

# *Climate-friendly Reform of Bilateral Investment Treaties: Background, Current Situation and Approaches*

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**Abstract:** International Investment Agreements are an important vehicle for global climate governance, but their role is still not fully realized. The lack of protection of climate and relevant interests in the old-generation investment treaties hinders climate governance, and climate-friendly reform is urgently needed. At present, there exist a multitude of BITs in the world, and the old-generation treaties account for a huge proportion. Moreover, BITs have the characteristics of flexibility, pertinence, high efficiency, and clarity of legal binding. Compared with launching multilateral actions, the reform of BITs is an effective way to mitigate and respond to climate change at present, as well as an effective way to give consideration to the interests and responsibilities of the majority of developing countries. In the future, the reform should be guided by the core value of the concept of Sustainable Development and the concept of a Community with a Shared Future for Mankind, coordinate the environmental-social-governance (ESG) paradigm, and build a new treaty paradigm compatible with climate justice and investment protection based on Principle of Common but Differentiated Responsibilities, aiming to realize the balance between climate governance and investor interests.

**Keywords:** Bilateral Investment Treaties, climate-friendly reform, investor interests, regulatory right, Principle of Common but Differentiated Responsibilities

## **1. Introduction**

Climate change and climate governance have attracted global attention. In recent years, the relationship and interaction between climate governance and investment governance have been widely discussed in academic and practical circles. Under the sustainable development goals and the concept of a Community with a Shared Future for Mankind, International Investment Treaties (IIAs), as an enormously important part of investment governance, are becoming an important carrier to respond to climate change. However, climate governance also poses new challenges to IIAs. Due to the lack of concern for environmental protection, old-generation investment treaties have been unable to effectively respond to the urgent needs of climate governance. Therefore, IIAs reform is an important issue that the international community must face up to. What should be noticed is the fact that, in the slow progress of global climate negotiations and the US's withdrawal from the Paris Agreement and other events, IIAs reform is under great pressure, and the idea of promoting climate governance through multilateral treaties is difficult to realize. According to

Trends in the Investment Treaty Regime and A Reform Toolbox for the Energy Transition released by the United Nations Conference on Trade and Development (UNCTAD), by 2023, there had been more than 4,400 Bilateral Investment Treaties (BITs) in force worldwide, of which old-generation treaties signed before 2012 account for more than 88%. At the same time, bilateral treaties have the characteristics of flexibility, pertinence, high efficiency, fast implementation and clear legal binding force. Therefore, the reform of BITs can quickly respond to the urgent needs of climate governance, and effectively mitigate and face up to climate change. This paper takes BITs as the object to explore how to reform the old-generation investment treaties in the context of climate change, achieving a balance between climate governance and the interests of investors.

## **2. Shortcomings of the old-generation BITs in the context of climate change**

### **2.1. Value positioning imbalance and the absence of climate-related clauses**

The old generation of BITs have obvious problems of value positioning imbalance and the absence of climate-related clauses. From the perspective of value positioning, most of the old-generation treaties have an emphasis on economic interests. Since the 1980s, the bilateral liberalization investment treaties promoted by developed countries, in which the United States was the lead, namely United States Model BIT, have had a profound impact on global BITs. These old-generation treaties took advantage of the debt crises in developing countries, difficulties in attracting foreign capital, and the development of economic globalization, while ignoring the drawbacks and preventive measures of investment liberalization, attaching importance to investors' interests protection, weakening the jurisdiction of the host state [1], and overly pursuing economic interests while neglecting the protection of the host state's environment and human rights. With such value orientation, the old-generation treaties have a problem of the absence of climate-related clauses at the substantive level. The issue of climate change is more indirectly and implicitly covered under the sustainable development clauses or environmental protection clauses. However, practice has shown that when investment treaties do not explicitly mention climate change, arbitral tribunals generally will not actively apply the clauses of international climate change treaties and will not consider the global public welfare purposes of the host state's climate-related actions [2]. Therefore, host states face significant obstacles in promoting climate governance.

### **2.2. Imbalance of interests in international investment arbitration practice**

In existing international arbitration cases, environmental protection is often used as a defense reason by the host state. For example, in the case *TransCanada v. The United States*, the US government refused to approve TransCanada's plan to build the Keystone XL project due to environmental issues. TransCanada submitted an arbitration request to the International Centre for Settlement of Investment Disputes (ICSID). The company argued that because the Obama administration's decision on whether to grant a presidential permit for the Keystone XL pipeline was "politicized", the US government violated the provisions regarding national treatment, most-favored-nation treatment, and minimum standards, and its actions amounted to confiscating the company's property entitled to compensation. Later, after the Trump administration overturned the decision to deny the presidential permit, the arbitration request was withdrawn. However, in arbitration cases where the host state used environmental regulatory measures as a defense reason, the number of times the host state's defense was rejected is significantly higher than the number of times it was supported [3]. Moreover, the arbitral tribunal's arbitrary interpretation of treaties is very prominent [1]. This poses

a potential threat to reasonably protecting the host state's interests in climate-governance-related international investment arbitration cases.

### 2.3. Brief summary

Shortcomings of the previous generation of BITs have placed the host state in a very disadvantageous position. For one thing, they are with the obligations to protect human rights and environment under international and domestic laws, by conducting measures like legislation; for another thing, the obligation of protecting the foreign investors' interests is also what they must assume. Nevertheless, these obligations often meet conflicts, which leads to the "chilling effect" of regulation — the high risk of compensation forces the host state not to implement investment regulation, thereby delaying or weakening climate policies. Research has pointed out that the fossil fuel industry is what has been most prone to litigation among all ISDS cases, with investors winning 72% of the cases and the average compensation amount being nearly five times higher than that of non-fossil fuel cases [4]. In conclusion, the investment treatment clauses, the expropriation clauses, the umbrella clauses, and the investment liberalization clauses have already had adverse consequences and threats for the host state to achieving international-investment-associated values of human rights and environmental protection [1]. Therefore, the reform of BITs is imperative.

## 3. Current situation of climate-friendly reform in BITs

From an international perspective, the climate-friendly reform of BITs has shown initial progress, but it is still in the exploratory stage overall. The BITs, represented by US Model BIT (2004), included environmental protection clauses, but they only had declaratory content and did not set specific rights and obligations. Currently, BITs' environmental clauses have shifted from generalization to specificity [5]. According to Trends in the Investment Treaty System and the Toolkit for Energy Transition and Climate Action Reform, the investment treaties concluded between 2012 and 2022 related to energy transition and climate action included provisions such as setting climate or environmental issues as exceptions to expropriation clauses, clarifying the regulatory right of the host state, and setting climate or environmental issues as exceptions to investment treatment (see Figure 1, produced by the author based on the Investment Treaty Regime Trends and Energy Transition Reform Toolbox published by the UNCTAD). UNCTAD 2023 World Investment Report also pointed out, "IIAs signed since 2020 feature many reformed provisions aimed at safeguarding states' right to regulate and reforming ISDS. In light of emerging interpretations of reformed provisions in investment treaty arbitration cases, it remains to be seen whether they are sufficiently robust to support and not hinder countries' implementation of legitimate measures and their efforts towards achieving the SDGs." The emergence of these new clauses indicates that IIAs are gradually changing in a climate-friendly direction.

In general, the new generation of BITs or Model BITs has made significant progress in terms of climate provisions, with provisions on climate governance declaration in the preamble, dedicated climate governance provisions, and other directly relevant clauses on climate governance.

### 3.1. Climate governance declaration provisions in the preamble

The climate governance declaration clauses in the preamble emphasize either emission reduction commitments and sustainable development goals, or environmental regulation right of the host state, or the balance between investment protection and climate interests. For example, the preamble to

China-EU Comprehensive Agreement on Investment explicitly reaffirms the commitment of the parties to tackle climate change and the autonomy to regulate public policy objectives such as addressing climate change within their territories.

### 3.2. Dedicated climate governance provisions

The dedicated climate governance provisions stipulate cooperation in mitigating and responding to climate change, including cooperation in the field of carbon trading and climate investment policies. They also stipulate specific procedures and mechanisms for the cooperation in implementing climate action policies, such as the establishment of joint commissions, joint dialogue mechanisms, climate action consultations and expert groups. Typical examples include UK-Moldova Strategic Partnership, Trade and Cooperation Agreement (2020) and Angola-EU Sustainable Investment Facilitation Agreement (2022).

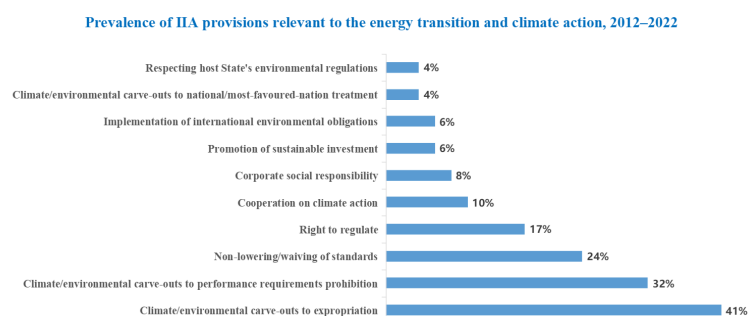


Figure 1. The chart shows IIA provisions related to energy transition and climate action concluded between 2012 and 2022

### 3.3. Other provisions directly related to climate governance

From the perspective of the whole investment process control, other provisions directly related to climate governance include investment access and climate-friendly investment promotion provisions, regulatory right provisions, exception provisions, investor responsibility provisions, etc.

#### 3.3.1. Investment access and climate-friendly investment promotion provisions

Investment access and climate-friendly investment promotion clauses focus on the positive or negative effects of investment projects on climate governance, and their main role is to restrict climate-unfriendly investment and promote climate-friendly investment. Article 1 (1) of UAE-Greece BIT (2014) and Article 1 (a) of Japan-Arabia BIT (2018) distinguish the protection of different types of investments. Article 24.9 (2) of Canada-EU Comprehensive Economic and Trade Agreement (2016) stipulates the obligation of parties to remove investment barriers related to climate change mitigation. Chapter 4 of China-EU Comprehensive Agreement on Investment includes a separate section entitled “Investment and Climate Change” to ensure that parties fulfill their commitments to achieve climate goals and nationally determined contributions, and promote investment related to climate change mitigation and adaptation. Article 16.5 (c) of EU-Japan Economic Partnership Agreement (2018), Article 16.5 (c) of UK-Japan Comprehensive Economic Partnership Agreement (2020), and Annex 10-A of Chapter 10 and Article 19.11 of Annex 19 of Chapter 19 of EU-New Zealand FTA (2023) lay the foundation and facilitate the promotion and support of climate-friendly investment.

The Environmental Impact Assessment (EIAs) provision is also a new type of provision on investment access in the new generation of investment treaties. For example, Article 14 of Morocco-Nigeria BIT (2016) states, “Investors or the investment shall comply with environmental assessment screening and assessment processes applicable to their proposed investments prior to their establishment, as required by the laws of the host state for such an investment or the laws of the home state for such an investment, whichever is more rigorous in relation to the investment in question.”

It is worth pointing out that the climate-friendly investment promotion provisions in the new generation of BITs take various forms. For example, Article 9 of Canada-Guinea BIT (2015) and Article 10.7 of Korea-Chile FTA (2003) stipulate that “measures requiring the use of a certain technology to meet generally prescribed environmental requirements” do not constitute a violation of the requirement to prohibit technology transfer, which to some extent creates favorable conditions for climate governance or the transfer of climate-friendly technologies.

### 3.3.2. Regulatory right clause

The regulatory right clause stipulates that the host state retains the power to formulate or adjust domestic laws and regulations to safeguard public interests, including environmental protection, public health, and national security. The regulatory right can give the host state space to implement climate policies and allow its regulation of foreign capital to deviate from the investment protection obligation in the investment treaties, which can be a legal defense reason the host state can invoke in investment arbitration [6].

Article 2(2) of Netherlands model Investment Agreement (2019), Article 13.8 of Australia-UK FTA (2021), Article 3 of Canada’s 2021 Foreign Investment Promotion and Protection Agreement (FIPA) Model, Article 1(2) of Angola-EU Sustainable Investment Facilitation Agreement (2022), and Article 10.1(2) of EU-New Zealand FTA (2023) directly stipulate the host state’s regulatory right , including protecting the environment and coping with climate change. Article 2(2) of Netherlands model Investment Agreement (2019) states, “The provisions of this Agreement shall not affect the right of the Contracting Parties to regulate within their territories necessary to achieve legitimate policy objectives such as the protection of public health, safety, environment, public morals, labor rights, animal welfare, social or consumer protection or for prudential financial reasons. The mere fact that a Contracting 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 expectation of profits, is not a breach of an obligation under this Agreement. ” Although climate change is not directly mentioned, it indeed made specific provisions regarding the rights of the host country in terms of environmental governance. Article 3 of Canada’s 2021 Foreign Investment Promotion and Protection Agreement (FIPA) Model makes a direct reference to climate change, stating, “The Parties reaffirm the right of each Party to regulate within its territory to achieve legitimate policy objectives, such as with respect to the protection of the environment and addressing climate change; social or consumer protection; or the promotion and protection of health, safety, rights of Indigenous peoples, gender equality, and cultural diversity.”

It is worth mentioning that, in some investment treaties, provisions related to environmental protection have explicitly stipulated exemption clauses related to environmental protection in the MFN treatment clause, fair and equitable treatment clause, and indirect expropriation clause, in order to limit the application scope of such clauses and leave room for the host state to reasonably and legally exercise its regulatory rights. For example, Article 5 of Burkina Faso-Turkey BIT (2019) states, “Nothing in this Agreement shall be interpreted as preventing a Contracting Party from

adopting, maintaining or applying non-discriminatory legal measures: (a) designed and applied for the protection of human, animal or plant life or health or of the environment; (b) relating to the conservation of exhaustible natural resources, living or non-living.” Article 3 of Annex 8-A of Canada-EU Comprehensive Economic and Trade Agreement (2016) stipulates that, “For greater certainty, except in the rare circumstance when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations.”

### 3.3.3. Exception clause

The exception clause matching the regulatory right clause is also an important basis for realizing the effective exercise of the regulatory right. Exceptions related to climate change contain general exceptions and expropriation exceptions. Article 32.1 of UK-New Zealand FTA (2021) clearly stipulates that measures to mitigate climate change are included in environmental measures under the general exception clause. Article 33 of China-Canada BIT (2012) provides that “Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Contracting Party from adopting or maintaining measures, including environmental measures.....”, which also indirectly provides exemptions for climate governance measures’ implementation. The provisions on the exaction exception can be found in Article 6.3 of China-Uzbekistan BIT (2011), Article 4 of Annex B of United States Model BIT (2012), and Article 3 of Annex 8-A of Canada-EU Comprehensive Economic and Trade Agreement (2016) and other treaties or model treaties. If the preconditions of due process and timely, adequate and effective compensation are met, the non-discriminatory regulatory measures designed and adopted by the host state to achieve legitimate social and public welfare goals, involving environmental protection, will not be considered to constitute indirect expropriation. This, to some extent, alleviates the potential threat posed by investment protection obligations to the host state’s achievement of emission reduction targets [7].

### 3.3.4. Investor responsibility clause

As the direct implementers of transnational investment, it has gradually become a consensus that investors should undertake corresponding environmental protection obligations and promote carbon reduction obligations. Corporate social responsibility (CSR) guidelines have been incorporated in more and more new-generation BITs or Model BITs, such as Brazil Cooperation and Facilitation Investment Agreement (2015), which details that investors should abide by CSR principles and standards including “contributing to economic, social and environmental progress to achieve sustainable development”. Article 5.7 of Angola-EU Sustainable Investment Facilitation Agreement (2022) stipulates that investors must identify and address adverse impacts on environmental and labour conditions in their operations, supply chains and other commercial relationships by using UN Guiding Principles on Business and Human Rights, UN Global Compact, OECD Guidelines for Multinational Enterprises and relevant due diligence guidelines, so as to urge enterprises and investors to assume corporate social responsibility and promote sustainable development and responsible investment.

### 3.4. Summary

The overall trend of climate-friendly reform in BITs is to make climate governance a clear issue, with clear provisions to support climate-friendly actions and regulate behaviors that are not conducive to combating climate change. The new generation of BITs or model treaty takes climate provisions as an important and clear content. Whether it is to reaffirm carbon reduction commitments in the preamble or emphasize rights and obligations of parties in climate governance, or to implant climate governance into various entity rules to form dedicated climate provisions, they are beneficial attempt to make climate-friendly transformation of the value orientation and entity rules of the old-generation treaties. It is worthy of critical inheritance in the future reform process.

However, it is worth noting that from the perspective of existing reform, on the one hand, due to the huge proportion of BITs in the IIAs system, the current reform has obvious characteristics of decentralization and individualization, and has not become a global systematic project; on the other hand, the reform is fragmented in content, only focusing on climate change in individual provisions, and the specific provisions on climate change are very limited, lacking the overall and specialized provision design. Moreover, the wording of many clauses is declarative and persuasive, without setting clear rights and obligations and lacking punishment mechanism for violating obligations [2]. UNCTAD 2023 World Investment Report also points to problems with the new generation of treaties, such as “Existing old-generation IIAs are insufficiently attuned to ensure an effective energy transition from high- to low-carbon economies. New IIAs fare relatively better by safeguarding states’ right to regulate but remain weak in incorporating specific provisions relevant to sustainable energy investment and the energy transition.”

From the reality of reform, due to “innate factors” such as differences in national resource endowments and “acquired factors” such as differences in economic development and cultural differences, there are obvious differences in the ability and willingness of different countries to contribute to climate governance. Developing countries, in particular, face technical obstacles in the formulation and application of climate change regulation provisions, and may also face the challenge of insufficient capacity to deal with climate investment disputes [8]. In addition, international investment principles such as MFN treatment, national treatment and fair and equitable treatment also hinder climate governance to a certain extent, and investors often use such principles as a defense against climate governance measures in host states.

As climate change threatens the survival of humans and other species, it is urgent to mitigate and respond to climate change. BITs, as an important carrier of global investment governance and climate governance, is an issue that the international community must face up to. Two key issues are worth thinking about: firstly, how to better coordinate climate governance and investment protection, achieve a balance between climate governance and investors’ interests, and try to reduce the occurrence of investment disputes; secondly, how to promote climate-friendly investment to effectively address climate change while achieving economic benefits.

### 4. Future direction of BITs reform

In fact, scholars at home and abroad and relevant international organizations have paid attention to the reform of investment treaties, among which the research on climate-friendly reform is constantly advancing. At the same time, some countries or economies have begun relevant attempts, which have also been shown above. However, “despite the fact that some states have begun to reform their international investment agreements in light of climate change, there are still many shortcomings to be addressed” [9]. This paper argues that the climate-friendly reform of BITs is essentially a

deconstruction and reconstruction of the traditional benefit distribution and protection mechanism, which requires a systematic reform promoted by the two aspects of intrinsic value orientation and external clause design. That is to support and encourage climate-friendly actions, as well as regulating and reducing climate-unfriendly behaviors, so as to return the balance between climate governance and investors' interests. The article will attempt to make recommendations for the future of climate-friendly reform of BITs by combining existing research results and practice.

#### 4.1. Value-oriented transformation of BITs

Value orientation is the core logic basis of BITs, and also the “general command” of the formulation of provisions. Therefore, in order to reconstruct the traditional benefit distribution and protection mechanism, and achieve the balance between climate governance and investors' interests, the future reform of BITs should be guided by the core value of the concept of Sustainable Development and the concept of a Community with a Shared Future for Mankind, promoting, encouraging and supporting host states and investors to actively handle climate change from the standpoint of long-term human development. The two concepts are the two core frameworks of today's global governance and should serve as the conceptual engines for climate-friendly reform of BITs.

The core of the concept of Sustainable Development is around the intergenerational equity and the systematic coordination of the economic, environmental and society. From being proposed in the World Conservation Programme in 1980 and clearly defined in Our Common Future Report in 1987, to global consensus and institutionalization, deepening and target upgrading, and to the establishment of implementation and monitoring system today, the concept has become a systematic framework covering global governance, national strategy, economic transformation, scientific and technological innovation, and social and cultural change. In terms of international investment, it is “a comprehensive and holistic transformation process including resource development, investment direction, technology development direction and institutional reform” [10]. Therefore, in the process of the reform, BITs should change the value imbalance in old-generation treaties and concentrate on the coordination of sustainable development goals, investment liberalization and facilitation, and protection of investors' interests.

The concept of a Community with a Shared Future for Mankind is an epoch-making new wisdom and solution provided by China to solve the problems of global governance. This proposition represents a new perspective on international cooperation and international order and a new concept of development, security and civilization [11]. The concept focuses on reconstructing the ethics of international relations, advocating “extensive consultation, joint contribution and shared benefits” and breaking the zero-sum game mentality. In terms of global climate change governance, the idea is both the logical starting point and the theoretical basis [12]. The concept requires BITs to pay attention to and effectively safeguard climate interests, a global interest. At the same time, based on historical fairness and national governance capacity, it is required that major countries take the initiative to shoulder international responsibilities in terms of climate governance, and do not harm the interests of other countries through investment treaties.

On the basis of value-oriented reform, the future generation of treaties should continue to develop declarative provisions on climate governance in the preamble, such as emphasizing participation in climate governance, achieving emission reduction commitments and sustainable development goals, emphasizing the balance between investment protection and climate interests, and stressing the host states right to environmental regulation. Although the preamble itself is not legally binding, it can set the general climate friendly tone of the treaty and provide reference for the interpretation of the purpose of the treaty [13]. Explicit consideration of climate change policy objectives in the preamble

can guide dispute settlement bodies to interpret investment treaties in the spirit of protecting global climate interests and respecting the host state's climate governance regulatory right, and clarify that regulatory changes required to respond to the climate emergency are not in violation of investment treaties [2].

#### **4.2. The formulation of Model BITs and the construction of climate governance cooperation mechanisms**

The formulation of Model BITs can not only improve the efficiency of international cooperation and promote investment flows, but also effectively indicate the position of a state or economy on climate governance, clarify the climate governance standards and relevant investment promotion and control measures adopted based on its own situation and scientifically coordinate the domestic legal system and international rules related to climate governance, laying the groundwork for treaty negotiations. More important, it is possible to build a new treaty paradigm that is compatible with climate justice and investment protection based on the Principle of Common but Differentiated Responsibilities (CBDR). On the one hand, the number of BITs is huge. On the other hand, due to differences in national conditions and the the Principle of CBRD, the cornerstone of balancing global environmental justice and development, different countries have different degrees of climate governance obligations. By developing Model BITs, countries can clarify their specific climate governance obligations under current circumstances and future treaty revisions can be facilitated. In order to promote climate governance cooperation and effectively respond to future changes and treaty revisions, the future generation of investment treaties can set up specific procedures and mechanisms for the cooperation between countries to implement national climate action policies.

#### **4.3. Distinguish between climate-friendly investments and climate-unfriendly investments in BITs**

Distinguishing between climate-friendly and climate-unfriendly investments can make it convenient to set different measure provisions for the two. Specifically, on the one hand, energy transition plays a fundamental role in achieving climate goals, and energy transition is bound to require the elimination of fossil energy and the promotion of clean energy. 2022 OECD Public Consultation on Investment Treaties and Climate Change states that current international investment treaties are inadequately prepared to meet the demand for decarbonization. This mainly lies in the fact that these treaties fail to distinguish between the protection standards for high-carbon emission investments and climate-friendly investments. On the other hand, reducing greenhouse gas emissions and promoting the energy transition need to guide investors to mobilize their capital and technology towards low-carbon sectors and industries, and UNCTAD Policy Summary on International Investment Treaties and Climate Action points out that investment treaties need to do more to promote, facilitate and protect low-carbon investment. Therefore, the future generation of BITs needs to distinguish the nature of investment, protect and promote climate-friendly investments, and reduce the protection level of climate-unfriendly investments. Specifically,

First, develop definition clauses that clearly distinguish between climate-friendly and climate-unfriendly investments [2];

Second, set terms of climate-friendly investment promotion from the angle of whole process of investment, including preferential access treatments and subsidies terms, access process facilitation terms, climate-friendly technologies (clean technology, energy-efficiency-improvement techniques) transfer support terms, climate-friendly technological innovation support terms, etc.;

Third, reduce climate-unfriendly investment protection level (details will be discussed below);

Fourth, formulate legitimacy support terms to offer climate-friendly investment preferential treatments and reduce protection level of climate-unfriendly investment. The doctrine of Police Power in customary international law allows states to be exempted from liability for measures taken for legitimate public purposes that have a significant impact on investment. Therefore, future BITs can imitate the exemption clauses concerning environmental protection proposed in the MFN clause, the FET clause and the indirect expropriation clause mentioned above, and stipulate that “differentiated measures to protect investors on the basis of carbon emissions are within the scope of legitimate public purposes, and thus climate measures adopted do not violate the non-discrimination requirement”.

#### **4.4. Balance between climate governance regulatory right and investment protection in BITs**

##### **4.4.1. Clarify the host state’s climate governance regulatory right and its reasonable scope of exercise**

The future-generation BITs needs to clarify the host state’s climate governance regulatory right by listing the regulatory right clause with the word “climate governance”, so as to positively confirm the host state’s climate governance regulatory right to fulfill international obligations and safeguard climate interests. Also, the obligation clause of the host state should be improved. As is mentioned above, clauses on the obligations of host states, such as national treatment and MFN treatment, are often used by investors as their own defense reasons, which actually reflects the incompatibility between these clauses and the needs of climate governance. Therefore, the future reform should pay attention to such issues as the explanation of “similar circumstances” in national treatment, the clarification of the conditions for granting MFN treatment, the clarification of the application scope of fair and equitable treatment, and the exemption of the host state’s reasonable exercise of regulatory right in indirect expropriation. In addition, climate factors should be embedded in these clauses to ensure the effective and reasonable exercise of the regulatory right.

##### **4.4.2. Focus on environmental impact assessment**

The environmental impact assessment system with “prevention first” at its core serves as a “balancer” for coordinating development and protection, capable of avoiding the passive situation of “polluting first and treating later”, and reducing environmental damage from the source. Domestic environmental laws generally have provisions on environmental impact assessment, and this practice can be extended to international law, especially in the formulation of investment treaties. Formulating pre-access and post-access environmental impact assessment provisions and clarifying the rules for assessment can effectively grasp the climate friendliness of investment projects, and also force enterprises that hope to invest to carry out technological innovation, thereby promoting climate governance.

##### **4.4.3. Formulate climate exception clauses**

The climate exception clauses are effective to ensure that the host state exercises its regulatory right and fulfills its climate governance obligations. The clauses can further promote the growth of green investment and technology, narrow the scope of obligations related to investment treaties in host states, and are specific requirements for climate-friendly reform to actively pursue sustainable

development. They are also an important way to reconcile investors' private interests with the climate protection interests of host states [7].

In the future reform, general exception provisions for climate governance can be formulated, and attention should be paid to clearly excluding liability for compensation. Some scholars have also put forward higher requirements — adding climate security exception clause into the national security exception clause [14], that is, in specific circumstances, for the climate security interests of the state or region, allowing parties to take necessary measures such as greenhouse gas reduction or industrial structure adjustment when responding to climate change and climate risks, even if such measures may conflict with the protection of investors' interests and impose certain restrictions or adverse effects on investment [15]. At present, there is controversy over whether climate governance can reach the level of safety exception. There is no consensus yet on whether to stipulate climate governance-related matters through the general exception clause or the safety exception clause. This paper holds that, given that it is still undetermined whether climate change can constitute safety exception, the general exception clause can be temporarily used to stipulate climate governance matters. This can at least provide a certain basis for the arbitration tribunal's interpretation and avoid causing major disputes.

#### **4.4.4. Attach importance to formulating climate governance responsibility clauses for investors**

In international investment, investors are the main body that makes investments and generates carbon emissions. Under the new value orientation, investors should also become participants in climate governance. Moreover, investors are also beneficiaries of climate governance. Therefore, in order to achieve the coordinated advancement and effective implementation of climate governance, and to coordinate with ESG investment governance, it is highly necessary to incorporate climate governance into the investor social responsibility clause. Firstly, on the basis of the existing CSR provisions, the climate protection responsibilities of investors should be clearly defined, and a corresponding feedback mechanism should be established to supervise the fulfillment of investors, effectively promoting them to practice the principles of sustainable and responsible investment. Secondly, the fulfillment of an investor's CSR can also be linked to the treatments and protection they enjoy, and the investor's behavior can be taken into account as a factor in the application of investment treatment and protection terms [16]. Furthermore, it is also possible to consider granting the host state the right of counterclaim. When investors fail to comply with relevant obligations, the contracting party may file a counterclaim, demanding damages or other remedies [7]. In this regard, Article 14.3 of Islamic Republic of Iran-Slovakia BIT (2016) has already put this into practice.

#### **4.4.5. Quantify the impact of climate policies on investors' expected returns and establish a dynamic compensation mechanism**

Although the reform needs to expand the host state's right to a certain extent, it must pay attention to the balance between climate governance and the interests of investors. Existing studies have revealed the institutional predicament and reform direction of BITs in the context of climate change, but there are still deficiencies in how to quantify the impact of climate policies on investors' expected returns and establish a dynamic compensation mechanism. This paper holds that, due to the large number of countries and economies, adjustments to climate policies may have an impact on investors at any time, and the frequency of climate policy adjustments is also difficult to predict at

present. Therefore, the future generation of BITs should make the following efforts through the approach of “quantitative assessment + dynamic compensation + classified treatment” .

In terms of quantifying the impact of climate policies on investors’ expected returns, first, clarify the public interest attribute of climate policies; second, establish a climate risk assessment framework, including the direct impact of climate policies on operating costs, changes in market demand caused by policies, and depreciation of asset values (such as depreciation losses from the early retirement of high-carbon assets due to policy restrictions); third, establish a climate policy-investment impact assessment mechanism.

In terms of the construction of a dynamic compensation mechanism, first, set the trigger conditions for compensation and clearly state that compensation is applicable to “significant losses in investors’ expected returns due to policy adjustments in line with international climate goals that are not due to their own business operations”. Second, set the basic compensation amount based on the “fair market value”, add dynamic adjustment factors and adjust the compensation ratio according to the implementation effect of the climate policies, and set a policy notification period to clarify the “predictability” of policy adjustments. Third, based on the advance notice period for policy adjustments, set compensation gradients, such as 20% compensation during a five-year buffer period, 35% compensation during a three-year buffer period, and over 50% compensation for emergency policies.

At the same time, based on the distinction between climate-friendly investment and climate-unfriendly investment, differentiated compensation threshold amount and compensation proportion should be set for the two, and it is of necessity that incentive compensation funds be established to support investors to participate in climate governance through low-carbon technology innovation and other means. In this way, climate-friendly investments can be better attracted and the transition or exit of climate-unfriendly investments can be gradually promoted.

## 5. Conclusion

It is an undeniable fact that climate change is a global concern. As an important vehicle of global climate governance, the role of IIAs has yet to be fully exerted. The old-generation investment treaties lack protection for climate and relevant interests, and it has become an international consensus to carry out climate-friendly reform of them.

BITs reform, at present, is an effective way to mitigate and respond to climate change, and it is also an effective way to give consideration to the interests and responsibilities of the majority of developing countries. Future reform should make efforts in aspects like value orientation, formulation of Model BITs, effective exercise of climate governance regulatory right, and investor responsibility, supporting and encouraging climate-friendly actions, as well as regulating and reducing climate-unfriendly behaviors. In general, it is necessary to take the concept of Sustainable Development and the concept of a Community with a Shared Future for Mankind as the core value orientation, coordinate ESG investment governance, and form a new treaty paradigm compatible with climate justice and investment protection based on the Principle of CBDR, realizing the balance between climate governance and investor interests. The international community should also make full use of the IIAs reform platforms initiated by the UNCTAD, ICSID and UNCITRAL Working Group III to strengthen dialogue and cooperation, so as to accelerate the modernization and climate-friendly reform of investment treaties.

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