Veblen Institute for Economic Reforms

Unlocking the Investment Arbitration System to Phase Out Fossil Fuels

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The Veblen Institute for Economic Reforms is a non-profit think tank that advocates for public policies and civil society initiatives supporting the ecological transition.
It seeks to transform the current, deeply unsustainable economic model with a commitment to social justice and respect for planetary boundaries.

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Investment arbitration is increasingly recognized as an obstacle to the implementation of ambitious climate policies by states. This issue will be on the agenda of the "First Conference on Transitioning Away from Fossil Fuels", to be held in Colombia from 24 to 29 April 2026 and co-hosted by Colombia and the Netherlands[1].

In this context, and as part of the consultation on the Brazilian Presidency COP Transitioning Away from Fossil Fuels (TAFF) Roadmap[2], the Veblen Institute has prepared this brief to put forward several concrete proposals.

1. How does investment arbitration affect climate policy ?

The investment protection regime allows foreign investors, in particular, to challenge host states of their investment through an ad hoc Investor-State Dispute Settlement (ISDS) mechanism. Investors can trigger this mechanism if they believe that States have breached investment protection provisions contained in bilateral agreements by adopting measures that harm their interests. The amounts that investors may claim in disputes (if the outcome is in their favour) can be considerable. The very foundations of this regime call into question states' regulatory powers, particularly in the field of climate policy.

Legal protection for future stranded assets

An analysis by E3G published[3] in mid-2024 shows that **investment treaties protect around 2 gigatonnes (Gt) of CO_2-equivalent in potential greenhouse gas emissions each year**. Of these emissions, G7 countries are responsible for protecting 50% (1 Gt CO_2e) abroad, led by the United Kingdom, Japan, France, and the United States. A ranking of the ten investment treaties that protect the highest levels of greenhouse gas emissions through ISDS[4] shows the following:

- The Energy Charter Treaty (ECT) remains the most harmful to the energy transition, potentially protecting 319.7 $MtCO_2e$ per year.
- The Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) ranks second, with 164.9 $MtCO_2e$.
- Two bilateral agreements also feature among the ten most harmful treaties: the Kazakhstan/United States and Indonesia/Japan investment treaties.

Research published in Science has estimated that g**lobal action on climate change could expose governments to more than USD 340 billion in legal claims** from oil and gas investors in projects that have yet to start production.[5]

1 https://transitionawayconference.com/

2 Invitation to Submit Contributions to COP 30 Presidency Roadmaps, February 2026, Invitation to Submit Contributions to COP 30 Presidency Roadmaps | UNFCCC and COP30 Presidency Announces Consultations on Roadmaps

3 Jordan Dilworth and Eunjung Lee, E3G, Investment treaties are undermining the global energy transition. Mapping the global coverage of ISDS-protected fossil fuel assets, 31 July 2024, https://www.e3g.org/publications/investment-treaties-are-undermining-the-global-energy-transition/

4 Jordan Dilworth and Eunjung Lee, E3G, The Energy Charter Treaty remains the most dangerous investment treaty to the energy transition, Blog, 4 December 2024, https://www.e3g.org/news/the-energy-charter-treaty-remains-the-most-dangerous-to-the-energy-transition/

5 Kyla Tienhaara et al (2022) Investor-state disputes threaten the global green energy transition, Science.

Fossil investors are the primary users of ISDS

With ISDS, fossil fuel investors seek to delay or obtain substantial financial compensation against measures aimed at phasing out or stranding their assets:

- **The fossil fuel sector is the largest user** of investment arbitration, accounting for 20% of known cases, ahead of the extractive sector, which represents 11%[6].
- The majority of known cases have been decided **in favor of investors**.
- On the merits, investors have won in 72% of cases[7].
- **The average award in fossil fuel-related disputes** - over USD 600 million - is **nearly five times higher than in other sectors**[8].

Landmark examples

In Rockhopper v. Italy case, brought under the ECT (the most frequently invoked treaty), Italy's refusal to grant an oil exploration permit was found to constitute indirect expropriation, resulting in an award of more than €240. The company announced its intention to reinvest the compensation in the development of another oil project off the Falkland Islands[9]. Subsequently, Italy succeeded in having the award annulled on procedural grounds (because of the failure of one of the tribunal judges to disclose previous involvement in criminal proceedings). However, the investor refiled a new arbitration claim[10].

The Netherlands has also been targeted by claims following the adoption of a coal phase-out law[11] and more recently over the early termination of gas extraction in the province of Groningen[12].

For its part, **Slovenia** was challenged over its ban on hydraulic fracturing[13].

Regulatory chill

Beyond actual disputes, mere threats of claims — or governments' anticipation of potential litigation — can delay or weaken climate ambition. This phenomenon is commonly referred to as regulatory chill.

- Several governments, notably in Denmark, Germany, and New Zealand, have acknowledged that some of their recent decisions on phasing out fossil fuels were partly designed to minimise the risk of disputes[14].
- In France, the Hulot Law on Hydrocarbon Exploration was also subject to threats from the company Vermilion before the Conseil d'État.[15]

6 Investor-State Disputes in the Fossil Industry, IISD, Lea Salvatore, December 2021, https://www.iisd.org/publications/report/investor-state-disputes-fossil-fuel-industry
7 Ibid.
8 Ibid.
9 *Rockhopper v. Italy*, ICSID, Case ARB/167/14, Award of 23 August 2022 ; The Guardian, "Oil firm Rockhopper wins £210m payout after being banned from drilling", 24 August 2022 https://www.theguardian.com/business/2022/aug/24/oil-firm-rockhopper-wins-210m-payout-after-being-banned-from-drilling
10 https://www.iareporter.com/articles/meg-kinnear-is-tapped-to-chair-rockhopper-v-italy-resubmission-tribunal/
11 *RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands*, ICSID Case No. ARB/21/4 and *Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v. Kingdom of the Netherlands*, ICSID Case No. ARB/21/22
12 Bart-Jaap Verbeek, Shell files new arbitration against the Netherlands over Groningen gas field closure, SOMO, January 2026 https://www.somo.nl/shell-files-new-arbitration-against-the-netherlands-over-groningen-gas-field-closure/
13 *Ascent Resources Plc and Ascent Slovenia Ltd v. Republic of Slovenia* (ICSID Case No. ARB/22/21) https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/1252/ascent-v-slovenia
14 Cabinet Baldon, Regulatory chill, Note appended to the complaint lodged in June 2022 by five young climate victims with the European Court of Human Rights against twelve states for their participation in the ECT, https://www.exitect.org/sites/default/files/2022-06/Summary_Note_on_Regulatory_Chill.pdf
15 Le Monde, M Vaudano, Comment la menace d'arbitrage a permis aux lobbys de détricoter la loi Hulot, 4 September 2018, https://www.lemonde.fr/accord-commercial-europe-canada-ceta/article/2018/09/04/comment-la-menace-d-arbitrage-a-permis-aux-lobbys-de-detricoter-la-loi-hulot_6005132_4998347.html

2. Awareness raising in the international climate community

There is growing recognition of the incompatibility of the investment protection regime with the implementation of the Paris Agreement:

- **The IPCC** acknowledges that international investment treaties, particularly the ECT, constrain states' ability to adopt ambitious climate policies (see the Third Working Group report on Climate Change Mitigation, 2022[16]).
- **The UN Special Rapporteur on Human Rights and Environment,** David Boyd, has called on States to terminate, unilaterally or jointly, international investment treaties containing ISDS, warning of "the surge in ISDS cases filed by fossil fuel investors" using investment treaties, especially the ECT[17].
- In 2025, **the UN Special Rapporteur on Human Rights and Climate Change,** Elisa Morgera, published a report[18] titled The Imperative to Phase Out Fossil Fuels from Our Economies, highlighting the investor-state dispute settlement mechanism.
- **At the national level, the Haut Conseil pour le Climat,** in France, issued an opinion in October 2022 in favor of exiting the ECT[19]. Likewise, **the UK Climate Change Committee** noted in June 2023 that participation "in outdated treaties like the ECT risks delaying the low-carbon transition"[20].

The OECD has launched a discussion process aimed at revising investment protection policies in light of the Paris Agreement, in particular Article 2.1(c), which calls for aligning financial flows with climate objectives[21]. In this context, it conducted a survey on climate-related policies and practices that governments have implemented or are considering with respect to their investment treaties. Among the key findings:

- 78% of respondents consider it very important to align financial flows associated with investment treaties with Article 2.1(c) of the Paris Agreement.
- More than one-fifth (22%) of respondents report having received more than one threat of ISDS claims related to their climate policies, and acknowledge having repeatedly considered the risk of such claims when designing climate or environmental measures.

After several years of discussions, **the OECD Secretariat has put forward concrete proposals** to implement the exclusion of fossil fuel investments under existing agreements:

- **Fossil carve out :** A first proposal to exclude fossil fuel investments from the scope of protection of investment treaties[22].
- **Climate policy carve out :** A second, potentially complementary proposal to exclude climate policies from the types of state measures that can be challenged in disputes[23].

16 Part III of the IPCC's Sixth Assessment Report, "Climate Change 2022: Mitigation of Climate Change", April 2022, https://www.ipcc.ch/report/ar6/wg3/
On biodiversity, IPBES recently reached a similar conclusion, noting that multilateral trade and investment agreements can also make it more difficult for states to prioritise environmental health. See IPBES Transformative Change Assessment : Chapter 4. Overcoming the challenges of achieving transformative change towards a sustainable world, Avril 2025. (p.20)
17 Thematic report A/78/168: Paying polluters: the catastrophic consequences of investor-State dispute settlement for climate and environment action and human rights, 13 Juillet 2023, https://www.ohchr.org/en/documents/thematic-reports/a78168-paying-polluters-catastrophic-consequences-investor-state-dispute
18 See the press release and the report, De-fossilising economies key to course correction on climate change and human rights protection, says UN expert, OHCHR, 30 June 2025 https://www.ohchr.org/en/press-releases/2025/06/de-fossilising-economies-key-course-correction-climate-change-and-human
19 High Council for Climate, Opinion on the modernisation of the Energy Charter Treaty, 19 October 2022, https://www.hautconseilclimat.fr/publications/avis-sur-la-modernisation-du-traite-sur-la-charte-de-lenergie/
20 Climate Change Committee, 2023 Progress Report to Parliament, 28 Juin 2023, https://www.theccc.org.uk/publication/2023-progress-report-to-parliament/
21 9th Investment Treaty Conference - OECD, https://www.oecd.org/investment/conference-investment-treaties.htm
22 OECD Secretariat note on Methods to align investment treaty benefits for energy investment with the Paris Agreement and net zero, June 2024, https://one.oecd.org/document/DAF/INV/TR1/WD(2024)1/REV1/en/pdf
23 See for instance the proposal of Joshua Paine, Elizabeth Sheargold, A Climate Change Carve-Out for Investment Treaties, Journal of International Economic Law, Volume 26, Issue 2, June 2023, Pages 285–304, https://doi.org/10.1093/jiel/jgad011

The ICJ Advisory Opinion of July 2025[24] clarifies that States have binding legal duties to address climate change and protect the climate system. The Advisory Opinion acknowledges that ISDS can deter climate regulation and, citing the IPCC, notes that investment agreements may contribute to regulatory chill[25]. The opinion clarifies that States have stringent due diligence obligations to protect the climate system, including through regulation of fossil fuel production, licensing, and subsidies. As a consequence, **investment protection cannot override States' climate obligations and must be interpreted in harmony with international climate law**[26].

3. Possible avenues

States have several possible courses of action at their disposal, ranging from the most to the least ambitious:

- **Withdrawal from agreements, coupled with the neutralisation of sunset clause** through **coordinated action** among the parties
- **Adoption of explicit fossil fuel investment carve-outs,** as well as climate and human rights clauses in existing treaties.
- **Denial of access to arbitration for investors challenging fossil fuel divestment measures or bans** adopted in fulfilment of *erga omnes* climate obligations, as clarified in the ICJ Advisory opinion of 23 July 2025.

4. Actions taken by States

A frequent concern raised in discussions about reforming or terminating investment protection agreements is that such moves would be unprecedented, destabilising - all the more so in the current context of challenges to international law - or legally impractical. In reality, States have repeatedly demonstrated both the capacity and the willingness to withdraw from, or modernise international investment agreements (IIAs) when these no longer align with public policy objectives. Other States, such as **Brazil, have never ratified any investment agreement containing an ISDS mechanism**. And contrary to the arguments often put forward, there is **no clear evidence to suggest that ISDS is necessary to attract foreign direct investment**[27].

4.1. Examples of countries withdrawing from IIAs

After a period of exceptional proliferation in the number of BITs between 1980 and 2015, **the total stock of agreements started to decline for the first time in 2017 and continued to decrease regularly between 2019 and 2022**. This has no longer been the case since 2023.

The European Union itself provides a first and highly significant precedent. Following the Court of Justice of the European Union's Achmea judgment in 2018[28], **Member States agreed to terminate all intra-EU bilateral investment treaties (BITs)**. In 2020, 23 Member States signed a plurilateral agreement formally terminating these treaties and neutralising intra-EU ISDS mechanisms. This marked a systemic rollback of investor-state arbitration within the internal market.

24 International Court of Justice, 23 July 2025. Obligations of states in respect of climate change. https://www.icj-cij.org/sites/default/files/case-related/187/187-20250723-adv-01-00-en.pdf

25 See Judge Cleveland separate declaration, https://www.icj-cij.org/sites/default/files/case-related/187/187-20250723-adv-01-10-en.pdf

26 Lukas Schaugg, What Does the International Court of Justice Advisory Opinion on Climate Change Mean for International Investment Law?, IISD, March 2026 https://www.iisd.org/fr/publications/brief/icj-advisory-opinion-international-investment-law

27 Josef Brada, Zdenek Drabek, Ichiro Iwasaki, Does investor protection increase foreign direct investment ? A meta-analysis, September 2020, https://onlinelibrary.wiley.com/doi/10.1111/joes.12392

28 Slowakische Republik c/ Achmea BV, 2018

A second major example is the **coordinated withdrawal from the Energy Charter Treaty (ECT)**. After Italy in 2016, several EU Member States — Denmark, France, Germany, Lithuania, Luxembourg, Netherlands, Poland, Portugal, Slovenia, Spain — have announced or completed their withdrawal from the ECT, citing incompatibility with climate objectives and the risks posed by fossil fuel-related arbitration claims. In parallel, the European Union itself has withdrawn in June 2025. And in January 2026, the European Commission initiated legal action against 16 Member States that remain contracting parties to the ECT (Belgium, Bulgaria, Czechia, Estonia, Ireland, Greece, Croatia, Cyprus, Latvia, Hungary, Malta, Austria, Romania, Slovakia, Finland and Sweden). This represents a clear recognition that treaty-based fossil investment protection can conflict with energy transition goals.

Outside Europe, **the United States, Canada and Mexico fundamentally restructured their investment relationship when replacing NAFTA with the United States–Mexico–Canada Agreement (USMCA)**. ISDS between the United States and Canada was eliminated entirely. Investor–state arbitration was significantly curtailed even between the United States and Mexico, and limited to specific sectors and conditions.

This demonstrates that even deeply integrated economies can scale back ISDS when political consensus emerges.

Other examples include:

- **South Africa**, which **terminated several BITs** and replaced them with a domestic investment protection framework aligned with constitutional principles.
- **Indonesia and India,** which **have terminated or renegotiated numerous BITs** to rebalance investor protections and safeguard regulatory space.
- **Bolivia, Ecuador and Venezuela**, which **withdrew from the ICSID Convention** (even if these countries are currently rejoining ICSID).
- In 2022, **Australia** adopted a policy with a commitment to **exclude ISDS from any new treaty** and to reform existing ISDS mechanism. Australia is currently renegotiating treaties containing ISDS with several European countries.
- **Colombia**, which has just announced[29] that it will **withdraw from the ISDS system**, in response to a letter signed by 200 leading economists and academics[30] calling for a multilateral action to exit ISDS, **ahead of the First Conference on transitioning away from fossil fuels** in Santa Marta, in April 2026.

These examples illustrate that withdrawal of investment protection mechanisms is neither legally extraordinary nor economically prohibitive. It is a recognised sovereign choice.

29 Press release, Colombia to withdraw from the international investment arbitration regime; 23 March 2026 https://www.presidencia.gov.co/prensa/Paginas/Colombia-saldra-del-regimen-de-arbitraje-internacional-de-inversion-presidente-260325.aspx

30 Letter from 220 Economists and Legal Scholars to Colombian President Gustavo Petro Calling for Action on ISDS https://www.bu.edu/gdp/2026/03/19/isds-letter/

4.2. Examples of treaty reform limiting fossil fuel protection

States have also modified existing agreements to introduce safeguards that reduce the exposure of climate policies to arbitration.

The modernised Energy Charter Treaty text (although now largely overtaken by withdrawals) attempted to allow parties to exclude new fossil fuel investments from protection and to phase out protection for existing fossil assets over time. Initially, the EU and the UK[31] had made use of this option.

In its resolution of 23 June 2022 on the future of the European Union's policy on international investment[32], **the European Parliament** sets as an objective "*the exclusion of investments in fossil fuels or in any other activities that seriously harm the environment and human rights' from the scope of investments that benefit from legal protection*."

Similarly, some states have narrowed ISDS access by carving out sensitive sectors, even not necessarily for climate reasons. For instance, only investors in specific sectors (notably oil and gas, power generation, telecommunications, transportation, and certain infrastructure projects) retain access to ISDS between Mexico and the US **under the USMCA.**

While these reforms do not fully eliminate climate-related litigation risks, they show that treaty architecture can be recalibrated to align with decarbonisation pathways.

A relevant parallel: the OECD tax treaty reform

A useful comparison can be drawn with the evolution of international tax cooperation. For decades, bilateral tax treaties were based on exchange of information "upon request," a system that proved insufficient to combat tax evasion.

In response, states, under OECD leadership, developed the Common Reporting Standard, introducing automatic exchange of financial account information. Crucially, they adopted a multilateral convention — the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, complemented by the Multilateral Instrument — allowing signatories to **update large networks of existing bilateral treaties simultaneously** without renegotiating each one individually.

This plurilateral mechanism enabled the rapid and coordinated reform of thousands of bilateral agreements, fundamentally transforming global tax transparency standards.

The lesson is clear: when systemic risks become evident — whether tax evasion or climate-constrained energy transition — states can collectively modernise entrenched treaty networks through coordinated legal innovation.

Ending protection for fossil fuel investments is an essential prerequisite to ensure that taxpayers do not bear the excessive costs of the transition by compensating fossil fuel investors — often under valuation methods highly favourable to them — for public policies aimed at phasing out fossil fuels and managing stranded assets.

Such a withdrawal of protection does not prejudge the trajectory or pace of the fossil fuel phase-out, which may legitimately vary across countries depending on their level of development and degree of dependence on fossil fuels.

31 Yamina Saheb, Modernisation of the Energy Charter Treaty, Understanding what is at stake and what's next, 2022, https://www.openexp.eu/sites/default/files/publication/files/ect_understanding_what_is_at_stake_and_whats_next.pdf

32 European Parliament resolution of 23 June 2022 on the future of EU international investment policy (2021/2176(INI)) https://www.europarl.europa.eu/doceo/document/TA-9-2022-0268_EN.html