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Taking Equity into Account in International and Domestic Legal Frameworks on Compensation for Climate Change and the Energy Transition

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The valuation of fossil fuel assets[1] *and the quantification of compensation amounts*[2] *under investment treaties and arbitration, as well as under domestic compensation schemes, are hot economic and legal topics in the context of a changing climate, the energy transition, and the mounting risk of climate-related arbitrations*[3] *by fossil fuel investors to complain against inherently disruptive yet urgent climate policy. Before considering compensation for fossil fuel investors, it is important to reflect on what compensation* ***should*** *mean, from an equity standpoint, in the context of climate change and the energy transition, and the role of international and domestic law in shaping what it means.*

Equity in the Context of Climate Change and the Energy Transition

Achieving the 1.5 °C goal of the Paris Agreement principally depends on a swift transition away from fossil fuels and toward renewable energy in the next couple of decades. The report *Climate Change 2022: Mitigation of Climate Change*, published by Working Group III of the Intergovernmental Panel on Climate Change (IPCC), appropriately recalls the challenging equity dimension of the energy transition: "[a]mbitious mitigation pathways imply large and sometimes disruptive changes in economic structure, with significant distributional consequences, **within** and **between** countries."[4]

Within countries, distributional consequences include the "shifting of income and employment ... from high to low-emissions activities."[5] Jobs in fossil fuel and other high-emission sectors will be lost, even if new ones will be created in the zero-carbon economy.

Between countries, distributional consequences include the negative impacts of the transition on developing countries whose economies and government revenue depend heavily on coal, oil, and gas. Besides often being the most vulnerable to the **physical impacts** of climate change, fossil fuel–dependent countries are the most exposed to the negative **economic and fiscal impacts** of the zero-carbon transition, which will disrupt their fossil fuel value chains, even if they can take steps to manage those challenges.

Equity is therefore integral to climate change and the energy transition. It refers to how costs and benefits are distributed, according to "social contracts, national policy, and international agreements," as the IPCC puts it, acknowledging the role of domestic and international legal frameworks.[6]

Equity Frameworks—Including Just Transition and Climate Justice—and Their Distributive and Procedural Justice Elements

Several conceptual frameworks are relevant to taking equity into account in the context of climate change and the energy transition, in particular, just transition and the broader notion of climate justice.

At the basis of these equity frameworks is the acknowledgment that climate change and the energy transition are inherently disruptive,[7] with different impacts on different stakeholders—in particular, with disproportionately negative impacts on communities and countries that depend on fossil energy or are otherwise more vulnerable.

Equity has a **distributive justice** element: beyond recognizing that impacts are disproportionate, it calls for deliberate action to minimize negative impacts on the underprivileged and achieve a fairer sharing of burdens and benefits.

Equity also has a **procedural justice** element: it calls for equitable access by those most vulnerable and disproportionately impacted to meaningfully participate in decision-making processes, including transparency and accountability mechanisms, to ensure that their needs are appropriately taken into account and, to the extent possible, met.[8]

The preamble of the Paris Agreement mentions a "just transition," and several international documents flesh out what it means in practice.[9] The International Labor Organization (ILO) published its 2015 Guidelines for a Just Transition Towards Environmentally Sustainable Economies and Societies for All,[10] negotiated between governments and unions of employers and workers. Also, a number of heads of state and government signed just transition declarations at two recent UN climate conferences, COP 24 in Katowice[11] and COP 26 in Glasgow.[12]

The 2022 IPCC report usefully summarizes the just transition framework with excellent wording applicable to equity frameworks more broadly, noting that just transition comprises:[13]

> *[…] a set of principles, processes, and practices aimed at ensuring that no people, workers, places, sectors, countries or regions are left behind in the move from a high-carbon to a low-carbon economy. It includes respect and dignity for vulnerable groups; creation of decent jobs; social protection; employment rights; fairness in energy access and use, and social dialogue and democratic consultation with relevant stakeholders. […]*
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> *A Just Transition entails targeted and proactive measures […] to ensure that any negative social, environmental, or economic impacts of economy wide transitions are minimized, whilst benefits are maximized for those disproportionally affected. These proactive measures include eradication of poverty, regulating prosperity, and creating jobs in "green" sectors. In addition, governments, polluting industries, corporations, and those more able to pay higher associated taxes, can pay for transition costs by providing a welfare safety net and adequate compensation to people, communities, and regions that have been impacted by pollution, or are marginalized, or are negatively impacted by a transition from a high- to low-carbon economy and society.*

Just transition has become an internationally recognized framework to take equity into account in the energy transition. Equity frameworks, including climate justice as well, are also relevant in climate-related issues adjacent to the energy transition, for example, the need for compensation for loss and damage[14] associated with climate impacts such as extreme weather events and slow onset events.

The equity equation is a complex one, but it is important as well as beneficial to consider. The IPCC report indicates,[15] for example, that paying attention to equity, including meaningful participation of all stakeholders in decision-making, can build social trust, increase the social acceptance and the effectiveness of climate mitigation policies, and allow for faster climate action and higher levels of ambition.

Equity in the Context of Compensation

Many existing international and domestic legal frameworks create privileges for fossil fuel asset owners to receive compensation from states, inviting debates on how much, *if anything*, should be paid as compensation[16] to fossil fuel asset owners, what criteria should be applied[17] to calculate those amounts, and who should make those decisions.

While it is true that fossil fuel asset owners are exposed to transition risks and costs, their exposure does not translate into vulnerability. Fossil fuel companies, besides having long known that they are major sources of the greenhouse gas emissions that cause climate change, generally have substantial economic capability to insure themselves against risks and can afford any uninsured costs.

Current debates and practices on compensation for fossil fuel companies ignore the fundamental, broader questions on the distribution of costs and benefits, including: **who is effectively more vulnerable** to suffering the risks and bearing the costs of climate change and the energy transition, who **can afford** to bear those costs, and, relatedly, who **should pay** compensation, and who **should benefit from** compensation in this context.

Principles on Equity Considerations in Legal Frameworks on Compensation

The following principles on equity considerations could serve as a starting point to tackle these questions in domestic and legal frameworks on compensation for climate change and the energy transition.

Domestic Legal Frameworks

Domestic legal frameworks on compensation should primarily focus on benefitting **workers** affected by the phase-out of fossil fuels, who will need compensation in the form of severance packages, social safety nets, and resources and opportunities for retraining and upskilling. Domestic schemes should also primarily benefit other **local and Indigenous communities and broader populations and taxpayers** directly or indirectly affected by climate change and the energy transition.[18] They may suffer negative economic, social, and environmental impacts from: the closure of coal mines and the decommissioning of oil and gas fields and infrastructure; broader economic diversification away from fossil energy; eventual increases in energy prices; increased mining of critical minerals and metals needed for the energy transition; and the upscaling of investments in land-intensive renewable energy and other climate solutions.[19]

If **companies** are to be compensated, smaller ones, especially in non-energy sectors that have to retrofit their operations because of the zero-carbon energy transition, would rank higher than larger ones as potential beneficiaries. International fossil fuel companies—especially companies that continue to recklessly invest in fossil fuel exploration and extraction—would rank the lowest. Any compensation a fossil fuel company might receive should, at a minimum, be conditioned upon the explicit prohibition of reinvesting any compensation received in fossil fuel projects and related infrastructure, and upon specific, enforceable just transition obligations imposed on the company for the benefit of its employees.

International Legal Frameworks

In turn, international legal frameworks should focus on ensuring that states have adequate resources to invest in climate mitigation and adaptation, and to cover the growing costs of loss and damage. Compensation should be available especially for lower-income countries that are most vulnerable to climate change and energy transition impacts and have the least access to public finance.

International law should be the steward of distributive and procedural justice in climate change and the energy transition. In the context of investment treaties and arbitration, states should not put private arbitrators in the driver's seat on issues of valuation of fossil fuel assets and compensation. Instead, states should bring these discussions to a state-led decision-making forum—possibly under the climate change regime—that would define principles and criteria on compensation, including on compensation to developing countries for loss and damage, and for keeping their fossil fuels in the ground. Such an international forum should also include procedural justice mechanisms to ensure that the input from those affected and vulnerable is taken into account, their rights realized, and their needs met, as possible. Finally, international law should also embed commitments by states to translate those principles and criteria of distributive and procedural justice into their respective domestic legal frameworks and mechanisms—for example, just transition or climate justice commissions or task forces—mindful of countries' different priorities and capabilities.

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