FOSSIL FUEL PHASE OUT AND CLIMATE REGULATION IN INVESTOR-STATE ARBITRATION: RETHINKING PERMANENT SOVEREIGNTY OVER NATURAL RESOURCES

Anjali Kumari, LLM, NALSAR University of Law

ABSTRACT

International energy investment law and international climate law face an imminent conflict. An investor-state arbitral tribunal granted the claimant about €190 million after Italy refused to extend an offshore oil exploration license because it violated their energy transition program without examining Italy's Paris Agreement obligations or its sovereign right to decide how to use its natural resources according to the Permanent Sovereignty over Natural Resources principle. The research investigates whether states can use existing international investment law under its correct interpretation to phase out fossil fuel extraction for climate change protection and presents a legal solution.

The question matters because the energy transition is not merely a policy ambition it is a legal obligation. States must gradually decrease their reliance on fossil fuels to achieve the 1.5°C temperature target established by the Paris Agreement, while the International Energy Agency determined that the current fossil fuel field development needs to stop for a net-zero transition. The **United States has over 3,000 bilateral investment treaties, together with the Energy Charter Treaty, which allow foreign investors to file ISDS claims worth billions of dollars against countries that implement climate-related regulatory reforms**. The legal framework for energy transition creates a regulatory vice which prevents energy transition legal costs from being affordable, this issue stands as the most critical challenge obstructing the energy trade and investment legal system.

The research uses doctrinal legal research as its method to solve the legal problem. The legal system interprets UNGA Resolution 1803 (1962), the Paris Agreement, the Energy Charter Treaty, and the ILC Articles on State Responsibility through the Vienna Convention's Article 31(3)(c) systemic integration principle while the researcher examines how *Rockhopper, Vattenfall, RWE, Methanex, Saluka, and Philip Morris v. Uruguay* arbitral jurisprudence have developed investment law doctrinal resources. The paper reaches three conclusions. The PSNR treaty gives people the "conservation dimension" right to stop all fossil fuel extraction activities which has become a customary international law norm because the Paris Agreement. The post-Paris world environment makes fossil fuel licensing investor expectations about regulatory continuation no longer legally "legitimate" because climate-motivated phase-out emerged as an international requirement. The paper develops a "climate necessity doctrine" which combines systemic integration and police powers doctrine and necessity defense and proportionality review through four qualifying criteria. The law delivers all necessary tools through its existing text.

1. Introduction

The arbitral tribunal in *Rockhopper Exploration Plc v. Italian Republic* awarded the British oil company damages of approximately €190 million because Italy refused to extend its offshore hydrocarbon exploration permit in the Adriatic Sea. The award established a core contradiction that exists between international investment law and climate governance because a state that follows its Paris Agreement commitments, together with its green energy transition, will face serious legal consequences when investors claim that the state failed to protect their right to uninterrupted regulations.

The paradox exists in a wider framework that demonstrates how two international legal systems have developed independently throughout time. The **United Nations General Assembly Resolution 1803** (XVII) **of 1962 establishes that Permanent Sovereignty over Natural Resources (PSNR**) grants each state unbreakable control over its natural resources **which it can manage according to its own rules for resource extraction and management and for resource conservation and extraction cessation.**

International investment law establishes regulatory stability protection for investors through its network of bilateral investment treaties and its multilateral treaties, which include the Energy Charter Treaty. The Fair and Equitable Treatment standard, together with the indirect expropriation prohibition and related legal principles, which developed through investor-state dispute settlement procedures, function as safeguards for investor protection under this international investment law framework.

The global energy transition has become a battleground for these two legal systems because their relationship is now being argued by competing parties. The Paris Agreement requires states to meet their climate obligations and scientific evidence shows that fossil fuel systems must be abandoned but this transition leads to investment treaty arbitration claims which can reach hundreds of millions or billions of dollars. Scholars have identified an **international law 'regulatory vice' pattern in which states must comply with climate obligations to reduce fossil fuel usage yet face legal risks when they implement these climate obligations** through their climate obligations.

The existing literature addresses these tensions in segmented ways. Scholars of PSNR have traced its evolution from the post-colonial resource nationalism of the 1960s to its contemporary relevance in the climate era, but they have not conducted a thorough analysis of PSNR's ability to function as an effective defense against investment treaty claims which result from fossil fuel phase-out policies. Investment law scholars have extensively documented the 'regulatory chill' effect of ISDS and the doctrinal evolution of legitimate expectations in energy arbitration, particularly in the context of Spain's solar tariff reversals, but they have not created a complete overview which integrates these two elements with the PSNR framework. Climate lawyers have developed proposals which establish **a 'right to fossil fuel phase-out' based on human rights and UNFCCC obligations, but they have not directly addressed the legal issue which determines how such a right affects current ISDS operations**.

This paper proposes to fill that gap by conducting a doctrinal legal analysis at the intersection of **PSNR, investment treaty law, and international climate obligations.** The study will assess whether PSNR functions as a customary international law principle which establishes the legal basis for a 'climate necessity doctrine' in ISDS that enables states to fight investment treaty claims which stem from scientifically justified fossil fuel phase-out activities without needing to pay damages or at least to decrease their damages obligations.

2. Permanent Sovereignty over Natural Resources: From Post-Colonial Right to Climate Era Principle

2.1 Genesis of PSNR

The principle of PSNR originated from the political and economic concerns which emerged during the post-colonial period. The newly independent states worldwide developed structural dependencies on Western capital between the Second World War and the rest of the 20th century, which forced them to rely on foreign funding to extract their natural resources. The dependency established by these countries extended beyond economic factors to include legal obligations. Colonial-era concession agreements and bilateral investment arrangements had vested comprehensive rights in foreign corporations, which enabled them to maintain operations without local rule changes through stabilisation clauses and international minimum standards protection.[1] Resource-rich developing countries demanded complete control over their resources, together with rights to determine how their resources should be extracted and rights to end or change contracts that they believed to be unfair. The United Nations General Assembly adopted Resolution 1803 (XVII) on 14 December 1962, which established "Permanent Sovereignty over Natural Resources" as the primary legal document which supports the PSNR doctrine.[2] This resolution presents an official explanation of customary international law, which governs state ownership of natural resources.[3]

The International Covenant on Economic, Social and Cultural Rights (**ICESCR**)and the International Covenant on Civil and Political Rights (I**CCPR**) were approved by the United Nations General Assembly in December 1966**, which do not explicitly refer to PSNR, but they support the right of peoples to use their natural resources** according to their own interests.

The Charter of Economic Rights and Duties of States (**CERDS**), which the international community approved in 1974, establishes worldwide standards for international economic relations.[4] CERDS establishes **that all nations possess the right to manage their natural resources according to their own preferred methods which exists as a fundamental principle of PSNR**.[5] The 1962 Resolution contained investment dispute settlement procedures that used host country laws and courts for resolution, but this system received more weight in CERDS. The United Nations General Assembly adopted the New International Economic Order (NIEO) in 1974. Developing nations wanted to alter the worldwide economic system **with the NIEO, and they sought to abolish the economic principles that currently benefited developed nations.** The new system needed to replace the Bretton Woods system, which defined all currencies against the dollar. The system benefited mainly the countries that created it, with the United States receiving special advantages.[6] The **NIEO included PSNR as**

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[1] See generally Nico J Schrijver, Sovereignty over Natural Resources: Balancing Rights and Duties (Cambridge University Press 1997) ch 2-3, for a comprehensive account of the colonial and post-colonial context of resource sovereignty.
[2] UNGA Resolution 1803 (XVII), 'Permanent Sovereignty over Natural Resources' (14 December 1962).
[3] Schrijver (n 2) 372-380. See also the analysis of the resolution's voting record and the participation of capital-exporting states ibid 155-158.
[4] Charter of Economic Rights and Duties of States, UN GA Res 3281 (XXIX).
[5] Charter of Economic Rights and Duties of States, art 2.
[6] New International Economic Order, UNITED NATIONS ECONOMIC AND SOCIAL COMMISSION FOR WESTERN ASIA, https://www.unescwa.org/new-international-economic-order

one of its fundamental principles.

Article 2 of CERDS affirms the right to "regulate and exercise authority over foreign investment", while **Article 30 establishes state responsibility for the "protection, preservation and enhancement" of the environment, beginning to construct PSNR and environmental stewardship as complementary obligation**s. The two instruments face greater challenges than Resolution 1803 because capital-exporting states oppose them- six states, including the United States, the United Kingdom, and West Germany, voted against CERDS, with ten further abstentions, primarily objecting to its provisions on expropriation compensation and the scope of resource sovereignty. Yet the paper uses these instruments as evidence, which shows how norms have developed and explains the environmental aspects of resource sovereignty.[7]

2.2 Legal status of PSNR

The legal status of **PSNR as a norm of customary international law** is well-established in its core content. Schrijver, the leading scholarly authority, concludes that PSNR's central entitlements, the right to regulate resource exploitation, the right to nationalise subject to an obligation of compensation, and the right to determine the pace and terms of resource development, have crystallised into customary international law through widespread state practice and *opinio juris*.[8] The **International Court of Justice considered PSNR as positive international law in** its decision about the **Case Concerning Armed Activities on the Territory of the Cong**o (2005), which found that **Uganda had violated "well-established principles of international law" by exploiting DRC natural resources, including permanent sovereignty over natural resources**.[9]

Perrez's concept of "**cooperative sovereignty**" adds a critical refinement: sovereignty over natural resources is not a licence for unlimited extraction but a responsibility-bearing right, qualified by the obligation to avoid transboundary environmental harm.[10] On this reading, PSNR is inherently calibrated to environmental obligations, and a **state's decision to phase**

[7] Schrijver (n 2) 237-241. The US, UK, and several Western European states voted against Resolution 3281, primarily objecting to its provisions on expropriation compensation.
[8] Schrijver (n 2) 363-380.
[9] Case Concerning Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v Uganda) [2005] ICJ Rep 168, para 244.
[10] Felix Perrez, Cooperative Sovereignty: From Independence to Interdependence in the Structure of International Environmental Law (Kluwer 2000) 207–230.

out fossil fuel exploitation in response to climate science is not a derogation from PSNR but an exercise of it. This understanding is particularly significant because it situates the conservation dimension within the existing customary content of PSNR, rather than requiring the development of an entirely new rule.

The recognition of **PSNR** limitations in this situation serves as an essential component of the evaluation process. The principle **does not immunise arbitrary or discriminatory regulatory measures from investment treaty scrutiny, nor does it eliminate compensation obligations altogether**. The precise question of how PSNR's conservation dimension interacts with the investment treaty framework when a state undertakes a genuine, science-based fossil fuel phase-out is the doctrinal problem this paper addresses in Chapters III and IV.

2.3 PSNR and the Paris Agreement

The adoption of the Paris Agreement in 2015 constitutes a transformative development in the normative environment within which PSNR operates.[11] Articles 2 and 4 commit states parties to limiting global warming to well below 2°C and to progressively ratcheting up their Nationally Determined Contributions (NDCs) over time. The scientific corollaries of these commitments are unambiguous: the IPCC's 2023 Synthesis Report confirms that limiting warming to 1.5°C requires rapid and deep reductions in fossil fuel usage across all sectors,[12] while the IEA's Net Zero by 2050 roadmap concludes that no new oil or gas field development is required on a credible net-zero pathway.[13] States that phase out fossil fuel exploitation in compliance with their Paris Agreement NDC obligations are thus not acting arbitrarily; they are **exercising their PSNR-based conservation prerogative in fulfilment of a binding multilateral commitment**.

Van Asselt's analysis of the emerging "international law of leaving it in the ground" develops this argument in detail, deducing that PSNR's conservation dimension, Paris Agreement obligations, and the principle of intergenerational equity together create a legal framework that requires fossil fuel phase-out as an increasing necessity.[14] The research findings show that

[11] Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) UNTS 54113, Arts 2, 4.
[12] IPCC, 'Climate Change 2023: Synthesis Report - Summary for Policymakers' (Intergovernmental Panel on Climate Change 2023) 15.
[13] IEA, 'Net Zero by 2050: A Roadmap for the Global Energy Sector' (International Energy Agency 2021) 21.
[14] Harro van Asselt, 'Governing Fossil Fuel Production in the Age of Climate Disruption: Towards an International Law of Leaving It in the Ground' (2021) 9 Earth System Governance 100118, 3-12.

Garcia Sanchez's **study about "energy sovereignty" demonstrates that countries have the right to choose their energy sources and transition away from fossil fuels since this principle now exists as a separate legal standard in the post-Paris legal system, which combines traditional PSNR principles with new legal elements.**[15] The *Rockhopper v. Italy* award (2022) demonstrates how ignoring these developments leads to doctrinal failures. The tribunal determined that Italy breached the Fair and Equitable Treatment standard according to the Energy Charter Treaty because it refused to extend an offshore oil exploration licence, without engaging with Italy's PSNR-based sovereign authority or its Paris Agreement obligations.[16] The doctrinal gap that this research addresses represents its main objective.

3. Fair And Equitable Treatment and The Legitimacy of Expectations of Fossil Fuel Investors

The Fair and Equitable Treatment standard serves as the **primary legal provision which investors use** to initiate their disputes in investor-state dispute settlement (ISDS) and climate-based regulations most often trigger and invoke it. **Article 10(1) of the Energy Charter Treaty addresses it,** and also appears in most bilateral investment treaties, yet lacks a standard definition. The content of this legal rule derives mainly from arbitral jurisprudence while its most significant impact on state regulatory power occurs through the legitimate expectations doctrine.[17]

The ***Tecmed v. Mexico*** ruling established the first guidelines that define **how FET standard transparency and consistency** requirements should operate. The tribunal determined that **FET needs host states to execute their duties through consistent actions which include complete transparency and unambiguous conduct**. This approach enables investors to **foresee all regulations which will control their investment activities**.[18] This case established that Mexico's decision to deny a landfill operation permit renewal constituted indirect expropriation resulting in complete economic loss for the investor because the investor had reasonable grounds to believe that operations would continue indefinitely despite the license

[15] Guillermo J Garcia Sanchez, 'In the Name of Energy Sovereignty' (2022) 63 Boston College Law Review 2475, 2490-2510.

[16] Rockhopper Exploration Plc, Rockhopper Italia SpA and Rockhopper Mediterranean Ltd v Italian Republic, ICSID Case No ARB/17/14, Award (24 August 2022).

[17] Energy Charter Treaty (adopted 17 December 1994, entered into force 16 April 1998) 2080 UNTS 95, Art 10(1).

[18] Tecmed SA v United Mexican States, ICSID Case No ARB(AF)/00/2, Award (29 May 2003), para 154.

requiring yearly renewals.[19] The FET standard in *Tecmed* requires transparency, but it also combines with expropriation analysis while protecting the legitimate expectation rights of parties involved, which results in a broad range of protection rights.

The ***Saluka v.*** *Czech Republic* tribunal found that **the Czech Republic had violated the FET** standard because it **treated the claimant's investment unfairly compared to other major banks**, which received state assistance for bad debt, but it made this finding because of discriminatory conduct that existed. This indicates that **regulatory changes do not result in legitimate expectations claims, as expectations must be evaluated based on specific circumstances. It clarified that investors cannot legitimately expect states to avoid stringent prudential rules**.[20]

The leading investment law treatise as described by Dolzer and Schreuer shows that arbitration practice has developed from its previous state because legal protections for expectations have expanded throughout the arbitration process.[21] The extended development of this trajectory presents the greatest risk to state energy transition implementation because it creates potential ISDS liability.

- **Case laws**

The rulings below illustrate the structural tension between climate-focused regulations and investment treaty protections.

In the case of ***Rockhopper v. Italy***[22], Italy enacted legislation in 2015 prohibiting new hydrocarbon exploration within twelve nautical miles of its coastline. Rockhopper filed an ECT claim because the legislation stopped them from renewing their offshore Adriatic permit. The tribunal found Italy liable but critically, the **primary basis of liability was direct expropriation, not the FET standard.** The tribunal determined that Italy's refusal to grant the production concession expropriated Rockhopper's legal entitlement under Italian law which led to a direct award of approximately €190 million in damages without needing to conduct an

[19] Ibid, paras 116-122.
[20] Saluka Investments BV (The Netherlands) v Czech Republic, UNCITRAL, Partial Award (17 March 2006), paras 302–308.
[21] Dolzer and Schreuer (n 1) 145–152.
[22] Rockhopper Exploration Plc, Rockhopper Italia SpA and Rockhopper Mediterranean Ltd v Italian Republic, ICSID Case No ARB/17/14, Award (24 August 2022).

extended FET examination.

The above decision identifies two elements that hold doctrinal value. The tribunal decision which identified direct expropriation from a regulatory decision shows that the **expropriation standard functions as a strong barrier against climate-related regulatory changes just like the FET standard.** The award received complete annulment through the ICSID ad hoc Committee on 2 June 2025 because the tribunal had been formed incorrectly after Rockhopper's selected arbitrator failed to reveal his past Italian criminal cases which generated doubts about his ability to judge fairly.[23] The annulment means that no final award binding on the parties presently exists. The **case maintains its doctrinal importance because the tribunal used environmental legislative measures as direct expropriation while ignoring Italy's Paris Agreement obligations and PSNR conservation prerogative which creates a system that will continue the regulatory problems** identified in this paper.

The Swedish energy company **Vattenfall sued Germany for €6 billion ECT** damages because Germany decided to stop nuclear power usage in 2011 after the Fukushima disaster.8 The case reached its conclusion through settlement in 2021.[24] The German Federal Constitutional Court had already determined that the **13th Amendment to the Atomic Energy Act contained unconstitutional elements because it violated property rights under Article 14(1) of the Basic Law by not ensuring electricity delivery for designated electrical capacity nor providing proper financial restitution for investments made based on the 2010** legislative extensions that had previously extended operational life.[25] The domestic constitutional review process and international ISDS system both operate in the same regulatory area which creates multiple legal risks that states must handle during their energy transition process. The political pressure to reach a settlement instead of pursuing a court case demonstrates what Tienhaara documented as the **"regulatory chill" effect because the potential for ISDS claims worth billion euros leads states to postpone or reduce their actual regulatory change**s.[26]

The ICSID claim in ***RWE v. Netherlands*** was filed in 2021 after the Netherlands implemented the Coal Prohibition Act 2019, which required all coal-fired power plants to cease operations

[23] Rockhopper Exploration Plc, Rockhopper Italia SpA and Rockhopper Mediterranean Ltd v Italian Republic, ICSID Case No ARB/17/14, Decision on Annulment (2 June 2025).
[24] Vattenfall AB and others v Federal Republic of Germany (II), ICSID Case No ARB/12/12 (settled 2021).
[25] Bundesverfassungsgericht, 1 BvR 2821/11, Judgment (6 December 2016).
[26] Kyla Tienhaara, 'Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement' (2018) 7(2) Transnational Environmental Law 229, 231–238.

by 2030.[27] The claimant requested to end the proceeding on 12 January 2024, so the tribunal decided that each side would pay their respective expenses. The case outcome did not result in any legal resolution through the discontinuance process but it operates as an essential legal precedent which proves the **existence of a regulatory vice.** An energy utility company based outside of the EU brought an international arbitration case against an EU country because the country had implemented domestic coal phase-out measures which the Paris Agreement and EU climate regulations mandate. The ISDS system creates a chilling effect on climate regulation because the Netherlands experienced legal uncertainty and compliance expenses from the three-year claim process which ended with the registration of the claim.

- **Post-Paris Legitimate Expectations for Fossil Fuel Investors**

The cases reviewed above share a common doctrinal premise that states must provide investors who invested in fossil fuel and carbon-intensive energy assets with either compensation or regulatory continuity. The central argument of this chapter demonstrates **that international law no longer recognises this premise as valid after the Paris Agreement.**

The legitimate expectations doctrine, as qualified in *Saluka*, protects expectations that are reasonable; assessed in the specific legal and factual context in which the investment was made and maintained. Reasonableness must measure against the international legal environment which exists at that time and will continue to develop. The Paris Agreement represents precisely such an evolution: a **universally adopted, legally binding treaty that placed all states on formal notice that fossil fuel-intensive** industries would be subject to progressive and increasingly ambitious climate-motivated regulation.[28] The **investor who continued to put money into fossil fuel assets after December 2015 had full awareness or at least partial awareness that the world community had begun to move away from those assets.** The Paris Agreement was not a surprise regulatory intervention; it was the foreseeable culmination of decades of climate diplomacy and scientific consensus.

The **human rights obligations under the VCLT's systemic integration principle and the Paris Agreement require the ECT to be interpreted in this way**, as propounded by Ekardt

[27] RWE AG and RWE Eemshaven Holding II BV v Kingdom of the Netherlands, ICSID Case No ARB/21/4, Order Taking Note of Discontinuance (12 January 2024).

[28] Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) UNTS 54113, Arts 2, 4. See also Harro van Asselt, 'Governing Fossil Fuel Production in the Age of Climate Disruption: Towards an International Law of Leaving It in the Ground' (2021) 9 Earth System Governance 100118, 9–11.

and his colleagues, because this interpretation significantly limits FET and expropriation rights, which fossil fuel investors could use in their protection.[29] Verbeek's study of ECT modernisation shows that **environmental protection laws should not allow countries to protect their fossil fuel investments from climate change regulations because this practice has become common knowledge** among ECT member states which includes ECT state parties. The evidence for this statement exists through the multiple EU nations which ended their participation in the treaty between the years 2023 and 2024.[30]

The argument maintains **partial investment protection** for fossil fuel investors who have invested in their projects. An investor can establish **legitimate expectations based on the specific individual representations which a state made to them through its assurances of license renewal and its assurances of regulatory framework stability**. The *Saluka* tribunal established two categories which distinguish between investor rights that arise from government actions and the typical regulatory uncertainties which investors must accept as part of their business operations. The argument proves targeted because the **expectation of continuous fossil fuel licensing regulation, which developed in a climate-motivated phase-out environment, violates the legal standards** for legitimate expectations. The *Rockhopper* tribunal treated the situation as ordinary regulatory risk through expropriation analysis, which failed to consider Italy's Paris Agreement obligations.

The FET standard, together with its expropriation legal framework, creates a fundamental mismatch with the international legal system, which currently governs state operations in fossil fuel investment arbitration. The Rockhopper award, though subsequently annulled on procedural grounds, the Vattenfall settlement, and the RWE claim demonstrate that states which fulfil their Paris Agreement commitments together with their PSNR-based conservation rights face serious ISDS risks. The international system requires doctrinal correction through investor protection elimination but needs balanced adjustments which recognize the new global regulatory framework established after Paris. Chapter IV develops that corrective through the proposed climate necessity doctrine.

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[29] Felix Ekardt, Paula Roos, Marie Bärenwaldt and Lea Nesselhauf, 'Energy Charter Treaty: Towards a New Interpretation in the Light of Paris Agreement and Human Rights' (2023) 15(6) Sustainability 5006, 5010–5016.

[30] Bart-Jaap Verbeek, 'The Modernization of the Energy Charter Treaty: Fulfilled or Broken Promises?' (2023) 8 Business and Human Rights Journal 1, 4–9; Isabelle Wenger and Ellen Dixon, 'A Reflection on the Withdrawal from the Energy Charter Treaty: A Step in the Right Direction and Where Do We Go from Here?' (Daily Jus, 19 March 2025).

4. Towards a Climate Necessity Doctrine: Doctrinal Pathways and Framework Proposal

The Vienna Convention on the Law of Treaties (**VCLT**) establishes, through A**rticle 31(3)(c**), that interpreters of treaties must consider international law rules which apply to the parties' relationships together with the treaty's contextual elements.[31] The ILC Study Group on International Law Fragmentation identified this provision as the foundation which establishes the **systemic integration principle requiring treaties to be understood through their relationship to international law** rather than through their separate examination.[32] McLachlan demonstrates that systemic integration requires tribunals to consider all treaty updates which have changed the legal framework that governs specific treaty obligations when they interpret those obligations.[33]

Article 31(3)(c) mandates that the FET standard and expropriation prohibition set forth in the ECT or in any BIT signed between Paris Agreement parties must be interpreted through the framework of the Paris Agreement because it stands as a relevant international law rule which governs the relationships between the involved parties. The **Paris Agreement does not allow parties to disregard their investment treaty obligations.** The tribunal must evaluate fossil fuel phase-out measures because they fall under the jurisdiction of both "fair and equitable" standards and "expropriation" standards which require the tribunal to reach its decision through compliance with the host state's Paris Agreement obligations. The reading of the FET standard, which allows Paris Agreement-mandated phase-out measures to create a "legitimate expectation" of regulatory continuity for the host state, **will lead to a situation where two mandatory international obligations will force the host state to choose between two different binding international obligation**s, which the systemic integration principle exists to prevent.

The Article 31(3)(c) function as an interpretation method not as an independent mechanism which provides defense. The measure will reduce FET protection for fossil fuel investors because it removes certain types of protection. The combination of this element with the

[31] Vienna Convention on the Law of Treaties (adopted 23 May 1969, entered into force 27 January 1980) 1155 UNTS 331, Art 31(3)(c).
[32] ILC, 'Conclusions of the Work of the Study Group on the Fragmentation of International Law' (2006) UN Doc A/CN.4/L.702, Conclusion 17.
[33] Campbell McLachlan, 'The Principle of Systemic Integration and Article 31(3)(c) of the Vienna Convention' (2005) 54(2) International and Comparative Law Quarterly 279, 311-312.

subsequent doctrines delivers optimal effectiveness.

Secondly, the police powers doctrine argues that states cannot be held liable for regulatory actions that do not discriminate against others, serve public interests, and follow proper legal procedures, even if those actions cause economic damage to foreign investors. The investment law doctrine finds its most accurate description through the ***Methanex Corporation v. United States of America*****,** where the tribunal decided that general international law treats non-discriminatory public purpose regulations which follow due process requirements as non-expropriatory regulations which do not require compensation unless the government had made specific international investment protection commitments to the foreign investor before the regulation was enacted.[34] The *Saluka* tribunal established that states hold the authority to regulate for public purposes, while the investor protection rights extend only to the existing regulatory system at the time of the investment, which includes all potential future regulatory changes.[35]

The legislation for fossil fuel phase-out operates through transparent and non-discriminatory laws, which create structural pathways for police powers evaluation because it establishes general rules that serve a recognised public interest through standard legislative procedures. The ***Methanex*** **caveat establishes that the doctrine becomes void when the state establishes "specific commitments"** to avoid particular regulatory actions. Police powers doctrine establishes grounds for non-compensable treatment of climate-related phase-outs because no investor-specific guarantees were provided to the parties involved. The doctrine's limitation arises from different tribunals, which implement a competing test that evaluates expropriation based on "sole effects", which makes the regulatory purpose of the actions become unimportant when the investor faces major economic losses. The ISDS system does not treat this doctrine as a universally binding principle because different tribunals apply their own standards to expropriation assessment.[36]

The ILC's Articles on Responsibility of States for Internationally Wrongful Acts (2001) Article 25 depicts that States can only use necessity as a defence when an essential interest faces

[34] Methanex Corporation v United States of America, UNCITRAL, Final Award on Jurisdiction and Merits (3 August 2005), Part IV, Chapter D, para 7.

[35] Saluka Investments BV (The Netherlands) v Czech Republic, UNCITRAL, Partial Award (17 March 2006), para 305.

[36] Catharine Titi, 'Police Powers Doctrine and International Investment Law' in Andrea Gattini, Attila Tanzi and Filippo Fontanelli (eds), General Principles of Law and International Investment Arbitration (Brill Nijhoff 2018) 322-340.

imminent danger, and the State must take the necessary action to protect it. The international community recognizes Article 25(2) that States cannot use necessity defense when international treaties already established their obligation to act without exception.[37]

The threshold requirement deliberately operates at an elevated standard. The ICJ confirmed in **Gabčíkovo-Nagymaros Project (1997) that the peril invoked must be "established at the relevant point in time" and the contested measure must be "the only means" available to the state a strict necessity requirement that excludes the defence where** less treaty-incompatible alternatives exist.[38] The necessity defence has not succeeded in ISDS cases because the annulment committee **in *Sempra v. Argentina* established that states lack the authority to determine their own necessity requirements according to customary law**.[39] The "only way" requirement creates significant problems for fossil fuel phase-outs because tribunals can determine that less disruptive alternatives (extended timelines, partial curtailment, domestic compensation schemes) remained accessible for investment protection. The proposed doctrine treats Article 25 as a residual pathway for extreme cases while establishing other provisions as its primary foundation.

A proportionality framework requires a tribunal to weigh the public interest pursued by a regulatory measure against the specific harm imposed on the investor, rather than treating the investor's expectation as an absolute entitlement. The tribunal in *Philip Morris Brands v. Uruguay* (ICSID, 2016) used this analysis to determine that Uruguay's tobacco packaging regulations served as a "reasonable bona fide exercise of police powers" for public health protection. The tribunal found the regulations to be proportional to their public health objective notwithstanding that they created major financial burdens for the investor.[40]

In investment cases where tribunals use a proportionality framework, the public interest weight determines the case outcomes.[41] Proportionality is particularly suited to the climate context because it allows tribunals to acknowledge investor loss while according substantive weight to climate objectives whose importance the international community has formally recognised.

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[37] ILC, 'Articles on Responsibility of States for Internationally Wrongful Acts' (2001) UN Doc A/56/10, Art 25(1)-(2).

[38] Case Concerning the Gabcikovo-Nagymaros Project (Hungary v Slovakia) [1997] ICJ Rep 7, para 52.

[39] Sempra Energy International v Argentine Republic, ICSID Case No ARB/02/16, Decision on Annulment (29 June 2010), para 202.

[40] Philip Morris Brands Sarl, Philip Morris Products SA and Abal Hermanos SA v Oriental Republic of Uruguay, ICSID Case No ARB/10/7, Award (8 July 2016), paras 291-305.

[41] Caroline Henckels, 'Proportionality and the Separation of Powers in International Investment Law: Judicial Restraint or Slippage?' (2013) 4(2) Journal of International Dispute Settlement 229, 237-242.

The framework permits analysis through its discretionary nature, but functions as a non-binding rule which tribunals will apply differently.

4.1 The Proposed Climate Necessity Doctrine: Criteria, Scope, and Consequences

The **four pathways are individually incomplete but collectively coherent**. The synthesis supports a "climate necessity doctrine" that establishes a structured framework which enables states to limit and resist ISDS liability for fossil fuel phase-out measures that meet four cumulative qualifying criteria. The doctrine applies existing investment law tools through its principled implementation to address urgent climate-related regulatory changes.

The first criterion is **scientific basis**: the phase-out measure must be demonstrably grounded in IPCC-recognised climate science or in the state's binding commitments under the Paris Agreement NDC mechanism. The requirement establishes limits for the doctrine which only permit real climate action while banning its usage for arbitrary resource nationalism. The IEA's Net Zero by 2050 finding that no new fossil fuel supply development is required on a credible 1.5°C pathway beyond projects already approved in 2021 **provides a concrete technical benchmark against which the necessity of phase-out decisions** can be assessed.[42]

The second criterion is **non-arbitrariness**: the measure must be implemented through transparent, non-discriminatory, and procedurally fair regulatory action, consistent with the *Methanex* formulation. A phase-out applicable only to certain foreign investors' assets would not meet this standard, when some equivalent operations proceed thereunder domestically. The doctrine operates exclusively on general measures which "affect, inter alios, a foreign investor" according to Methanex but it does not apply to measures which specifically target that investor.

The third criterion is **proportionality**: the measure must not impose a burden on the investor that is manifestly disproportionate to the climate objective pursued, as informed by the *Philip Morris* and *Saluka* proportionality analysis. Measures which provide a reasonable transition period for operation phase-out while giving investors sufficient notice and adaptation time will meet this requirement more easily than an abrupt termination without transitional arrangements.

The fourth criterion requires that the state must not have made specific individual promises to

[42] IEA, 'Net Zero by 2050: A Roadmap for the Global Energy Sector' (International Energy Agency 2021) 21.

the investor which would guarantee their protection from the relevant phase-out. The doctrine of legitimate expectations maintains its essential function through the Methanex and Tecmed judgments, which establish that a **state must sustain its commitments after creating specific reliance through its particular commitments**. The doctrine applies to general regulatory change, not to the breach of specific investor-directed promises.

4.2 Repercussions of Successful Invocation

The successful invocation of the doctrine results in two distinct outcomes. The first one establishes full non-compensation; it treats any measure that meets all four criteria as non-compensable regulatory action because the state exercises its PSNR conservation prerogative to fulfil international climate obligations without committing any internationally wrongful act. The current model delivers a doctrinal solution which maintains full consistency with the PSNR analysis presented in Chapter 2. The goal proves more challenging to reach because investment tribunals prioritise investor protection rights according to their established policies.

The second model establishes partial compensation because successful invocation results in a decrease of damages instead of complete damage elimination, as the investor invested in a sector with climate-mandated phase-out requirements. The approach applies the contributory fault and investor due diligence analysis which some investment tribunals used to reduce damages.[43] The approach exists at a more fundamental degree yet it maintains better possibilities for practical accomplishment while it aligns with the sustainability-oriented investment law framework which Wewerinke-Singh and Triefus developed.[44] The above doctrine holds that a state fulfilling all four criterias should not be exposed to full commercial replacement value as the damages baseline, an outcome that would make Paris Agreement compliance financially prohibitive.

[43] Josef Ostransky, Florencia Sarmiento and Suzy Nikiema, 'Why Is Investment Treaty and Investor-State Dispute Settlement Reform Needed?' (IISD, March 2025) 14-16.

[44] Margaretha Wewerinke-Singh and Stephanie Triefus, 'Key Dimensions of International Trade and Investment Law from a Sustainability Perspective' in M Wewerinke-Singh (ed), Handboek Duurzaamheid en Recht (Wolters Kluwer 2025).

5. Critical Analysis

5.1 Key Objections

Objection 1: Uncertain Investment

The proposed doctrine faces its first major objection which states that it will create unpredictability for fossil fuel investments while raising capital costs for energy initiatives in developing countries that rely on hydrocarbon revenue streams. The objection has substantial impact because investment treaty protection functions to diminish political risk premiums which leads to capital attraction, while the doctrine will restrict this protection, raising financing expenses for projects that some countries still consider valid development priorities.

Response: The objection assumes that fossil fuel asset investors expect regulatory stability which the doctrine takes away. The assumption fails to defend itself after the Paris Agreement because sophisticated investors in carbon-intensive assets gained constructive notice of climate-based regulatory changes from 2015 onward. The doctrine does not take away a legitimate investor right because it refuses to accept an expectation which international law had already diminished. The fourth criterion of the doctrine establishes that states maintain full investment protection when they provide particularized guarantees to investors. The effects extend to general regulatory expectations whereas specific reliance on regulations remains unaffected. The existing ISDS system produces major economic burdens for developing countries which result from its extended legal procedures and costly damage payouts and regulatory restrictions that make investment choices and development plans impractical.[45]

Objection 2: Climate Necessity Clause

It states that governments will misuse climate requirements to implement policies which function as arbitrary and discriminatory and confiscatory practices while claiming them to be climate-based measures. The public interest defense has been attempted by states in investment arbitration where the regulatory intent of the case was disputed.

Response: The four-criteria framework from Chapter IV provides a direct method to deal with this risk. The scientific basis criterion requires that the measure be grounded in IPCC-

[45] Josef Ostransky, Florencia Sarmiento and Suzy Nikiema, 'Why Is Investment Treaty and Investor-State Dispute Settlement Reform Needed?' (IISD, March 2025) 14-16.

recognised climate science or Paris Agreement NDC commitments, a requirement that creates an objective, internationally recognised benchmark against which the claim of necessity can be assessed. Measures that do not correspond to any recognised climate target cannot fulfil this requirement. The non-arbitrariness criterion excludes measures of selective application that target specific investors. Proportionality review permits the tribunal to scrutinise the regulatory design. The absence-of-specific-representations criterion protects investors because states created the reliance that they now attempt to disprove. These criteria function as the protective measures which the doctrine demands and they emerge from existing standards which investment tribunals utilize. The objection, in short, is an argument for robust criteria, not an argument against the doctrine itself.

Objection 3: Treaty Reform

The third objection states that investment law should undergo climate regulation changes through treaty amendments which will be achieved by ECT modernization and bilateral investment treaty renegotiation and UNCITRAL multilateral instrument development while arbitral interpretation should not create new legal standards which the process considers illegitimate at this stage.

Response:

The doctrinal development proposed in this paper does not require any tribunal to exceed its interpretive mandate: it applies the VCLT's own rules of treaty interpretation (Article 31(3)(c)), draws on recognised doctrines (police powers, proportionality, necessity), and asks only that tribunals read investment treaty obligations consistently with co-existing international law including the Paris Agreement. This practice fulfils the requirements of systemic integration.[46] Investment law's most fundamental doctrines, legitimate expectations, proportionality, and the police powers doctrine itself, were developed through arbitral jurisprudence without explicit treaty authority. The proposed doctrine follows the same methodology. The process of treaty reform moves at a very slow pace while facing high levels of unpredictability. The ECT modernisation process required seven years to complete treaty negotiations, and states that withdraw from the treaty will face a 20-year period during which they must adhere to the original ECT terms after withdrawal. The process of doctrinal development through

[46] Campbell McLachlan, 'The Principle of Systemic Integration and Article 31(3)(c) of the Vienna Convention' (2005) 54(2) International and Comparative Law Quarterly 279, 311-312.

interpretation functions as an essential temporary solution which enables operations during the time before reform achieves its total implementation.

5.2 Consequences

The proposed doctrine requires its implementation to connect with two major ongoing investment law reform processes which are currently in progress.

The Energy Charter Conference approved the modernized ECT on 3 December 2024 after fifteen negotiation rounds which began with an initial agreement on 24 June 2022.[47] The modernized treaty establishes multiple provisions which directly address the doctrine's fundamental issues. The Treaty introduces a new article in Part III which establishes a separate right-to-regulate for contracting parties to execute their regulatory authority according to their public policy goals which the Energy Charter Secretariat defines as environmental protection goals which include climate change mitigation and adaptation.[48] The new Article 19 bis establishes a basic duty for all contracting parties to fulfil their commitments from the UNFCCC and the Paris Agreement. The definition of indirect expropriation is also modified to establish that non-discriminatory measures which governments adopt to protect their legitimate policy objectives will not count as indirect expropriation because these measures protect climate change mitigation and adaptation design.[49]

The modernised ECT requires two restrictions which must be recognized for its operational outcomes. First, ten Contracting Parties including Germany, France, the United Kingdom, Spain, the Netherlands, Poland, Slovenia, Luxembourg, Portugal, and the EU itself have formally withdrawn from the ECT, largely citing climate-related concerns.[50] Verbeek's analysis demonstrates that the modernisation project resulted in a politically important division which undermined ECT's function as the main international investment treaty for the energy sector.[51] The ECT's original twenty-year sunset clause protects all investments which take place before a country exits from the treaty until their sunset dates, because treaty text protects

[47] Energy Charter Conference, Decision on the Modernisation of the Energy Charter Treaty (3 December 2024)
[48] Energy Charter Secretariat, 'Public Communication Explaining the Main Changes Contained in the Agreement in Principle' (24 June 2022).
[49] Ibid.
[50] Isabelle Wenger and Ellen Dixon, 'A Reflection on the Withdrawal from the Energy Charter Treaty: A Step in the Right Direction and Where Do We Go from Here?' (Daily Jus, 19 March 2026).
[51] Bart-Jaap Verbeek, "The Modernization of the Energy Charter Treaty: Fulfilled or Broken Promises?" (2023) 8 Business and Human Rights Journal 1, 4-9.

such investments until the established expiration date. The proposed climate necessity doctrine therefore retains its relevance as an interpretive tool under the original ECT for precisely the cases where the modernised text does not yet apply.

UNCITRAL Working Group III, which started its first mandate in 2017, has developed ISDS reform solutions through its establishment of a Code of Conduct for Adjudicators and an Advisory Centre Statute for International Investment Dispute Resolution.[52] The Working Group identified "regulatory chill" as an issue requiring more research during its September 2022 session which included the Draft Provision 12 on the Right to Regulate that UNCITRAL Secretariat proposed.[53] The EJIL commentary on the Working Group's proceedings shows that the body's mandate has emerged through procedural definitions, while states still dispute basic climate-related regulatory rights and capital-exporting states oppose any rule changes which would reduce investor safeguards.[54] The climate necessity doctrine exists as an operational framework which remains suspended until Working Group III reaches its final decision.

[52] UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the Work of Its Forty-Fourth Session' (Vienna, 14-18 February 2022) UN Doc A/CN.9/1124.
[53] UNCITRAL Secretariat, 'Draft Provisions on Procedural and Cross-Cutting Issues' (July 2023) UN Doc A/CN.9/WG.III/WP.232, Draft Provision 12 (Right to Regulate).
[54] See the discussion of the 46th Session (October 2023) in 'The Mandate Conundrum: Reflections on the 46th Session of the UNCITRAL Working Group III on ISDS Reform'.