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UNPACKING THE IMPLICATIONS OF THE ICJ ADVISORY OPINION ON CLIMATE CHANGE
Briefing Note

What Does the International Court of Justice Advisory Opinion on Climate Change Mean for International Investment Law?

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In July 2025, the International Court of Justice (ICJ) delivered its landmark Advisory Opinion on the Obligations of States in Respect of Climate Change. The opinion provides authoritative legal guidance on states' obligations to address climate change and prevent significant harm to vulnerable countries and communities. While the opinion is non-binding, it makes clear that failure to act can trigger legal consequences. States require timely and accessible analysis to understand their legal obligations and the consequences of breaching them.

This brief is part of a series of publications aimed at unpacking the implications of the opinion and suggesting clear actions governments can take to ensure compliance across five critical areas: climate adaptation, environmental impact assessments, environmentally harmful subsidies, international investment law, and multilateral environmental agreements.

Introduction

International investment law provides foreign investors with protection against government measures through a network of bilateral and plurilateral investment treaties, investor–state contracts, and domestic investment laws. Investment treaties typically extend broad substantive guarantees, such as fair and equitable treatment (FET), protection against expropriation, and non-discrimination. Crucially, all three sources of investment protection—treaties, contracts, and domestic investment laws—can grant investors access to investor–state dispute settlement (ISDS), a mechanism that allows foreign investors to enforce those substantive standards by bringing claims directly against host states before international arbitral tribunals, bypassing domestic courts.

Over the past two decades, ISDS has drawn growing criticism from states, including for the lack of coherence and predictability of decisions, arbitrator conflicts of interest, and

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increasingly high amounts of compensation awarded to investors. The investment treaty regime was designed in an era marked by decolonization and the Cold War. The possibility that host states might need to rapidly phase out carbon-intensive investments was neither contemplated nor reflected in treaty texts. Today, this architecture sits in growing tension with the imperative of climate action.

Against this backdrop, the ICJ Advisory Opinion marks a turning point. The opinion clarifies that states have binding legal duties to address climate change and protect the climate system. These are not merely matters of policy discretion. It directly addresses fossil fuel production, licensing, and subsidies, the very policies that have triggered, and will continue to trigger, investor–state disputes. This policy brief examines what the ICJ opinion means for investment governance, ISDS, and the ongoing reform of international investment agreements.

Key Implications of the Advisory Opinion for Investment Law

The ICJ confirmed that climate action constitutes a binding legal obligation under international law, not a discretionary policy choice. The court established that obligations pertaining to the protection of the climate system do not rest exclusively with consumers and end users, but also include activities such as ongoing production, licensing, and subsidizing of fossil fuels (ICJ, 2025c, para. 94). This finding carries significant weight for investment disputes where host states increasingly defend regulatory measures aimed at reducing carbon-intensive energy production.

The opinion establishes that a state's failure to take appropriate action to protect the climate system may constitute an internationally wrongful act (ICJ, 2025c, para. 427). This framing directly challenges the legal foundations of many recent investor–state claims, where investors have argued that measures such as drilling bans, coal phase-outs, or windfall profit taxes constitute breaches of investment protection. This recognition of state responsibility for fossil fuel exploitation represents a reversal of the outmoded assumption that the growth of oil, gas, and coal production is internationally lawful.

The court also recognized that states' climate obligations are owed to the international community as a whole, known as obligations *erga omnes*. This characterization has important consequences for investment arbitration because it undermines investor claims of legitimate expectations to continue fossil fuel activities for extensive time periods or indefinitely. If states have a duty to all other states to phase out fossil fuels, investors cannot reasonably expect regulatory frameworks to remain frozen. The ICJ also emphasized the principle of common but differentiated responsibilities and respective capabilities (CBDR), which means the specific timeline and measures expected from each state vary based on their historical responsibility, current emissions, and economic capacity. However, the *erga omnes* character means no state—regardless of development level—can justify indefinite regulatory stability for fossil fuel activities.

The joint and separate declarations of Judges Bhandari and Cleveland provided more precise guidance on fossil fuel phase-out. They found it "unimaginable" that states can perform

their climate obligations without a rapid and drastic reduction in, and the phasing out of, fossil fuel production and dependency (ICJ, 2025b, para. 1). Judge Bhandari specified that the "duty of cessation would probably have to take the form of discontinuing practices that directly contribute to GHG emissions," including fossil fuel extraction and subsidies for fossil fuel production and consumption (ICJ, 2025d, para. 5). At the level of general regulation, the judges clarified that nationally determined contributions must address all fossil fuel production, licensing, and subsidy activities in a manner consistent with achieving the 1.5°C temperature goal, subject to the principle of CBDR.

The declarations also clarified that states must ensure environmental impact assessments account for cumulative harm to the climate system from downstream or Scope 3 emissions, as domestic and regional courts have confirmed in a growing number of cases.[2] Accordingly, investors cannot claim legitimate expectations that such holistic environmental impact assessments will not be required in respect of their fossil fuel operations.

Implications for ISDS

Regulatory Chill and Recent Cases

A critical aspect of the advisory proceedings was the explicit acknowledgement of how the prospect of investor–state dispute settlement can deter climate regulation. Judge Cleveland, in her separate declaration, cited the Intergovernmental Panel on Climate Change's finding that investment agreements may lead to regulatory chill (ICJ, 2025a, para. 21).

This acknowledgement is significant because judicial recognition of regulatory chill at the apex of the international legal order legitimizes a concern that investment tribunals have rarely addressed. It provides support for arguments that states should not maintain treaty regimes that systematically impede compliance with their climate obligations. National courts reviewing awards in set-aside or enforcement proceedings may increasingly consider whether upholding damages against climate measures aligns with public policy and the forum state's[3] own international obligations.

Recent cases illustrate this concern (Baldon & Craveia, 2025). Under the Energy Charter Treaty alone, investors have challenged Germany's coal phase-out *(Azienda Elettrica Ticinese v. Germany)*, Slovenia's fracking ban *(Ascent Resources v. Slovenia)*, and the Netherlands' phase-out of the Groningen gas field *(ExxonMobil v. Netherlands)*. The threat of costly arbitration can modify or delay climate policies even when states ultimately prevail.

[2] See Hailes (2025b), citing *R (Finch) v Surrey County Council* [2024] UKSC 20; Case E-18/24, *Norwegian State v Greenpeace Nordic & Nature and Youth Norway* (EFTA Court, Grand Chamber, 21 May 2025); *Morris and Marcus v Environmental Protection Agency* (High Court, Supreme Court of Judicature of Guyana, 14 March 2025); *Petitions by Greenpeace Ltd and Uplift for Judicial Review* [2025] CSOH 10; *Green Connection NPC & Anor v Minister of Forestry, Fisheries and the Environment* & Ors (5676/2024) [2025] ZAWCHC 349 (13 August 2025); *Greenpeace Nordic and Others v Norway* (ECtHR, 28 October 2025) App no 34068/21.

[3] That is, the state where such set-aside or enforcement applications are filed.

FET and Legitimate Expectations

The opinion also provides states with stronger defences against common investor claims. Many of these claims rely on the FET standard. FET is the most frequently invoked protection standard in treaty-based investor–state arbitration, appearing in nearly 95% of investment treaties and raised in over 80% of ISDS claims. Despite its prominence in investment treaties, the standard is notoriously vague and has been interpreted expansively by tribunals to cover conduct ranging from denial of justice to the frustration of investors' "legitimate expectations"—a concept that itself lacks a consistent definition (Sarmiento & Nikièma, 2022).

Where investors allege violations of the FET standard, particularly the frustration of legitimate expectations, the ICJ's findings establish that compliance with international law requires progressively stricter environmental regulation. Investors cannot, therefore, expect states to maintain regulatory frameworks that violate binding international obligations.

The *Renco Group v. Peru* arbitration illustrates this tension (Sequeira, 2025), albeit in a mining context. When Peru introduced stricter environmental regulations for the notoriously polluting La Oroya smelter, the investor initiated arbitration alleging violations of FET and expropriation. Such claims now face a transformed legal landscape.

Proportionality assessments may also shift because the stringent due diligence standard articulated by the ICJ suggests that environmental measures will be more readily justified as proportionate (Daele et al., 2025; ICJ, 2025c, para. 117). These assessments are increasingly employed by investment tribunals to assess whether a state's regulatory measure is justified despite harming an investment. Tribunals typically examine whether the measure pursues a legitimate public policy aim; whether the state is authorized to act; whether the measure is rationally connected to that aim; and whether it represents the least restrictive means available (Schaugg et al., 2025, pp. 5, 6, 11–12).

The tribunal in *Discovery Global v Slovakia* recently held that an investor could not assert a legitimate expectation that its oil and gas drilling would not be subject to evolving environmental impact assessment requirements, particularly since the state was obliged by EU law to implement those requirements. One may expect similar reasoning in emerging cases where a state has refused to approve a project in light of the ICJ's authoritative guidance.

Expropriation and Compensation

Environmental regulations can trigger expropriation, and especially indirect expropriation, claims. Indirect expropriation typically occurs when state measures substantially deprive an investor of the economic value or use of an investment without formally withdrawing legal title. Unlike direct expropriation, it does not involve an explicit government taking but may arise from regulatory measures that render an investment economically unviable. The Rockhopper v. Italy case, where an investor was awarded EUR 190 million for Italy's offshore drilling ban before the award was annulled on procedural grounds, illustrates the potential risk exposure. In light of the ICJ opinion, Italy would have had significantly stronger legal defences.

The traditional fair market value standard for compensation also faces challenges when asset values decline due to inevitable climate regulations (Atanasova et al., 2024). Fair market value is the standard of valuation typically applied in investment treaties for calculating compensation, yet treaties rarely define the term with precision. Tribunals routinely use so-called discounted cash flow methods to estimate this value based on projected future revenues, an approach that has been criticized for inflating damages by treating inherent uncertainty as calculable risk (Atanasova et al., 2024; López, 2026). Calculating damages based on projected fossil fuel revenues thus ignores the reality that these assets are increasingly stranded by enforcement of law.

Judge Cleveland's declaration emphasized that the interpretation of investment instruments must be informed by states' obligations in respect of climate change under international law, including the stringent due diligence standard (ICJ, 2025a, para. 22). Investment treaties cannot be read in isolation. This aligns with general principles of treaty interpretation under the Vienna Convention, which requires consideration of relevant rules of international law applicable between parties. Investment tribunals should increasingly interpret treaty protections in light of states' binding climate obligations, narrowing the scope for successful investor challenges to legitimate climate measures.

Stabilization Clauses

The opinion also has implications for stabilization clauses in investor–state contracts. Stabilization clauses are provisions in investor–state contracts that seek to insulate investments from changes in the host state's legal and regulatory framework. These clauses may "freeze" applicable laws at the time of contract signing, require the state to compensate investors for compliance costs arising from new regulations, or exempt the investment from future laws altogether. In the extractive industries, stabilization clauses have been particularly common, with some contracts purporting to shield fossil fuel investments from subsequent climate measures for decades.

Where such clauses purport to freeze environmental or climate regulations, the ICJ's findings suggest that tribunals should consider whether enforcement would compel the host state to breach its binding international obligations—a consideration reinforced by the Organization for Economic Cooperation and Development's 2020 Guiding Principles for Durable Extractive Contracts, which reflect emerging consensus that climate and environmental laws should never be subject to stabilization (Nikièma et al., 2024).

Implications for Investment Treaty Reform

While the ICJ opinion may influence the interpretation of existing treaties, specific reform of treaty texts in line with the Advisory Opinion remains essential. Early bilateral investment treaties from the 1980s and 1990s focused almost exclusively on investor protection. Over 95% of African investment disputes, for instance, are still adjudicated under these older instruments. Newer treaties increasingly incorporate environmental considerations, but practical impact will be delayed until existing treaties are replaced or updated, a process that may take many years.

States should consider excluding lawful climate measures from the scope of compensation claims. The most promising mechanism for a near-term implementation is a sector-based or measure-based carveout. Such a carveout would represent a paradigm shift, removing categories of climate-conflicting investments from treaty coverage rather than relying on defences that must be litigated case by case (Hailes, 2025a).

Forward-looking damages that penalize states for climate action should also be restricted (Marzal, 2024). When tribunals award compensation based on decades of projected future revenues from fossil fuel extraction, they effectively require states to subsidize the very activities they are legally obligated to phase out. Reform should ensure that damages calculations account for the declining value of stranded assets and the legal constraints on their continued exploitation.

Even after withdrawing from problematic treaties, states remain exposed. Article 47(3) of the Energy Charter Treaty, the most-litigated investment treaty, allows investors to initiate proceedings up to 20 years after a state's withdrawal takes effect. The EU formally decided to withdraw from the treaty in 2024, following Italy, Spain, France, Germany, the Netherlands, Luxembourg, and the United Kingdom. Yet these states remain vulnerable to costly arbitration for two decades. To neutralize this risk, withdrawing EU and non-EU states should negotiate a binding *inter se* agreement. IISD has published a Model Agreement to facilitate this process (Schaugg & Nikièma, 2024).

Recommendations for States

Conclude a plurilateral climate change carveout applicable to new and existing investment agreements. Consider both sector-based exclusions that remove fossil fuel investments from treaty coverage and measure-based exclusions that exclude climate regulations from investor claims.

Reform damages rules and regulate third-party funding in investment arbitration. Restrict forward-looking damages awards, which are often based on projected future revenues, and regulate third-party funding arrangements, as funders may incentivize speculative claims against climate measures.

Coordinate withdrawal from or termination of outdated investment treaties and negotiate agreements to neutralize sunset clauses. The Energy Charter Treaty remains the most urgent priority, but other treaties with broad fossil fuel coverage should also be reviewed.

Limit stabilization clauses in contracts with host governments or their state-owned enterprises that could lock in fossil fuel commitments. States should seek renegotiation of such clauses in legacy contracts and resist their inclusion in new contracts that would constrain future climate regulation.

Pursue fundamental reform of the international investment regime to resolve the structural tension between investment protection and climate action. The current system reflects an era when fossil fuel expansion was seen as desirable development. IISD's work on rethinking investment instruments (Ostřanský & Bonnitcha, 2024) offers pathways toward aligning investment governance with climate imperatives.

Conclusion

The ICJ Advisory Opinion represents a watershed moment for the relationship between international investment law and climate action. States have stringent due diligence obligations to protect the climate system, including through regulation of fossil fuel production, licensing, and subsidies. Investment protection cannot override states' climate obligations. As Judge Cleveland emphasized, investment instruments must be interpreted in harmony with international climate law. Investors cannot legitimately expect states to continue violating universal obligations owed to the international community as a whole.

The opinion does not eliminate investment protection by itself, but it establishes a framework for its integration with climate policy considerations. This integration requires action from states, including reviewing existing treaties, reforming investor–state dispute settlement, and designing policies that fulfill climate obligations while managing arbitration risk. The ICJ Advisory Opinion provides the legal foundation for this transformation, but its impact will depend on whether states seize this opportunity to align investment governance with the imperatives of climate action.

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