



# Breaking Barriers: Integrating Energy Justice to Overcome Investor-State Dispute Settlement (ISDS) Roadblocks to Climate Change Mitigation Efforts

*Demilade Isioma Elemo*

**Abstract** This chapter examines the relationship between investment, energy security, and the investor-state dispute settlement (ISDS) regime, an area often overlooked in energy justice conversation. The ISDS regime, designed to safeguard foreign investments, faces a legitimacy crisis exacerbated by its perceived misalignment with climate change mitigation efforts. Through the lens of energy justice, this chapter explores the criticisms against the ISDS regime by framing them as “energy injustices”. Distributive injustices manifest in unfair cost allocation, favouring investors over just transition efforts and placing a disproportionate burden on developing nations. Restorative injustices arise from the potential for opportunistic claims and excessive compensation claims, hindering

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D. I. Elemo (✉)  
Centre for Energy, Petroleum and Mineral Law and Policy (CEPMLP),  
University of Dundee, Dundee, UK  
e-mail: [140004258@dundee.ac.uk](mailto:140004258@dundee.ac.uk)

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the just transition. Cosmopolitan injustices occur when tribunals fail to address human and environmental rights issues in investment disputes. The chapter proposes that the ongoing reforms of the ISDS regime be guided by energy justice principles, emphasising equitable cost-sharing, clear criteria for damages, and integrating human and environmental rights into investment agreements. Aligning reforms with energy justice principles can help legitimise the regime, ensuring it plays an effective role the transition to a low-carbon economy and contributing to global energy justice.

**Keywords** Investor-state dispute settlement · Energy justice · Climate change · Distributive justice

## 14.1 INTRODUCTION

Investment is essential to obtaining energy security, addressing energy poverty, putting the world on a path to net-zero emissions, stimulating post-COVID-19 economic recovery, and ensuring sustainable development in developing nations.<sup>1</sup> As such, the investor-state dispute settlement (ISDS) regime, a contract or (but mostly) treaty-based regime of rights, principles, and standards that imposes obligations on host states to foreign investments in their territories, is a vital aspect of the energy sector. Though often overlooked in the energy justice discourse, the ISDS regime is particularly relevant to the energy sector as it mitigates political risks associated with energy projects.<sup>2</sup>

<sup>1</sup> IEA. (2022). World Energy Investment 2022, IEA, Paris. <https://www.iea.org/reports/world-energy-investment-2022>, License: CC BY 4.0.

<sup>2</sup> Moehlecke, C., & Wellhausen, R.L. (2022). Political Risk and International Investment Law. *Annual Review of Political Science*, 25, pp. 485–507. For more on political risk, see Yackee, J.W. (2014). Political Risk and International Investment Law. *Duke Journal of Comparative & International Law*, 24, pp. 477–500.

However, the regime is currently facing a legitimacy crisis.<sup>3</sup> The criticisms of the ISDS regime are myriad, but most relevant to the energy justice conversation is the claim that the regime is at odds with climate efforts.<sup>4</sup> Considering the symbiotic relationship between the ISDS regime and the energy sector,<sup>5</sup> this chapter analyses the criticisms of the ISDS regime through an energy justice lens and examines how justice principles may legitimise the regime.

## 14.2 LEGITIMACY CRITICISMS OF THE ISDS REGIME AS “ENERGY INJUSTICES”

Energy justice comprises central tenets, including distribution, procedural, recognition, restorative, and cosmopolitan justice.<sup>6</sup> Many criticisms of the ISDS regime can be represented as energy injustices within these tenets.

<sup>3</sup> See generally, Waibel, M., Kaushal, A., Chung, K., & Balchin, C. (2010). *The Backlash Against Investment Arbitration: Perceptions and Reality*. Wolters Kluwer Law & Business.

<sup>4</sup> Tienhaara, K. (2018). Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement. *Transnational Environmental Law*, 7, p. 229.

<sup>5</sup> Whitsitt, E., & Banks, N. (2013). The Evolution of International Investment Law and Its Application to the Energy Sector. *Alberta Law Review*, 51, p. 207.

<sup>6</sup> Jenkins, K.E.H., McCauley, D., Heffron, R., Stephan, H., & Rehner, R.W.M. (2016). Energy Justice: A Conceptual Review. *Energy Research and Social Science*, 11, pp. 174–182. <https://doi.org/10.1016/j.erss.2015.10.004>; Sovacool, B.K., & Dworkin, M.H. (2021). *Global Energy Justice: Problems, Principles, and Practices*. Cambridge University Press; Heffron, R.J., & McCauley, D. (2017). The Concept of Energy Justice Across The Disciplines. *Energy Policy*, 105, pp. 658–667; Sovacool, B.K., Martiskainen, M., Hook, A., & Baker, L. (2019). Decarbonization and Its Discontents: A Critical Energy Justice Perspective on Four Low-Carbon Transitions. *Climatic Change*, 155, pp. 581–619.

### 14.2.1 *Distributive Injustice in ISDS*

Distributive justice is concerned with the fair and equitable distribution of the costs and benefits in the energy system.<sup>7</sup> Within the ISDS regime, distributive justice concerns are raised in two dimensions. First, distributive injustice arises from unfair cost allocation between host states and foreign investors,<sup>8</sup> benefiting investors at the expense of just transition efforts. The implication of this is that states can be and have been challenged for actions taken in furtherance of the just transition to a low-carbon economy.<sup>9</sup> The other dimension is the disproportionate burden developing nations bear within the regime.<sup>10</sup> Regulatory chill, for instance, is more likely to occur in developing nations<sup>11</sup> and even more so for climate-related policies.<sup>12</sup> Furthermore, the criticism of high litigation and liability costs<sup>13</sup> imposes a more significant burden on developing nations. While substantial damages have been granted against both developed and developing countries, the amounts awarded constitute a

<sup>7</sup> Van Bommel, N., & Höffken, J.I. (2021). Energy Justice Within, Between and Beyond European Community Energy Initiatives: A Review. *Energy Research and Social Science*, 79, 102157.

<sup>8</sup> Bonnitcha, J. (2014). *Substantive Protection Under Investment Treaties: A Legal and Economic Analysis*. Cambridge University Press. Chapter 3, pp. 83–102.

<sup>9</sup> In *RWE v. Netherlands*, ICSID Case No. ARB/21/4, 20 January 2021 and *Uniper v. Netherlands*, ICSID Case No. ARB/21/22, Order of Discontinuance, 17 March 2023, the investors sued the Dutch government on the grounds that coal phase-out legislation interfered with their property rights. In *Westmoreland v. Canada* ICSID Case No. UNCT/20/3, and *Lone Pine v. Canada* ICSID Case No. UNCT/15/2, the government was sued for placing a moratorium on hydrocarbon exploration in Alberta and Quebec.

<sup>10</sup> Bonnitcha, J., Poulsen, L., & Waibel, M. (2017). *The Political Economy of the Investment Treaty Regime*. Oxford: Oxford University Press.

<sup>11</sup> Wälde, T. (2010). The Regulatory Chill in International Investment Law: A Threat to Development? *Journal of World Investment & Trade*, 11(1), pp. 131–158.

<sup>12</sup> Tienhaara, K. (2019). Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement. *Journal of International Economic Law*, 22(2), pp. 341–374.

<sup>13</sup> Johnson, L., & Sachs, L. (2016). The Outsized Costs of Investor-State Dispute Settlement. 16 AIB Insights [https://scholarship.law.columbia.edu/sustainable\\_investment\\_staffpubs/114](https://scholarship.law.columbia.edu/sustainable_investment_staffpubs/114). Accessed 28 May 2023.

larger percentage of the income of poorer nations. Two of the most widely criticised awards in terms of the quantum of damages are in relation to energy-related disputes in developing nations. Recently, Pakistan and Nigeria had US\$4 billion and US\$6 billion awarded against them, respectively.<sup>14</sup> Compared to the €1.4 billion claimed by RWE against Netherlands, the 17th largest economy in the world, it appears that developing nations get the shorter end of the stick. Concerningly, the Pakistani award was comparable to the value of International Monetary Fund's (IMF) bailout that had only recently been negotiated to prevent the collapse of the Pakistani economy.<sup>15</sup> Also, a recent study which anticipated financial risk from possible ISDS claims found that more than two-thirds of the risk is borne by nations in the Global South.<sup>16</sup>

#### 14.2.2 Restorative Injustice in ISDS

Restorative justice is concerned with rectifying injustices arising from energy decision-making.<sup>17</sup> It seeks to restore claimants to their original position prior to a damaging activity.<sup>18</sup> In the ISDS regime, this is what happens when tribunals instruct states to pay investors for their wrongful interference with investments. However, the regime is vulnerable to exploitation by unscrupulous investors seeking financial gains

<sup>14</sup> Tethyan Copper Company Pty Limited v Islamic Republic of Pakistan, ICSID Case No ARB/12/1, Award, 12 July 2019, para 278; Process and Industrial Developments Limited v Nigeria, 2018 WL 2080765, Ad Hoc Arbitration, Final Award, 31 January 2017.

<sup>15</sup> Masood, S. (2019, May 12). Pakistan to Accept \$6 Billion Bailout from I.M.F. *The New York Times*. <https://www.nytimes.com/2019/05/12/world/asia/pakistan-imf-bailout.html>.

<sup>16</sup> Tienhaara, K., Thrasher, R., Alexander Simmons, B., & Gallagher, K.P. (2022). Investor-State Dispute Settlement: Obstructing a Just Energy Transition. *Climate Policy*. <https://doi.org/10.1080/14693062.2022.2153102>.

<sup>17</sup> Sovacool, B.K., Heffron, R.J., McCauley, D., & Goldthau, A. (2016). Energy Decisions Reframed as Justice and Ethical Concerns. *Nature Energy*, 1(5), pp. 1–6.

<sup>18</sup> Hazrati, M., & Heffron, R.J. (2021). Conceptualising Restorative Justice in the Energy Transition: Changing the Perspectives of Fossil Fuels. *Energy Research & Social Science*, 78, 102115.

rather than engaging in legitimate business activities. In fact, the awards against Nigeria and Pakistan were in relation to projects that never got off the ground, highlighting the potential for opportunistic claims within the ISDS system. This exploitation has led to ISDS awards being treated as speculative financial assets, with financial speculators purchasing corporations with potential winnable ISDS claims, and even hedge funds financing ISDS cases.<sup>19</sup> A study has shown that a majority of the claimants in the Spanish renewable energy investments disputes saga were portfolio investors,<sup>20</sup> some of whom profited both from an increase in value of their stake and from the ISDS awards.<sup>21</sup> Restorative injustice also occurs with respect to liability costs. Damages claimed by investors have increasingly become higher over the years with more incidents of claims in excess of US\$ 1 billion.<sup>22</sup> These “mega claims” are a consequence of the structural bias in the ISDS regime in favour of claimants,<sup>23</sup> the huge discretion wielded by tribunals,<sup>24</sup> and the underdeveloped body of rules pertaining to valuation of damages.<sup>25</sup> The challenge this poses with respect to the just transition is that the exorbitant amount of compensation that investors receive serve to raise the cost of the transition and reduce the public funding available for green investments.<sup>26</sup>

<sup>19</sup> Sundaram, J.K. (2017). Investor-State Dispute Settlement Becomes Speculative Financial Asset. *Third World Economics*, Issue No. 637, p. 15. [https://twm.my/title2/twe/2017/637/8\(Opinion\).htm](https://twm.my/title2/twe/2017/637/8(Opinion).htm).

<sup>20</sup> Bárcena, L., & Flues, F. 2020. From Solar Dream to Legal Nightmare. How Financial Investors, Law Firms, and Arbitrators Are Profiting from the Investment Arbitration Boom in Spain. *Policy*.

<sup>21</sup> See *Watkins Holdings S.à r.l. and others v. Kingdom of Spain*, ICSID Case no. ARB/15/44, Award (21 Jan 2020), at para. 16.

<sup>22</sup> Hart, T.H., & Vélez, R. (2021). Study of Damages Awards in Investor-State Cases. *Transnational Dispute Management (TDM)*, 18(3).

<sup>23</sup> Kahale, G. (2021). It’s quantum! Columbia FDI Perspectives. No. 314.

<sup>24</sup> Marzal, T. (2021). Quantum (In) Justice: Rethinking the Calculation of Compensation and Damages in ISDS. *The Journal of World Investment & Trade*, 22(2), pp. 249–312.

<sup>25</sup> Tszchanz, P.Y., & Viñuales, J.E. (2009). Compensation for Non-expropriatory Breaches of International Investment Law—The Contribution of the Argentine Awards. *Journal of International Arbitration*, 26(5).

<sup>26</sup> Tienhaara, K., Thrasher, R., Simmons, B.A., & Gallagher, K.P. (2022). Investor-State Dispute Settlement: Obstructing a Just Energy Transition. *Climate Policy*, pp. 1–16.

### 14.2.3 *Cosmopolitan Injustice in ISDS*

The cosmopolitan view considers injustice to be a universal problem that applies to all human beings in all nations<sup>27</sup> and necessitates the adherence to universal principles.<sup>28</sup> It is particularly concerned with the protection of global human rights,<sup>29</sup> an idea at the core of Heffron's energy justice circle.<sup>30</sup> In ISDS, cosmopolitan injustice manifests when tribunals decline to address human and environmental rights issues in investment disputes. Increasingly, national courts have been instrumental in upholding energy justice by safeguarding human rights in response to diverse energy activities throughout the energy life cycle.<sup>31</sup> Unfortunately, the ISDS regime has lagged in this regard, facing criticism for its failure to align with the protection of human and environmental rights.<sup>32</sup>

Although it has been argued that Article 31(3)(c) of the Vienna Convention on the Law of Treaties<sup>33</sup> could be invoked to incorporate international human rights law in investment arbitration, tribunals

<sup>27</sup> McCauley, D., Ramasar, V., Heffron, R.J., Sovacool, B.K., Mebratu, D., & Mundaca, L. (2019). Energy Justice in the Transition to Low Carbon Energy Systems: Exploring Key Themes in Interdisciplinary Research. *Applied Energy*, 233, 916–921.

<sup>28</sup> Moellendorf, D. (2018). *Cosmopolitan Justice*. Routledge, p. 171.

<sup>29</sup> Sovacool, B.K., Martiskainen, M., Hook, A., & Baker, L. (2019). Decarbonization and Its Discontents: A Critical Energy Justice Perspective on Four Low-Carbon Transitions. *Climatic Change*, 155, pp. 581–619.

<sup>30</sup> Heffron, R.J. (2021). Human Rights at the Heart of Energy Justice. *Global Energy Law and Sustainability*, 2(2), pp. v–ix. Heffron, R.J. (2021). Editorial: Human Rights at the Heart of Energy Justice. *Global Energy Law and Sustainability*, 2, v.; Wewerinke-Singh, M. (2022). A Human Rights Approach to Energy: Realizing the Rights of Billions Within Ecological Limits. *Review of European, Comparative & International Environmental Law*, 31(1), 16–26.

<sup>31</sup> In an analysis of over 100 energy-related cases across the world, Heffron finds that through energy justice, national courts have protected the right to life, health, minimum subsistence, freedom, human dignity, water, healthy environment, air, culture, property, adequate housing, security and a fair trial. Heffron, R.J. (2022). Applying Energy Justice into the Energy Transition. *Renewable and Sustainable Energy Reviews*, 156, 111936.

<sup>32</sup> Behn, D., & Langford, M. (2017). Trumping the Environment? An Empirical Perspective on the Legitimacy of Investment Treaty Arbitration. *The Journal of World Investment & Trade*, 18(1), pp. 14–61; Bodea, C., & Ye, F. (2017). Bilateral Investment Treaties (BITs): The Global Investment Regime and Human Rights. *British Journal of Political Science*.

<sup>33</sup> The article states that “any relevant rules of international law applicable in the relations between the parties” must be taken into account when interpreting treaties”.

have been hesitant to venture beyond the specific investment treaty at hand in addressing human rights issues.<sup>34</sup> Even when they do consider such matters, tribunals have typically concluded that corporations bear the obligation to refrain from actions that infringe upon human rights, but they are not obliged to take affirmative actions to promote human rights.<sup>35</sup> This represents a missed opportunity for the ISDS regime to advance energy justice, particularly as the foreign investor tends to be cosmopolitan, having business interests in several states.<sup>36</sup> If ISDS can hold multinational corporations accountable and responsible for human rights violations and protections in one host state, it will influence corporate behaviour in other host states.

### 14.3 RETOOLING ENERGY JUSTICE PRINCIPLES FOR ISDS REFORM

Recognising the shortcomings of the ISDS regime, various reform proposals have been put forward.<sup>37</sup> To ensure meaningful reform, energy justice principles should guide these efforts.

Proposed amendments to underlying investment treaties should adopt firstly a distributive justice approach. This will ensure that costs and responsibilities are equitably allocated under the regime by imposing reciprocal obligations on investors, such as the inclusion of human rights and environmental issues in IIAs such as in the Nigeria-Morocco BIT. Secondly, restorative justice principles can help strike a balance between protecting investments and preventing opportunistic behaviour. Establishing clear criteria and guidelines for determining damages can prevent

<sup>34</sup> For example, in *Bear Creek Mining Corporation v. Republic of Peru*, ICSID Case No. ARB/14/2.

<sup>35</sup> *Urbaser S.A. and Consorcio de Aguas Bilbao Biskaia, Bilbao Biskaia Ur Partzuergoa v. Argentine Republic* (ICSID Case No. ARB/07/26) para. 1210.

<sup>36</sup> Sloane, R.D. (2009). Breaking the Genuine Link: The Contemporary International Legal Regulation of Nationality. *Harvard International Law Journal*, 50, p. 54.

<sup>37</sup> See Brewin, S., & Schaugg, L. (2022). Uncertain Climate Impact and Several Open Questions: An Analysis of the Proposed Reform of the Energy Charter Treaty. IISD. <https://www.iisd.org/publications/report/energy-charter-treaty-agreement-analysis>; UNCITRAL Working group III on ISDS Reform.



inflated compensation claims that hamper the just transition.<sup>38</sup> Another valid suggestion that aligns with restorative justice is a gain-based calculation which suggests that compensation be limited to the investor's actual expenditure, taking into account whether the host state benefitted from the investment before breaching its obligations. The approach aims to discourage opportunistic conduct while allowing host states to adapt to changing circumstances.<sup>39</sup> Lastly, cosmopolitan justice entails a collective moral obligation and responsibility towards others, thereby encompassing ethical responsibilities that apply to all actors capable of comprehending, facilitating, and acting upon them.<sup>40</sup> This should include arbitrators on ISDS tribunals. Human rights and investment concerns are not mutually exclusive and should not be compartmentalised, particularly considering the track record of energy investors in violating human and environmental rights, especially in the Global South.

#### 14.4 CONCLUSION

The shortcomings of the ISDS regime present a real threat to the just transition agenda and the pursuit of energy justice. Distributive injustices pose a challenge by allowing claims against climate policy and set back energy access goals in developing nations. Restorative injustice can circumvent climate finance and cosmopolitan injustices undermine environmental efforts.

<sup>38</sup> Bekker and Bello have suggested a three-stage contextualised approach to adopt some structure in the valuation of damages in Bekker, P., & Bello, F. (2021). Reimagining the Damages Valuation Framework Underlying Fair and Equitable Treatment Standard Violations through a Three-Stage Contextualized Approach. *ICSID Review-Foreign Investment Law Journal*, 36(2), pp. 339–365.

<sup>39</sup> Bonnitche, J., & Aisbett, E. (2020). Against Balancing: Revisiting the Use/Regulation Distinction to Reform Liability and Compensation Under Investment Treaties. *Michigan Journal of International Law*, 42, p. 231.

<sup>40</sup> Sovacool, B.K., Martiskainen, M., Hook, A., & Baker, L. (2019). Decarbonization and Its Discontents: A Critical Energy Justice Perspective on Four Low-Carbon Transitions. *Climatic Change*, 155, pp. 581–619.

Following the backlash against ISDS, states have been withdrawing or exiting from the regime.<sup>41</sup> This is not a particularly welcome development as investments remain a key part of achieving net-zero targets. Studies have shown that foreign investors value access to non-state dispute resolution methods as it depoliticises disputes. In the absence of the ISDS regime, investors might seek alternatives in political risk insurance with the high cost of premiums being transferred to the final consumer. This may make clean energy less affordable and further exacerbate energy poverty and lower living standards, especially in poorer nations and amongst the less privileged in developed countries. ISDS thus plays an important role in balancing the interests between states and foreign investors, thus achieving global energy justice.

Yet, it can lose its effectiveness without legitimacy and energy justice can help to legitimise the regime. This is important because rules that align with a general sense of justice are more likely to be respected.<sup>42</sup> Energy justice is proving increasingly useful as a means of bringing together disparate but clearly linked causes under a shared discourse.<sup>43</sup> Overall, reforming the ISDS regime in alignment with energy justice principles positions it as an effective tool in the just transition to a low-carbon economy.

<sup>41</sup> For instance, South Africa terminated its BITs. France, Spain and other EU countries have withdrawn from the Energy Charter Treaty. <https://www.euractiv.com/section/energy/news/exit-from-energy-charter-treaty-unavoidable-eu-commission-says/>.

<sup>42</sup> Ratner, S.R. (2017). International Investment Law Through the Lens of Global Justice. *Journal of International Economic Law*, 20(4), pp. 747–775.

<sup>43</sup> Jenkins, K. (2018). Setting Energy Justice Apart From the Crowd: Lessons from Environmental and Climate Justice. *Energy Research & Social Science*, 39, pp. 117–121.

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