and increasing the share of renewable energy in the energy mix go hand in hand with climate targets in the EU's policy. The Green Deal has contributed to further merging the EU's climate policy and energy policy, combining their respective targets. The EU achieved its first renewable energy target of having a share of 20 per cent of renewables in the gross final energy consumption by 2020.[59] The new overall EU target, as stipulated in the revised

[55] Bradford 2019, pp. 226–30.
[56] Delbeke 2024, p. 31.
[57] Ibid.; Council of the European Union 3 December 2025.
[58] Turano – Van Ierland 2024, p. 175.
[59] Ibid, pp. 175–76.

Renewable Energy Directive[60], is 42.5 per cent of renewable energy by 2030, to which national contributions are calculated using a formula. In addition to the war in Ukraine, the war in Iran in the spring of 2026 and its effect on oil prices was another push for the EU to expedite the shift away from fossil fuels.[61]

## 2.4 Member States' Role in Climate Action

Domestic legislation is required from the member states to reach the EU's common climate goals. Moreover, the member states are committed to international climate targets not only as part of the EU but also as individual members to the UNFCCC, the Kyoto Protocol, and the Paris Agreement.

While the EU ETS regulates GHG emissions produced by stationary installations in the energy sector and manufacturing as well as aviation, those falling outside – such as road transport, agriculture, and buildings – are included in the effort sharing sectors.[62] Agreeing on common climate goals is complicated due to differences between the member states, but effort sharing has enabled emission reductions in a manner that takes into account the countries' different starting points: the richer states have had to commit to reductions larger than the average. Additionally, as the effort sharing sectors comprise of more local aspects of climate policy, such as public transportation, member state or regional level regulation can be considered as more effective than EU-initiated rules. The differentiation between member states has been adopted in the EU ETS as well, where part of the auctioning proceeds are directed to lower-income countries enabling them to address the financial burden that comes with modernising the economy.[63]

After 2013, the EU's GHG emissions in the effort sharing sectors were below the annual limit, and the EU achieved its 2020 climate targets, highlighting the importance of individual member states' role in implementing common objectives.[64] For 2030, an overall reduction of 40 per cent for the effort sharing sectors compared to the level of 2005 was set in the Effort

[60] Directive (EU) 2023/2413 of the European Parliament and of the Council of 18 October 2023 amending Directive (EU) 2018/2001, Regulation (EU) 2018/1999 and Directive 98/70/EC as regards the promotion of energy from renewable sources, and repealing Council Directive (EU) 2015/652.
[61] Abnett 14 April 2026.
[62] Hanoune 2024, p. 155.
[63] Ibid., pp. 157–58.
[64] Ibid., p. 158.

Sharing Regulation (ESR) of 2023.[65] The Commission monitors whether member states reach their individual targets and requires corrective action if they lag behind, and the ESR determines sanctions for non-compliance.[66]

Multiple member states have opted for stricter national targets than EU legislation requires, within and outside the effort sharing sectors. Germany is one of the EU's most significant emitters of GHG, accounting for over 20 per cent of the Union's total net emissions.[67] The national goal of Germany, as stipulated in Section 3 of the German Climate Change Act[68], is to reduce emissions by 65 per cent by 2030 and to reach net-zero emissions by 2045. Germany is one of the EU member states that have been challenged to ISDS as a result of its climate policy as it is gradually phasing out fossil fuels, including coal.

In 2020, the German Government enacted the Act to Reduce and End Coal-Fired Power Generation, which led to an ISDS dispute: in 2023, Germany was challenged by Azienda Elettrica Ticinese, a Swiss producer of electricity and an investor in the Lünen coal power plant, which is to be rendered unusable after 2031 as a result of the new policy. The investors in *AET v. Germany* emphasise the importance of a market-based approach to phase-outs, asserting that ETS is the cornerstone of the EU's climate policy and that emissions should be regulated solely at the European level.[69] The investors claim that at the time of making the investment, they were in the understanding that EU ETS would remain as the sole mechanism for controlling carbon emissions. According to the investors, a coal ban is unproportional in relation to its sought objectives as other options, such as resorting exclusively to the ETS, remained. According to Germany, EU ETS was never intended nor promised as the sole method to regulate GHG emissions, but one out of multiple. Germany points out that relying exclusively on ETS would not reduce emissions enough to achieve the national emission reduction target set for 2030.[70]

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[65] Regulation (EU) 2023/857 of the European Parliament and of the Council of 19 April 2023 amending Regulation (EU) 2018/842 on binding annual greenhouse gas emission reductions by Member States from 2021 to 2030 contributing to climate action to meet commitments under the Paris Agreement, and Regulation (EU) 2018/1999.
[66] Hanoune 2024, p. 169–70.
[67] Erbach 2024, p. 1.
[68] Federal Climate Action Act of 12 December 2019 (Bundes-Klimaschutzgesetz – KSG).
[69] *Azienda Elettrica Ticinese (AET) v. Germany*, ICSID Case No. ARB/23/47, Claimant's Memorial, 26 July 2024, paras 84–90.
[70] Ibid., Counter-Memorial, 26 March 2025, paras 74, 208.

## 2.5 Implementation of the EU's Climate Targets

The EU's relative share of global GHG emissions has steadily been decreasing since 1990 – partly due to its own climate policy, but also because the proportions of emerging economies keep rising. Globally, we have not yet reached a peak in GHG emissions.[71] Considering currently implemented and planned measures, the EU seems to be behind its climate targets. The gap between realised and targeted reductions is only estimated to broaden with time. With current climate plans, net emissions are predicted to have fallen by 78 per cent in 2050, missing the legally binding net-zero goal.[72]

In the EU economic expansion is not dependent on producing more emissions anymore. The EU's emissions decreased by 32.5 per cent from 1990 to 2022, meanwhile its GDP increased by 65 per cent over the time period.[73] During the past couple of decades, the EU's economic growth has however been slow, which concerns citizens and decision-makers. As the European Green Deal demonstrates, the EU and its member states frame climate measures through the lens of green growth and competitiveness. In spite of this, climate targets and economic growth have not been successfully aligned yet, which the continued use of the ISDS system and the on-going investment disputes involving member states evidence. The fact that the EU's net zero target will not be achieved with in-force and planned measures conveys that additional measures will need to be adopted, potentially giving rise to new disputes comparable to the one currently faced by Germany.

[71] Delbeke 2024, p. 31.
[72] European Environment Agency 6 November 2025.
[73] Delbeke 2024, p. 32.

# 3 Investment Agreements and ISDS

## 3.1 International Investment Agreements

### 3.1.1 History

Unlike most other international regimes, such as international human rights, the investment protection regime has developed as a result of bilateral agreements between developed, capital-exporting countries and developing, capital-importing countries.[74] The movement was started after World War II by individual, capital-exporting countries like the US. In Europe, Germany, which had been defeated in the war and consequently suffered significant losses of foreign investment, was the first country to begin negotiating bilateral investment treaties (BITs) in 1959, soon followed by other countries.[75] The first BIT involving the ISDS mechanism was ratified between Italy and Chad in 1969.[76]

In theory, international investment agreements protect investment reciprocally among signatories. In practice, however, investment was always anticipated to flow principally from Western countries to countries that had recently gained independence.[77] Throughout time, capital-exporting states have wished to protect themselves from harmful actions of the investment's host country governments – this was the objective especially soon after World War II, due to significant economic growth and decolonisation of their former territories that were rich in natural resources.[78] In these countries, that had recently gained independence, nationalisation threatened the investments of the former colonisers, which, from the perspective of the capital-exporting states, required access to new form of legal remedy. Before establishing the regime, international law lacked effective and clear rules on foreign investment. There were no mechanisms to protect foreign investment against host countries that did not comply with their contractual obligations. Diplomatic protection could offer some help but was as a process quite clumsy and more political than legal.[79]

Capital-importing states have purportedly signed BITs in order to attract foreign capital, strengthen relationships with capital-exporting countries, and to promote economic growth,

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[74] Salacuse 2010, p. 463.
[75] Ibid., p. 433.
[76] De Boeck 2022, p. 3.
[77] Pathak 2025, p. 19.
[78] Salacuse 2010, pp. 436–37; Pathak 2025, p. 18.
[79] Salacuse 2010, pp. 437–39.

domestic investment, and rule of law.[80] However, due to the power imbalance between colonisers and their former colonies, the latter had limited actual influence in negotiating the treaties they signed with capital-exporting countries.[81] As the economic situations in many developing states have made them dependent on foreign investment, these states have modified their policies to attract it.[82] In reality, the treaties have ended up reflecting signatories' interests one-sidedly, supposing developing states as respondents and Western-based companies as claimants.[83]

It is because of the differences between capital-exporting and capital-importing countries that the investment regime started as a network of bilateral relationships, [84] between colonisers and former colonies but also between other developed and developing states.[85] A bilateral agreement may make it easier for a more developed country to use its power more effectively than with a group of developing countries working together. For a developing country, the benefits of an investment agreement with only one capital-exporting state may seem more concrete and probable than with a group of such countries. As capital-exporting countries have established these bilateral agreements with a growing number of individual states, and as the agreements have not varied from each other to a great extent, this process has gradually led to the development of an international investment regime.[86] The formation of international arbitration framework, for example the adoption of the UNCITRAL Arbitration Rules in 1976, has contributed to the development of the regime[87] as have lawyers and scholars.[88]

Importantly, investors themselves have also contributed to the development of the investment protection regime. Nationalisation efforts in the 1950s induced action to protect free enterprise, of which FDI protection was an essential part. Nicolás M. Perrone talks about "the norm entrepreneurs for international investment protection", by which he refers to the businesses – banking and oil companies in particular – and lawyers pushing the agenda in the 1950s and 1960s.[89] In 1958 these entities established the Geneva Association, which involved executives from corporations, banks, and law firms such as Credit Suisse, Deutsche Bank,

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[80] Salacuse 2010, pp. 441–44.
[81] Haynes – Hippolyte 2023, pp. 111–12.
[82] Betz – Kerner 2016, p. 444; Pathak 2025, pp. 8–9.
[83] Pathak 2025, p. 19.
[84] Salacuse 2010, p. 464.
[85] Pathak 2025, p. 19.
[86] Salacuse 2010, p. 464.
[87] Pathak 2025, p. 19.
[88] Salacuse 2010, p. 465.
[89] Perrone 2021, pp. 51–53.

Royal Dutch Shell, and Standard Oil of New Jersey, that together advocated for more favourable investment conditions. They put forward their ideas for example by lobbying governments and organisations: the Geneva Association had provably close relationships with German and Swiss leaders as well as the World Bank, and worked together with other likeminded organisations such as the International Bar Association and the International Chamber of Commerce, the latter of which had been planning a system for investor protection since the 1920s.[90] These efforts help explain why international investment agreements of today cover the investors' backs so efficiently.

Not all BITs currently in force follow the developed-developing state pattern, although this conventional paradigm still shows in recent ISDS statistics: for example, in the mining industry, 85 per cent of disputes in 2020 were initiated by Western mining companies against developing nations.[91] Protecting states' public policies was evidently not vested in the purpose of the investment protection regime's establishment, partly explaining its contradictory relationship with many current issues such as climate goals. Although individual provisions in investment agreements have evolved to some extent, as will be discussed later, full deployment of more fundamental reforms of the regime are yet to be seen.[92]

### 3.1.2 Content

International investment agreements can be divided into three main categories: (1) bilateral investment treaties (BITs), (2) bilateral economic agreements that include chapters on investment – often free trade agreements (FTAs), and (3) multilateral investment-related agreements between more than two states, such as the Energy Charter Treaty (ECT) and multilateral FTAs.[93] Even though all investment agreements, which there are thousands of, are distinct treaties, they are very similar in structure and purpose – the totality of them may well be called *a regime*.[94] In investment agreements states lay down rules on how they undertake to treat investments from other contracting states. The rules are typically enforced using some type of a dispute resolution mechanism that is relied on in case of a disagreement between

[90] Perrone 2021, pp. 55–58.
[91] Niemelä 2020, p. 7.
[92] Pathak 2025, p. 19.
[93] Salacuse 2010, p. 429.
[94] Salacuse 2010, p. 432.

investors and a host state – ISDS being the most important.[95] Since the conclusion of the first BIT in 1959, most currently in-force BITs still remain notably similar in content.[96]

International investment agreements protect *investments*. Despite the agreements including a definition for an investment, it is not uncommon that the scope of the term is disputed in ISDS proceedings. The ECT defines investment as *every kind of asset, owned or controlled directly or indirectly by an Investor*, followed by a non-exhaustive list of examples. The more recent Canada-EU Comprehensive Economic and Trade Agreement (CETA) specifies that an investment must have *the characteristics of an investment, which includes a certain duration and other characteristics such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk*. In climate and fossil fuel cases, the investment is typically directed into a power plant or an oil or gas field.

Although improvements have been made during recent years, the provisions in international investment agreements tend to be relatively vague and ambiguous in wording, which has gathered substantial criticism.[97] The ambiguous wording leaves more room for interpretation for the arbitral tribunals and places value on previous awards, although they are not legally binding.[98] The decisions made by arbitral tribunals within ISDS thus form a source of investment jurisprudence, although often difficult to access due to strict confidentiality of the proceedings.[99]

Investment agreements contain provisions that guarantee certain standards of treatment for foreign investments. Different investment agreements often contain similar or identical provisions, for example on fair and equitable treatment, full protection and security, most-favoured-nation treatment, expropriation, and national treatment. The ECT specifies promotion, protection, and treatment of investments in Article 10(1), which stipulates:

> Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory

[95] Salacuse 2010, p. 427.
[96] Pathak 2025, p. 7.
[97] Ankersmit 2025, p. 240.
[98] Salacuse 2010, pp. 453, 461.
[99] Ibid., p. 447.

> measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations. […]

Correspondingly, under Article 3 of the BIT between France and Argentina, [e]*ach Contracting Party shall undertake to accord in its territory and maritime zone just and equitable treatment, in accordance with the principles of international law, to the investments of investors of the other Party and to ensure that the exercise of the right so granted is not impeded either de jure or de facto*.

The most common breaches of investment agreements arising in ISDS disputes are those of *fair and equitable treatment* (FET) and *indirect expropriation*.[100] FET is a general and vague principle connected by scholars and tribunals with treating foreign investments according to rule of law and in an unbiased manner.[101] Indirect expropriation causes economic effects comparable to those of direct expropriation (claiming private property for public use) but does not meet its established criteria.[102] According to the UN Conference on Trade and Development (UNCTAD), between 1987 and 2024, investors claimed breaches of FET in 87 per cent of the ISDS cases and indirect expropriation in 68 per cent of the cases. In cases where tribunals found breaches of an investment agreement, 68 per cent of those breaches concerned FET and 26 per cent regarded indirect expropriation.[103]

Indirect expropriation and FET are some of the most essential investment protection provisions in climate disputes as well. In these cases, a state does not usually take over investors' property but instead sets rules that are likely to affect it, according to the investors amounting to indirect expropriation. Investors have relied on FET for example when they have considered their *legitimate expectations* having been breached.[104] In climate disputes, violation of legitimate expectations has been argued when a state measure has varied from what the state has earlier indicated about a specific matter that concerns investors. For example, in *RWE v. Netherlands*, the investors claimed that before banning the use of coal as

[100] UNCTAD 2025, p. 9.
[101] Reinisch – Schreuer 2020, paras 4, 122–28, 444–54.
[102] OECD 2021, para 1.
[103] UNCTAD 2025, p. 9.
[104] VanDuzer 2016, pp. 438–41.

an energy source, the Dutch government had, in earlier energy reports, "openly advocated the construction of new coal-fired plants, arguing their need until 2050".[105]

Investment agreements focus on protecting the investors, seldom stipulating obligations for them.[106] Comparing to any other private entities within the entire field of public international law, international investment agreements afford foreign investors a distinctive legal status.[107]

### 3.2 ISDS as a Dispute Resolution Mechanism

If an investor considers that their investment has not been treated in the manner guaranteed in an investment agreement, a dispute resolution process can be initiated. Multiple methods of dispute resolution exist: Provisions on state-to-state arbitration are common but in practice they have almost never been invoked. Investor-state arbitration is much more common, as it enables the investor to challenge the host state directly, and typically without the need to ask permission from their home state. Accordingly, ISDS has become the most important method of dispute resolution under international investment agreements.[108]

ISDS is a unique system in that it allows private entities to challenge a state before an arbitral tribunal and enables this tribunal to make the decisions: the power to give awards has not been given to a centralised authority or organisation, but ISDS takes place in individual ad-hoc proceedings or in institution-assisted arbitration where private arbitrators, often corporate lawyers, are in charge of the decision-making.[109] The tribunal consists typically of three arbitrators – one chosen by each party and a third one mutually agreed on or selected by an arbitration institute.[110] One of the most important institutions for ISDS is the International Centre for Settlement of Investment Disputes (ICSID).

In climate and environmental cases, government measures that investors challenge can include for example refusal or delay in granting permits, establishing environmental reserves, imposing a fine for breaching environmental regulations, requiring an environmental impact assessment, and prohibiting mining or setting stricter standards for it.[111] Multiple recent examples from Europe exist. Slovenia, for instance, was challenged in 2022 by Ascent

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[105] *RWE v. Netherlands*, ICSID Case No. ARB/21/4, Claimant's Memorial, 18 December 2021, para 531.
[106] Ankersmit 2025, p. 239.
[107] Simmons 2014, p. 18; Dietz – Dotzauer – Cohen 2019, p. 749.
[108] Salacuse 2010, pp. 458–59.
[109] Ibid., pp. 460, 466.
[110] Tienhaara 2018, pp. 230–31.
[111] Sarvarian 2023, pp. 433–434.

Resources Plc and Ascent Slovenia Ltd after it had amended a mining law to ban hydraulic fracturing in hydrocarbon exploration.[112] The investors asked for damages in the amount of EUR 500 million.[113] The dispute is pending. In 2022, Italy was ordered to pay damages of over EUR 190 million to Rockhopper Exploration Plc as the tribunal considered that the state has expropriated the UK-based company's project as a result of banning offshore oil and gas production within a certain distance of the Italian shore in 2015.[114]

The decision of an arbitral tribunal is called *an award*. In *an award on jurisdiction* the tribunal decides whether it has jurisdiction to hear the case, and in *an award on merits* it considers if the applicable investment treaty has been breached. *An award on costs* determines the costs of the dispute.[115] *Enforcement* of the awards is one of the reasons for why ISDS, and arbitration in general, is such a popular method of dispute resolution among private entities. Enforcing an award means recognising the effects of the award as binding, i.e. same as those of a court judgment. In ISDS under the ICSID Convention, the obligation to recognise and enforce the award arises from the treaty itself, whereas in other types of arbitration this is regulated by the New York Convention. Enforcement under the New York Convention requires a court proceeding, in which the winning party of the arbitration must request enforcement of the award in a court of a Convention member state.[116]

In case a tribunal considers that the host-state has breached the investment agreement, it can order the state to pay damages to the investor. The question is often about hundreds of millions, but sometimes even billions of dollars.[117] The significance of large compensation is underlined when the host state is a developing nation, as the respondent countries in ISDS proceedings often are. For example in a 2019 case *Tethyan Copper v. Pakistan*, Pakistan was ordered to pay damages in the amount of USD 4 billion – "almost [equal to] the International Monetary Fund's (IMF) bailout that had been agreed two months earlier with the intention of

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[112] *Ascent v. Slovenia*, ICSID Case No. ARB/22/21, Notice of Dispute, 5 May 2022.
[113] Ibid., Ascent Resources plc: Arbitration Initiation and Revised Damages Estimate, 15 August 2022.
[114] *Rockhopper v. Italy*, ICSID Case No. ARB/17/14, Final Award, 23 August 2022, paras 6, 335. This Decision was annulled by Italy's demand in 2025. The tribunal was found to be improperly constituted due to an arbitrator's failure to disclose that he had in the past been prosecuted and convicted in Italy for work as lawyer, which created justified doubts about his impartiality in the present proceedings. See Decision on Annulment, 2 June 2025, paras 411–416, 435.
[115] Titi 2024, p. 3.
[116] Ibid., p. 15.
[117] International Institute for Sustainable Development (IISD) 2020, p. 1.

saving the Pakistani economy from collapse", as noted in a report by the International Institute for Sustainable Development (IISD).[118]

Investment agreements define the basis for calculating the damages in expropriation cases, in which the compensation is to correspond to the fair market value of the expropriated investment.[119] Most agreements do not stipulate compensation standards for other types of breaches. Today's prevailing view promotes the principle of full reparation – restoring the economic situation that would have likely remained in the absence of the breach.[120] Despite these accepted principles, there are inconsistencies to tribunals' cost awards, some tribunals grounding their evaluations on the cost-based method, while others rely on future discounted cashflow predictions.[121] With respect to climate-related state measures, some authors have suggested that fossil fuel investors should receive only partial compensation or even be left entirely without compensation due to the inevitable nature of the energy transition, which the investors must have been aware of for a long time.[122]

As stated, the arbitral awards are an important part of the investment protection regime in helping the decision-makers to interpret the vague provisions in the investment agreements. At the same time, however, the proceedings are often protected by high levels of confidentiality.[123] Confidentiality is based on the desire to protect commercially sensitive information but counterweighted by the lack of transparency and accountability, both vital in order for states to serve public interest.[124]

States may also engage in commercial arbitration – a more conventional type of alternative dispute resolution, in which parties resolve a disagreement arising from a commercial contract. The difference to ISDS is that in such disputes states operate in the capacity of a private entity that has concluded an individual arbitration agreement with another private actor. ISDS is included in international agreements concluded among two or multiple states.[125] ISDS is a private dispute resolution mechanism rooted in commercial arbitration frameworks while addressing disputes that are public-law in nature.[126] Considering states as

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[118] International Institute for Sustainable Development (IISD) 2020, p. 1.
[119] Ibid., p. 6.
[120] Ibid., pp. 8–9.
[121] Preston – Butler 2025, pp. 78–79.
[122] Tienhaara – Cotula 2020, p. 3.
[123] Salacuse 2010, p. 462.
[124] Kenny 2016, p. 489.
[125] Von Papp 2025, p. 78.
[126] Dimopoulos 2016, p. 433; Knieper 2016, p. 156.

commercial actors in this way is problematic in light of the fact that while companies exist to maximise shareholder value, states have other, public interests to promote and protect, distinguishing them from ordinary commercial operators.

### 3.3 Investment Protection and ISDS in the EU Legal Order

As stated earlier, some of the EU member states have been among the very first countries to conclude BITs with their former colonies. These member states have also been active in concluding BITs with other more recently acceded member states, particularly with Central and Eastern European countries following the fall of communism.[127] Investment agreements and ISDS proceedings are hence not new to the EU countries but discussion about their problems has begun relatively recently. An EU-specific problem regarding ISDS concerns its position in the EU legal order and particularly the tribunals' competence to address matters of EU law. Arbitration, based on contractual freedom, takes place outside state courts. It is, however, the courts of the member states that have in the EU treaties been given the power to interpret EU law, including the fundamental freedom of establishment and free movement of capital, that investment especially connects to.[128]

The complexity of the relationship between ISDS and EU law is demonstrated by case law of the ECJ. In a 2018 judgment, *Achmea*, the ECJ ruled that BITs between two EU member states are incompatible with EU law.[129] The question was about the ISDS provision in the BIT between the Netherlands and Slovakia. More specifically, the Court was to assess whether the provision contradicted with Articles 267 and 344 TFEU. Article 267 TFEU accord the ECJ the power to give preliminary rulings on *the interpretation of the Treaties* and *the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union*, where such an issue is *raised before any court or tribunal of a Member State*. Under article 344 TFEU, member states are not to use any other methods of dispute settlement than those included in the Treaties, when the dispute concerns *the interpretation or application of the Treaties*. In this regard, the ECJ interpreted first, whether the arbitral tribunal applied EU law in its decision-making; second, whether the tribunal can be considered a court of a member state in

[127] Butler 2025, p. 2.
[128] Ibid., pp. 2–3.
[129] Judgment 6 March 2018, Achmea, C- 284/16, EU:C:2018:158.

the meaning of Article 267 TFEU; and third, whether the arbitral award of the tribunal can be reviewed by a court of a member state.

The ECJ held that the ISDS provision of the BIT accorded the tribunal the power to apply EU law, in particular its fundamental rules on freedom of establishment and free movement of capital. It ruled that the arbitral tribunal could not be regarded as part of judicial system of either the Netherlands or Slovakia. Finally, the ECJ found that the arbitral award could not have been subjected to a review by a member state court, as pursuant to the BIT the arbitral tribunal has the power to determine its own jurisdiction and the awards of an arbitral tribunal are final.

The ECJ concluded that the ISDS provision of the Netherlands-Slovakia BIT had "an adverse effect on the autonomy of EU law". It held that intra-EU BITs could prevent disputes between investors and member states "from being resolved in a manner that ensures the full effectiveness of EU law, even though they might concern the interpretation or application of that law". Since *Achmea*, the ECJ has maintained its position in other judgments, such as *Komstroy*, in which it held that intra-EU disputes under the Energy Charter Treaty (ECT) specifically are not aligned with the law of the EU.[130]

Following *Achmea*, 23 EU member states signed an agreement for the termination of intra-EU BITs, including their sunset clauses that would have extended their application beyond the termination.[131] The rest of the member states, including Finland, have since then terminated their intra-EU BITs bilaterally. Despite the termination, ISDS cases have still been initiated based on intra-EU BITs, such as the Bulgaria-Romania BIT. In the on-going case of *Eurohold and Euroins v. Romania*, the tribunal decided to continue the proceedings despite Romania's opposition based on the termination of intra-EU BITs, but found that the termination issue will be addressed in a separate stage of the proceedings.[132]

In summary, after seven years since *Achmea*, it is still not entirely clear how the ECJ's stance will affect ISDS between two EU member states, and various – including climate-related – intra-EU ISDS cases are pending at the publication of the thesis.

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[130] Judgment 2 September 2021, Komstroy, C-741/19, EU:C:2021:655.
[131] Agreement for the termination of Bilateral Investment Treaties between the Member States of the European Union, 29 May 2020.
[132] *Eurohold and Euroins v. Romania*, ICSID Case No. ARB/24/18, Decision on the Respondent's Rule 41 and Rule 48 Objections, 30 September 2025, paras 102–105.

When it comes to BITs with third countries, the EU has taken steps to establish an EU-wide system of investment protection. In Article 3 TFEU, the EU has been granted exclusive competence in the area of common commercial policy, and Article 207 specifies that FDI is included in this policy area. In 2009, when Article 207 was adopted, member states had 1,360 international investment agreements in force.[133] As a result of this change in competences, the member states encouraged the adoption of the so-called *Grandfathering Regulation*[134], which ensures that member states can continue the BITs they have entered into with third countries before the adoption of Article 207 until replaced by new agreements negotiated by the EU. Member states can also conclude new agreements with the Commission's permit.

Under Article 351, the EU Treaties cannot influence international agreements concluded by member states before the date of their accession to the Union. In the event such agreements conflict with the Treaties, the member states must take *all appropriate steps to eliminate the incompatibilities*. The provision effectively means that all BITs concluded by the member states with third countries before their accession are legally binding until replaced with new ones entered into by the EU with the same third country.[135]

In summary, the EU member states have largely created the system of international investment protection for their own interests. As the world has since changed, the EU has started to question the system as it is and has been for decades. The EU's and the ECJ's stances indicate that ISDS is problematic both from the perspective of the EU's current policy priorisations as well as the overall system of EU law as defined in the Treaties. Recent developments indicate that the investment protection regime in the EU is changing, but the change is happening slowly. Even though intra-EU BITs are now against the law of the EU, multiple disputes based on these agreements are currently pending in ISDS tribunals. Even though member states are not to conclude new BITs with third countries, old agreements are still in force and will be until the EU negotiates new ones – a development not likely to take place fast.

In addition to the discussion about ISDS' relation to the EU legal order, the EU has also presented concerns over the procedural aspects of ISDS as well as the insufficient

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[133] Ankersmit 2025, p. 231.
[134] Regulation (EU) No 1219/2012 of the European Parliament and of the Council of 12 December 2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries.
[135] Butler 2025, p. 4.

consideration of public policy concerns in the tribunals' decision-making. These problems will be discussed next, and the EU's initiatives regarding ISDS reform will be explored later in the thesis.

# 4 The Conflict Between ISDS and the EU's Climate Policy

## 4.1 Climate-Related ISDS Disputes Involving EU Member States

ISDS case statistics indicate a clear division, with Global North countries commonly appearing as investors' home states and Global South countries more frequently acting as respondent states. According to the UNCTAD Investment Dispute Settlement Navigator tool[136], the most ISDS proceedings have throughout the years been brought against Venezuela (67 cases), Argentina (65 cases), and Mexico (61 cases). By contrast, disputes have most often been initiated by investors from the US (240 cases), the Netherlands (138 cases), and the UK (129 cases). In total 681 cases have been initiated by investors residing in the EU, while the member states have been challenged by foreign investors 320 times.

Throughout ISDS history, the EU countries have hence been represented much more as home states of the investors than as respondent states. More recently the member states have been forced to realise that the system they have promoted to advocate for their own interests has on numerous occasions been turned against them. In general, both the number of international investment agreements and the disputes brought under them have increased over recent decades.[137]

The discussion of the problems of ISDS often relate to public policy concerns, among which climate and environmental problems are especially highlighted due to their urgency and topicality. In an era defined by the climate crisis, the fact that ISDS provides a possibility to obstruct climate measures is something to be taken seriously. To determine the actual scale of the problem, I examined the volume of previous and current cases brought against the EU member states. To reduce the amount of case material, I focused on the cases filed against member states since 2019 – the year marking the establishment of the European Green Deal with its emission reduction and net zero targets. It should be noted that due to the lack of transparency in ISDS proceedings, the true number of cases pending against the member states is impossible to know, not to mention having access to the case materials.

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[136] The UNCTAD Investment Dispute Settlement Navigator has, for the purposes of this thesis, been last accessed on 17 April 2026, on which date the website had been updated as of 31 December 2025. All quantitative data in this chapter is gathered from the UNCTAD tool.
[137] Hallak 2022, p. 1.

Between 1 January 2019 and 31 December 2025, investors challenged the EU member states – or on two occasions the Union itself – to ISDS 80 times. The most cases were initiated by investors in the electricity, gas, steam, and air conditioning supply sector (28 cases), followed by the financial and insurance activities sector (14 cases) and the mining and quarrying sector (12 cases). The rest of the cases were allocated relatively evenly among nine other sectors, with one case missing information concerning the investor's sector. Table 1 below lists the number of cases for every economic sector. Out of the 80 cases, eight had been decided in favour of the investor and 12 in favour of the state, some cases discontinued or settled, and the clear majority pending, highlighting the general length of ISDS proceedings. The damages ordered to be paid to investors varied between USD 20.50 and 330.70 million.

Table 1. The number of ISDS cases against the EU member states initiated between 2019–2025 by economic sector of the investor. Some investors operate in multiple sectors, the total hence adding up to more than the number of cases.

| Economic sector | Number of cases |
|---|---|
| Electricity, gas, steam and air conditioning supply | 28 |
| Financial and insurance activities | 14 |
| Mining and quarrying | 12 |
| Manufacturing | 6 |
| Construction | 5 |
| Real estate activities | 5 |
| Wholesale and retail trade; repair of motor vehicles and motorcycles | 4 |
| Information and communication | 3 |
| Transportation and storage | 3 |
| Arts, entertainment and recreation | 2 |
| Data not available | 1 |
| Water supply; sewerage, waste management and remediation activities | 1 |
| Professional, scientific and technical activities | 1 |

The most GHG emissions in the EU are produced, other than households, by the manufacturing sector, the electricity, gas, steam and air conditioning supply sector, and the transportation and storage sector[138] – the sectors accounting for 44% of the ISDS cases brought against the EU member states between 2019–2025, as displayed in Figure 1. Mining companies have been active in bringing ISDS claims, representing the third largest group of investors to start proceedings, after electricity, gas, steam, and air conditioning supply sector and financial and insurance activities sector, as shown in Figure 2.

[138] Eurostat 2024.

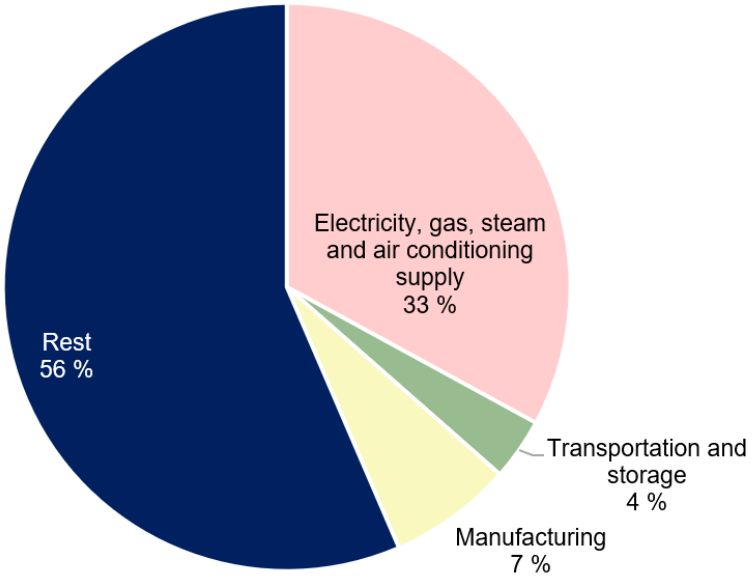


Figure 1. Proportions of ISDS cases initiated against EU member states by economic sector, 2019–2025 – highlighting the sectors producing the most GHG emissions.

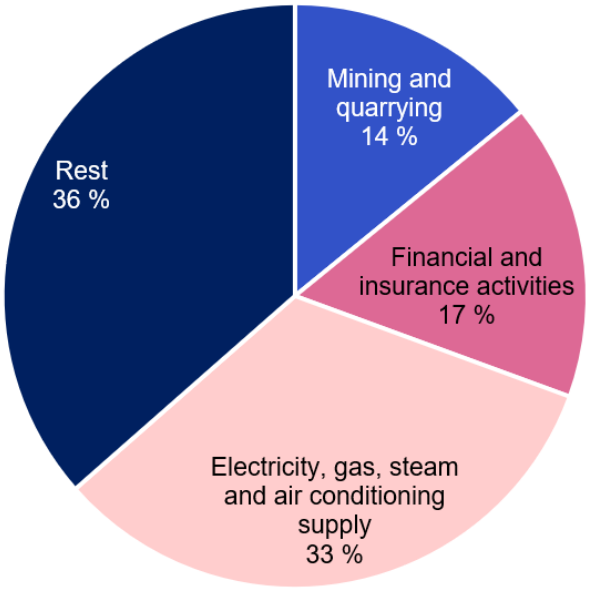


Figure 2. Proportions of ISDS cases initiated against the EU member states by economic sector, 2019–2025 – highlighting the sectors initiating the most cases.

Not all the cases brought by companies within for example mining and quarrying or electricity, gas, steam, and air conditioning supply have been initiated as a result of climate measures. In fact, only a few cases have been brought as a result of climate measures in a strict sense; *AET v. Germany*, *Uniper v. Netherlands*, and *RWE v. Netherlands*, which all concern measures to phase out coal. The statistics reveal nevertheless that ISDS is an often-

used tool for investors of which operations cause the most harmful emissions, upstream and downstream, and of which operations are consequently most often disturbed by climate regulation. The downstream use of commodities such as oil and gas generates substantial emissions, meaning that measures regarding mining play a key role in achieving net zero targets.[139] Notably, in the International Energy Agency's roadmap to Net Zero by 2050, the development of new oil and gas fields should have been finished in 2021.[140] According to other research, some already developed oil, gas, and coal reserves should be kept in the ground in order to limit global warming as required by instruments of international law.[141]

The discontinued cases of RWE and Uniper against the Netherlands represent the more strictly climate-related ISDS disputes against the EU member states. Maxron Holder argues that the investors in those disputes had a "valid claim to legitimate expectations" in their hands considering that before phasing out coal, the Dutch government had encouraged the commissioning of new coal plants until 2050. These cases indicate that if a member state has once advocated for fossil fuels, a change in the policy is not unproblematic under investment agreements: an ISDS tribunal may consider it a breach of investors' legitimate expectations.[142]

While the proceedings against the Netherlands have been discontinued, AET's similar dispute against Germany is pending at the time of the thesis' publication. Germany points out that if decided in favour of the investor, the *AET v. Germany* tribunal will be "the first investment treaty tribunal ever to order a State to pay damages for a legislative measure dedicated to climate action."[143] According to the tribunal's procedural calendar, next steps in the proceedings have been taken during the spring of 2026 but the materials are not publically available.[144] If the case is not discontinued or settled, the eventual final award will undoubtedly provoke considerable discussion in the EU.

The small number of climate-related ISDS awards in the EU so far makes it difficult to conduct a reliable analysis on the extent of threat that ISDS truly poses for implementation of climate regulation. The discussion about ISDS' problems in the EU is, hence, less about the

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[139] Green – Denniss 2018, p. 74.
[140] International Energy Agency 2021, p. 21.
[141] Trout et al. 2022, p. 7.
[142] Holder 2024, p. 142.
[143] *Azienda Elettrica Ticinese (AET) v. Germany*, Counter-Memorial, 26 March 2025, para 1.
[144] Ibid., Prodecural Order No. 7 On the Procedural Calendar, Annex A.

extent of damage that ISDS has caused to climate protection and more about the features of ISDS that cause potential threat to climate ambition. In spite of this, as J. Anthony VanDuzer concludes, "[…] investors will bring claims against climate change measures and some of them will succeed."[145] As the statistics above indicate, investors in fossil fuels and mining are relatively active in bringing ISDS claims compared to investors in many other sectors, with the exception of financial and insurance activities. Fossil fuels continue to have the biggest share in the EU's energy mix[146], meaning that a move away from them is likely to induce additional ISDS action. The essential role of foreign investment in the energy market explains the relatively high proportion of climate and energy related cases globally. Foreign investors finance 45–50 per cent of oil and gas projects and 40 per cent of power generation projects.[147] As ISDS is a special mechanism available for foreign investors only, many oil and gas fields and power plants around the world are protected with international investment agreements and ISDS. The various reasons for why this is problematic will be analysed next.

## 4.2 The Problems of Addressing Climate Matters in ISDS

### 4.2.1 Public Policy and the Limited Jurisdiction of Arbitral Tribunals

As touched on earlier, ISDS has been created for a different world with different objectives, rendering it an unfit system for today's world. The unsuitability of ISDS to assess climate matters and other public policy concerns is reflected in the rules according to which arbitral tribunals decide the disputes brought before them.

State courts apply international law as part of their national legal systems. Arbitral tribunals are different to state courts in that they only have to apply the substantive law chosen by the parties, which – in ISDS based on an international investment agreement – is usually the treaty itself, supplemented by other rules such as customary international law or the host state's national law.[148] Article 8.31 of the Canada-EU Comprehensive Economic and Trade Agreement (CETA), for instance, determines the applicable law to be *this Agreement as interpreted in accordance with the Vienna Convention on the Law of Treaties, and other rules and principles of international law applicable between the Parties.* Accordingly, whether an ISDS tribunal has to consider climate regulation in its decision-making, depends on the

[145] VanDuzer 2016, pp. 434–35.
[146] Eurostat 2026.
[147] Holder 2024, p. 139.
[148] Dimopoulos 2016, pp. 426–27.

applicable investment agreement. If an agreement explicitly refers to an instrument that regulates climate action, the tribunal must take it into account. Without such a reference, the tribunal is not bound by that instrument.[149] Even customary international law – which climate obligations are a part of according to an Advisory Opinion of the International Court of Justice[150] – does not bind an arbitral tribunal without an explicit reference to such general principles in the applicable investment agreement.[151]

Tribunals' limited jurisdiction makes it possible for them to ignore even the most fundamental principles of international environmental law, such as the polluter pays principle, that assigns the costs of pollution, i.e. the expenses of securing an acceptable state of the environment, to the one responsible of causing the pollution.[152] The principle aims at internalising the negative externalities produced by the markets.[153] A UN Special Rapporteur notes that in ISDS, "[t]he polluter pays principle, widely accepted in international environmental law, has been turned upside down, as polluters get paid."[154]

A general reference to *international law* makes it possible for a tribunal to apply the provisions of UNFCCC and Kyoto Protocol as international instruments of climate change law. The tribunal's task is, however, to analyse strictly whether investment protection standards have been breached. The tribunal can therefore consider climate legislation if that particular legislation regulates the governmental action that has been challenged by the investor.[155]

The applicable law provision of the CETA refers to the Vienna Convention on the Law of Treaties, which involves the principle of systematic interpretation. The principle, according to Angelos Dimopoulos, "presents an excellent tool available at the disposal of investment tribunals to avoid potential conflicts between investment protection and climate change norms."[156] Using this tool means that climate law would guide the arbitrators' interpretation of the investment agreement's provisions so as to prevent clashes between the two different regimes. While these rules of treaty interpretation may bring the conflict considerations within

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[149] Cole et al. 2014, p. 302.
[150] International Court of Justice, Obligations of States in respect of Climate Change, Advisory Opinion of 23 July 2025, para 457.
[151] Cole et al. 2014, pp. 302–3.
[152] OECD 1975, pp. 12–13.
[153] Sands et al. 2012, p. 125.
[154] Boyd 2023, para 41.
[155] Dimopoulos 2016, pp. 427–28.
[156] Ibid., p. 428.

the tribunal's jurisdiction, it is nevertheless entirely another question how the arbitrators balance the different interests in practice. As Bruno Simma and Theodore Kill have stated in the context of human rights – a regime somewhat comparable to climate law in terms of their relations to investment protection – "[o]nce a tribunal has before it the applicable norms of human rights, it must decide whether or how these rules affect the arguments advanced by the parties to a dispute."[157]

Concerns about tribunals' limited yet broadly worded jurisdiction have been taken into account in drafting the EU's most recent investment agreements, such as the investment protection provisions of the CETA. The CETA regulates investment protection more clearly than the EU's older investment agreements. The agreement contains, for instance, an exhaustive list of situations in which the FET principle is to be regarded as breached. Moreover, the threshold for non-compliance is higher: some violations are to be *fundamental* or *manifest* in order to be considered breaches. In addition, the CETA is more progressive when it comes to environmental protection: Article 8.9 stipulates that the parties *reaffirm their right to regulate within their territories to achieve legitimate policy objectives*, specifically mentioning the environment as one of them. The CETA aims at ensuring that the starting point of disputes is that states have the right to regulate – it is not possible for regulation to stay untouched.[158] Whether the advancements in the CETA are successful in protecting states' right to regulate is impossible to know yet, as Chapter 8, which governs investment protection, will only enter into force once all EU Member States have ratified the agreement.[159] While clarifications have been made, the provisions still leave room for alternative understandings as for example the definitions of fundamental and manifest depend on the interpreter.

The ISDS mechanism has been established to protect specifically foreign investors' interests, meaning that tools for guarding other interests were not originally included in the system. While tribunals' limited jurisdiction presents one problem, another significant challenge is how the arbitrators use their discretion within the limits of that jurisdiction. Even though the more recently negotiated agreements, such as the CETA, include explicit provisions on protecting public policies such as the climate, it remains to be seen how tribunals will in

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[157] Simma – Kill 2009, p. 707.
[158] HE 126/2022 vp, pp. 44–45.
[159] European Commission, The EU-Canada agreement explained.

practice balance the investors' interests and public policy concerns once these provisions enter into force.

### 4.2.2 Arbitrators' Competence to Assess Climate Concerns

Even if climate concerns fell within the jurisdiction of arbitral tribunals, individual arbitrators' own ideals may play a part in the decision-making, and their expertise in the area of climate law may be limited. As it is the parties that nominate the arbitrators, the arbitrators are most likely experts in investment law and not in environmental and climate law.[160] This poses a risk to the proper assessment of climate obligations.

In a 2021 survey on "Adapting Arbitration to a Changing World", "[s]ome interviewees, both counsel and arbitrators" considered that in arbitration, and especially in ISDS, arbitrators' lack of diversity may affect the parties' and the public's assessment of the proceedings' legitimacy. Further, it was pointed out that if none of the arbitrators are familiar with the culture or area essential to the dispute, it may distort assessment to favour parties of which origins the tribunal understands better.[161]

This risk must be considered in connection with climate concerns as well. According to David R. Boyd, the former UN Special Rapporteur on the issue of human rights and the environment, "arbitrators are predominantly white, male, business-friendly investment law attorneys from the global North, many of whom litigate ISDS cases for clients or work for firms that do so."[162] Experts have recognised the rather common practice of *double hatting* – successively or even simultaneously serving as an arbitrator in one dispute and counseling for an investor in another. This double role may, at least subconsciously, lead to *pro-investor bias* at the cost of climate commitments.[163] Referring to a survey on investors' perceptions of ISDS, Justice Brian J. Preston and Kate Butler remark it being of no surprise that most investor respondents reported being content with arbitrators having the possibility to act as counsels and expert witnesses in other proceedings, which makes sense if the investors truly gain from the double role.[164]

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[160] Cole et al. 2014, p. 303.
[161] White & Case and the Queen Mary University of London 2021, p. 17.
[162] Boyd 2023, para 27.
[163] Langford – Behn – Lie 2017, pp. 301–2; Boyd 2023, para 28.
[164] Preston – Butler 2025, pp. 93–94.

The combination of investment agreements' ambiguous provisions and arbitrators' lack of expertise or impartiality may lead to inconsistent decisions. For example, the cases *Rockhopper v. Italy*[165] and *Lone Pine v. Canada*[166] both concerned a government measure limiting oil and gas exploration. In the prior case, the tribunal considered the government action unlawful expropriation, whereas the claims in the latter case were dismissed. The disputes were based on different investment agreements and their facts varied to some extent, but this did not entirely explain the different applications of international investment law leading to opposite awards, as argued by Jean-Michel Marcoux. According to him, the different outcomes "result from political choices that were made by each tribunal at crucially important steps of their reasoning."[167] Although it is ordinary for different tribunals to come to different conclusions and disagree about application of treaty provisions, this example connects to a broader discussion about the *indeterminacy* of ISDS. The variability in decision-making is not necessarily explained by incorrect application of the rules, but it is rather the rules themselves that enable subjective opinions. The rules seem to even intrinsically lack the capacity to define a single correct conclusion.[168] This indeterminacy poses a serious risk to climate efforts, such as banning oil and gas exploitation.[169]

### 4.2.3 Dispute Resolution Behind Closed Doors

Arbitration, in general, is attractive to businesses partly because it enables handling commercial information and trade secrets behind closed doors. ISDS is a private dispute resolution mechanism inspired by commercial arbitration while it resolves disputes that are largely different, public law based. Confidentiality is a suitable feature for commercial arbitration as the dispute is between private operators that are not accountable to the public in the same manner as states. The influence of ISDS on both state budgets and critical public policies, including climate regulation, highlights the fact that ISDS should not operate under the same confidentiality rules as commercial arbitration.

Handling matters of public policy in secret is questionable from the outset but dealing with environmental and climate issues in particular adds another level of sensitivity, as the issues concern everyone's well-being. *Environmental issues are best handled with the participation*

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[165] *Rockhopper v. Italy*, ICSID Case No. ARB/17/14.
[166] *Lone Pine v. Canada*, ICSID Case No. UNCT/15/2.
[167] Marcoux 2024, p. 352.
[168] Pathak 2025, pp. 16–17.
[169] Marcoux, pp. 352–53.

*of all concerned citizens*, as Principle 10 of the Rio Declaration of 1992 puts out. The significance of access to environmental decision-making and information is worded in legislation. For example, under Section 20 of the Finnish Constitution, public authorities should strive to guarantee *everyone the possibility to influence the decisions that concern their own living environment*.

In 1998, the European Community adopted the United Nations Economic Commission for Europe Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters – the Aarhus Convention. The EU adopted the Aarhus Convention in 2005. The objective of the Convention is to promote these rights *in order to contribute to the protection of the right of every person of present and future generations to live in an environment adequate to his or her health and well-being*, as stated in Article 1. Article 2 of the Convention defines *environmental information* broadly, stating that it can take form as *any information in written, visual, aural, electronic or any other material form.*

Handling climate-related ISDS claims in secret goes against the principles enshrined in the Aarhus Convention and makes public participation difficult or impossible. Even outside environmental and climate regulation the case for increasing transparency in ISDS is strong: ISDS awards should be published at the very least because the damages are paid with taxpayers' money.[170]

As touched upon earlier, the international investment protection system was established to protect investors against domestic legal systems in countries with weak rule of law. The concept of the rule of law can be considered to consist of principles such as transparency, independency, consistency with human rights, fairness, participation in decision-making, and legal certainty.[171] In light of the considerations above, ISDS itself seems to lack many of these essential characteristics. Hence, it is reasonable to question the plausibility of the argument that this system is a requirement of the rule of law.

[170] Preston – Butler 2025, p. 99.
[171] United Nations Security Council 2004, para 6.

## 4.3 The Influence of ISDS on Lawmaking: A Chill in the Level of Regulation

### 4.3.1 The Regulatory Chill Hypothesis

When an arbitral tribunal assesses a dispute between an investor and a host-state, it does not have the competence to directly influence the state's regulations: it cannot deem a government measure "illegal". Rather, the potential risk posed by ISDS on establishing more ambitious climate policies is more indirect – it is based on the *regulatory chill hypothesis*: governments may be discouraged to regulate environmental and climate matters in a fear of having to pay substantial damages to foreign investors.[172] A study by Kyla Tienhaara et al. estimates that state action to achieve the 2050 net zero target could lead up to USD 340 billion in legal claims globally from the oil and gas industry, and even more counting in the lower stream industries, such as coal mining. The fear of high damages may be strengthened by the fact that the outcomes of ISDS processes are difficult to predict due to ambiguous rules and a lack of a binding system of precedent.[173]

Regulatory chill has been discussed in academic literature. According David Schneiderman, threats of arbitration under the North American Free Trade Agreement (NAFTA) "played a role in limiting the range of social policy choices" of governments proposing for example plain packaging for cigarettes."[174] Furthermore, the Intergovernmental Panel on Climate Change (IPCC) has noted that "legal norms designed to protect the interests of owners of fossil assets" have "a chilling effect on climate mitigation".[175]

Despite academic discussion around the concept, there is relatively little empirical evidence of regulatory chill resulted from ISDS, since it is difficult to perceive: when a government leaves a matter unregulated or adopts a more lenient version of a law, it is not necessarily because of the threat of ISDS, or if it is, the government might not want to disclose this information. A government may abandon a regulation that is unfavourable for foreign investors, but it does not necessarily do this because of the threat of ISDS, but other monetary consequences resulted from foreign investment, such as increased employment rate.[176] Some instances of lawmaking have however been connected with regulatory chill. One of the most famous

[172] Tienhaara 2018, pp. 232–33; De Boeck 2022, p. 7.
[173] Tienhaara et al. 2022, pp. 701–3.
[174] Schneiderman 2001, pp. 524–25.
[175] IPCC 2022, p. 1506.
[176] Tienhaara 2018, p. 236.

examples regards tobacco regulation: After the tobacco company Philip Morris had challenged Australia to ISDS due to the country's new plain packaging legislation, the government of New Zealand postponed the entry into force of its own such regulation.[177]

Turning to European examples, ISDS seems to have played its part in lowering environmental and climate protection standards in some EU member states. In 2020, Denmark made a decision to stop extraction of oil in the North Sea in 2050. Climate and environmental spokespeople criticised the lack of ambition regarding the timeline. The then Minister of Climate Dan Jørgensen explained that an earlier finish date, for example in 2040, would likely have led to significant compensation having to be paid to the investors, making 2050 a more viable option.[178] A similar debate was had in France: the Hulot law of 2017 on phasing out fossil fuel extraction by 2040 was scaled back after a Canadian oil company Vermilion threatened to initiate ISDS.[179]

Another European example is the *Vattenfall v. Germany* case initiated in 2009, in which Vattenfall claimed that Germany had breached the Energy Charter Treaty (ECT) in the permitting process of a new coal plant. Vattenfall argued that taken together, the effects of a delay in issuing permits and issuing a restricted water use permit led to loss of economic value and constituted, among other things, indirect expropriation of Vattenfall's investments.[180] In 2010, the proceedings were suspended and the parties came to a resolution: Germany agreed to modify the water permit[181], effectively lowering its environmental protection standards. Later, when planning the national act banning coal-fired power generation, German experts pointed out the risk of ISDS.[182] These concerns did not lead to a regulatory chill as the legislation was ultimately adopted. The new regulation did, however, once again induce ISDS action against Germany as evidenced by the *AET v. Germany* dispute discussed earlier.

### 4.3.2 A Finnish Case Study on Regulatory Chill

Looking further into whether ISDS has been brought up in the preparation of new state policies, as it was in Germany, can provide insight into how its potential threat influences

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[177] Niemelä 2020, p. 4.
[178] Berlingske 3 December 2020.
[179] Vaudano 4 September 2018.
[180] *Vattenfall v. Germany (I)*, ICSID Case No. ARB/09/6, Request for Arbitration, 30 March 2009, para 54.
[181] Ibid., Award, 11 March 2011, p. 6.
[182] *Azienda Elettrica Ticinese* (*AET) v. Germany*, Claimant's Memorial, 26 July 2024, paras 234–35.

government decision-making. To assess whether ISDS has led to a regulatory chill in Finland, mentions of ISDS and investment protection were searched in Finnish legislation's preparatory materials.[183] It was found that in Finland, ISDS has been considered at least in connection with the preparation of a new Mining Act.[184] This is unsurprising in light of the fact that investors in mining and quarrying, as opposed to most other economic sectors, are one of the most active to initiate ISDS claims in the EU member states.[185] In preparing the Mining Act, Finnish lawmakers assessed whether the new provisions could trigger changes particularly in claims brought under the CETA.

Doctor Pekka Niemelä states, in his expert opinion to the Finnish Parliament's Economic Committee, that investment protection provisions and particularly the dispute resolution mechanism in the CETA cause uncertainties in developing mining legislation. In a citizens' initiative various improvements were proposed to the previous mining act, which, according to Niemelä, could lead to claims for damages under the CETA's rules. Niemelä points out that actions violating the CETA are likely to be assessed differently by arbitral tribunals than breaches of national law by state courts, as the CETA does not recognise any "opposite" rights to those of investors – such as the right to a healthy environment, which is acknowledged in the Finnish Constitution. He points out that even though the threat of CETA-based claims should not be overemphasised in lawmaking, such claims are possible since the improvements proposed in the citizens' initiative would significantly affect mining companies' operations and ability to anticipate the outcomes of environmental permit processes. Niemelä emphasises the difficulty of predicting how a CETA tribunal would interpret the new regulation.[186]

With the support of expert opinions, the Parliament's Economic Committee proposed the citizen's initiative to be rejected on the basis that it contains far-reaching and, in regard to their effects, uncertain proposals.[187] With respect to the CETA, the Committee referred to Niemelä's statements and concluded that the proposals in the citizens' initiative would require a comprehensive impact analysis.[188] The Parliament hence proceeded to reject the citizens' initiative, but adopted several statements that emerged during its analysis of the initiative. One

[183] The search was conducted in lakitutka.fi.
[184] Laki kaivoslain muuttamisesta ("Act Amending the Mining Act") (505/2023).
[185] See Table 1.
[186] Niemelä 2020, pp. 10–12.
[187] TaVM 7/2020 vp, p. 19.
[188] Ibid., p. 16.

of them was that in preparing a new mining act, the Government should take into consideration possible effects of the CETA.[189] Later, the Government adopted a new Mining Act, which, according to the preparatory materials, does not include any changes that would significantly increase Finland's risk of being challenged to ISDS.[190]

In sum, investment protection has been taken into account recently in at least one Finnish regulatory process. The fact that the Parliament saw the citizens' initiative as overly far-reaching and uncertain, and raised investment protection as one of the reasons for its rejection, suggests a type of regulatory chill in the Mining Act regulatory process. Ultimately, the Government decided to adopt an act that was less far-reaching.

A regulatory process requires balancing various different and opposite interests, and in this case investment protection was one of the factors that compelled the lawmakers to choose different interests than those promoted in the citizens' initiative. The various interests make it difficult to recognise when a particular concern is leading to a regulatory chill, but lawmakers should be aware of the hypothesis in order to consciously reflect on their decisions. The threat of ISDS leading to more lenient legislation would, from the climate perspective, be an alarming direction.

### 4.4 Conclusion: the Conflict Between ISDS and the EU's Climate Policy

The risk of ISDS to the implementation of the EU's climate policy is a sum of multiple factors. Cases against the EU member states show that investors in fossil fuels and power generation are relatively active in bringing ISDS claims. Since member states are still relying on fossil fuels, phasing them out may require closing additional power plants and oil fields, suggesting that more disputes may be on their way. Provided that investment protection standards are vague and arbitral tribunals enjoy wide discretion, it is difficult to predict how tribunals will balance between investor rights and climate protection in the future.

The key features of ISDS explored in this section reveal that ISDS is not a suitable method to resolve climate-related disputes. Climate protection is a public concern, shared among all citizens, yet the decisions are made behind closed doors by arbitrators with substantial autonomy to decide how much weight is given to each aspect of the case. While this feature

[189] EK 40/2020 vp, p. 1.
[190] HE 126/2022 vp, p. 71.

has been considered problematic across various public policy areas, it is perhaps particularly ill-suited to climate and environmental disputes, given the existing frameworks safeguarding public participation in environmental decision-making.

The potential adverse effect of ISDS on lawmaking can be framed through the regulatory chill hypothesis, which supposes that the threat of ISDS can deter states from enacting climate regulation or make them lower existing standards. Even though regulatory chill may be difficult to prove, some instances of ISDS-connected occasions of loosening standards, choosing a less ambitious option, and postponing regulation provide alarming examples that lawmakers should be conscious of going forward. Given that the EU is behind in achieving its legally binding net zero target, all incentives to ease existing standards should be taken very seriously. By implementing climate measures, the EU member states are not only adhering to the EU-wide targets but also doing their part as developed states in globally shared climate protection efforts.

The combination of these factors demonstrates that the ISDS system is a gravely outdated system. The next section will analyse reform ideas explored by lawmakers and academic authors, and evaluate whether these ideas would be able to address the various problems.

# 5 The Future of ISDS in the EU

## 5.1 The EU's Reaction to the Conflict

In light of the discussion on the conflict between ISDS and the EU's climate commitments, it is clear that investment protection, and ISDS in particular, has gathered a substantial amount of criticism over the years: critics have paid attention, among other things, to non-transparency, infringement of host countries' sovereignty, and arbitrators' lack of independence. Perhaps most typically condemnation has been targeted towards investors' ability to challenge regulatory action on public policies, creating tension between different regulatory regimes and highlighting financial gain over more general public interest.

According to the Commission, the EU must "lead the reform of the global investment regime, as its founder and main actor".[191] The European Parliament responded to the climate-related ISDS concerns in 2022 by adopting a resolution *on the future of EU international investment policy*. The resolution addresses the fact that a concerning number of disputes have been brought against environmental and climate measures, which is not in line with the European Green Deal. In the resolution, the Parliament acknowledges the threat of regulatory chill and calls ISDS "an overall subsidy provided by taxpayers to the fossil fuel sector". The resolution also encourages the modernisation of the Energy Charter Treaty (ECT).[192]

The ECT is a multilateral agreement established in 1998 to encourage international cooperation in the energy field and promote energy security. The history of the treaty dates back to the time after the Soviet Union's fall, when companies from Western countries wanted to make investments in the energy sectors of Eastern European countries.[193] Importantly, it involves provisions on investment protection and ISDS.

On 27 June 2024, the EU formally exited the ECT, which took effect a year later, as it considered the treaty out-of-date. The ECT was deemed to encourage investment in fossil fuels, therefore being incompatible with the fight against climate change.[194] Due to a sunset clause included in the ECT, the treaty remains to apply to existing investments for 20 years

[191] European Commission 2015, p. 15.
[192] European Parliament 2022, paras 20–25, 39–45.
[193] European Parliament 2023, p. 2.
[194] Council of the European Union 27 June 2024.

after the withdrawal has taken effect. Out of the 80 disputes initiated against the EU member states between 2019 and 2025, 41 were or are currently brought under the ECT.

Based on the EU institutions' statements, the EU has acknowledged the need to reform ISDS and has secured a position as a front-runner in improving the system. The EU has withdrawn from the ECT and established updated forms of investment protection and ISDS in its recent trade agreements, such as the CETA. These reforms will be explored more closely next.

## 5.2 Modernising the Investment Protection Regime

### 5.2.1 Carve-outs, Exceptions, and Narrow Interpretation of Protection Standards

As mentioned earlier, an arbitral tribunal has a duty to consider climate regulation when the investment agreement applicable to a specific dispute directly refers to an instrument containing such regulation. The exact wording of an investment treaty is hence critical, as it dictates the tribunal's jurisdiction.[195] As described earlier, older international investment agreements are general in their wording, while in more recent agreements, more precise language, for example in the definition of fair and equitable treatment, has been adopted and the states' right to regulate emphasised. Nonetheless, the purpose of these newer agreements is still to primarily protect foreign investment and not other interests.[196]

As investment agreements tend to accord arbitrators wide discretion, many consider guiding the arbitrators' interpretation as key in taking climate protection better into account in ISDS decision-making.[197] Some arbitrators have, even under older agreements, adopted a narrow perspective to interpreting alleged investment agreement breaches. At least in the case *Mathias Kruck and others v. Spain* one of the arbitrators, Zachary Douglas, presented a dissenting opinion, in which he stated that in an era defined by the need for energy reform, "interpreting the FET standard as requiring States to buy back their right to implement those reforms at the highest price" seems out of place. The case was not about fossil fuels but renewable energy: the tribunal considered that Spain had violated the investors' legitimate expections as a result of changing the national rules for solar power state subsidies, which the investors had profited from. Douglas acknowledged that even though the present case was

[195] Cole et al. 2014, p. 302.
[196] Talus 2021, pp. 4–5.
[197] See for example Holder 2024, p. 157.

about renewable energy, generalising the tribunal's strict approach to other forms of energy would risk harmful effects for climate protection, such as regulatory chill.[198]

In 2019, before the CETA was concluded, the ECJ was requested for an opinion on whether it is "compatible with the Treaties, including with fundamental rights".[199] Article 8.9 of the CETA stipulates that *the Parties reaffirm their right to regulate within their territories to achieve legitimate policy objectives, such as the protection of public health, safety, the environment or public morals*, meaning that *the mere fact that a Party regulates, including through a modification to its laws, in a manner which negatively affects an investment or interferes with an investor's expectations, including its expectations of profits, does not amount to a breach of an obligation*. The ECJ considered that this carve out provision makes sure that tribunals have no jurisdiction to assess member states' public policy measures and overall deemed the CETA's dispute resolution section compatible with EU law.[200]

The problem with carve-out rules is that they are still quite vaguely expressed and up to arbitrators' interpretation. Hence, these provisions have even been estimated to be more diplomatic in nature than have actual legal consequences.[201] Environmental carve-outs have already been considered in multiple cases and the interpretation has been inconsistent across different tribunals.[202] In the cases *Eco Oro Minerals Corp. v. Colombia* and *Infinito Gold v. Costa Rica*, the tribunals saw that the environmental carve-out provisions of the applicable investment agreements did not justify breaches of legitimate expectations and FET. In the prior, the investment agreement stipulated that adopting or enforcing *environmental measures necessary to protect human, animal or plant life and health* is not to be prevented, *subject to the requirement that such measures are not applied in a manner that constitute arbitrary or unjustifiable discrimination between investment or between investors, or a disguised restriction on international trade or investment*. In the latter case, the applicable BIT provided that it does not prevent *a Contracting Party from adopting, maintaining or enforcing any* [environmental] *measure otherwise consistent with this Agreement*. In both cases, the tribunals held that it was not the carve-out's objective to rule out all possibility to challenge environmental regulation, but to enable those measures given that they do not obstruct the

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[198] *Mathias Kruck and others v. Spain*, ICSID Case No. ARB/15/23, Partial Dissenting Opinion by Zachary Douglas, 13 September 2022, paras 1–2, 157.
[199] Opinion 30 April 2019, C-1/17, EU:C:2019:341, para 1.
[200] Ibid., paras 137–161, 245.
[201] James 2017, p. 206.
[202] Mathews – Devitre 11 April 2022.

goals of investment protection.[203] These agreements do not concern the EU, and the provisions in the EU's recent investment agreements, such as Article 8.9 in the CETA, are formulated differently, with more emphasis on public policy protection: *the Parties reaffirm their right to regulate within their territories to achieve legitimate policy objectives, such as the protection of public health, safety, the environment or public morals, social or consumer protection or the promotion and protection of cultural diversity.* This provision is not yet in force, so it remains to be seen how tribunals interpret it as compared to the examples of Colombia and Costa Rica.

### 5.2.2 Increasing Transparency and Involving Experts and Stakeholders

The fact that only parties to the dispute participate in ISDS proceedings appears especially challenging in climate-related disputes. Disputes involving states, and especially the ones containing environmental and climate considerations, have many stakeholders in addition to the parties, including non-governmental organisations and other actors within the civil society.[204] As discussed earlier, citizens should be given an opportunity to have a say in environmental decision-making. *Amici curiae* provide a possibility for third parties to submit their views and expertise to arbitral tribunals.[205] For example, in the case *RWE v. Netherlands*, multiple climate and human rights organisations submitted a letter on interest to participate in the proceedings as amici curiae, yet the case never proceeded to the merits phase due to discontinuation.[206]

Involving climate considerations in an arbitral tribunal's decision-making is not only about jurisdiction, but likely also about the expertise of the individual arbitrators. Some climate and environment related carve-out provisions in investment agreements require the measure to be non-discriminatory or proportionate to the pursued aim,[207] in which case the expertise on climate and environmental law can help make an educated assessment of this balancing act.[208] In fact, in case the arbitrators are not sufficiently familiar with the climate aspects of the case, it should be mandatory to consult climate law experts. Experts are, after all, regularly

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[203] *Eco Oro Minerals Corp. v. Republic of Colombia*, ICSID Case No. ARB/16/41, Decision on Jurisdiction, Liability and Directions on Quantum, 9 September 2021, paras 822–37; *Infinito Gold Ltd. v. Costa Rica*, ICSID Case No. ARB/14/5, Award, 3 June 2021, paras 770–81.
[204] Preston – Butler 2025, p. 69; Dimopoulos 2016, p. 421.
[205] Dimopoulos 2016, p. 421.
[206] *RWE v. Netherlands*, ICSID Case No. ARB/21/4, Expression of interest in exploring amicus curiae participation, 19 July 2021.
[207] VanDuzer 2016, p. 460.
[208] Dimopoulos 2016, p. 422.

consulted on other matters as well, for example when dealing with domestic legislation of an unfamiliar jurisdiction.[209]

Accepting amici curiae has mainly been dependent on tribunals' discretion but some international investment agreements and arbitration rules have introduced express provisions on their approval. For example, the UNCITRAL Rules on Transparency in Treaty-Based Investor-State Arbitration establish a set of provisions that enhance the transparency and accessibility of ISDS.[210] Article 3 of the Rules determines *significant interest in the arbitral proceedings* and *the extent to which the submission would assist the arbitral tribunal in the determination of a factual or legal issue related to the arbitral proceedings* as relevant considerations in whether an amicus curiae should be accepted.

Even though explicit rules on transparency have been introduced, the acceptance of and weight given to amici curiae still ultimately lies in the hands of the arbitral tribunal. Furthermore, amici curiae are usually written submissions; only rarely are third parties allowed to be heard in-person.[211] Those opposing extensive amici curiae reforms have argued that third party participation easily leads to significantly increased costs – a concern especially for lower income states.[212]

### 5.2.3 A New Court System to Decide Investment Disputes

Within the EU, ISDS was the main concern in negotiating the now stranded Transatlantic Trade and Investment Partnership treaty (TTIP), which then led to a proposal for a new Investment Court System (ICS) to substitute ISDS in the EU's new investment agreements.[213] Under the ICS investment disputes are to be decided in a permanent adjudicative institution with a two-tiered appellate system instead of ad-hoc tribunals. One third of the judges are to be member state nationals, one third nationals of the other party, and the remaining nationals of third countries.[214] The ICS was first included in the CETA and the EU-Vietnam FTA.[215] It

[209] Cole et al. 2014, p. 303.
[210] Dimopoulos 2016, p. 422.
[211] Ibid., p. 423; Bastin 2012, p. 208.
[212] UNCTAD 2008, pp. 73–74.
[213] Dietz – Dotzauer – Cohen 2019, p. 750.
[214] European Commission, The Investment Court System.
[215] Dietz – Dotzauer – Cohen 2019, p. 750.

has not been put into practice yet as the investment provisions in both agreements remain to enter into force.[216]

The establishment of the ICS is an initial step toward creating the Multilateral Investment Court (MIC) – an entirely new court system that represents an essential part of the EU's ISDS reform plans. Even though the MIC would not be a state court, it would comprise a permanent institution, responding to multiple concerns regarding the current ISDS tribunals, especially questions of transparency and arbitrators' independence. The proceedings would be managed transparently by remunerated full-time judges instead of party-chosen arbitrators. A possibility to appeal the award would be included. The MIC would also enable smaller costs for more disadvantaged state parties. The arbitrators would still decide the disputes based on international investment agreements.[217]

The MIC would also be able respond to the problem of inconsistent case law if its establishment included the application of a *doctrine of precedent*. Doctrine of precedent would first of all promote efficiency in the form of more negotiation instead of litigation, less appeals, and less error costs due to more "correct" decision-making. Precedent would also help in narrowing arbitrators' discretion, leading to stronger judicial independency and less arbitrator biases.[218]

Even though the ICS and the MIC represent the most ambitious suggested methods of ISDS reform, many see the new mechanisms as insufficient improvements, referring to the deeper structural reform needs of ISDS. Thomas Dietz, Marius Dotzauer, and Edward S. Cohen have studied the "legitimacy gaps" of ISDS and whether the ICS is able to fill them. They conclude that multiple gaps remain after the reform as the ICS does not respond to the public's most grave concern, that ISDS puts foreign investors in a special position compared to other actors. They also refer to multiple "smaller" flaws of the ICS, such as insufficient participation rights and relatively low wages of the judges, that are likely to add to the lack of legitimacy.[219] Moreover, a new court system does not solve the problems that ISDS was originally founded

[216] European Commission, The EU-Canada agreement explained; European Commission, EU-Viet Nam Trade Agreement and Investment Protection Agreement.
[217] Council of the European Union 2018, paras 6–18; European Commission, Multilateral Investment Court project.
[218] Jarrett 2024, pp. 46–48.
[219] Dietz – Dotzauer – Cohen 2019, pp. 755, 767–68.

to respond to: it does not improve access to justice and the rule of law in local state courts that lack them.[220]

Citizens and other stakeholders have likewise presented concerns over the new court mechanisms. According to Greenpeace, the MIC "fails to address the fundamental shortcomings of investment protection rules and mechanisms as they currently stand". Greenpeace highlights that investors should not be granted special rights outside the established legal system, and that investors' rights should be accompanied by corresponding obligations.[221] A research group Corporate Europe Observatory similarly remarks that establishing the MIC would not change the fact that there would still be a special method of dispute resolution available exclusively for foreign investors. Including such a method in significant international trade agreements would mean "forever lock[ing] EU member states into a legal regime where private profits trump the public interest and democracy".[222]

## 5.3 Abolition of ISDS

### 5.3.1 Why terminate instead of reform?

The multiple above-discussed, currently implemented and planned ideas may successfully improve some problematic aspects of ISDS, especially when it comes to lack of transparency and arbitrators' independence – the "procedural" concerns. The reforms regarding the ICS and climate carve-outs have been well-received by many, for example the Finnish Government. In its proposal for approval and entry into force of the CETA, the Government commends the agreement for making significant improvements to investment protection and ISDS.[223] Despite improving the outdated system, not everyone considers the different reforms sufficient but sees abolition of ISDS the only viable way forward, especially in the middle of the climate crisis.

Despite improvements, reforms cannot be deemed sufficient when the system is deeply and inherently outdated. Critics have underlined that reforming ISDS – for example by establishing a new court system – entails significant risks. Implementing such reforms in new trade agreements could install systems that offer only limited improvements, effectively

[220] Vastardis 2020, p. 637.
[221] Greenpeace 2017, pp. 1– 2.
[222] Eberhardt 2016, p. 28.
[223] HE 149/2017 vp, p. 61.

"locking" the member states in for the long term. It might hinder or postpone the adoption of more extensive reforms or the possibility to terminate the system, and therefore reinforce arbitration as the field's preferred method of dispute resolution.[224] Some have criticised the reforms as focusing too much on the procedural aspects of ISDS, overlooking the problems of the substantive legal safeguards.[225] More specific treaty language and carve-out clauses that have already been implemented have not proved to be very effective in protecting the climate: the outcomes of disputes seem to have largely remained similar as before introducing the new provisions.[226]

Furthermore, none of the improvement plans sufficiently address the underlying concern that ISDS puts foreign investors in a special position within the international legal system, forming a so-called "justice bubble".[227] Effectively, ISDS provides "a free insurance policy for foreign investors".[228] Their unique status can be considered especially unreasonable in light of current internationally shared concerns, such as protecting the climate. Climate change leaves many local communities vulnerable, which are not given an effective opportunity to participate in ISDS.[229] The ultimate question regarding the future of ISDS is therefore, in the words of Thomas Dietz, Marius Dotzauer, and Edward S. Cohen, "[…] why within democratic, rule-of-law based political systems, international investors deserve a privileged position to pursue their economic rights at the expense of wider public concerns […]"?[230]

Investing in a foreign country always entails a risk: governments regulate on different matters continuously, and some of the regulation surely affects foreign investors among other commercial and non-commercial actors. Investment agreements with ISDS provisions shift a part or all of the risk related to the investment from the investor to the state – and its public.[231] The question about risk allocation ties to the discussion about a state's purpose, especially as an actor in the global markets. The reason for a state to attract investment and participate in global trade is to improve the country's economy, which contributes to the public good. Therefore, the consequences of aiming at attracting FDI by signing international investment

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[224] Eberhardt 2016, p. 28; Van Harten – Vastardis 2023, p. 364.
[225] Van Harten – Vastardis 2023, p. 364; Polonskaya 2020, p. 964.
[226] Van Harten – Vastardis 2023, p. 365.
[227] Vastardis 2020, p. 618.
[228] Ipp 4 May 2024.
[229] Van Harten – Vastardis 2023, pp. 364–65.
[230] Dietz – Dotzauer – Cohen 2019, p. 768.
[231] James 2017, p. 212.

agreements should not negatively impact the public good. According to Aaron James, an investor demanding compensation in ISDS means "to fail to appreciate the very social purpose according to which cross-border investment is allowed and legitimate in the first place." James argues that as the public good is the whole underlying justification for global trade, investors should reasonably be assumed to expect regulation in the interest of public good and take this risk into account when making investment decisions.[232] Therefore, from the perspective of climate measures and other regulation in the public interest, the free insurance policy, that ISDS represents, does not seem very justified.

Globally comparing, the EU and its member states have one of the most well-functioning legal systems in the world. The member states' constitutions and cross-border instruments such as the Charter of Fundamental Rights of the European Union and the European Convention on Human Rights ensure everyone effective judicial protection, and the European Court of Human Rights and the Court of Justice provide possibilities for remedies in addition to member state courts.[233] The European legal system largely guarantees the same treatment for foreign investors as international investment agreements.[234]

Investment has been considered to play an important role in climate action, as highlighted in the Paris Agreement. *Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development* is one of the aims of the Agreement pursuant to Article 2. The role of ISDS in pushing the green transition has in fact been raised by ISDS proponents.[235] Proponents of (the reformed) ISDS mechanism are concerned about weakening the rights of those investors that contribute to green transition, particularly mining companies. According to them, since clean technology requires metals and minerals, miners should be entitled to the protection provided by investment agreements and ISDS.[236] It is true that state funds are needed to achieve the energy transition.[237] Foreign investment does contribute to development of areas but the system that it is protected with puts foreign investors in a special position. Considering from a utilitarian perspective, for this

[232] James 2017, pp. 218–19.
[233] Vastardis 2020, p. 635.
[234] Talus 2021, p. 3.
[235] Ipp 4 May 2024.
[236] Burgstaller – Macpherson 2024, pp. 2–4.
[237] Dehm 2022, p. 84.

special position to be justifiable, the benefits of the system to the general welfare would have to exceed the harm it causes to justice.[238]

When making an investment decision, foreign investors need to consider the whole: overall regulatory predictability and stability as well as growth potential in the market. Attracting foreign capital requires good underlying economic prospects since ISDS cannot, after all, provide guarantees against market-driven losses. It can therefore be asked whether a state should even aim at attracting companies that make their investment decisions based on investment agreements. Those investors are prepared to utilise the dispute resolution tools accorded to them, potentially leading to considerable costs to the general public. Aaron James estimates that improving the investment environment in other ways is more likely to lead to long-term mutual economic benefits.[239]

International investment agreements are based on the belief that international rules on investment create more favourable and predictable conditions for investment by reducing risk, increased investment in turn leading to economic development.[240] Nonetheless, it is not clear whether the investment regime has in reality reached the goals of increased investment and economic development.[241]

The usefulness of investment agreements has been studied by investigating the effects of investment agreements and BITs on FDI and investment decisions. The results are contradictory. A study by Neumayer and Spess and another one by Bankole and Adewuyi found that developing countries that enter into more BITs with developed countries tend to attract higher levels of FDI.[242] Similarly, increase in FDI to Australia has been correlated with BITs.[243] By contrast, Yackee came to the opposite conclusion that BITs have "little or no impact on investment decisions".[244]

It would seem logical if investment agreements made the biggest impact on the economies of countries with the weakest rule of law systems, as a strong legal system may already provide sufficient protection to investors without the need for specific international agreements.

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[238] James 2017, pp. 210–11.
[239] James 2017, p. 213.
[240] Salacuse 2010, p. 451.
[241] Ibid., p. 469.
[242] Neumayer – Spess 2005, p. 1582; Bankole – Adewuyi 2013, p. 147.
[243] Crotti – Cavoli – Wilson 2010, p. 270.
[244] Yackee 2008, p. 828;

Interestingly, Hallward-Driemeier has concluded that developing nations with weaker domestic institutions gain fewer benefits from signing BITs than those with stronger domestic institutions – which themselves benefit only "slightly". The findings indicate that BITs are not enough to replace more comprehensive domestic reforms and consequently help the least those that allegedly need them the most.[245] A case study on Brazil demonstrates that signing BITs is not required in order for developing states to attract investment: Brazil, as the only developing country not having signed any BITs or other investment agreements involving ISDS, has successfully attracted foreign investment, supposedly due to its investor-friendly domestic legal system.[246] Since the thesis focuses on EU member states, it should be noted that other factors may play an important role in attracting investment in these countries: a study by Camarero, Moliner, and Tamarit demonstrates that European integration, and especially the shared euro currency, has contributed significantly to increased FDI to the EU area.[247]

### 5.3.2 How to terminate ISDS?

In practice, there are multiple ways to abolish ISDS. States can unilaterally withdraw their consent to arbitration or terminate their investment agreements. All parties to an agreement can also commonly agree to terminate it, which is the most preferred method as it is the only way to terminate also the sunset clauses that an agreement may contain.[248]

Terminating investment agreements is not unprecedented. As discussed earlier, the EU has already terminated intra-EU BITs and exited from the ECT as the ECJ held that they are incompatible with the law of the EU. Many countries have terminated investment agreements containing ISDS also unilaterally, which according to some research has not decreased flows of FDI to those countries.[249] New agreements have also been concluded without including ISDS. For example, the EU-Mercosur FTA lacks any dispute settlement mechanism – a decision to which criticism towards ISDS has supposedly had a considerable impact. Brazil has notably regarded international investment agreements negatively, and many Mercosur states have faced multiple human rights disputes, which has likely also contributed to the outcome. The problem with EU-Mercosur FTA and its omission of a dispute resolution

[245] Hallward-Driemeier 2009, p. 374.
[246] Poulsen 2010, p. 571.
[247] Camarero – Moliner – Tamarit 2025.
[248] Boyd 2023, paras 67–69.
[249] Public Citizen 2018, p. 2.

mechanism remains that some of the still-in-force international investment agreements between individual EU and Mercosur states include ISDS.[250]

## 5.4 Conclusion: the Future of ISDS in the EU

Studies have led to different, even opposite results, making it difficult to reach a convincing overall conclusion on whether investment agreements fulfill their intended purpose. Despite the conflicting evidence, the EU seems not to have doubted their essentiality.[251] The Commission, in particular, has been a proponent of investment protection and the ISDS. In a 2010 communication, the Commission stated that the EU's investment agreements should contain ISDS because it is "such an established feature of investment agreements that its absence would in fact discourage investors and make a host economy less attractive than others."[252]

More recently, the EU has however reacted to the increased criticism towards ISDS and attempted to reform the system. It withdrew from the highly controversial ECT and has improved the dispute resolution system in its new investment agreements, introducing a new Investment Court System. Carve-out clauses for protecting public policies and more precise language have also been included in these agreements to render decision-making more consistent, transparent, and objective. The ECJ has given green light to a new investment court in its Opinion on the CETA. According to the Court, it is because of the reciprocal character of international agreements and the EU's need to preserve its power in international relations, that the EU should remain free to conclude investment agreements that include such a mechanism.[253]

The EU has promoted the system of investment protection as an important part of attracting FDI to the member states, concentrating on reforms rather discussing the possibility of terminating the system. This thesis concludes that a discussion about the possibility of terminating ISDS – even in its improved forms – should be had in the EU. While the planned and implemented reforms improve some, especially procedural, problems of ISDS, multiple open questions remain. The EU's reforms materialise into action slowly, leaving the concrete results of many changes to be seen in the future, and implemented reforms elsewhere have

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[250] Duarte 2020, pp. 198–99.
[251] Fanou 2025, p. 278.
[252] The Commission 2010.
[253] Opinion 30 April 2019, C-1/17, EU:C:2019:341, paras 117–18.

produced varied results. Ultimately, foreign investors are still placed in a special position compared to anyone else, which is acceptable only if the system truly produces positive outcomes, not only to the investors themselves but to the overall public. In light of the conflicting evidence on investment agreements' ability to attract foreign investment, the justification seems feeble. Terminating ISDS would mean that foreign investors would have to follow the same path for legal remedies as everyone else, exhausting the domestic system before turning to international mechanisms. In the EU, the domestic systems are already relatively strong, and some scholars estimate that this could even encourage states to improve domestic legal systems where that is still needed to attract investment.[254]

If the EU ends up considering the termination of ISDS as too radical, the reforms should still be ambitious enough. Surya Deva and Tara Van Ho suggest that if states wish to establish a new mechanism to substitute ISDS, it should encompass eight qualities to be compliant with human rights: "equal, accessible, participatory, independent, diverse, coherent, transparent, and reviewable." The mechanism should give all affected parties the possibility to bring a claim and participate in the proceedings. The adjudicators should be permanently appointed and have expertise in different areas of law, including climate law. The principle of proportionality should be considered when deciding about the confidentiality of the proceedings. The applicable agreement should be interpreted in the context of the whole system of international law and not as a standalone framework.[255] In light of the criticism presented towards ISDS and the suggested reforms, these factors would likely enable considering climate commitments more effectively.

[254] Deva – Van Ho 2023, p. 429.
[255] Ibid., pp. 430–34.

# 6 Conclusions

This thesis has assessed the compatibility of ISDS with the EU's climate commitments – a topic relevant during times defined by both, the need for ambitious climate measures and concerned discussion about competitiveness. Investment agreements with ISDS provisions were first established between developed and developing states, to protect the developed states' investments in the areas of newly decolonised nations. The history of investment agreements already reveals that the system was created to protect Western states rather than all nations equally and investors' interests rather than the overall public good.

The first research question examined the legal framework and current status of ISDS in the EU. The thesis showed that while some of the EU member states were among the first proponents of investment agreements and ISDS, today's EU has recognised the various problems of ISDS and paved the way in reforming the system. The EU has exited from the ECT and terminated intra-EU BITs. It has aimed at implementing a new court system for settling investment disputes and incorporated improved dispute resolution provisions in its new investment agreements. The EU is moving away from the old ISDS system, attempting to substitute it with a system that addresses the criticism.

The second question assessed the kind of challenges that ISDS causes to the implementation of the EU's climate policy. It was shown that investors in the fields of fossil fuels and mining are relatively active in bringing ISDS claims against the EU member states. Currently, at least Germany is a party to an on-going ISDS process, to which it was challenged after enacting legislation to phase out coal. The various problems of addressing climate matters in ISDS were discussed, and it was demonstrated that a system that is meant to serve investor interests is not built to assess climate concerns. Tribunals' jurisdiction is limited to the text of the relevant investment agreement, potentially leaving arbitrators unbound by instruments of climate law. Even if bound by them, the wording of investment agreements tends to be broad, leaving tribunals with significant room for interpretation. There is a risk of this interpretation leading to harmful outcomes for the climate, as lawyer arbitrators have been found to practice double hatting, i.e. successively or simultaneously arbitrating one dispute and acting as an advocate for an investor in the next. Moreover, the confidential nature of ISDS prevents the public from being aware of the proceedings that, notably, concern public law and public interest.

The effect of ISDS on lawmaking was also examined. Namely, the regulatory chill hypothesis and proof of it in the climate and environmental context was analysed. Even though the causes of regulatory chill are difficult to ascertain, some instances of scaling back or postponing legislation from Denmark, France, and Finland were recognised. A particularly alarming example is that of *Vattenfall v. Germany*, in which Germany agreed to lower its environmental protection standards after being challenged to ISDS.

The findings regarding the conflict between ISDS and the EU's climate policy can be condensed into three points. First, ISDS became popular originally because it allows for a nonpolitical enforcement of investment protection in the sense that neither party's state court is involved in resolving the dispute. These days the combination of nonpolitical and ISDS may sound foreign since public policy concerns have become more common in the discussion regarding the system. Second, ISDS was allegedly established to enforce rule of law, especially in states where domestic legal systems were not considered stable enough but, deducing from the criticism on its insufficient transparency, consistency, and independence, seems to lack the essential features of the rule of law itself.[256] Proponents emphasise that ISDS cannot be initiated simply as a result of lost profits – but loss of profits resulting from fidelity to a state's commitments.[257] This is not an unproblematic justification for ISDS in light of the fact that breaches of the commitments are not straightforward to define. Third, green transition requires increased state funds to guide and support innovation and investment that enables carbon neutrality. Consequently, the idea of states compensating fossil fuel investors seems incongruous – these companies have capitalised on carbon-intensive activities at the cost of climate degradation for decades. This is in direct conflict with the most fundamental principles of environmental law, such as the polluter pays principle, that economists have deemed necessary to take into account in order to deal with the negative externalities of economic activities.

This thesis concentrated on the EU's climate policy. It should nevertheless be noted that the effects of ISDS on climate action are particularly detrimental in the Global South, demonstrating that the developed-developing state pattern, present in ISDS throughout its history, still holds true. According to a UN report, ISDS is expandingly being used to enforce

[256] Vastardis 2020, p. 617; Živković 2019, p. 551.
[257] James 2017, p. 208.

states' debt obligations, which compels states to prioritise these payments at the expense of other critical priorities, such as addressing the climate crisis.[258]

The last research question asked whether it is possible for the EU to reform ISDS to ensure consistency with its climate commitments. The ultimate assessment of this thesis is that ISDS and ambitious climate protection measures cannot coexist in the EU without an inherent contradiction. In selecting to transform ISDS instead of aiming at its termination, the EU inevitably chooses financial interest over larger public good. The EU has presented concerns over the threat of ISDS on climate policy as well as its deficit of transparency and objectivity, but has failed to assess the more deep-rooted contradiction: any type of dispute resolution mechanism explicitly available for foreign investors puts them in a unique position within the entire system of international law. It is reasonable to ask why they are entitled to these special rights, especially in light of the extremely divided evidence on whether ISDS promotes foreign investment and therefore truly serves a nation's public, which can be stated as the ultimate justification for any type of state measures.

In times characterised by the spreading of right-wing populism[259], which has been connected with undermining the importance of shared responsibilities and collaboration[260] and the weakening of climate regulation[261], we truly should be concerned about sustaining the rule of law: international law as well as efficient and well-built legal systems play a key role in responding to climate change.[262] There is, however, no evidence to prove that foreign investors, in specific, would not have sufficient access to effective legal remedies in the EU without ISDS.[263] The original justification for ISDS – possible bias against foreign investors in host state courts – cannot be considered a very convincing reasoning for carrying on with the mechanism. While some state courts may be partial, it seems very unlikely that foreign investors would be the only group to experience this, yet they are the only group to enjoy a special mechanism of dispute resolution. [264] All disputes should be heard before an independent court, whether the claimant is a foreign investor or a non-governmental organisation promoting climate action.

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[258] Boyd 2023, para 8.
[259] Halikiopoulou – Vlandas 1 June 2022.
[260] Carlarne 2020, p. 20.
[261] Preston 2019, p. 399.
[262] Carlarne 2020, p. 14; Sands 2016, p. 32.
[263] Vastardis 2020, p. 635.
[264] Vastardis 2020, pp. 634–35.

Fossil fuels still account for a large portion of the EU's energy use.[265] As it is inevitable to move away from them, fossil fuel investors are certainly going to be affected. This is the risk they must have considered when originally entering the particular field of business. As many ISDS provisions in investment agreements include sunset clauses, ISDS will likely continue to be used for many years to come, even if all agreements are terminated. Some kind of crisis management is hence crucial, in which regard the discussed reforms, such as promotion of third party participation rights and climate carve-outs can provide some aid. The risk is, nevertheless, that taking the trouble to establish these reformed mechanisms leads to another long-term mechanism, which turns out to be insufficiently competent in addressing climate concerns. Hence, if climate protection is truly among the EU's top priorities, it should urgently initiate a discussion about potentially terminating this method of dispute resolution, whichever exact form it will take place next.

[265] Eurostat 2026.