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FINANCING THE ENERGY TRANSITION: PROTECTING FOREIGN INVESTMENTS FROM REGULATORY CHANGES

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Investment treaties with investor–state dispute settlement (ISDS) provisions have been defended as being necessary to protect foreign investments into clean energy projects in countries that lack a stable legal or regulatory environment. However, a package of investment governance options can offer similar protection, but with a lower risk to both host countries and the global energy transition.

While some investors perceive ISDS as a risk management tool to protect investments from regulatory changes once the investment has been made, there is no conclusive evidence that renewable investors consider ISDS a key factor when making investment decisions or that ISDS attracts foreign direct investment (FDI) to host states.[1] Other options are available that are more important in shaping investments, and together can offer similar benefits to investors without the drawbacks of ISDS:

> **Political risk insurance:** Investors paying an insurance provider a premium to receive a payout in the event of a defined political risk trigger event occurring.

> **Co-investing with national, regional, and multilateral stakeholders**: Co-investing with public entities allows for public negotiation and diplomacy if there is a threat to an investment.

[1] E3G, 2022, **Clean investments shun Investor-State Dispute Settlements**, p. 3; International Institute for Sustainable Development (IISD), 2017, **Assessing the Impacts of Investment Treaties for Sustainable Development**, p. 4

> **Bilateral partnerships:** Various partnership models signal political support to certain policy trajectories and establish a mechanism for policy cooperation that can potentially help prevent or manage unexpected policy shifts.

Introduction

The third report of the Independent High-Level Expert Group on Climate Finance (IHLEG), released at COP29, estimated that emerging markets and developing economies (EMDEs) excluding China will require $1 trillion per year in international investment for the global energy transition by 2030. Around half of that amount will need to be mobilised from private finance, representing up to an 18-fold increase over current investment levels.[2]

The New Collective Quantified Goal (NCQG) on climate finance, agreed at COP29, requires all actors to scale up funds from public and private sources to at least $1.3 trillion by 2035, and developed countries to lead mobilisation of at least $300 billion a year for developing countries by 2035.[3] Despite some innovative ideas, public funds are limited, and private finance has an important role in achieving these targets.

Yet, while private finance to EMDEs excluding China rose from 43% to 47% of total climate finance between 2018 and 2022, private finance represented less than 10% of total finance to least developed countries (LDCs) in the same period.[4] A wide range of barriers, including perceived political risks and legal instability, continue to exist for developing economies to attract private finance.[5] Investment treaties with ISDS provisions are often promoted as a necessary tool to protect foreign investment against undue regulatory changes, particularly in host states perceived to have weak legal systems.

[2] Bhattacharya, A., Songwe, V., Soubeyran, E. Stern, N., 2024, **Third report of the Independent High-Level Expert Group on Climate Finance: Raising ambition and accelerating delivery of climate finance**, p. 5

[3] UNFCCC, 2024, **COP29 UN Climate Conference Agrees to Triple Finance to Developing Countries, Protecting Lives and Livelihoods**

[4] Climate Policy Initiative, 2024, **Global Landscape of Climate Finance 2024: Insights for COP29**, pp. 29, 32

[5] For a comprehensive analysis of barriers to climate finance, see CCSI, 2022, **Scaling investment in renewable energy generation to achieve sustainable development goals 7 (affordable and clean energy) and 13 (climate action) and the Paris Agreement: Roadblocks and drivers**.

What is ISDS?

Investor–state dispute settlement (ISDS) is a mechanism that allows foreign investors to sue host governments in international arbitration tribunals if host government measures harm their business interests. It was originally designed to protect foreign investors from extreme state interventions, such as nationalisation without due compensation. However, over time, it has increasingly limited countries' right to regulate, even when governments are pursuing legitimate public policy objectives, including phasing out fossil fuels as part of their climate policies.

Historically, the fossil fuel industry has benefitted the most from the ISDS mechanism. Recent research has found that fossil fuel investors have won at least $82.8 billion in damages.[6]

However, ISDS poses significant financial and regulatory risks to host states, which could undermine the energy transition.[7] By providing protection to fossil fuel investments, the threat of being sued can result in host states adopting less ambitious climate action. Insulating fossil fuel investors from transition risks also encourages further investment in fossil fuels.

More broadly, ISDS undermines a state's right to regulate. Arbitration tribunals have significant discretion in interpreting treaty language, often leading to inconsistent and unpredictable rulings.[8] The financial stakes are also high, which can significantly affect a host state's fiscal space. The average ISDS claim seeks $1.1 billion in damages and, in cases decided in favour of the investor, awards around $385 million.[9] These costs have grown rapidly in the last decade, partly due to arbitration tribunals often taking speculative assumptions about future profits.[10] In addition, the legal costs to deal with ISDS proceedings are high, averaging $4.7 million for states.[11]

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[6] International Institute for Environment and Development (IIED) and Columbia Center on Sustainable Investment (CCSI), 2023, **Investor-state dispute settlements: a hidden handbrake on climate action**

[7] E3G, 2024, **Investment treaties are undermining the global energy transition**, pp. 11–13

[8] See CCSI, 2022, **Primer on International Investment Treaties and Investor-State Dispute Settlement** for more detail on arbitration panels and the risks posed by ISDS.

[9] UN Trade & Development (UNCTAD), 2024, **IIA Issues Note International Investment Agreements: Facts and Figures on Investor–State Dispute Settlement Cases**, p. 5

[10] UNCTAD, 2024, **IIA Issues Note International Investment Agreements: Compensation and Damages in Investor-State Dispute Settlement Proceedings**, p. 1

[11] IISD, 2025, **Why is investment treaty and investor-state dispute settlement reform needed?**, p. 13

Given these serious drawbacks, this briefing explores whether other instruments that support clean energy investment can achieve similar protection offered by ISDS: political risk insurance; co-investing with local, multilateral, prominent stakeholders; and bilateral partnerships. These tools have either been prioritised by investors themselves[12] or identified as addressing the risk of undue regulatory change.

The value of ISDS provisions in investment decisions and attracting FDI is doubtful

ISDS's role in protecting investments abroad from regulatory change
Investment treaties with ISDS provisions are often signed and promoted by capital-exporting countries as tools to protect their investors from political risk and regulatory changes once an investment has been made abroad. Once the investment is in place, the concern is that the foreign investor may lose their bargaining power – especially if the host government prioritises domestic interests when changing policies that could impact investor returns.[13]

Investment treaties aim to mitigate this risk through enforceable standards, such as "fair and equitable treatment", "national treatment" and "most favoured nation treatment" clauses. These provisions are designed to ensure that foreign investors are treated above certain standards and at least as favourably as domestic investors, providing a legal mechanism to hold governments accountable if treatment falls short. In theory, these protections are particularly valuable for large-scale, capital-intensive projects vulnerable to policy shifts over time.[14] This may be particularly relevant to clean energy projects, which typically involve long-term investments that require a large up-front capital commitment.

However, despite the theoretical appeal, there is limited evidence that ISDS provisions play a decisive role in investment decisions. In a survey conducted by the Columbia Center on Sustainable Investment (CCSI), in partnership with E3G, renewable energy investors were asked about the legal factors influencing their

[12] E3G, 2022, **Clean investments shun Investor-State Dispute Settlements**, p. 4

[13] See Kohler, W., Stähler, F., *Journal of International Economics*, 2019, **The economics of investor protection: ISDS versus national treatment** for ISDS mechanism as addressing a hold-up problem with foreign investment.

[14] See Burke-White, W. W., *Kleinmann Center for Energy Policy,* 2024, **Closing the Climate Finance Gap: a Proposal for a New Green Investment Protocol**.

decisions when investing in the renewable energy sector.[15] The results showed that domestic factors were the most important in shaping investment decisions, including regulatory stability in the energy sector, domestic protections for investor rights, non-discriminatory administration of laws, and transparency in rulemaking within countries.

ISDS ranked near the bottom of the list.[16] Only 3 out of 32 respondents said the absence of an investment treaty would deter them from investing in a new foreign market. When asked about the relative importance of six different risk management tools, respondents placed treaty-based ISDS as second to last. Instead, they prioritised political risk insurance (private or public), credit guarantees, co-investment with local, multilateral or prominent stakeholders, and other guarantee instruments.

Rather than being a key driver of investment decisions, ISDS was generally perceived as a complementary tool, useful only after an investment has been made, as part of a broader risk management strategy. While the survey sample is not representative,[17] the findings are consistent with broader research suggesting that ISDS is not a key factor in attracting foreign investment, as discussed in the following section.

ISDS's role in attracting foreign direct investment (FDI)

Countries with developing economies might sign investment treaties with ISDS provisions based on the perception that they attract foreign investment. The idea is that by committing to international rules and the rule of law, a host state signals to foreign investors that they are less likely to renege on international agreements, thereby reducing political risk. Yet, the evidence that investment treaties with ISDS attract FDI is inconclusive.

Multiple factors play a role in FDI inflows; based on existing studies it is not clear that the ISDS mechanism is a causal factor in increasing FDI flows. The International Institute for Sustainable Development (IISD) reviewed the economic literature and found that while investment treaties may have some impact on FDI flows to developing countries, the effect is generally not

[15] CCSI, 2022, **The Role of Investment Treaties and Investor–State Dispute Settlement (ISDS) in Renewable Energy Investments**

[16] E3G, 2022, **Clean investments shun Investor-State Dispute Settlements**

[17] The survey sample consisted of 32 renewable energy investors investing abroad, who were not selected as a statistically significant sample.

statistically significant.[18] According to the IISD report, many studies also fail to identify which components of investment treaties influence investment decisions.

Similarly, a meta-analysis of 74 studies concluded that the effect of investment treaties on FDI was "so small as to be considered zero".[19] The authors did acknowledge the possibility that current research methods are insufficiently powerful to detect any underlying positive effect and emphasised that the most policy-relevant insights are likely to come from analysing specific home–host country pairs rather than looking at global averages.

There are only a few studies that have specifically analysed these bilateral relationships in detail. The recent termination of bilateral investment treaties (BITs) with ISDS provisions offers an opportunity to study such effects more closely. So far, findings remain mixed. Public Citizen have indicated that investment flows to Bolivia, Ecuador, India, Indonesia, and South Africa increased from former BIT partner countries after termination.[20] In contrast, another study found that BIT termination reduced FDI flows to India – particularly in mergers, acquisitions, and buyouts – though the impact on investments in new projects was insignificant.[21]

Alternative approaches to international investment arbitration

There is growing recognition that investment treaties with ISDS provisions are costly and pose risks to the global energy transition. In recent years, a number of states have reassessed their participation in these treaties. Most notably, a wave of European countries withdrew from the Energy Charter Treaty (ECT), the most frequently invoked investment treaty, culminating in the European Union's notification to leave in 2024.[22]

[18] *Ibid.* p. 4

[19] Brada, J.C., Drabek, Z. and Iwasaki, I., 2021, **Does investor protection increase foreign direct investment? A meta-analysis**, Journal of Economic Surveys, 35: pp. 34–70

[20] Public Citizen, 2018, **Termination of bilateral investment treaties has not negatively affected countries' foreign direct investment inflows**

[21] Hartmann, S., Spruk, R., 2023, **The impact of unilateral BIT terminations on FDI: Quasi-experimental evidence from India**, Rev Int Organ 18, pp. 259–296

[22] Council of the EU, 2024, **Energy Charter Treaty: EU notifies its withdrawal**

While this withdrawal was significant, there are other countries that have already taken a more principled stance against ISDS and adopted alternative approaches to international investment arbitration.[23] While not exhaustive, these include:

Brazil has rejected ISDS provisions in favour of dispute prevention mechanisms and state-to-state dispute settlement, placing greater emphasis on dialogue and early resolution. Brazil has never ratified any investment treaty with ISDS.

India terminated 77 of its bilateral investment treaties following a high-profile ISDS claim.[24] It subsequently adopted a new Model BIT that requires investors to exhaust local remedies before accessing international arbitration.

South Africa terminated 12 of its bilateral investment treaties[25] and opted to strengthen domestic legal protections through its *Protection of Investment Act* (2015), which emphasises national courts as the forum for resolving disputes.

Assessment of other instruments that protect investments abroad

Although the evidence does not support ISDS being a key driver of clean energy investment decisions, some clean energy investors view ISDS as a risk management tool for protecting investments after they have been made. The main benefit of ISDS therefore appears to be protecting investments by having recourse against policy changes. In this section, we explore what alternative tools exist to protect foreign investors from regulatory changes.

Political risk insurance

Political risk insurance (PRI), offered by both public and private providers, is widely recognised as a key tool for de-risking international investments. PRI

[23] See CCSI, 2024, **Breaking Free: Strategies for Governments on Terminated Investment Treaties and Removing ISDS Provisions**, pp. 26–36, for a comprehensive overview of exit and reform strategies pursued by select countries.

[24] UNCTAD, **International Investment Agreements Navigator – India.** Last accessed: May 2025.

[25] UNCTAD, **International Investment Agreements Navigator – South Africa**. Last accessed: May 2025.

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functions by allowing investors to purchase coverage in exchange for a premium. In return, they receive compensation if a defined political risk materialises, such as expropriation. In recent years, PRI coverage has expanded beyond traditional expropriation to include protection against unilateral cancellation of contracts by host states.[26] PRI and ISDS are often viewed as complementary mechanisms, as both aim to protect investors against losses caused by political and regulatory risks.[27]

The primary providers of PRI are export credit agencies (ECAs), which accounted for 78% of total issuance between 2014 and 2023. Multilateral institutions and private insurers provided 7% and 15% respectively.[28] However, renewable energy projects received just 4% of total PRI issued during this period, while fossil fuel investments received more than three times as much (14%).[29] Although underused for renewable energy projects, PRI has strong potential to be scaled up and cover similar risks to those ISDS aims to address.

From the investor's perspective, PRI offers protection against losses from policy change, similar to ISDS. However, unlike ISDS, which protects all eligible investments at no cost, PRI only applies to specific investments by investors who purchase coverage, but paying for investment protection reflects other options that are available on the market.

In theory, PRI should not have an impact on the fiscal space of the host country. Compensation is paid by the insurer, often the home country's ECA, rather than by the host country. Some policies allow home states to act as agents of the insurer after the insurance has been paid, which enables them to recover the costs from host states through diplomatic channels or instructing investors to raise an ISDS claim. For instance, the United States reportedly recovers around 90% of payouts made to its investors under PRI from host states, and Germany has been known to prevent new PRI coverage for investments in countries that fail to reimburse investors.[30] Compensation in these cases is generally based on

[26] Alschner, W., 2025, **To Transform the International Investment Regime, Look to Political Risk Insurance and Not (Only) to Investment Treaties**

[27] See OECD, 2024, **Leveraging De-Risking Instruments and International Co-ordination to Catalyse Investment in Clean Hydrogen**; UNCTAD Investment Policy Monitor, Issue No 30, 2025, **FDI derisking: Political risk insurance**; Alschner, W., 2025, **To Transform the International Investment Regime, Look to Political Risk Insurance and Not (Only) to Investment Treaties**.

[28] UNCTAD, 2025, **Investment Policy Monitor #30: FDI Derisking**, p. 9

[29] *Ibid*. p. 13

[30] Alschner, W., 2025, **To Transform the International Investment Regime, Look to Political Risk Insurance and Not (Only) to Investment Treaties**

the book value of the investment, rather than the often much higher damages awarded by an arbitration tribunal under ISDS, often based on speculative methods like discounted future earnings.[31]

Co-investing with national, regional, and multilateral stakeholders

Co-investing with public and multilateral stakeholders, such as regional and multilateral development banks, was ranked the second most important risk mitigation tool in the CCSI's survey of cross-border clean energy investors. One approach to reducing the perceived risks of investing abroad is to coordinate financing around national priorities through country platforms. The G20 defines these platforms as "voluntary country-level mechanisms, set out by governments and designed to foster collaboration among development partners, based on a shared strategic vision and priorities".[32]

E3G has previously highlighted how well-designed country platforms can enhance country-level collaboration across a wide range of stakeholders.[33] An effective country platform should involve the full financial ecosystem, with a central role for national and multilateral development banks, providing guarantees and other risk-sharing tools. These mechanisms help to crowd in private investment and minimise risks to the sovereign balance sheet. Country platforms can also incorporate feedback loops into their institutional design that allow domestic and international private investors to communicate their needs and concerns.[34]

When designed well, country platforms can provide a degree of protection against policy shifts by aligning governments, public development banks, and private investors on key investment policies. For instance, the Brazil Climate and Ecological Transformation Investment Platform, launched in October 2024, has approved 13 projects worth $21.5 billion by coordinating private and public investors around state-identified, transition-aligned projects.[35] This coordination process can effectively align investment around national priorities, which sends a strong signal that the host state is committed to the energy transition.

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[31] Kantor, M., *TDM 6 in Investor-State Disputes - International Investment Law*, 2015, **Comparing Political Risk Insurance and Investment Treaty Arbitration**

[32] G20, 2020, **Reference Framework for Effective Country Platforms**

[33] E3G, 2024, **Country platforms for climate safety and sustainable development**

[34] *Ibid.* p. 11

[35] Ministério da Fazenda, 2024, **Brazil Climate and Ecological Transformation Platform – BIP**

Many country platforms also involve partnerships with international financial institutions that reduce the risk of investment. For example, the European Bank for Reconstruction and Development (EBRD) has formed a partnership with Türkiye under the Türkiye Industrial Decarbonisation Investment Platform, which aims to deploy €5 billion in industry decarbonisation investment by 2030.[36] Similarly, the EBRD has worked with other countries and development banks to help catalyse investment in specific projects, like Egypt's Benban solar park[37] and solar energy projects in Kazakhstan that subsequently attracted private investment from Bulgaria, China, France, Germany, the UAE, and the UK.[38]

Unlike solely private investments on individual projects, country platforms can create interdependencies and strategic partnerships between investors, public entities, and the host state. While these co-investment platforms may not offer direct legal protection, they can significantly reduce regulatory risk. Co-investing with public entities allows public negotiation and diplomacy in case of a potential threat to an investment. In many cases, partnerships with multilateral or regional development banks often provides a form of first-loss guarantee for private investors, further reducing risk to them.

Bilateral partnerships

Bilateral partnerships are typically non-binding arrangements that have become popular due to their flexibility and ability to target specific industries. Recently, bilateral partnerships have been particularly used to support the energy transition by mobilising private investment into clean energy and its supply chains, including critical raw materials.

While they do not provide direct investment protection against undue policy changes, entering into such partnerships can signal strong political support for the energy transition. These partnerships often create a policy cooperation mechanism between states to catalyse investments in specific sectors, aligned with national priorities. Such a cooperation mechanism could help prevent or manage unexpected policy shifts in a partner country.

For instance, the UK concluded an MoU with Brazil in 2023 to promote bilateral cooperation on Brazil's industrial decarbonisation through policy dialogues and

[36] EBRD, 2024, **Türkiye launches industrial decarbonisation investment platform**

[37] EBRD, 2019, **First EBRD funded Egyptian solar plant begins generation**

[38] EBRD, 2020, **How the EBRD and CIF are driving investment in Kazakh renewables**

workshops.[39] This memorandum can align foreign investments around Brazil's national priorities and strengthen policy cooperation between states through regular dialogue. While not providing direct protection, these dialogues can help prevent or manage sudden policy shifts that could impact the investments from the other party.

In February 2025, the European Commission announced a new instrument for bilateral partnerships, called Clean Trade and Investment Partnerships (CTIPs). CTIPs aim to "bring together targeted trade and investment rules, Global Gateway investments and regulatory cooperation", to help the EU secure clean energy value chains and scale up European sustainable investments to partner countries.[40] CTIPs are expected to complement free trade agreements (FTAs) by targeting specific clean energy sectors to deliver faster progress on securing bilateral cooperation.[41] The EU is negotiating its first CTIP with South Africa, which is intended to be non-binding.

Like other bilateral partnerships, CTIPs are expected to include elements of regulatory cooperation. As these partnerships are still in development, there could be a room to enhance policy certainty. Since CTIPs aim to establish targeted trade and investment rules, incorporating a consultation mechanism between the parties to address potential deviations could help build investor confidence.

The EU has already included such provisions – focused on dispute avoidance and state-to-state dispute settlement – in the EU–Angola Sustainable Investment Facilitation Agreement (SIFA). While SIFA is a binding agreement, non-binding partnership instruments often outline how to resolve differences or disputes related to their implementation and interpretation.

Contrasting these mechanisms with ISDS

Each of the three mechanisms outlined above addresses the same core concern as ISDS: protecting investors from undue policy changes. Yet ISDS has also attracted criticisms: the threat of being sued can result in "regulatory chill", where host states adopt less ambitious climate action. In addition, the compensation awarded to investors can have a devastating impact on a country's finances.

[39] DESNZ, 2023, **Industrial Decarbonisation Hub: Brazil-UK memorandum of understanding**

[40] European Commission, 2025, **A Competitive Compass for the EU**

[41] E3G, 2025, **Pursuing a proactive green trade agenda in a multipolar world**

We therefore assess how these mechanisms compare to ISDS (performing better, similar or worse) across these three key criteria (see Figure 1):

> Protection against undue policy changes.

> Impact on the host country's regulatory space.

> Impact on the host country's fiscal space.

Assessing alternative mechanisms to protect investment abroad against investor–state dispute settlement measures (ISDS)

	Protection against undue policy change	Impact on the host country's fiscal space	Impact on the host country's regulatory space
ISDS	Allows claims through arbitration if business interests are affected.	Can impose significant costs on host states, even for unsuccessful claims.	Governments may avoid adopting ambitious climate policies to reduce legal risk.
Political risk insurance (PRI)	**Similar** Offers definite and direct protection through payouts if defined political risks occur.	**Better** Home states may recover costs from host states, but compensation tends to reflect book value.	**Better** No example that PRI causes regulatory chill.
Co-investment	**Worse** No formal protection, but shared policy commitments and coordinated response to threats offer indirect safeguards.	**Better** Typically increases public and private investment, benefiting host country finances.	**Better** Policies are negotiated among stakeholders; host state retains substantial autonomy.
Bilateral partnerships	**Worse** Provide low-degree indirect protection through cooperation frameworks.	**Better** Can mobilise investment in targeted sectors aligned with national priorities.	**Better** Generally aligned with host states' policy priorities but could risk asymmetry if deals are fast-tracked under geopolitical pressure.

Figure 1: Alternative mechanisms to ISDS are available that together give investors similar protection against policy changes, but avoid the negative impacts of ISDS on the host country.

Conclusion

While ISDS offers strong protection for investors, it also imposes significant costs, especially on host states. Other mechanisms, such as PRI, co-investment models, and bilateral partnerships, can offer varying degrees of protection for investors against undue policy change without the same risks to host states' regulatory and fiscal space. Investors could still receive adequate safeguards to their foreign investments when these mechanisms are adopted together as a package of alternative investment governance options.

Each country will need to consider which mechanisms best suit the needs of their investors, how much protection to offer, and what level of risk investors should bear. These alternatives offer policymakers a broader set of options to mobilise clean energy investment abroad – options that are more aligned with sustainable development goals.

The risks ISDS poses to climate and sustainable development goals have already been debated in multilateral forums, including the OECD, UN Commission on International Trade Law (UNCITRAL) and UN Trade and Development (UNCTAD). Last year, the UNFCCC dialogue on aligning finance flows with climate goals, also recognised investment treaties as a relevant topic needing further discussion.[42]

As governments face mounting pressure to mobilise the necessary climate finance for the global energy transition, decision-makers must consider whether these tools can complement or provide a more equitable alternative to traditional investment arbitration.

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[42] United Nations Framework Convention on Climate Change (UNFCCC), 2024, **Sharm el-Sheikh dialogue on the scope of Article 2, paragraph 1(c), of the Paris Agreement and its complementarity with Article 9 of the Paris Agreement. Report by the co-chairs (FCCC/PA/CMA/2024/11)**

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We drive systemic action on climate by identifying barriers and constructing coalitions to advance the solutions needed. We create spaces for honest dialogue, and help guide governments, businesses and the public on how to deliver change at the pace the planet demands.

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