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International Carbon Disputes - How can they be resolved through Arbitration?

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1. Introduction:

- 1.1 Climate change has been one of the world's most pressing issues. The threats of climate change are multifarious and the stakeholders are numerous. In a special report of Intergovernmental Panel on Climate Change (“**IPCC**”) on Global Warming of 1.5°C published in 2018, it states that it will “*require rapid and far-reaching transitions of energy, land, urban, infrastructural, and industrial systems*” to mitigate the worst effects of climate change. Climate change disputes include any dispute arising out of or in relation to the effect of climate change and climate change policies, as well as the United Nations Framework Convention on Climate Change (“**UNFCCC**”) and the Paris Agreement.¹ Climate change disputes include those that arise from natural climate phenomena, human activities, or violations of international or national environmental laws and regulations.
- 1.2 Climate change disputes is a broad concept and disputes under it arise in various forms, one of which being - Carbon Disputes. These carbon disputes range from claims against governments and major carbon emitters to investigations launched by governments themselves. Carbon disputes frequently revolve on issues that are common to other contractual disputes such as commodity non-delivery, breach of covenants or guarantees, ownership or security disputes, failure to meet conditions precedent etc. Carbon disputes are not limited to carbon contracts themselves but extend to the full gamut of disputes, concerning the underlying infrastructure projects undertaken to generate emission reductions, potentially resulting in commercial or investment arbitration proceedings. Inter-state arbitration is also a preference for disputes settlement concerning international emission trading corporations.²
- 1.3 Climate change disputes have reached an all-time high as a result of several international treaties signed by states (such as the Paris Agreement, 2015), as well as their subsequent obligations and constant pressure from non-governmental organisations to save the environment and prevent climate change. An escalation in these disputes, has resulted in an increase in discussion regarding the role that arbitration may play in the collective global response. Arbitration has been utilised to settle disputes as market systems have been created to convey ozone-depleting substance outflow decreases. The International Chamber of Commerce (“**ICC**”) has highlighted the specific benefits of arbitration in this situation in its recent report.³ For example, the parties freedom in selecting arbitrators allows them to pick tribunals with sufficient expertise of the regulatory and technical problems at stake in such disputes. Furthermore, commercial arbitration also provides the option of choosing a neutral tribunal for resolving sensitive disputes, as well as seamless enforcement of awards since majority of country states are signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 (“**New York Convention**”).⁴

2. Recent developments in Carbon Disputes:

¹ ICC Commission Report: Resolving Climate Change Related Disputes Through Arbitration and ADR, November 2019 available at <https://iccwbo.org/publication/icc-arbitration-and-adr-commission-report-on-resolving-climate-change-related-disputes-through-arbitration-and-adr/> (last accessed: May 28,2022).

² Stephen Minas, “COP26 created New Carbon Market Rules: How will Arbitration Respond?”, January 23,2022, available at <http://arbitrationblog.kluwerarbitration.com/2022/01/23/cop26-created-new-carbon-market-rules-how-will-arbitration-respond/> (last accessed: May 28,2022).

³ Ibid.

⁴ Susan Field, Helin Laufer, “Climate Change, the environment and Commercial Arbitration”, March 9 2020, available at <http://arbitrationblog.kluwerarbitration.com/2020/03/09/climate-change-the-environment-and-commercial-arbitration/> (last accessed: May 28,2022).

- 2.1 With the increase in climate crisis, various governments have opted to become signatory to treaties and conventions towards climate change control. The Kyoto Protocol was adopted at the Conference of Parties i.e., COP 3 of the UNFCCC on 16th March 1998 which puts the UNFCCC into action by committing industrialised and developing nations to restrict and reduce greenhouse gas emissions in line with agreed-upon individual objectives. The Kyoto Protocol sets out three flexibility mechanisms viz. Joint implementation, Emission trading and Clean Development Mechanism (“CDM”). The Paris Agreement is another international treaty on climate change with a goal to limit global warming to well below 2 degrees Celsius.
- 2.2 Recently at COP26, which was the 26th United Nations Climate Change Conference held in Glasgow, various significant developments that took place in the carbon industry. The 27 member nations accepted long-awaited rules for Carbon Market Cooperation under Articles 6.2 and 6.4 of the Paris Agreement. The Paris Agreement’s Article 6 established ‘cooperative methods’ incorporating Internationally Transferred Mitigation Outcomes (“ITMOs”) and Article 6.2 as well to contribute to emissions mitigation and sustainable development (Article 6.4), as well as non-market approaches (Article 6.8). According to these agreed rules, the Article 6.2 and 6.4 modalities differ from their Kyoto predecessors. The recommendation on Article 6.2 calls for all Paris Agreement Parties to participate in cooperative initiatives, rather than simply developed Parties as in Kyoto carbon trading. ITMOs can be quantified in tonnes of CO2 equivalent (as with Kyoto units) or in other metrics consistent with the Nationally Determined Contributions (“NDCs”) of participating Parties. ITMOs can be transmitted for ‘international mitigation reasons’ as well as credit against a recipient Party’s NDC target. For instance, developed nations who emit less carbon gases than their target NDC, transact credits with developing nations who have exhausted their target.
- 2.3 Due to COP26, there has been a rise in the carbon markets because of the creation and trade in ITMOs which in turn leads to more disputes. For instance, disputes arise because of non-compliance of rules for carbon market cooperation and greenhouse gas emissions by developed nations. Carbon contracts will need to be modified to reflect the new rules, impacting the respective duties of the parties. A new generation of carbon contracts is being developed for this purpose. There can also be a possible outcome of COP26 which would incorporate Arbitration provisions in its rules. According to Article 6.4 of the rules for carbon market cooperation under the Paris agreement state “*stakeholders, activity participants and participating Parties may appeal decisions of the Supervisory Body or request that a grievance be resolved by an independent grievance mechanism*”.
- 2.4 This language suggests that two distinct processes must be made available – a grievance process and an appeal process.⁵ Arbitration might potentially be used in the appeals procedure. Institutions considering a larger role in carbon market disputes may also consider measures such as the adoption of specialised rules tailored to this market, the formation of a panel of arbitrators with appropriate expertise, and the establishment of a list of technical experts.

3. Current position in India:

- 3.1 India now has a variety of constitutional and legislative provisions for environmental protections. The Judiciary and the National Green Tribunal have played critical roles in

⁵ Stephen Minas, “COP26 created New Carbon Market Rules: How will Arbitration Respond?”, January 23,2022, available at <http://arbitrationblog.kluwerarbitration.com/2022/01/23/cop26-created-new-carbon-market-rules-how-will-arbitration-respond/> (last accessed: May 28,2022).

creating and improving environmental jurisprudence in India. Despite the existence of such a solid framework, there are certain challenges that underlay the whole legal structure. Improper policy execution, callousness in implementing judicial judgements, a lack of competence & technical know-how within the legal fraternity and loopholes in the legislative framework continue to be sources of concern. At a time when India is seeing a phenomenal increase in industries and growth, the country is also dealing with environmental concerns at a rapid rate.

- 3.2 Being a developing nation, the current statutory framework for resolving environmental issues in India is insufficient to satisfy the requirements of the hour. To resolve concerns effectively, it is required to send the issues to an autonomous multi-specialty body based on the nature and complexity of the difficulties.
- 3.3 Arbitration will play a pivotal role in resolving Carbon disputes in India. Following are certain unique characteristics of Arbitration that would aid in resolving Carbon disputes.
 - The parties capacity to select arbitrators and experts with adequate scientific and environmental skills;
 - The capacity to accelerate legal processes and impose interim and conservatory remedies, particularly in situations involving potential permanent environmental harm;
 - The capacity to apply certain governing or applicable law, including relevant environmental statutes;
 - Maintaining confidentiality while also taking efforts toward improved transparency in line with the parties' requirements and considering the public interest concerned;
 - Arbitral rules are sufficiently flexible to be applied to specific scenarios.
- 3.4 Resolution of environment-related disputes through arbitration is not something new to India, the prominent amongst such arbitration was for the resolution of the dispute which arose between two countries of India and Pakistan over the construction of 330 MW Kishenganga Hydroelectric Project in the then State of J&K at the Permanent Court of Arbitration (“PCA”).⁶ The PCA ruled in favour of India and stated that a minimum flow of nine cubic meters per second shall be released into the Kishanganga river to maintain environmental flows. As India is aiming to become a global arbitration hub, it is important to quote here that India also adopts arbitration in resolving climate change disputes as well.

4. Concerns relating to Arbitration in Climate Change disputes:

- 4.1 Alternate Dispute Resolution (“ADR”) procedures for resolving complicated environmental concerns provide a variety of challenges that must be addressed. The most debated question is who is included and who is excluded from the process. Stakeholders or the party affected by this dispute, as a rule, should be defined as broadly as possible. It becomes critical if the proposed agreements and solutions are to gain widespread political and popular support.
- 4.2 A limited number of stakeholders may ultimately lead to future disagreements, requiring all parties to return to the negotiating table or face litigation. Cost and time consumed in such procedures is also one of the major concerns while arbitrating climate change disputes.

⁶ Alpesh Yadav, “Arbitrating Climate Change in India”, June 5, 2021 available at <https://www.thearbitrationworkshop.com/post/arbitrating-climate-change-in-india#:~:text=The%20United%20Nations%20Framework%20Convention,in%20an%20annex%20on%20arbitration%E2%80%9D.> (Last accessed: May 28,2022.)

5. Conclusion:

- 5.1 Climate change has implications and threats that can cause significant pain and loss. With economic uncertainties and growing environmental challenges, identifying risks is critical and there is an urgent need for all stakeholders to prevent, adapt and mitigate. While commercial entities must integrate their internal rules and agreements with climate change-related developments, they shall also foresee and plan for risks associated with climate-change-related disputes. The Paris Climate Agreement 2015 proved to be a watershed moment in climate change history, since it was for the first time the world community joined together to acknowledge & confront climate change and the accompanying issues.
- 5.2 Arbitration could be effective in resolving issues around climate change. However, one of the biggest shortcomings of the Paris Climate Agreement 2015 is the inability to meet the demands of nations who are not signatories to the said agreement. Arbitration has played a vital role in resolving carbon/environment disputes. However, it should be highlighted that ADR is not always effective, especially when the situation is complicated. As a result, legal authorities and courts continue to insist that issues be resolved through ADR. It is extremely critical in present times to manage carbon disputes with changing times in the society in which Arbitration as a dispute resolution mechanism plays a critical role.

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