REGULATORY CHILL IN ENERGY SECTOR: BALANCING INVESTOR PROTECTION AND STATE SOVEREIGNTY

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ABSTRACT

The accelerating global energy transition has increased tension between investor protection and State sovereignty within international investment law. As governments implement climate and decarbonization policies, the prospect of investor-State arbitration under investment treaties increasingly impacts regulatory behavior-a phenomenon termed regulatory chill. This paper examines how the doctrinal expansion of fair and equitable treatment and indirect expropriation standards, combined with the institutional fragmentation of investor-State dispute settlement, generates uncertainty that deters robust environmental regulation. Drawing upon leading cases such as Vattenfall v Germany, Charanne v Spain, and Rockhopper v Italy, the analysis shows that arbitral interpretations of stability and legitimate expectations can transform lawful climate regulation into compensable breaches, thus constraining States' ability to pursue energy transition policies.

Introduction

Energy policy has been moved to a very prevalent position of international economic law, by virtue of the recent global trends shifting towards decarbonization. There is an increase in the number of nations which are undertaking stricter measures to reduce their dependency on fossil fuels, further incentivize the use of renewable energy over non-renewable sources, and to comply with obligations under the Paris Agreement. These regulatory actions can't be observed in a silo and must be analyzed in light of their intersection with investment law, especially in energy sectors where there is a dominant presence of foreign capital. The investor-state dispute settlement (ISDS) mechanism, while initially championed as a stabilizing agent for cross-border investment, has now been challenged by many as a constraint on legitimate public regulation by a sovereign authority. This "constraint" or so-called *regulatory chill* refers to the possibility that states may tend to delay, dilute or altogether abandon regulatory measures solely to avoid triggering potentially costly arbitration claims by foreign investors.[1]

The very existence of a notion of a "regulatory chill" is a preview of a crisis regarding legitimacy within the field of investment arbitration.[2] Susan Franck posits that the privatization of aspects of public international law through inconsistency in arbitral awards diminishes the predictability and takes away from the fairness of the ISDS.[3] Especially in the context of the energy sector, where governments must balance various considerations such as protecting the environment, security of supply and must also manage the expectations of foreign investors, this gap in legitimacy is all the more important. High-value investment arbitration awards such as *Occidental Petroleum v Ecuador*[4] and *Yukos Universal v Russian Federation*[5] display that the financial repercussions and reputational consequences of arbitral proceedings can have a profound influence on subsequent regulatory actions by the State.

The universality of the regulatory chill effect has been brought into question by recent empirical research. Guillermo Garcia Sanchez's piece *Defrosting Regulatory Chill* finds out that the possibility of arbitration may play a role in regulatory timing, evidence of a systemic chill is context dependent.[6] Regulatory chill occurs most frequently amongst states possessing weak

[1] Kyla Tienhaara, *Regulatory Chill in a Warming World* (2011) 10(3) *Transnational Environmental Law* 1.
[2] Susan D Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration' (2005) 73(4) *Fordham Law Review* 1521.
[3] ibid 1523–24.
[4] *Occidental Petroleum Corporation v Republic of Ecuador* (ICSID ARB/06/11, Award 5 October 2012).
[5] *Yukos Universal Ltd (Isle of Man) v Russian Federation* (PCA Case No AA 227, Final Award 18 July 2014).
[6] Guillermo J García Sánchez, *Defrosting Regulatory Chill* (2024) (forthcoming manuscript) 5.

fiduciary capacity or policy frameworks which might be inconsistent.[7] The transition to decarbonization is an ideal case study, as this sector has various factors which play a key role, namely the extensive foreign investment combined with multiple political pressures to begin the process towards phasing out carbon-intensive assets.

This paper argues that ISDS jurisprudence and arbitral awards have created a verifiable chilling effect on States' energy-transition policies by affording more protection to investors under the doctrines of fair and equitable treatment and indirect expropriation. Through an analysis of arbitral decisions, developments in relevant legal doctrines and proposals for reform, the paper seeks to question whether these innovations are capable of reconciling investor protection with state sovereignty in the context of climate governance.

Literature Review and Conceptual Framework

Academic rhetoric on regulatory chill in international investment law can be traced to the 2000s, where noted academics aimed to look at the complex relationship between investor protection and state sovereignty. Susan Franck's piece on the legitimacy crisis in international investment arbitration aimed to frame the debate around both procedural and normative inconsistencies that occur in arbitral decisions.[8] The lack of coherent precedent and transparent reasoning heavily downplays the implicit fairness of the system of investment arbitration, and this inconsistency and diminished fairness is referred to her as a "crisis of legitimacy."[9] The consequence of this crisis is the effect it has on the behavior of states, wherein a lack of uncertainty about interpretive standards may tend to encourage states to act defensively, diminishing regulations or refraining from enacting new ones altogether.[10]

Adding to the dialogue that Franck began, Kyla Tienhaara opined that *regulatory chill* was a specific manifestation of the legitimacy crisis.[11] She defines the chill as arising when the possible threat of investor claims act as a deterrent affecting governments from enacting socially desirable regulations, especially in domains which are significant to the larger population, such as environmental and public-health domains.[12] Kyla posits that the effect is

[7] ibid 7.
[8] Franck (n 2) 1522.
[9] ibid 1523–24.
[10] ibid 1530.
[11] Tienhaara (n 1) 5.
[12] ibid 6.

both anticipatory, in that governments alter their behavior to avoid claims, as well as being reactive, as states would roll back or diminish regulatory measures after facing arbitration.[13]

The legal materialization of the chill phenomenon can be observed through analysis of investment arbitral jurisprudence, which shows that standards such as FET and indirect expropriation have grown to abet investor expectations of regulatory stability in the sectors they have invested in.[14] In actuality, arbitral tribunals have essentially frozen the policy space of states, by inferring contractual obligations from public regulation frameworks.[15] Guillermo Garcia Sanchez posits that dialogue around regulatory chill must move on from case-to-case anecdotal alarmism to a style of institutional analysis that is also context-sensitive.[16]

This institutional turn coincides with debates regarding reform within UNCITRAL Working Group III, which has identified certain systemic flaws in ISDS, these being inconsistency, cost and bias of the arbitrator.[17] Somesh Dutta in his piece published in the Indian Journal of International Economic Law, speaks on the proposed Multilateral Investment Court (MIC), and how a standing appellate mechanism could increase certainty and ensure a higher level of coherence and cohesiveness, thereby mitigating the phenomenon of regulatory chill.[18]

The literary discourse surrounding regulatory chill, when looked at as a whole, reveals certain interlinked aspects of regulatory chill, namely doctrinal (arising from overly broad readings of investment-protection standards such as FET), institutional (symptomatic of the inconsistent awards given in investment arbitration), and behavioral (referring to the tendency of States to restrain themselves or lessen regulations). The doctrinal expansion of investment protection in conjunction with judicial uncertainty caused by inconsistencies in awards produce a regulatory chill especially with regards to regulations governing transition from fossil fuels to renewable sources of energy.

Legal and Doctrinal Framework

The raison d'etre for investment treaties is to safeguard investors from unfair treatment and

[13] ibid 8.
[14] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (3rd edn, OUP 2022) 134.
[15] ibid 135–37.
[16] García Sánchez (n 6) 7.
[17] UNCITRAL Working Group III, *Report on Investor-State Dispute Settlement Reform* (A/CN.9/1136, 2023) paras 24–26.
[18] Somesh Dutta, 'The Quest for Consistency in International Investment Jurisprudence and the Idea of a Multilateral Investment Court' (2021) *Indian Journal of International Economic Law* 56, 59.

uncompensated expropriation. The following clauses have been expanded by arbitral tribunals into a framework that governs regulatory discretion.

Fair and Equitable Treatment

The FET clause requires host states to act in a manner that is consistent and transparent while also aiming to protect the legitimate expectations of investors from the other treaty state.[19] Tribunals have oft interpreted this obligation to include a duty to maintain a legal environment that is stable.[20] In *Occidental Petroleum v Ecuador*, the tribunal noted that the "stability of the legal and business framework" is a *sine qua non* of FET.[21] Applying this standard of FET, the tribunal, in *Tecmed v Mexico,* held that the denial of an environmental licence by the state breached the investor's legitimate expectations.[22]

While this construction of the FET clause would have the effect of increasing legal certainty, at the same time it acts as a restraint on adaptive governance. Franck argues that overtly expansive readings of FET amplify the legitimacy crisis by elevating ordinary regulatory actions into breach of a treaty.[23] When policy evolution is being equated with expropriation of expectations, states hesitate to enact regulatory legislations by virtue of internalising the risk of investors claims in arbitration. The *Charanne* and *Antin* awards are an example of this, wherein Spain's reform of renewable-energy incentives was held by the tribunals to have the effect of frustrating the legitimate expectations of foreign investors.[24]

UNCITRAL Working Group III makes note of the fact that inconsistency in interpreting FET "undermines predictability and imposes a chilling effect on new regulations."[25] The presence of multilateral appellate mechanism could potentially have the effect of harmonising standards of FET.[26]

[19] Dolzer and Schreuer (n 14) 145.
[20] ibid 146–47.
[21] *Occidental Petroleum Corporation v Republic of Ecuador* (n 4) [183].
[22] *Tecnicas Medioambientales Tecmed SA v Mexico* (ICSID ARB(AF)/00/2, Award 29 May 2003) [154].
[23] Franck (n 2) 1532.
[24] *Charanne BV and Construction Investments SARL v Spain* (SCC Case No 062/2012, Final Award 21 January 2016); *Antin Infrastructure Services Luxembourg SARL v Spain* (ICSID ARB/13/31, Award 15 June 2018).
[25] UNCITRAL Working Group III (n 20) para 27.
[26] Dutta (n 21) 61.

Indirect Expropriation

Indirect expropriation refers to the extension of protection to measures which significantly deprive investors of value.[27] Analysis with regards to indirect expropriation focuses on the effect of the expropriation rather than the reason behind it.[28] Environmental regulations which were enacted for bona fide purposes may trigger liability under the treaty in the event they cause a severely negative economic impact on the investment.

In *Rockhopper v Italy*, the arbitral tribunal determined that the host state's legislative ban on offshore drilling constituted as expropriation due to the detriment it caused the claimant's investment.[29] Despite there being strong justification behind the legislation, the tribunal awarded nearly USD 190 million to the claimant.[30] A similar result occurred in *Metalclad v Mexico*, where the closure of a hazardous-waste facility was treated as expropriation.[31] These decisions tend to further fuel bureaucrats' fear of arbitral claims.[32]

Newer investment treaties and the modernised Energy Charter Treaty attempt to mitigate this over-expansive interpretation of what constitutes expropriation by affirming that environmental regulations which are non-discriminatory don't have the effect of expropriation.[33]

Full Protection and Security

Although traditionally, FPS is solely confined to physical protection of the investment, the standard has on occasion been afforded even to regulatory security. In *Biwater Gauff v Tanzania,* the tribunal observed that "a stable investment environment" formed part of investors' security.[34] This extension of FPS, risks conflating it with FET, which would create further uncertainty for host states.[35]

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[27] Dolzer and Schreuer (n 14) 101.
[28] ibid 102.
[29] *Rockhopper Exploration plc v Italy* (ICSID ARB/17/14, Award 23 August 2022) [750].
[30] ibid [752].
[31] *Metalclad Corporation v United Mexican States* (ICSID ARB(AF)/97/1, Award 30 August 2000) [103].
[32] Dolzer and Schreuer (n 14) 104.
[33] Energy Charter Treaty (Modernised Text 2024) art 8(2).
[34] *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania* (ICSID ARB/05/22, Award 24 July 2008) [730].
[35] Dolzer and Schreuer (n 14) 157.

Institutional Recognition of these Issues

UNCITRAL's 2023 report makes explicit mention of inconsistency in arbitral awards, linking this inconsistency and cost to concerns regarding legitimacy that could act as a deterrent for the regulatory measures undertaken by host states.[36] The Multilateral Investment Court would go a long way in providing cohesion and appellate oversight to investment arbitration, as fragmented separate arbitral proceedings would be brought into an adjudicating framework that could very well be consistent and predictable in a way that previous international investment jurisprudence hasn't.[37]

Case Studies

The theoretical aspects concerning regulatory chill are better understood when examined through arbitral jurisprudence. Energy disputes especially display the mediating nature of the ISDS framework with respect to easing the tension between investor expectations and state sovereignty when it comes to regulations for sustainability.

Vattenfall v Germany

The *Vattenfall* arbitral proceedings against the host state of Germany showcase the conflict between regulatory policies and investment protection under the Energy Charter Treaty.[38] In *Vattenfall I*, the Swedish energy company claimed that overly stringent standards of water-quality made the investment uneconomic.[39] The dispute was eventually settled when Germany relaxed the impugned regulations,[40] a textbook instance of regulatory chill, wherein the mere initiation of arbitral proceedings by an investor led to a state recalibrating its domestic policy.

The conflict between these parties occurred again in *Vattenfall II* in 2012, where the claimant contested Germany's decision to speed up its nuclear phase-out after the Fukushima disaster.[41] The claim, which sought around 4.7 billion euros in damages, was based on alleged violations by the Host State of the ECT's FET and expropriation clauses.[42] The proceedings were

[36] UNCITRAL Working Group III (n 20) para 25.
[37] ibid paras 33–40.
[38] *Vattenfall AB and others v Federal Republic of Germany (I)* (ICSID ARB/09/6, Settlement Agreement 2011).
[39] ibid Statement of Claim [15].
[40] International Institute for Sustainable Development (IISD), 'Vattenfall v Germany: Settlement and Environmental Regulation' (IISD Investment Treaty News, 2011).
[41] *Vattenfall AB and others v Federal Republic of Germany (II)* (ICSID ARB/12/12, Discontinued 2023).
[42] ibid Request for Arbitration [8].

concluded by virtue of a domestic court settlement.[43] This settlement still had significant political repercussions, as many Germany bureaucrats cited the proceedings as proof of the "legal risks" of "abrupt" decarbonization measures.[44]

Leading academic minds such as Garcia Sanchez speak about how *Vattenfall II* caused a *deterrent ripple effect*, in that it increased policymakers' caution in their subsequent making of energy-transition laws.[45] Even unresolved large-scale compensation claims can influence the direction of a country's energy strategy. Unpredictability in the outcome of arbitral proceedings can shift the motive behind policies from being precautionary regulation to a motive of avoiding risk.[46]

Spain's Renewable Energy Arbitrations

While *Vattenfall* is a clear display of bilateral conflict between investor and state, Spain's renewable energy arbitrations are a display of regulatory chill that was a result of serial litigation. Between 2013 and 2020, more than forty investor claims were brought under the ECT which challenged the state's modification of its feed-in-tariff- scheme for solar and wind energy producers.[47] Investors alleged that these reforms breached FET by frustrating the legitimate expectations they possessed regarding regulatory stability in their field of investment.

Arbitral tribunals in *Charanne, Novenergia II and Antin* reached outcomes which en masse, broadly favored the claimants.[48] In *Antin*, the ICSID tribunal awarded a sum of approximately 101 million euros, determining that Spain's reform of their FIT scheme violated FET, due to the "radical and unforeseen" nature of the changes.[49] The tribunal weighed the investors' expectation of "reasonable stability" over the host state's argument that the measures were crucial to restore financial equilibrium to the country.[50]

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[43] Federal Constitutional Court (Germany), Judgment 12 Nov 2020, BVerfG 1 BvR 2821/11.
[44] German Federal Ministry for Economic Affairs and Climate Action, *Nuclear Energy Phase-Out Review* (2021) 4.
[45] Guillermo J García Sánchez, *Defrosting Regulatory Chill* (2024) [manuscript 5–6].
[46] Susan D Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration' (2005) 73(4) *Fordham L Rev* 1521, 1533.
[47] UNCTAD, *Investment Dispute Settlement Navigator – Spain* (2024).
[48] *Charanne BV and Construction Investments SARL v Spain* (SCC 062/2012, Final Award 21 Jan 2016); *Novenergia II – Energy & Environment (SCA) v Spain* (SCC Award 15 Feb 2018); *Antin Infrastructure Services Luxembourg SARL v Spain* (ICSID ARB/13/31, Award 15 Jun 2018).
[49] *Antin v Spain* (n 12) [665].
[50] ibid [673].

The Spanish government faced awards exceeding 1.5 billion euros,[51] which led the state to delay in enacting further renewable energy adjustments and creating a defensive legislative posture. These arbitration proceedings showcase the elastic nature of an investor's "legitimate expectations." Arbitral tribunals tend to conflate the expectations of an investor with policy immutability, thereby transforming the regulatory space which is very obviously supposed to be dynamic and shifting, into a quasi-contractual commitment.[52] While such an approach would protect the interests of investors, it also narrows the policy space which is necessary to facilitate energy transition, a view which is echoed by the UNCITRAL Working Group III.[53]

Unqualified FET clauses could have the effect of amplifying risk in sectors which are prone to regulatory flux, and a fragmented dispute resolution framework could impede progressive reform.

Rockhopper v Italy and Uniper v Netherlands

In *Rockhopper Exploration v Italy*, the investor challenged the state's denial in granting a production concession for the Ombrina Mare oilfield after a legislative ban on offshore drilling within twelve nautical miles of the Italian coast.[54] The tribunal, applying the provisions of the ECT, arrived at the conclusion that Italy's conduct could be characterized as unlawful indirect expropriation and awarded US $ 190 million in damages to the claimant.[55] Despite Italy's withdrawal from the ECT in 2016, the "sunset clause" in the treaty preserved investors' rights for 20 years.[56]

Uniper v Netherlands is a case which strengthens the dynamics of anticipatory regulatory chill.[57] The claimant company challenged the Netherlands' 2019 Coal Phase-Out Act, alleging that the mandatory plant closures by 2030 violated FET and expropriation provisions.[58] Before a final award was given by the tribunal, the dispute was withdrawn after the host state agreed to nationalize the claimant's domestic assets in the midst of an energy-price crisis.[59] Although

[51] UNCTAD (n 10).
[52] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (3rd edn, OUP 2022) 145.
[53] UNCITRAL Working Group III, *Report on Investor-State Dispute Settlement Reform* (A/CN.9/1136, 2023) paras 24–26.
[54] *Rockhopper Exploration plc v Italy* (ICSID ARB/17/14, Award 23 Aug 2022).
[55] ibid [748]–[752].
[56] Energy Charter Treaty, art 47(3) ('sunset clause').
[57] *Uniper SE and others v Kingdom of the Netherlands* (ICSID ARB/21/22, discontinued 2024).
[58] ibid Request for Arbitration [11].
[59] Reuters, 'Dutch Government to Take Control of Uniper NL Units' (18 Jul 2024).

such a settlement avoided the possibility of payment of damages by the Dutch government, this case illustrates the leverage investors derive over states from ISDS exposure. The Netherlands delayed multiple aspects of its climate legislation, a clear consequence of regulatory chill.[60]

Both these cases reveal the asymmetry and clash between long-term fossil fuel contracts and environmental objectives that are constantly metamorphosizing. The existence of sunset clauses and broad treaty protections infringe on state sovereignty when reconsidering energy policy.[61] The mere possibility of billion-dollar awards being given converts precautionary regulation into strategic hesitation.[62]

Synthesis

Regulatory concessions were induced by settlement in Vattenfall; serial awards institutionalized caution in Spain's renewables cases; and the potential, then actual, costs of arbitration constrained legislative ambition in Rockhopper and Uniper. Together, they establish that ISDS can have a measurable chilling effect on energy transition policy. However, this effect is partial in magnitude and varies with context. As García Sánchez also observes, chill is most acute when States lack fiscal resilience or legal clarity.[63] Thus, efforts to reform clarifying treaty standards-and reinforcing the "right to regulate"-are existential for sustainable governance, rather than merely procedural.

Analysis and Reform

The previous case studies showcase that the chilling effect in investment treaty arbitration is not an abstraction but a phenomenon which is observable, especially in the field of carbon-intensive and renewable-energy transitions. The question to be answered is not with regards to the current ISDS framework's constraint on regulatory autonomy, but how the international investment law framework can be restructured so that investor confidence and state's ability to legislate regulations for climate governance don't have to be sacrificed for each other.

Doctrinal Drivers of Chill

The FET and indirect expropriation standards are the primary "agents" through which

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[60] Dutch Parliament, *Coal Phase-Out Implementation Review* (2025) 5.
[61] Energy Charter Treaty (n 22) art 47(3).
[62] Franck (n 9) 1534.
[63] García Sánchez (n 8) 8.

regulatory chill operates. The consequence of reading a stable environment for the investment into an FET clause is the freezing of policy evolution. In *Charanne* and *Antin*, the rationale that investors could rely on an indefinite continuation of feed-in tariffs essentially constitutionalized regulatory stability in the context of FET.[64]

The effect-based approach in contemplating whether an action by the state could amount to indirect expropriation protects investments from non-discriminatory environmental measures.[65] The tribunal's willingness in *Rockhopper* to prioritize economic impact over eco-centric views illustrates the elasticity of this doctrine[66].

Franck's critique of the legitimacy crisis plaguing the ISDS framework is relevant, especially her argument that inconsistency in awards and broken reasoning erodes the predictability of arbitral proceedings, converting discretion into political leverage which can be "abused" by investors.[67] When a host state can't possibly anticipate how a tribunal will weigh ecological and public interests against investor expectation, bureaucrats would tend to resort to defensive regulation[68], showcasing how the doctrinal ambiguity, especially with respect to FET and indirect expropriation, is the real reason for regulatory chill, rather than aggressive prosecution from investors.

Fiscal Capacity and Legal Clarity

Empirical research by Garcia Sanchez shows that chill operates unevenly.[69] Host states with higher income and wealth such as Germany or Spain possess the fiduciary capacity to absorb awards which go in the claimant's favour without abandoning their objectives regarding transition or climate governance.[70] In stark contrast, resource-dependent developing countries, where foreign investment plays a larger role in the GDP, are far more susceptible to regulatory chill,[71] showcasing how regulatory chill is not monolithic but dependent on other factors such as fiscal capacity of states and policy coherence.

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[64] *Charanne BV and Construction Investments SARL v Spain* (SCC 062/2012, Final Award 21 Jan 2016); *Antin Infrastructure Services Luxembourg SARL v Spain* (ICSID ARB/13/31, Award 15 Jun 2018).
[65] Dolzer and Schreuer (n 1) 102.
[66] *Rockhopper Exploration plc v Italy* (ICSID ARB/17/14, Award 23 Aug 2022).
[67] Susan D Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration' (2005) 73(4) *Fordham L Rev* 1521, 1534.
[68] ibid 1535.
[69] Guillermo J García Sánchez, *Defrosting Regulatory Chill* (2024) [manuscript 6–7].
[70] ibid.
[71] ibid 8.

Emerging Reform Pathways

UNCITRAL Working Group III

The ongoing ISDS Reform project by UNCITRAL identifies the structural reasons for chill, namely inconsistent jurisprudence, excessive cost and a lack of appellate oversight.[72] The Working Group has proposed a standing multilateral investment court, a code of conduct for adjudicators, and an advisory centre for developing nations.[73] A permanent adjudicatory mechanism could create a coherent system and thereby reduce regulatory over-deterrence.[74] Legitimacy in ISDS derives itself from a fair procedure and consistently reliable interpretation,[75] and by institutionalizing these components, UNCITRAL's reforms could go a long way.

Modernization of the ECT

The 2024 modernized ECT introduces a clause which affirms that the "inalienable right of Parties to regulate within their territories to achieve legitimate policy objectives such as environmental protection and sustainable development."[76] This clarification that non-discriminatory, proportionate regulations wouldn't constitute indirect expropriation, would pre-empt disputes arising from regulations and reduce regulatory chill.

Model BIT Reforms

India's 2016 Model BIT explicitly protects the State's right to regulate "for public health, safety, environment and public morals."[77] Such a textual re-calibration could potentially neutralize regulatory chill, whilst also ensuring that investment facilitation is not impeded upon.[78]

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72 UNCITRAL Working Group III, *Report on Investor-State Dispute Settlement Reform* (A/CN.9/1136, 2023) paras 24–27.
73 ibid paras 33–40.
74 Somesh Dutta, 'The Quest for Consistency in International Investment Jurisprudence and the Idea of a Multilateral Investment Court' (2021) *Indian J Intl Econ L* 56, 59.
75 Franck (n 5) 1537.
76 Energy Charter Treaty (Modernised Text 2024) art 8(2).
77 Government of India, *Model Text for the Indian Bilateral Investment Treaty* (2016) art 2.4.
78 Tienhaara (n 10) 13.

A Balanced Regime

These reforms are symbolic of a change from ad hoc arbitration to a more rule-governed institutional adjudicatory system. There is a necessity to ensure that investment capital must be protected against arbitrary treatment and this protection must harmonise with the imperative of ecological stewardship.

ISDS can regain a stronger sense of legitimacy through aligning its structural framework with goals of sustainable development.[79] This alignment requires the reduction of FET to cases of manifest arbitrariness, and adopting proportionality in arbitral claims where expropriation is alleged.

A balanced system would view protection of investment not as a goal to be met but rather something that aids in enabling sustainable development and transitions which would facilitate this. By clarifying standards, establishing appellate oversight and embedding the right to regulate, reform initiatives can transform the chilling effect cast by ISDS into a stable framework for climate transition.

Conclusion

The energy transition brings into sharp relief a fundamental paradox of contemporary international law: the very legal instruments designed to attract investment may deter the regulatory dynamism that is requisite for decarbonization. Through doctrines such as FET and indirect expropriation, arbitral tribunals have expanded investor-entitlements in ways that can generate regulatory hesitation. Case studies from Germany, Spain, and Italy detail how both the threat and actuality of multi-million-dollar awards being awarded by tribunals shapes the pace and scope of climate policy.

Regulatory chill is not inevitable, as García Sánchez shows, its intensity depends on legal clarity and fiscal resilience. The reforms flowing from UNCITRAL WG III, the modernized ECT, and progressive model BITs together signal a shift toward balance. Institutionalizing appellate mechanisms, ethical standards, and plainly worded rights to regulate should help these regimes restore legitimacy while preserving investor confidence.

[79] Franck (n 5) 1538.

Investment law thus stands at a crossroads: it can continue to promote uncertainty and chill, or it can develop into a regime that underwrites sustainable transformation. The balance between the protection of investors and State sovereignty will determine not only the fate of ISDS but the feasibility of the global energy transition itself.