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ARBITRATING CLIMATE DISPUTES: AN EMERGING TREND

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ABSTRACT

Climate change refers to changes in temperatures and weather patterns, mainly due to human activities such as burning of fossil fuels. It has become our biggest concern and it has consequences such as floods, droughts, melting of glaciers etc. Because of this, governments and companies have started taking steps such as making laws, regulations regarding climate change. Shareholders are putting pressure on companies to take measures regarding climate change. Companies are engaging in contracts and put obligations such as reducing carbon emission and greenhouse emissions and improving energy efficiency. When these obligations are violated, disputes arise between the companies. A dispute between the investor and government can also arise where, the government can sue the investors for violating the environment laws, rules and regulations or where companies sue the government under an International Investment Agreement (IIA) and claims that the climate policies harm their investment. Court proceedings can often take several years to reach a final judgment, making arbitration a preferred alternative for quicker dispute resolution. In this article we are going to analyze how climate dispute arise, how they can be resolved through arbitration and why it's becoming a preferred method to resolve climate-related disputes.

Keywords: - Climate Change dispute, International Arbitration, Net-zero commitments, International Chamber of Commerce.

INTRODUCTION

Climate change has become one of the biggest concerns in our time. Initiatives to control climate change have become a defining global issue. Although some climate variations occur naturally, human activities have been the main driver of climate change since the 1800s, mainly through the burning of fossil fuels such as coal, oil, and gas. These activities release greenhouse gas emissions into the atmosphere, trapping heat from the sun and causing the Earth's temperature to rise.

Other major contributors to climate change, closely linked to the burning of fossil fuels for energy, include transportation, industrial production, the energy used in buildings, food production systems, and deforestation. Together with growing levels of overconsumption and waste, these activities significantly increase greenhouse gas emissions and accelerate global warming.[1]

States and private enterprises have begun taking steps to address climate change. Conventions, laws, regulations, and contractual obligations measures are being taken. Governments have taken measures such as carbon pricing, renewable energy mandates, and compliance markets to enforce accountability. Companies are now required to account for the impact of climate-related risk in their financial statements. Shareholders and project finance are also putting pressure on companies to address climate change and net-zero goals.

What are Climate-Related Disputes?

There is no applied definition of climate disputes. The ICC commission report on "Resolving Climate Change-Related Disputes through Arbitration and ADR" defines "climate change-related disputes" as disputes arising out of or in relation to the effects of climate change and climate change policy.[2] Governments, investors and shareholders ask companies to meet goals such as reducing greenhouse gases, working towards zero emissions, and protecting the environment.

Disputes arise when companies fail to meet emission reduction targets under existing investment agreements, when companies make false or misleading claims about being environmentally friendly, or when a party fails to meet environmental obligations in commercial contracts. NGO's and Public Interest groups take action against the state when it fails to meet climate change-related commitments. **Urgenda Foundation v. State of the**

[1] https://www.un.org/en/global-issues/climate-change
[2] icc-arbitration-adr-commission-report-on-resolving-climate-change-related-disputes-english-version.pdf

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Netherland [3]is a landmark case filed by Dutch citizens arguing that the weak emission targets violated the state's duty of care. The Dutch Supreme Court upheld the lower court decision that the state has the obligation under the European Convention on Human Rights (ECHR) to take reasonable measures regarding climate change.

These disputes involve parties from different jurisdictions and highly technical subject matter; resolving them through litigation is inefficient, and parties are therefore increasingly turning to arbitration, an alternative dispute resolution mechanism, to resolve such disputes.

Arbitration offers parties in appointing arbitrators of their choice with expertise, provides confidentiality that protects a company's sensitive information, and offers cross-border enforceability under the New York Convention. This has made arbitration a preferred mechanism to resolve disputes emerging from the global climate transition.

How Climate- Related Disputes Arise between the Parties

Climate Disputes can arise between the parties in three ways:-

1) **Contracts related to the implementation of the energy transition, mitigation or adaptation according to the Paris Agreement-** Countries that have signed the Paris Agreement undertake to reduce greenhouse gas emissions, to be prepared for the effects of climate change and to shift from fossil fuels to cleaner energy. Companies, governments, and investors, when entering into contracts such as funding, insuring, licensing, plant construction, and supply of renewable energy, can specify adaptation to a warming climate, forestry infrastructure, improving energy efficiency and reducing greenhouse gas emissions. These projects involve significant investment and technical issues, and usually the contract specifically mentions that, in case any disputes arise, they shall be resolved through an arbitration mechanism.

2) **Contracts not specifically related to transition, mitigation or adaptation-** These types of contracts are not specifically related to climate change but are affected by climate policies, environmental law or commitments by the states related to climate change. Most of these contracts may have been signed before the Paris Agreement, yet their performance can be influenced by government regulations, corporate climate commitments, and legislation or court decisions.

[3] State of the Netherlands v. Urgenda Foundation, ECLI:NL:HR:2019:2007, Judgment (Sup. Ct. Neth. Dec. 20, 2019) (Neth.)

3) **A Submission Agreement, or "compromise"**, - It is different from a standard arbitration agreement, and it is entered into when the dispute has already arisen. In climate-related disputes, the court may lack jurisdiction or be inadequate to deal with the subject matter of the case or claims by non-parties to the underlying contract. In these circumstances, the parties, with consent, can resolve the dispute through a submission agreement.

Types of Climate-Related Disputes

There is a growing number of disputes that arise out of, or in relation to, climate change between companies and state-owned entities. These disputes can be divided into various categories.

CONTRACTUAL DISPUTES

These disputes often arise due to climate-related agreements and can be categorized into the following disputes.

1. Emissions trading and carbon footprints

Many states have implemented emissions trading schemes to meet the commitments of the Paris Agreement. Disputes related to emissions trading have increased, and international arbitration is used to resolve such disputes. Under the Emissions trading scheme (ETS), companies are permitted to emit a certain limit of greenhouse gas emissions. If companies want to emit more than their allowed limit, they must buy additional emissions permits from other companies. Carbon footprint means the total amount of greenhouse gases released into the atmosphere as a result of the activities done by companies, products, or activities. Carbon offsetting means when companies voluntarily try to reduce their environmental impact.
These emissions trading schemes and carbon offsetting have led to the growth of greenwashing disputes, and many of these disputes are subject to international arbitration.

2. Carbon Market disputes

Carbon market disputes often relate to the trading of carbon credits. This has resulted in a multiplicity of disputes in the area. Disputes in the carbon market can arise because of non-compliance with rules for carbon market corporations and greenhouse gas emissions by developed nations, the true amount of emissions produced by or avoided by a company or the proper calculation of carbon allowances. Many emissions trading systems and agreements contain arbitration clauses. The International Emission Trading Association (IETA) template agreement for trading in the EU carbon market includes an arbitration clause that provides parties with the option to choose among the ICC Rules, UNCITRAL Rules or the Permanent Court of Arbitration. This widespread use of arbitration clauses signifies that arbitration will play a significant role in resolving disputes related to carbon markets.

3. Greenwashing Disputes

Greenwashing disputes refer to making false or misleading claims about producing positive environment outcome when it is not the case. Greenwashing disputes can arise when companies make false claims about their environmental performance. Shareholders and investors may sue the company for making such false claims. Many of these may be resolved through arbitration if the contract contains an arbitration clause.

One example of a greenwashing dispute is **ClientEarth v. Shell.** [4]ClientEarth was a minority shareholder in Shell Plc. ClientEarth sued the directors of Shell in an English court of law and brought a derivative action against them, proclaiming that the directors had breached their statutory duties under the Companies Act 2006. The claimant argues that Shell's directors had failed to adopt and enforce management strategies for risks posed by climate change and for attaining the company's net-zero commitments. Such claims are likely to increase and may be resolved through arbitration.

INTER- STATE DISPUTES

These types of disputes happen when companies sue states under an international investment agreement (IIA) and claim that the climate policies have harm their investments. This creates tension between global climate goals and international trade laws.

1. Disputes between investors and states under investment treaties

These types of disputes happen when companies sue states under an international investment agreement (IIA) and claim that the climate policies have adversely effect on their investments. This creates tension between global climate goals and international trade laws.

According to the 2022 study by UNCTAD, 175 claims have been filed by investors against states related to environmental protection measures. 40 per cent of the cases were won by the

[4] [2023] EWHC 1897 (Ch)

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state, 38 per cent by the investors, and the rest were either settled or dropped. [5]

The investors take legal action against the state for two main reasons:-

A. **Fair and equitable Treatment (FET)** - Investors states that once they have invested, they expect that the rules would be stable, but when the government implement new rules and regulations related to climate change, it breaks the fair treatment procedure.

B. Expropriation- Investors argue that when the government cancel their licenses, do not give permits, or block the project, they take away their investments without paying them back, even if it was done for environmental concerns.

Some experts argue that arbitration is not appropriate to resolve such disputes. This is because it will discourage the government from taking actions related to climate change or from making policies.

2. Counter- Claims by the State

Two threshold issues arise with regard to counterclaims under IIAs: First, whether the relevant treaty can be read so as to reflect consent by the investor and the state to counterclaims and second, whether counterclaims are admissible because they are sufficiently connected to the investor's claims. Host tribunals simply require that a state's counterclaim share a connection with the investor's claim in order to permit a counterclaim to be brought[6].

Counterclaims are permitted procedurally under the rules of institutions such as the ICSID. However, the tribunal must have jurisdiction over the counterclaim. Tribunals usually require three conditions for counterclaims:

- Consent – the investment treaty or arbitration agreement must allow claims by both sides. Many older BITs implicitly assume only investor claims, which has limited counterclaims;
- Connection with the investment – the counterclaim must arise directly out of the same investment or dispute; and
- Applicable law – the investor must be subject to legal obligations under domestic law, contractual obligations and sometimes international law. [7]

There has been an increase in the number of cases by the government against the investors regarding environmental damages and violations of environmental obligations by the investors, and there are chances where that these disputes will rise as governments are taking strict actions

[5] https://unctad.org/system/files/official-document/diaepcbinf2022d7_en.pdf
[6] GAR-climate-related-disputes-and-international-arbitration.pdf
[7] https://globalarbitrationreview.com/review/the-asia-pacific-arbitration-review/2027/article/esg-and-investment-arbitration-how-counterclaims-are-reshaping-isds-china-and-asia-pacific-investors

and implementing laws, regulations and by-laws related to the environment.

Following are cases where the state filed a counterclaim against the investors regarding environmental harm caused by them.

1. **Burlington v Ecuador:** [8]This was an oil exploration dispute. Ecuador filed a counterclaim for environmental damage caused by the investor. The tribunal awarded millions of dollars in environmental damages to Ecuador. This case demonstrated that counterclaims could succeed and environmental harm can create investor liability in ISDS. It is widely considered the first successful environmental counterclaim in investment arbitration.[9]
2. **Urbaser v Argentina:** [10]The dispute concerned a water concession in Buenos Aires. Argentina filed a counterclaim alleging that the investor violated human rights obligations related to the right to water. The tribunal accepted jurisdiction over the counterclaim, recognizing that corporations may bear obligations under international law. This was the first major recognition that investors may have international obligations, opening the door to ESG-related counterclaims.[11]

Counter-claims by the state will be common as states are implementing new rules, regulations and laws related to environment and climate change concern, so there are chances that disputes can arise when these law and regulation might be violated by the investors.

BENEFITS OF ARBITRATION IN CLIMATE CHANGE RELATED DISPUTES

Climate-related disputes differ from other legal disputes, and arbitration has several attributes that make it ideal for resolving climate change-related disputes. Arbitration, conversely, offers structural features like specialized expertise, neutrality, speedy disposition of disputes, enforceability, etc.

I. Access to specialist climate experts.

The first and foremost feature of arbitration is the availability of expert opinion. Parties involved in the dispute can choose the arbitrator of their own choice with relevant experience.

[8] *Burlington Resources, Inc v Republic of Ecuador* (ICSID Case No. ARB/08/5).

[9] https://globalarbitrationreview.com/review/the-asia-pacific-arbitration-review/2027/article/esg-and-investment-arbitration-how-counterclaims-are-reshaping-isds-china-and-asia-pacific-investors

[10] *Urbaser S.A. and Consorcio de Aguas Bilbao Biskaia, Bilbao Biskaia Ur Partzuergoa v Argentine Republic* (ICSID Case No. ARB/07/26), Argentina - Spain BIT (1991)

[11] https://globalarbitrationreview.com/review/the-asia-pacific-arbitration-review/2027/article/esg-and-investment-arbitration-how-counterclaims-are-reshaping-isds-china-and-asia-pacific-investors

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This can be beneficial in resolving matters that involve practical knowledge or any other technical challenges, thereby helping in better adjudication of matters.

II. Compliance with enforceability

Climate disputes can arise between parties from two different nations. A domestic court may face jurisdiction limitations in such cross- border disputes. An arbitral award benefits from the New York Convention, which facilitates the global enforcement and execution of awards across more than 170 signatory jurisdictions.

III Procedural Flexibility

Another con of arbitration is that parties aren't restricted to a rigid procedure. Arbitration rules are flexible, streamlined, and less complex than the regulations of domestic courts. Parties and the arbitral tribunal can adopt various case management strategies for the resolution of disputes. In this regard, the ICC has recently issued specific guidance for the effective case management of climate-related disputes.

IV Neutrality

Climate disputes are usually cross-border, and sometimes disputes can arise between a foreign investor and the state because of policies, regulations, court decisions, or legislation. Such disputes can't be resolved by local courts, as they are not a neutral choice. Arbitration lets both sides choose an arbitrator to adjudicate the dispute. This keeps both the side's to fight over the local system.

V Capacity to Absorb Authoritative International Guidance

Arbitral tribunals are not bound by domestic laws or precedents. Instead, they focus on public international law and specific treaty agreements. They are backed by treaties such as the UNFCCC, the Paris Agreement, and human rights laws. This focus on international law helps them better understand and prevent climate damage.

BARRIERS TO EFFECTIVE RESOLUTION THROUGH ARBITRATION

I New and unsettled subject matter

As the climate crisis deepens, new dispute types are emerging in areas like renewable technologies, carbon capture, and electricity storage — including offshore wind farm projects and large-scale infrastructure disputes such as a 2021 case involving a $2.2 billion electricity transmission project in Pakistan. Tribunals often lack established doctrine or specialized technical expertise for these newer, fast-evolving sectors.

II Lack of Specialized Climate Arbitration Framework –

There is no universally established procedural framework specifically designed for climate disputes. Tribunals therefore have to work within existing arbitration rules while dealing with issues that may be fundamentally different from conventional commercial disputes.

III Lack of consent to arbitrate

Arbitration fundamentally requires consent, whether from corporates or states. Unlike national courts, where jurisdiction, limitation, and standing haven't been major barriers to climate claims (in the UK, for example, courts have shown flexibility), arbitration's position is very different because it requires first and foremost consent to arbitrate, whether from corporates or states. Absent an existing contract or applicable investment treaty, there's often simply no route into arbitration at all.

IV Rising Investor-State Tension

The increasing use of arbitration in environmental disputes has created a complex investor-state tension. A 2022 UNCTAD study found 175 investment treaty claims brought by investors against states over environmental protection measures. Investors may challenge environmental or climate regulations that adversely affect their investments, while arbitration is simultaneously being considered as a mechanism to hold states and corporations accountable for climate-related harm. This dual role creates conflicting objectives and raises concerns regarding the balance between investment protection and environmental protection.

V Confidentiality: Arbitration's Core Limitation for Climate Disputes

Arbitration is a private process, but climate change is a public-interest problem proceedings, evidence, and even final awards are typically inaccessible to anyone outside the case. This undermines the reputational and public-pressure value that makes climate litigation effective, and it shuts out the third parties and communities most affected by the harm. It also makes the field hard to study, since confidentiality obscures how much climate-related activity is even happening in arbitration.

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CONCLUSION

Climate change is one of the most concerning and deeply serious issues that causes harm to the human race. Climate-related disputes between individuals, corporations, governments, etc., arising from the Carbon Market, greenwashing, Commercial Contracts, or Investment Treaties have significantly increased over the period of time. For better adjudication of such disputes, arbitration contributes significantly. Expertise, Confidentiality, Neutrality, Flexible Procedure makes arbitration well-suited for the resolution of such disputes. With international law increasingly recognizing binding climate obligations, arbitration is well placed to become the preferred way of resolving these disputes.