

Environmental Policy Space  
and International Investment Law



# Environmental Policy Space and International Investment Law

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Stockholm  
University

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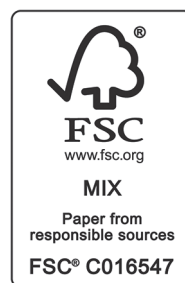
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\* \* \*

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# Abbreviations

ALBA	Bolivarian Alliance for the Americas (e.g. Venezuela, Nicaragua, Bolivia, Ecuador, Cuba)
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southern East Asian Nations
BAT	Best available techniques
BIT	Bilateral investment treaty
CCAD	Central American Commission on Environment and Development
CAFTA	Central American Free Trade Agreement (concluded with USA)
CARICOM	Caribbean states in cooperation:
CBD	Convention on Biological Diversity
CDM	Clean Development Mechanism (to the Kyoto Protocol, Climate Convention)
CEC	North American Commission on Environmental Cooperation
CITES	Convention on International Trade in Endangered Species of Wild Fauna and Flora
CSR	Corporate Social responsibility
ECHR	European Convention of Human Rights
ECtHR	European Court of Human Rights
ECT	European Charter Treaty
EFTA	European Free Trade Association (e.g. Norway, Iceland, Schweiz)
EPA	Economic Partnership Agreement

FAO	Food and Agriculture Organisation
FDI	Foreign direct investment
FET	Fair and equitable treatment
FTA	Free trade agreement
FCN	Friendship, commerce and navigation treaty
GATS	General Agreement on Trade in Services (WTO)
GATT	General Agreement on Tariff and Trade (WTO)
ICC	International Chamber of Commerce
ICJ	International Court of Justice
ICSID	International Center for the Settlement of Investment Disputes (at the World Bank)
IFC	International Finance Corporation (at the World Bank)
IIA	International investment agreement (joint term for BITs and FTAs with investment protection, here synonome with the more exact term international investment treaty)
IISD	International Institute for Sustainable Development
IMF	International Monetary Fund
IACHR	Inter-American Commission of Human Rights
IACtHR	Inter-American Court of Human Rights
IUCN	International Union on Conservation of Nature
MAI	Multilateral Agreement on Investment
MEA	Multilateral environmental agreement, also called international environmental treaty
MFN	Most favoured nation
MIGA	Multilateral Investment Guarantee Agency (at the World Bank)
MERCOSUR	Custom area for Brazil, Uruguay, Argentina, Paraguay and Venezuela
NAFTA	North American Free Trade Agreement
NGO	Non governmental organization
NT	National treatment
PCA	Permanant Court of Arbitration



PEEREA	Protocol on Energy Efficiency and Environmental Aspects (to the ECT)
OECD	Organisation for Economic Cooperation and Development
OPIC	Overseas Private Investment Corporation
SCC	Arbitration Institute of the Stockholm Chamber of Commerce
SIECA	Secretariat for Central American Economic Integration
TNC	Transnational corporation
TRIMs	Agreement on Trade Related Investment Measures
TRIPS	Agreement on Trade Related Aspects of Intellectual Property Rights
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
USAID	US Agency for International Development
WIR	World Investment Report (by UNCTAD)
WTO	World Trade Organisation



# I Introduction

## I.1 Setting the scene

In the Costa Rica mountains northeast of San José, close to the Nicaraguan border, a Canadian mining company wants to start an open-pit gold mine. The ecological consequences of open-pit mining in semi-rainforest are severe, and in this case the forest at the site is also an important feeding area for the *Loro Verde*, one of the Central American species of parrots. The views of local community members are split between those welcoming the opportunity of jobs and those criticising a local development built on a mining industry in sensitive areas which are important for tourism and ecological services. The divided perspectives are reflected also in the political-administrative response to the company's request to start the mine; the environmental protection agency did at first not accept the environmental impact assessment, then it approved the project, and a mining concession was granted. Later, however, the constitutional court objected to an operational agreement of the mining minister, and the court declared that the national forest law prohibit logging at the site.<sup>1</sup>

At the bank of the river Elbe, close to the German city of Hamburg, a Swedish energy company is planning a new stone coal-fired power

1 The development site Crucitas of the company Infito Gold Ltd. Villalta, José María Floréz-Estrada Crucitas: ¿Viabilidad ambiental o chantaje empresarial? [www.feconcr.org](http://www.feconcr.org), 2008-12-08; Fonseca, María Eugenia Calvo Decreto del Minaet abre peligroso portillo, [www.ucr.ac.cr](http://www.ucr.ac.cr), 2008-12-09.

plant. Such a plant would emit large quantities of greenhouse gases and use a lot of river water for cooling. Many citizens of Hamburg would like to see a cleaner form of energy for their heating and power, but the plans for the power plant are almost completed and the company has started to build. Although local politicians have expressed optimism about the project, the water permit that was finally approved includes tougher conditions than the company expected. The conditions on the amount of river water that could be used for cooling are tough, and the operator needs to take care of the fish habitat.<sup>2</sup>

These two stories have something more in common than to show modern dilemmas of environmental protection. Both situations led to companies claiming breaches to international investment treaties of the respective host state, however, none of the cases were ultimately decided on by an international investment arbitration tribunal. But in both cases that claim might has had an impact on subsequent public measures which allowed for considerable environmental impact. This situation shows there are new challenges for environmental regulation, the challenges that occur when environmental policies meet transnational investments and the land of international investment treaties.

## The urge for environmental law

In the ever-changing world where population growth and standards of living increase, the pressure on ecosystems and the human demands for natural resources increase. There is an urgent need to boost ways of developing human society that neither leave people in hunger or poverty, nor promote living patterns that overconsume resources or destroy ecosystems. Today, ongoing ecosystem degradation is of a proportion that may risk the future wellbeing of humanity.<sup>3</sup> A number of challenges related to earth ecosystems are simultaneously being

2 The power plant Morburg of the company Vattenfall. Telephone interview, Hobér, Kaj, Lawyer and legal representative Vattenfall, 2009-05-27; Telephone interview, Weggen, Jenny, spokesperson on energy issues Hamburg Green Party, 2009-05-27.

3 *Millennium Ecosystem Assessment*, Island Press, Washington D.C., 2005; Rockström, *et al.*, A safe operating space for humanity, *Nature*, 24 September 2009, pp. 472–475.

brought to the attention of governments around the world.<sup>4</sup> The causes of these urgent environmental challenges are very complex, and the response by society must fully reflect this complexity.<sup>5</sup>

Environmental policies play an important role and need to develop significantly to be able to halt degradation and support sustainable development. Effective implementation and enforcement of environmental regulation play key roles.<sup>6</sup> States are urged by international environmental law to progressively develop sound systems to manage natural resources, protect biodiversity, and secure healthy environments for people. There are positive trends of worldwide efforts to cooperate between states and non-state actors in mitigating environmental problems.<sup>7</sup> Yet, every society's full potential is far from used to meet the challenges of global ecosystems collapses predicted by scientists.

4 Thirteen urgent problems are highlighted for the UN Earth Summit 2012, among them energy crises, food crises, climate security, and health security; see <http://www.earthsummit2012.org/addressing-new-and-emerging-challenges/addressing-new-and-emerging-challenges>.

5 'If the fundamental mechanics of the earth as a whole are affected, a new kind of institution and, with it, institutional analysis is needed. As with earth system analysis, the analysis of institutions must be holistic. This is not to mean that international law must now develop towards a supranational organisation endowed with managing the fundamental laws of the globe. On the contrary, a holistic view requires us to look at the full scale of institutions, because all levels contribute to the systemic whole.' Winter, Gerd, *Multilevel Governance of Global Environmental Change*, Cambridge University Press, 2006, p. 2.

6 INECE Johannesburg Principles on the Role of Law and Sustainable Development, Adopted at the Global Judges Symposium held in Johannesburg, South Africa, on 18–20 August, 2002.

7 An increasing number of bilateral and multilateral environmental agreements, see *inter alia* the IEA database project at <http://iea.uoregon.edu>, according to Alan Boyle and Catherine Redgwell international environmental law is an 'ever-expanding topic', Birnie, Patricia, Boyle, Alan & Redgwell, Catherine, *International Law & the Environment*, 3:rd edition, Oxford university Press, Oxford, 2009, preface.

The Rio Declaration on Environment and Development<sup>8</sup> prescribes integration of environmental concerns in all relevant policy areas.<sup>9</sup> Nonetheless, up till now the Rio Declaration has not been effective in implementing a strong response to global earth crises. International economic treaties<sup>10</sup> play a part in this failure, since they by and large neglect environmental crises, and in some means counteract environmental protection by supporting unsustainable actions. The ambiguous mantra of the Rio+10 meeting in Johannesburg stated that the economic and trade agenda and the work on environmental efficiency and protection are ‘mutually reinforcing’ efforts.<sup>11</sup> However, this has so far not been materialised to a fully integrated approach in international law.

To make a truthful integration of environmental concerns in international law on investments, environmental concerns must be considered as fully valid. This means that environmental regulation must be fully respected as representing valid goals. Note that using the term ‘integration’ in this respect does not mean that environmental concerns are seen as subordinated to economic objectives. Environmental policy objectives should be ‘as commanding and central as those of finance or economic policy objectives’, to borrow the words of Audun Ruud.<sup>12</sup> Looking at policies in the global society today one sees that this is not often the case.

8 Rio Declaration on Environment and Development, UN Doc A/CONF.151/&(vol I), 31 ILM 874, 1992.

9 Principle 4: ‘In order to achieve sustainable development, environmental protection shall constitute an integral part of the development process and cannot be considered in isolation from it.’

10 Here referring to both trade and investment treaties, as well as treaties creating the framework of international economic transactions.

11 Johannesburg Declaration on Sustainable Development, UN World Summit on Sustainable Development, 2002, para 5.

12 Ruud, Audun, Governance for sustainable development: The challenge of environmental policy integration in Norway, Background paper for seminar on coherence and consistency in environmental governance in Oslo April 2009, p. 4: ‘Clearly, we are a long way from a situation where environmental objectives have a position as commanding and central as those of finance or economic policy objectives. However, the basic notion of EPI [environmental policy integration] is clearly formulated to

## International investment law

International investments are of great importance. It has long been considered fundamental to development and the fight against poverty. Yet international investments have many impacts on communities and the national governance, as shown by the two examples above. The road taken by investment could be problematic, as when investments result in land transfers that neglect existing land rights, as investors target countries with weak land governance.<sup>13</sup>

Before 1980 the protection of foreign investments almost entirely was the task of diplomatic negotiations, and when disputed, international customary law was in the eyes of *ad hoc* claims tribunals. Intensive debates in international forums were held on the subjects of nationalisation and violence against foreign property. Since the 1980s the protection of foreign investments outside the contractual relationship is regulated foremost by inter-state investment treaties. International investment law is related to, but only partly integrated into, the formation of widely spread trade rules. Several states and economic cooperation areas have integrated international investment rules in new, so-called free trade agreements. In the late 1990s and mid-2000s, global negotiations on investments failed; instead, several regional investment treaties have taken form, parallel to the bilateral ones. Focus for the debate is host state treatment of foreign business in a much wider perspective.

The number of international investment treaties (IIAs<sup>14</sup>) sharply increased between 1980–2000. While the traditional bilateral invest-

bring policy making closer to such an ideal type situation.’

13 The World Bank found that reported international deals on farm land amounted to 45 million hectares in 2009 alone. World Bank, *Rising Global Interest in Farmland: can it yield equitable and sustainable benefits?*, 2010.

14 The terms ‘international investment treaty’ and ‘international investment agreement’ (IIA) are throughout the work used synonymously. When referring to individual investor contracts with a host state, the term ‘investment contract’ or ‘concession’ is used to avoid confusion with the inter-state instruments. Henceforward ‘investment law’ will refer to rules and obligations by those bilateral and multilateral investment treaties, and not to *lex mercatoria*, stemming from investment contracts or other contractual relationships.

ment treaties (BITs) did not prompt much environmental debate, one of the first regional investment treaties integrated into a free trade agreement, the North American Free Trade Agreement (NAFTA), became an eye-opener for many environmental lawyers and policy makers about the potential risks to environmental regulation. Although the investment protection provided by these treaties seldom put restrictions in a formal way on host states' ambitions of environmental protection, the direct investor–state dispute settlement included in most of today's IIAs has led to a number of cases where environmental regulation are challenged.

### New field of research

While the troublesome relationship between world trade law and environmental regulation has been the subject of many analyses and discussions, the patchier development of international investment law has not attracted the same amount of attention and analysis from the viewpoint of environmental concerns. Yet, it is without doubt that stimulating transnational investments may have substantial environmental impact, for both the better and the worse. Global foreign investment inflow spans between 2,500 billion USD in 2007 and 1,500 billion USD in 2011.<sup>15</sup> Clearly, the way money is spent makes a difference, and foreign investments have very different environmental impacts. The introduction of potentially very harmful operations, such as large-scale chemical operations or extractive industries, often stems from foreign investors. At the same time, investments in modern city infrastructure and green technology are pinpointed as keys for more sustainable development and are also in great need of foreign capital.

The wider discussion of how modern international investment law affects environmental law and policy follows on debates in the 1990s and beginning of the 2000s around the creation of NAFTA and its side agreement on environment (North American Agreement of Environmental Cooperation, NAAEC), the negotiations in the Organisation for Economic Co-operation and Development (OECD) and the

15 UNCTAD Global Investment Trends Monitor, vol 8, 2012.



World Trade Organization (WTO) on the Multilateral Agreement on Investment (MAI), and the appearance of environmental disputes in IIA arbitration. The interest in the relationship between international investment law and environmental issues has increased dramatically, among both scholars and practitioners. So has the amount of literature produced, especially on IIA arbitration.

In the beginning of the 2000s environmental issues in the area of investment law were considered as *new* issues.<sup>16</sup> Several writers have since 2000, however, analysed and discussed environmental concerns in the area of investment law, and in particular with regard to international investment agreements, as the environmental view was considered to be neglected in IIA conclusion and IIA dispute settlement. Both in these studies and in case law it has been shown that national environmental regulation is challenged by IIA rules.<sup>17</sup> Some writers mean that the investment rules leave broad leeway for host states to implement new environmental regulations<sup>18</sup> and that investment rules do not shrink the space for environmental policies in practice more than customary rules do,<sup>19</sup> and still others mean that the costs of arbitration contribute to the chilling effect of IIA on environmental

16 Sornarajah, M., *The International Law on Foreign Investment*, 2:nd ed., Cambridge University Press, Cambridge, 2004, pp. 259–260; Sands, Phillipe, *Principles of international environmental law*, Cambridge University press, 2003, pp. 1056–1072.

17 Sands 2003, p. 1072. Also see a list of IIA cases challenging environmental regulation in Appendix I.

18 Schill, Stephan, Do Investment Treaties Chill Unilateral State Regulation to Mitigate Climate Change?, *Journal of International Arbitration*, vol 24, 5, 2007, pp. 469–477, Wälde T., Kolo A., Environmental regulation, investment protection and ‘regulatory taking’ in international law, *Int’l & Comp. L.Q.*, vol 50, 2001

19 Baughen, Simon, Expropriation and Environmental Regulation: the Lessons of NAFTA Chapter Eleven, *Journal of Environmental Law*, vol 18, 2, 2006.

policies.<sup>20</sup> Parallel to those contradictory opinions is a discussion on potential integration of environmental and investment perspectives.<sup>21</sup>

Further concerns about environmental matters and IIAs are that the investment rules in particular could have negative impact on the development and implementation of environmental policy in developing states,<sup>22</sup> that the IIA legal instruments are inadequate to deal with, *inter alia*, modern energy policies,<sup>23</sup> and that investment rules fails to appropriately encourage sustainable investments.<sup>24</sup> Some governmental officials have expressed doubts that environmental issues are in any special position in relation to IIAs, and rather, should be viewed as any public measure.<sup>25</sup> Several states have, however, developed their model treaties on investments by including references and special clauses on environmental measures, showing an ambition to reassure that IIAs should not bar relevant protective measures.<sup>26</sup>

IIA arbitration and the investor–state dispute settlement mechanism is an essential subject in the analysis of IIAs also from the view-

20 Tienhaara, Kyla, *The expropriation of environmental governance*, Cambridge University Press, 2009 p. 262; Fauchald, Ole K., International Investment Law and Environmental Protection, *Yearbook of International Environmental Law*, vol 17, 2006; Krajewski, Markus, The Impact of International Investment Agreements on Energy Regulation, *European Yearbook of International Economic Law*, 2013, May 30, 2011, Available at SSRN: <http://ssrn.com/abstract=1855639>.

21 Kläger, Roland, 'Fair and equitable treatment' and Sustainable development, Cordonier Segger, Ghering & Newcombe (Eds.), *Sustainable Development in World Investment Law*, chapter 11, Kluwer Law International, Amsterdam, 2011.

22 Fauchald 2006.

23 Krajewski 2011.

24 Boute, Anatole, Combating Climate Change and Securing Electricity Supply: The Role of Investment Protection Law, *European Environmental Law Review*, August/September 2007, p. 248.

25 Former counsel for Canada, Pencier, Joseph de, Investment , Environment and dispute settlement: Arbitration under NAFTA Chapter Eleven, *Hastings International Law & Comparative Law Review*, vol 23, 2000.

26 For example, USA and Canada. For an overview see Gordon, Kathryn & Pohl, Joachim, Environmental Concerns in International Investment Agreements: a survey, OECD Working Papers on International Investment 2011/1, 2011.

point of environmental regulation.<sup>27</sup> Opinions about the arbitration system in this regard, however, stretch from performing an ‘effective rule of law’<sup>28</sup> to ‘privatized legal entrepreneurship’<sup>29</sup> and an ‘expropriation of environmental governance’.<sup>30</sup> How to make the investor–state dispute settlement mechanism more transparent, consistent and better controlled by the state parties is debated.<sup>31</sup>

There are also calls for more radical changes of the international investment regime. In August 2010 more than 20 academics, among them Gus van Harten and David Schneiderman, made a call for states to change their IIAs, according to those signing the call the current IIAs are ‘hampering [...] the ability of governments to act for their people in response to the concerns of human development and environmental sustainability’.<sup>32</sup> The field of investment treaty law has indeed blossomed out as constested, especially because the tensions between public and private law, interest and governance.<sup>33</sup>

This work takes the perspective of host states’ and the impact of international investment law, in particular of investment treaties, on

27 In April 2002 in New York there was a colloquium on regulatory expropriations in international law, focusing much on environmental regulation, where scholars, practitioners, governmental representatives, and NGOs from the three North American states belonging to NAFTA participated. Synthesis from the colloquium was published in *New York University Environmental Law Journal*, vol 11, 2002–2003.

28 Wälde, Thomas, Investment arbitration and sustainable development: good intentions—or effective results? Response to James Chalker, *International Environmental Agreements: Politics, Law and Economics*, vol 6, 4, 2006.

29 Muchlinski, Peter, Corporations and the uses of law: International investment arbitration as a “multilateral legal order”, *Oñati Socio-Legal Series*, vol 1, 4, 2011, p. 15.

30 Tienhaara 2009.

31 Muchlinski 2011; Revising the UNCITRAL arbitration rules to address investor-state arbitrations, IISD & CIEL proposal on UNCITRAL rules, 2007 and Interpretation of IIAs: What States Can Do, UNCTAD IIA Issues Note, 3, 2011.

32 van Harten, Gus & Schneiderman, David, Osgood Hall Law School (Publ.), Public statement on the international investment regime, 31 August 2010, [http://www.osgoode.yorku.ca/public\\_statement](http://www.osgoode.yorku.ca/public_statement) (visited 2012-01-15).

33 Brown, Chester & Miles, Kate, Introduction: Evolution in Investment Treaty Law and Arbitration, Brown & Miles (Eds.), *Evolution in Investment Treaty Law and Arbitration*, Cambridge University Press, Cambridge, 2011.

domestic environmental regulation. In providing an in-depth analysis of environmental law related to the investment protection this work aims to contribute to a development towards a more balanced use of investment treaties.

## 1.2 Aim and method

This work puts its focus on the impacts of investment treaties on regulations or measures that host states apply, or wish to apply, in order to make investments and business operations environmentally sound, for example, measures to make industries comply with high standards of emission reduction or restrictions to certain businesses due to spatial planning, protection of biological diversity, or management of natural resources. The aim is to explore to what extent international investment law provides for sufficient 'policy space'<sup>34</sup> for the host state to adequately protect health and environment, regulate sustainable use of natural resources, and develop new approaches to manage environmental risks and uncertainties. What are the factors leading to such constraints, and how can investment treaties both respect and enhance policy space for environmental regulation?

The study is thus an examination of the effects of international investment treaties on host states' capacity to regulate environmental and health issues, and not an examination of the physical environmental effects of the very inflow of investments to a state or within a region. It is further a legal analysis in the sense that it aims at a 'legal' answer to its questions, rather than a 'political' or 'sociological' answer. It is the legal relationship, or potential conflict, between international investment rules and environmental law which is the centre of the study.

To carry out the analysis of the legal relationship between international investment rules and environmental law, and to subsequently measure the policy space for host states, two steps in structuring the analysis need to be clear: one that limits the analysis to the core area of

34 A definition of the term policy space is found further down in this section.

potential legal conflicts, and one that defines the term *policy space* and the design of this measuring device.

### 1.2.1 Focus of the analysis: three core IIA provisions related to six concepts in environmental law

International investment law and environmental law are both wide areas of law. Potential conflicts between the two legal ‘regimes’<sup>35</sup> appear at the levels of environmental principles and approaches, and in the choice of policy instrument and regulations. Even the structure of implementation and enforcement of environmental law may be affected by international investment rules. To investigate the more specific conflicts, it is necessary, initially, to limit the analysis to the core provisions of IIAs and a relevant set of corresponding concepts in environmental law.

The three main substantive provisions of investment protection commonly included in IIAs are the provision on ‘fair and equitable treatment’ (FET), which grants the investor justice and stability and predictability concerning the investment; the provision on ‘national treatment’, which grants the investor the right not to be discriminated against in relation to similar actors; and the provision on ‘expropriation’, which grants the investor protection against expropriatory acts and adequate compensation in case of expropriation. These three IIA provisions provide the structure in the three analytical chapters 4, 5, and 6, summarised in chapter 7. In chapter 2 there is a background on investment treaties which describes the broader context in which those provisions work.

35 The term regime here refers to rules accepted by international actors to regulate an issue area, in this context the area of environmental protection and efficient use of natural resources and the area of foreign investment protection, hence a law-centred and rather specific meaning. For discussion on the wider concept of regime in international law and policy research, see Langlet, David, *Prior Informed Consent and Hazardous Trade: Regulating Trade in Hazardous Goods at the Intersection of Sovereignty, Free Trade and Environmental Protection*, 2 ed, Kluwer Law International, Amsterdam, 2009, pp. 14–15.

It is a difficult task to define how environmental law can be analysed in relation to those investment provisions. As section 1.4 shows, the scope of environmental law is broad, there are different ways to 'cut the cake', and the borders with other areas of law are sometimes dim. In order to keep the examination at a sufficient level of generalisation three concepts are chosen which represent cross-cutting aspects of environmental law and which are relevant in different sub-areas like pollution control, land or water planning, or health protection. The concepts further relate to the control of economic activities such as investments. They are: (1) prevention and risk assessment, (2) multi-tiered governance structures, and (3) third-party participation in regulation and access to justice. The concept of prevention and risk assessment goes to the core of environmental law and entails dealing with uncertainty and carrying out impact assessments. The concept of multi-tiered governance structures refers to the interplay between environmental institutions and their administration of complex environmental issues. The concept of third-party participation in regulation refers to environmental procedural rules on both decision making and making of justice. In chapter 3 those concepts are examined further.

There are, nevertheless, three additional concepts in environmental law which also need to be part of the examination in relation to investment provisions. These are concepts in environmental law that reflect objectives, or share ideas, similar to those of the investment provisions. Like investment law's fair and equitable treatment, environmental law comprises an aim to offer predictable conditions to actors. Like investment law's national treatment, environmental law encompasses the aim for non-discrimination of similar actors. Like investment law's regulation on expropriation, environmental law also relates and make use of property or ownership rights. To some extent these aims are seen from a rather different approach. These three environmental concepts will also be examined in chapter 3 and related to investment law in chapters 4, 5, and 6. Together with the above-mentioned concepts, they illustrate the complex impacts international investment law may have.

Hence, the examination of potential conflict between investment law and environmental law, and the constraints of policy space implied by such conflicts, will put the three core provisions of investment treaties, fair and equitable treatment, national treatment, and expropriation, up against six general concepts of environmental law: (1) prevention and risk assessment, (2) multi-tiered governance structures, (3) third party participation in regulation and access to justice, (4) predictability and stability, (5) non-discrimination of similar actors, and (6) property rights.

### 1.2.2 Environmental policy space

The aim is to explore whether environmental law is allowed sufficient policy space. The amount of policy space is going to be used as a measuring device to illuminate the degree to which the state (and its authorities) risks being constrained from acting to prevent activities or operations harmful to the environment and thus make investments environmentally sound, while having an IIA in force. This measuring rod is construed to answer the questions as to what space there is for the host state to make use of common environmental principles, approaches, and instruments, and what space there is to develop and implement new reforms to protect health or environment or to safeguard efficient use of natural resources. The aim is to identify indicators on policy space constraints and put them together in a questionnaire to assist policy space analysis of investment treaty law.

The term policy space has been used in the critical debate on the current economic globalisation to highlight the 'tensions between international economic integration and the autonomy available to na-

tion states to pursue policies that effectively support their economic development'.<sup>36</sup> Policy space is a core concept in the policy debate on trade rules and macroeconomics, favoured by those who see that there is no universal set of rules for development and economic growth for all states but rather different paths for development in different states.<sup>37</sup> The use of the term policy space has also become common in judicial periodicals since 2005.<sup>38</sup>

In this broader context one may distinguish between policy space *de jure*, which means a state's room for manoeuvre in choosing policy instruments considering the constraints laid down in international economic law, and policy space *de facto*, which in practice give states similar constraints due to budget limitations or lack of administrative capacity.<sup>39</sup> Both those forms have implications for the development of

36 Mayer, Jörg, Policy Space: What, for What, and Where?, *Development Policy Review*, vol 27, 4, 2009, pp. 373–395.

37 See, in general, World Investment Report 2006, UNCTAD, 2006; Gallagher, Kevin P & Aguayo Ayala, Francisco, Preserving Policy Space for Sustainable Development, *Trade Knowledge Network Commentary*, Dec 2005; Hamwey, Robert, Expanding National Policy Space for Development: Why the Multilateral Trading System Must Change, South centre: TRADE Working Papers25, September 2005; Khor, Martin, Debate on policy space dominates UNCTAD Review, TWN Trade Issues May 2006. Also in the doctrine of environmental law, the term *policy space* sometimes is used, for example, Bernaconi-Osterwalder, *et.al.*, *Environment and Trade – A Guide to WTO Jurisprudence*, Earthscan, London, 2006, the introduction. Mayer notes that 'the mere fact of having policy space does not imply that it is always put to good use. Some developing countries have used their policy space effectively and have been rewarded with accelerated development, while others have been less able to capitalise on existing policy autonomy.' p. 375.

38 A search on HeinOnline on the phrase 'policy space' revealed 623 hits in legal journals untill January 2011 and a majority of those, 323 hits, were from the last five years. For definitions, see Mayer 2009, and UNCTAD Discussion Paper No 191, UNCTAD/OSG/DP/2008/6, 2008. See further in footnotes in this section.

39 See Langlet 2009, pp. 42–44. Chang, Ha-Joon, Policy space in Historical Perspective – with special reference to trade and industrial policies, Queen Elisabeth House 50th Anniversary Conference, Oxford, July 2005. Note Messerlin, Patric A, Enlarging the Vision for Trade Policy Space, *The World Economy*, 2006, pp. 1395–1406, who implies a different perspective and argues that strong economic constraints can help national leaders to overcome policy bars upheld by small groups blocking because of their own interest. For an overview, see Romson, Åsa, Policy Space – en diskussion



national environmental governance. The latter, *de facto* constraints, can without question be a significant obstacle in many countries where unbalanced relationships between regulatory bodies and the business sector, and shortage in skills and capacity at environmental authorities, constitute major obstacles. This analysis, however, concentrates on policy space in the sense of ‘room for manoeuvre’ in a more legalistic way. When putting environmental reforms in place, the potential constraints due to international economic law are important to analyse, since they may play a significant role for successful implementation of the environmental reforms.<sup>40</sup> Hence, this work deals with policy space defined as constraints to the national legislator and national authorities due to obligations in international investment law.

There are several legal terms that also reflect aspects of policy space, ‘sovereignty’ being the most common. However, it should be noted that legal writers often struggle with this concept of independence for its difficulties in international cooperation, rather than making long arguments about its usefulness in national policymaking. Further, some writers in environmental law earlier projected state sovereignty to erode, as it is seen almost as counterproductive in handling global environmental challenges.<sup>41</sup> However, these views have partly changed, and sovereignty has proven to be a resilient concept, including for environmental law.<sup>42</sup> While there is still need for analysis on the change of sovereignty in the era of globalisation, our concept ‘policy space’ makes use of the very essence of sovereignty, the responsibility for each state to provide for environmentally good conditions. It recognises the use-

på flera plan om politiskt handlingsutrymme för länder i syd, Report for Forum Syd, 2009.

40 Ulfstein notes that, together with environmental effectiveness and cost efficiency, international policy constraints play an important role in international environmental negotiations, Ulfstein, Geir, *Folkeretten og Norsk Miljøpolitikk – Muligheter og Begrensninger*, Sofus (Ed.), *Mot et globalisert Norge?*, 2001.

41 Sand, Peter H, *Global environmental change and the nation state: sovereignty bounded?*, Winter (Ed.), *Multilevel Governance of Global Environmental Change*, chapter 21, Cambridge University Press, Cambridge, 2006 pp. 519–520 which in footnote 2 refer to example by Richard Falk.

42 Ibid.

fulness of concepts like sovereignty in states' day-to-day activities in making society work. Thus, the focus here is states' 'right to regulate', while they comply with general international law and its international commitments. The concept in legal reviews of 'margin of appreciation' reflects policy space in its own way.<sup>43</sup> Indeed, when considering the investor's right to stable conditions, one must consider the host state's margin of appreciation, and when balancing investors' rights with the states' right to regulate for the public interest, reasoning of proportionality crosses the mind.<sup>44</sup> All these legal concepts shape perspectives of policy space.

As stated above, policy space will be used to illustrate how the international investment regime affects the scope of environmental law. Constraints of policy space implies that both legislators and public institutions are in some sense restricted in choosing different policy options in fulfilling their task as public institutions, in the case here, protecting health and environment or regulating for sustainable use of natural resources. Analysing and estimating environmental policy space is different from valuating which environmental regulations or instruments need to be developed to further handle the local and global challenges. Hence, any arguing in this work for legal reforms does not plead for a particular environmental instrument, principle, or law, but rather concerns the possible room for manoeuvre, the freedom for

43 For analysis of this concept, see Macdonald, R St J, The Margin of Appreciation, Macdonald, Matsher & Petzold (Eds.), *The European System for the Protection of Human Rights*, Martinus Nijhoff Publishers, Dordrecht, 1993; Dolzer, Rudolf, Indirect Expropriations: New Developments?, *New York University Environmental Law Journal*, vol 11, 2003, p. 64; Yourow, Howard Charels, *The Margin of Appreciation Doctrine in the dynamics of European Human Rights Jurisprudence*, Martinus Nijhoff Publisher, Dordrecht, 1996.

44 Burke-White, William & Staden, Andreas von, The need for public law standards of review in investor-state arbitrations, Schill (Ed.), *International investment law and comparative public law*, Oxford University Press, Oxford, 2010, pp. 720–721; Kingsbury, Benedict & Schill, Stephan, Public law concepts to balance investors' rights with state regulatory actions in the public interest – the concept of proportionality, Schill (Ed.), *International investment law and comparative public law*, Oxford Scholarship Online, 2011, pp. 82–83.

the state and its authorities to make use of such environmental instrument, principle, or law.

Broadening and deepening of the understanding of the complexity of environmental law in the context of investment protection is a prerequisite for any attempt to truly integrate environmental respect into this area of international economic law. If integrating environmental respect is not to mean subordinating it to the economic agenda, a certain regard for the autonomy of environmental law is needed. In other words, key environmental law concepts must be fully respected within the economic framework to ensure integration. Therefore, safeguarding the 'space' for host states to adopt environmental policies and reforms in line with sustainable development goals is a crucial concept in the integration process.<sup>45</sup>

### 1.2.3 A policy space analysis questionnaire

What policy space for environmental regulation do host states need then? And what indicators could there be on policy space constraints of investment provisions? To help answer these questions, a scheme is set up to illustrate the different parameters and to summarise the analysis in a simple form. The parameters are briefly explained here. They are, however, further elaborated in the following chapters. The whole questionnaire is reproduced in Appendix 2.

## Outline of policy space analysis questionnaire

### 1. General aspects

- Capacity of host state
- General scope of the investment treaty
- Investor–state dispute settlement mechanism

45 General on the principle of integration as part of sustainable development, see Birnie, Boyle & Redgwell, 2009, pp. 116–118; On sustainable development integration and investment law, also see Cordonier Segger, Marie-Claire & Kent, Avidan, Promoting sustainable investment through international law, Cordonier Segger, Ghering & Newcombe (Eds.), *Sustainable Development in World Investment Law*, pp. 771–792, Kluwer Law International, Amsterdam, 2011.

2. Environmental law
  - Average global conduct or frontrunner?
  - Good governance
  - General need for policy development
3. Provisions on investment protection – reflecting environmental aspects
  - Fair and equitable treatment
  - National treatment
  - Expropriation and compensation
4. Investment provisions on environmental concerns
  - ‘Green’ provisions

The first group of parameters includes general aspects of the host state and the IIA policy space implications, and will be elaborated further in chapters 2 and 3. The second group of parameters to consider concern the character of the environmental regulation. Is the measure in line with global standards for corporate behaviour, or does it raise the standard beyond what can be considered a globally harmonised minimum? Constraints by investment law may be different, depending on this character. Or, are the changes for the actor implemented with due consideration of transparency and time for preparations? Further, there might be some environmental issues where there is great need of development in environmental law and policy, and hence more need to secure the widest possible policy space. How would that work? These parameters will be elaborated further in chapter 3.

The third group of parameters to consider comprises relevant aspects of environmental respect by substantial IIA provisions. Considerations of the potential to constrain environmental policy space also depend on the scope and interpretation of each of the provisions. These parameters will be elaborated in chapter 7 as a summary of the analysis in chapters 4, 5, and 6. The fourth group of parameters concern the provisions trying to ‘green’ the IIA; these are elaborated in chapter 8. The final chapter summarises how this questionnaire could be used to analyse environmental policy space in the context of investment treaties.

### 1.2.4 IIA sustainable development rules

Respecting sufficient space for environmental regulation is, as was stated above, the first step in integrating environmental respect into the IIA regime. However, a second important step would be to use IIAs to strengthen environmental regulation and governance. This means protecting foreign investments as an aim of sustainable development and environmental protection, enhancing technology transfer through foreign investments, protecting 'green' investments, or promoting environmental governance in the host state. This step could also be described as enhancing the policy space for environmental law; see the 'green provisions' in the outline of the Policy Space Analysis Questionnaire above.

This work investigates this proactive role of IIAs in two limited aspects, by (1) identifying elements in existing IIAs which can be used for strengthening environmental governance, and (2) discussing how different approaches may transform IIAs into proactive instruments for sustainable development and technology transfer. This is elaborated in chapter 8.

It should be noted that this analysis has international investment treaties as its focal point, and reference to investment regulation in international environmental treaties (also commonly called multilateral environmental agreements, MEAs) is made only in order to give examples. Thus, no systematic study of specific MEA provisions on investment and technology transfer is carried out due to delimitation of the work. Further, the subject of corporate social responsibility (CSR) is touched upon as part of a broader analysis of possible reforms of the IIAs. However, it has not been possible to cover CSR in a comprehensive way within the framework of this study.

## 1.3 The scope of international investment law in this work

### 1.3.1 The international investment treaty regime

Focus for the analysis of international investment law in this work is on international investments treaties. As mentioned above, it is a relevant focus, since the investment treaties increasingly cover today's transnational investments. However, without a global treaty the coverage is not complete. To focus on the treaties is also to connect to the question of policy space. The rules set by treaties between two or more states, which in one way or another affect the actions of the state party, are seen as voluntary commitments by a sovereign state. It follows from sovereignty itself that states may commit themselves to particular rules set up in agreement with one or more other states which confirm or go beyond general international law.<sup>46</sup> The IIAs are thus international regulations which individual states in a formal sense govern the design of, thus shaping their own policy constraints.

In this context the perception of voluntarism in concluding international treaties, and thus constraining national policy space, is strictly formal and makes no account of the reality of world politics. It is rather evident that less powerful states sometimes make agreements to forced by other, more powerful states. Nothing suggests that international investment treaties are different; there are rather suggestions of the opposite.<sup>47</sup> The fact that many BITs are more or less copies of the capital-exporting-state model treaty indicates that the capital-importing state in many negotiations has had a subordinated role in setting the rules. While this is a fact, it is nevertheless relevant to take the point of departure in the formal distinction of the sovereign capacity to design the rules of international treaties, rather than try to qualify states' 'real' possibilities to influence the international

46 Wimbledon case, PCIJ Series A No 1 p. 25, 1923.

47 See the background of *Santa Elena* case in section 6.4.3; also Sornarajah 2004 p. 208 and footnote 16.

constraints, especially since this work is foremost a normative analysis of the constraints for environmental law and policy.

Notwithstanding the focus in this work on treaty law, many rules of general and customary international law must likewise be considered to understand the content of those treaties. General and customary international law control the issues not dealt with by the IIAs, for example, in many cases, the rules of treaty interpretation. It is also common that some of the substantive treaty provisions refer to general standards or customary international law. One of the issues debated is whether IIA provisions, and the interpretation of them in arbitration awards, reflect customary norms; see sections 4.3 and 6.2. The perspective taken in this work is that the IIA should be seen as a treaty instrument concluded between two or more state parties for preferential economic treatment, which cannot be extended to other parties without mutual ratification. It is further considered that the tribunals adjudging whether one party has breached the treaty in a specific situation may investigate the standards of customary international law as part of the interpretation of substantive provisions, but that an award of an IIA tribunal is not automatically a recognised source of general international law constituting standards applicable outside the area of the treaty at hand. This does not preclude that IIA tribunals may find interpretations of common IIA norms that are worth following or that they may develop coherent international law.

As will become apparent, international investment treaties are not a homogenous group of international treaties, and there is no uniform terminology with which to characterise various subgroups. The treaties analysed in this work are IIAs with clear investment protection provisions, including provisions on treatment, expropriation, and investor–state dispute settlement. This means that treaties only covering cooperation activities, framework agreements on investments, and

trade agreements lacking the provision of investor–state dispute settlement are left aside. This means, for instance, that the EU economic partnership and trade agreements are left out of the analysis. However, in the contextual discussion and in some of the aggregated figures referred to, it has not been possible to always subtract those other forms of economic treaties.

Although the investment treaties are different from each other in many respects, the contours of an increasingly coherent regime are observed by many writers.<sup>48</sup> And although the arbitration system lacks an appeal system or arbitrational rules to respect precedents, arbitrational tribunals frequently refer to each other and certain common practice appears to evolve.<sup>49</sup> However, there are also split tribunal practice on several provisions and arbitration awards which have come to different conclusions on one and the same situation.<sup>50</sup> The self-identification as a special legal field is strengthened by the number of judicial journals and special networks providing the practitioners in investment arbitration with legal analysis mainly from other IIA awards.<sup>51</sup> These contours make it possible to discuss general impacts of IIAs, and writers widely discuss IIA provisions in general terms, rather than referring to

48 Shaw, Malcolm, *International Law*, ed. 6, Cambridge University Press, 2008, p. 838; Lowenfeld, *International Economic Law*, Oxford University Press, Oxford, 2002, p. 474.

49 Fauchald, Ole K., The legal reasoning of ICSID tribunals – an empirical analysis, *European Journal of International Law*, vol 19, 2008, pp. 301–364.

50 The two *ad hoc* cases CME v. Czech Republic, Award 13 Spetember, 2001, and Ronald Lauder v. Czech Republic, Award 3 September, 2001, stemming from the same conflict, are examples of this problem, as well as the cases Sempra Energy International v. The Argentine Republic, ICSID ARB/02/16 Award 28 September, 2007, and CMS Gas v. Argentina, ICSID ARB/01/8 Award 12 May, 2005, which in part came to different conclusions regarding the necessity of certain public measures during the economic crisis in Argentina in 1998. There are also examples of tribunals with split views on how to relate to earlier tribunal decisions on similar issues: Burlington Resources Inc. and others v. Republic of Ecuador and PetroEcuador, ICSID ARB/08/5 Decision on jurisdiction 2 June, 2010, para 100.

51 Among the main journals and e-newsletters specialising in investment law are ICSID Review–Foreign Investment Law Journal, Transnational Dispute Management (TDM) and Investment Arbitration Reporter (IAR).



specific investment treaties. However, for this work it is relevant also to try to establish whether differences between individual IIAs are of importance for the impacts on environmental law and thus identify components which may create future investment frameworks more deferent to needs of host state environmental law.

### 1.3.2 How to deal with IIAs and IIA awards as sources

A study of the rules of international investment treaties has to deal with the sources of over 3,000 international investment agreements<sup>52</sup> and almost 400 arbitrations.<sup>53</sup> Since it is not feasible to analyse a number of 3,000 treaties, the selection of provisions will be based on surveys made by others, referred to in doctrine and handbooks.<sup>54</sup> The treaties are not collectively published in printed format but the United Nations Conference on Trade and Development (UNCTAD) holds an online archives, mainly of BITs, gathered from governments throughout the world.<sup>55</sup> Many western states and groups of trade cooperation also keep online records of their treaties. Also, model IIAs are sometimes published.<sup>56</sup> Both home state and host state governments have

52 World Investment Report 2010, UNCTAD, 2010, pp. 81–82.

53 Latest Developments in Investor-State Dispute Settlement, UNCTAD IIA Issues Note, 1, 2011.

54 The main survey is the general scanning of IIAs by UNCTAD 1999, complemented by yearly updates published in UNCTAD's series IIA Monitor and IIA Issues Note; Also see Tudor, Ioana, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment*, Oxford University Press, 2008, surveying 365 IIAs regarding the provision on fair and equitable treatment; Romson, Åsa, *Any Steps Towards Sustainable Development in International Investment Agreements? A Study of BITs of Nordic Countries and the US-Chile Free Trade Agreement Concerning the Potential Conflict with Health and Environmental Measures*, Bugge & Voigt (Eds.), *Sustainable Development in International and National Law*, Europa Law Publishing, Groningen, 2008, discussing a survey of Nordic states' BITs.

55 UNCTAD Investment Instruments Online at [http://www.unctadxi.org/templates/Startpage\\_\\_\\_\\_718.aspx](http://www.unctadxi.org/templates/Startpage____718.aspx).

56 Dolzer, Rudolf & Schreuer, Christoph, *Principles of International Investment Law*, Oxford University Press, Oxford, 2008, include an annex with model BITs of China,

an interest in making the IIAs public as part of investor promotion communication, and online records are often accessible from major capital-exporting countries.

For arbitration awards the situations is different. The principle is that the decisions of the tribunal and the award are public only if the parties agree. It depends on the practice of the governing arbitration institution (ICSID, PCA, SCC, ICC, and others) whether there is any public record that shows the existence of the arbitration, at all. If the parties do not agree to publish the award and there is no public record showing that the arbitration is taking place, the only ways to obtain information is through journalistic work, practitioners writing analytic articles, or leaks to NGOs or academic institutions. According to UNCTAD, there were at least 390 known IIA disputes by the end of 2010.<sup>57</sup> There are no complete figures of how many IIA-based arbitrations there are; however, most writers make general conclusions from the cases known.<sup>58</sup> A reasonable assumption is that IIA cases concerning public environmental regulation are revealed more often than other kind of cases, since these cases tends to get much attention by third parties. Therefore, the environmental IIA cases analysed and discussed in this work should represent an absolute majority of the real number of such cases.

A survey of the accessible investment arbitration cases shows that in around 10 per cent of the cases environmental regulation of the host state is challenged, and in almost 50 per cent of the cases the disputed matter relates to natural resource management, the energy sector, or basic services like water and waste.<sup>59</sup> Although individual cases are very

France, Germany, the United Kingdom, and the United States.

57 IIA Issues Note 1(2011); ICSID, which is the most transparent dispute forum and probably handles more than half of all IIA cases, reported some 240 IIA cases until the end of 2010, *The ICSID Caseload Statistics*, vol 2, 2011.

58 None of the textbooks on the subject take the number of unknown IIA cases as an argument to hesitate on drawing general conclusions from the caseload that is disclosed. See, *inter alia*, Dolzer & Schreuer 2008, or Newcombe, Andrew & Paradell, Lluís, *Law and Practice of Investment Treaties – Standards of Treatment*, Kluwer Law International, Amsterdam, 2009.

59 For the first category, see Appendix 1; Romson, Åsa, Investment and environment,

dependent on causalities in the specific situation, those numbers show that the risk for challenges of environmental law is real. It is, however, not possible to make any conclusions on environmental rules and subjects which have not been challenged. It is not necessarily the case that the host state has not enforced any radical environmental regulation; it might be that the company does not see any gains to be made from challenging the measure.

## 1.4 The scope of environmental law and policy in this work

### 1.4.1 Defining environmental law

Many have noted that the term *environment* is inherently difficult to define, and the scope of such an amorphous term is consequently hard to restrict.<sup>60</sup> Law and policy dealing with the environment are likewise hard to restrict in scope. For some, the notion ‘environment’ may indicate a narrow focus on regulation governing the biology around us and not seeing our own corpus as part of that environment. However, this work recognises that health and environment are deeply interconnected areas and that the majority of health regulations concerning prevention of unhealthiness, and not specifically concerning the treatment of sick people, could generally be regarded as part of environmental law.

The surrounding environment comes into focus, because it determines many of the aspects fundamental to health: pollution of air, ground, or water, and contamination remaining in food or other products for personal use. Several sources of air pollution in Europe are also

Gehring, Codornier Segger & Newcombe (Eds.), *Sustainable development in international investment law*, chapter 3, Kluwer Law International, Amsterdam, 2011, p. 38, n. 3.

60 ‘[The environment] [...] could be used to encompass anything from the whole biosphere to the habitat of the smallest creature or organism.’ Birnie, Boyle & Redgwell, 2009, p. 5.

regulated mainly regarding the impacts on people's health, rather than the damage caused to the environment.<sup>61</sup> Some constitutions include ecosystem balance or landscape beauty, recognising values of nature as human rights.<sup>62</sup> Even without the base in constitutional texts, legislators tend to recognise a sound environment as an aim and oblige the government and the public institutions to preserve and improve the environment. The reasons for that might, as well, be economic, as shown with the ecosystem services approach.<sup>63</sup> Since health and environmental aims are deeply interconnected, this work will in general include health-oriented regulation in the term *environmental law*.

Regulations on natural resources should also be recognised as part of environmental law. Natural resources contain the notion of 'natural wealth', which comes close to what is normally called the environment.<sup>64</sup> However, here it can be seen how environmental law mixes with other legal areas. In governing natural resources, a state may not only regulate the natural resource as such but also regulate how to make the best social and economic benefits out of it. It is not meaningful to say which types of rules regulating the use of natural resources are purely 'environmental' and which are of an economic nature. Rather, one and the same rule might be both, especially since regulation of natural resources reflects on two important aspects of environmental law, *intra-generational fairness*<sup>65</sup> and *inter-generational fairness*<sup>66</sup>. The understand-

61 2008/50/EC Directive on ambient air quality and cleaner air for Europe regulating large and fine particles which have significant health impact as air borne pollutant which mainly affect the environment.

62 For example, the constitution of Costa Rica, art. 50.

63 Analysis of ecosystem services shows alternatives costs for society if the present ecosystems stop delivering services like pollination or clean water or air; see <http://www.teebweb.org/> (visited 2012-01-10).

64 Following the reasoning of Schrijver around the terms natural resources and natural wealth, Schrijver, Nico, *Sovereignty over Natural Resources*, Cambridge University Press, 1997, p. 16.

65 An example of intra-generational fairness is the issue is how to divide the gains of the resource between different groups or stakeholders in the society, for example, by regional cooperation, or to make sure marginalised rural people get a fair share.

66 An example of inter-generational fairness is how to secure that resources last for

ing in this work is that any rule that has the purpose to protect health and the environment, or contribute to a sustainable use of natural resources, rightly should be seen as part of environmental law, and that it is impossible to draw a sharp line between environmental regulation and non-environmental regulation. This does not mean that all special areas of environmental law are considered in the coming analysis; most of them have not been possible, nor meaningful, to go into.<sup>67</sup>

This wide definition does not, however, exclude the recognition of different areas of environmental law. Identifying a core area of regulation concerning health and environmental quality in some sense, such as regulating anthropogenic polluting activities or protecting wildlife, is not uncommon.<sup>68</sup> On the other hand, the regulation towards an efficient and sustainable use of natural resources strikes out in the tight relation to social and economic development. In relation to international investment rules the core regulations protecting health and environment are often dealt with in a different manner than those governing the use of natural resources. It will thus be relevant to comment on those different fields of environmental law separately.

## 1.4.2 The use of sources and terminology in environmental law

Since the purpose of this study requires identifying and discussing general and common features of environmental law, it is most suitable to consider legal approaches with broad applicability. Although, bearing in mind that directly enforceable environmental law on economic activities is always placed in a national context, to deduce identical patterns in many countries would require studies in all national law, which is not feasible for this study, or necessary for the purpose. The study has been limited to legal literature mainly addressing EU

future generations.

67 As, for example, regulation of radioactive products or health standards for domiciled animals.

68 Macrory, Richard, *Regulation, enforcement and governance in environmental law*, Cameron May, 2008, p. 421.

or North American law as a basis for an assessment of typical environmental law instruments of pollution control, land use, and natural resource management used in the main capital-exporting countries.<sup>69</sup> Those analyses have been complemented by some specific studies in national law in order to give examples of national regulation, both in western states and in some developing countries.<sup>70</sup> As the law of the environment is an inherent mix of international legal instruments and nationally founded norms,<sup>71</sup> such a way of working well reflects the subject. The differences in the legal cultures of, for example, the Nordic countries, states using European civil law, and the common law states, are not assessed in particular, as the examples given could be understood clearly enough, based on the ordinary understanding of those legal differences.

The terminology in environmental law is not consistent between countries and sometimes not even consistent within the same state. There is, for example, seldom a clear distinction between the terms *concession*, *licence*, *permit*, and *permission*.<sup>72</sup> Thus, those English terms

69 *Inter alia*, Abbot, Carolyn, Environmental Command Regulation, Richardson & Wood (Eds.), *Environmental Law for Sustainability*, chapter 3, Hart Publishing, Portland, 2006; Bell, Stuart & McGillivray, Donald, *Environmental Law*, 6:th edition, Oxford University Press, Oxford, 2006; Seerden, René J.G.H., Heldeweg, Michiel A. & Deketelaere, Kurt R., *Public Environmental Law in the European Union and the United States*, Kluwer Law International, Amsterdam, 2002; Bodansky, Daniel, Brunnée, Jutta & Hey, Ellen, International Environmental Law – Mapping the Field, Bodansky, Brunnée & Hey (Eds.), *The Oxford Handbook of International Environmental Law*, chapter 1, Oxford University Press, 2007; Kiss, Alexandre & Shelton, Dinah, *Guide to international environmental law*, Martinus Nijhoff Publishers, Dordrecht, 2007; Macrory 2008; Moe, Mogens, *Miljøret*, 6, Thomson, Copenhagen, 2007; Basse, Ellen Margrethe *Environmental Law – Denmark*, 2, DJÖF/Kluwer, Copenhagen, 2004.

70 Reflected in literature such as Aguilar, Grethel & Iza, Alejandro, *Manual de Derecho Ambiental en Centroamérica*, IUCN, San José, 2005; Tiwari, A.K., *Environmental Laws in India*, Deep & Deep Publications, New Delhi, 2006. During winter 2008 the author was also guest researcher at the Faculty of Law at the University of Costa Rica in San José, and the environmental law NGO in Costa Rica, CEDARENA.

71 Ebbesson, Jonas, *Compatibility of International and National Environmental Law*, Kluwer, Haag/London/Boston, 1996.

72 Rönne, Anita, Public and Private Rights to Natural Resources, McHarg, *et al.* (Eds.), *Property and the Law in Energy and Natural Resources*, chapter 3, Oxford University

cannot be used to describe distinct types of vested rights in the domestic law without explanation. The terminology used in this work is 'concession' for allowances to exploit minerals and 'permits' for all other administrative decisions where private actors are allowed to carry out an activity otherwise prohibited for environmental reasons. The term *general regulation* is used for all public decisions of general applicability in this regard.

## 1.5 International law context

The relation between international investment treaties and environmental regulation reflects the general relation between economic and public regulation, and between international and national law. Globalisation is apparent also in international law, and some overarching perspectives are therefore useful to consider before moving on to the more specific analysis. This section also includes an overview on the interpretation of conflicting international law.

### 1.5.1 Globalisation of law

Globalisation raises new questions of how to understand law, questioning the role of the state as the only actor in international law,<sup>73</sup> arguing for new legal concepts spreading in multiple directions and being translated at different levels,<sup>74</sup> and furthermore suggesting that developments at the political 'centre' and 'peripheries' accord with respect to distinctive analyses.<sup>75</sup> Those perspectives may rightly be kept in mind in an analysis of the international investment regime, which indeed bears many signs of the new global legal order. The way in-

Press, Oxford, 2010, p. 73.

73 Twining, William, *Globalisation and Legal Theory*, Butterworth, London, 2000.

74 See, *inter alia*, Zamboni, Mauro, Globalization and Law-Making, Time to Shift a Legal Theory's Paradigm, *Legisprudence: International journal for the study of legislation*, vol 1, 1, 2007.

75 Elaborated on by Santos, Boaventura De Sousa, *Towards a New Legal Common Sense*, 2:nd ed., Butterworth, London, 2002.

vestment law has been formed by transnational corporate structures, defining the investor out of transnational corporate needs, shows an example of the development. International investment law also shows many examples of global spreading of legal terms and figures, for example, the US doctrine of regulatory takings, which has influenced the understanding of expropriation also of non-US IIAs. Further, few areas of law and policy are so clearly in the midst of the battle between the political 'peripheries' and 'centre'. With the majority of IIAs still running between capital-exporting and capital-importing states, and where the parent bodies of most transnational corporations (TNCs) foremost are situated in the former, it is still relevant to see differences in power between developed and developing countries, although things are much less black and white than they used to be.

Linked to the globalisation of law is the debate about fragmentation of international law. The refinement of international law forming various fields or 'regimes' becomes increasingly difficult to overview, or grasp a connecting thought in, and thus appears fragmented. A report by the International Law Commission on the Fragmentation of International Law: Difficulties Arising From the Diversification and the Expansion of International Law, conducted by Martti Koskenniemi, describes legal regimes contributing to such fragmentation as 'regimes of international law that have their basis in multilateral treaties and acts of international organizations, specialized treaties and customary patterns that are tailored to the needs and interests of each network but rarely take account of the outside world.'<sup>76</sup> Hence, when dealing with two different regimes, as here, one might find conflicting rules, due to the inabilities of the different regimes to accurately take account of the rules of other regimes. This work will elaborate on such inabilities in international investment law as part of constraints for environmental policy space.

Although it seems relevant to place an analysis on the interface of international investment law and environmental law in the context of

76 Fragmentation of International Law: Difficulties Arising From the Diversification and the Expansion of International Law, UN Doc A/CN.4/L.682 13 April 2006, para 482.



globalisation and fragmentation of law, this is not the way it will be done here. The main method described above is based on a more narrow and positive view of law, seeing the legal conflicts from within the present paradigm where investment treaties *are* enforcing corporate rights on host states. Reflections are, however, made along the road to which this post-modern view of law applies. Indeed, it will be argued that reconciliation of the two regimes is impossible, without broadening the perspective of law in global society.

### 1.5.2 Conflicts of norms and interpretation in international law

The disputes concerning environmental issues occurring today between foreign investors and host states channelled through investment treaties have a clear form: The investor claims rights of freedom to carry out the project invested in, and the host state defends its decisions to restrict the project. For the arbitration tribunal the investment treaty between the investor's home state and the host state forms the framework regarding both the substantive interpretation and procedural form. However, if one takes a more abstract perspective, one sees that the normative conflict often lies in international treaty obligations concerning one matter, that is, protection of foreign investments, and national regulation concerning another matter, protection of the environment, and that the latter often is related to rules of international environmental law. Is it a conflict of norms, and how should it be solved? Shall one norm take precedence over the other, or are there ways to reconcile the different norms?

The 1969 Vienna Convention on the Law of Treaties (VCLT) has codified customary rules on the relationship of treaties and their interpretation.<sup>77</sup> Those rules are well recognised and used by adjudication bodies, as well as by the *ad hoc* arbitration tribunals of IIA disputes.<sup>78</sup> In a situation where an environmental rule is fixed in a treaty to which both the IIA states are parties, the legal question could be which treaty

77 1969 Vienna Convention on the Law of Treaties, art. 30–33.

78 Fauchald 2008ii. See section 2.5.

should be giving priority over the other. In that case, the symmetric relationship, the VCLT says that if the norms are on the same subject matter and equally specific to the issue, but the environmental treaty was concluded later than the IIA, the environmental rule will govern the relationship between the states and the IIA rules should apply only to the extent they are compatible with those of the environmental treaty.<sup>79</sup> However, our situations are not all symmetric. They are likely to involve environmental standards expressed more like a principle in an environmental treaty, or a domestic standard being the result of an objective of such a treaty, or if ever so clearly defined, probably both IIA states are not parties to the environmental treaty. Hence, the most likely situations are where there is no binding treaty between the IIA parties in which the environmental standard is clearly prescribed. This results in a situation where there is no 'conflict' between rules, in the sense of VCLT, as to whether the IIA is at all applicable.

Only if the environmental obligation expresses a peremptory norm (*jus cogens*) will it rule out a conflicting provision in an IIA no matter whether both states are parties to the environmental treaty or not. However, few environmental obligations would pass the test for peremptory norms; in the literature only prohibitions of massive pollution of the atmosphere or of the sea have been mentioned.<sup>80</sup> International environmental law has rather emerged through the development of principles, approaches, standards in MEAs, and other common behaviour forming customary law.<sup>81</sup>

Hence, environmental norms seldom overhaul an investment treaty obligation otherwise in force. The relevant question is rather how the environmental norm may affect the interpretation of the scope and content of the IIA norm. In the asymmetric relation there are no general rules for how the provisions in both treaties shall be related. States which make commitments to environmental agreements to which another state party of the IIA do not commit risk being challenged by in-

79 Vienna Convention, art. 30(3).

80 Shaw 2008 p. 807; Birnie, Boyle & Redgwell, 2009, note that there is no obvious case for treating norms of environmental law as *jus cogens*, p. 110.

81 For background, see *inter alia* Bodansky, Brunnée & Hey 2007; Sands 2003.

vestors from the IIA (but not MEA) partner state when it takes actions which are required or authorised by the environmental agreement but, according to the investor, incompatible with the IIA.<sup>82</sup> Seen from the investor's point of view, it could then be more favourable to invest as a national of a state that has not signed the environmental agreements.<sup>83</sup> However, the International Court of Justice(ICJ) has found that international law has a strong presumption against normative conflict, since state parties do not intend inconsistency between rules.<sup>84</sup> That means relevant environmental treaties and customary law apply in investment arbitration, along with the applicable investment provisions.

The so-called systemic interpretation is argued to be a fruitful approach in cases where there are connections to both international environmental law and, for example, trade law.<sup>85</sup> For example, Philippe Sands has analysed the situation of potential conflict between a treaty rule and a subsequent customary rule of a different subject matter.<sup>86</sup> Based on article 31(3)(c) of the VCLT, he argues that an adjudicatory

82 Ebbesson concluded considering investment obligations proposed in the MAI draft, enforced by investor–state arbitration: '[I]f the parties to environmental agreements continue to act in a manner that clashes with the MAI, other states might also be brought to arbitration. Considering the balance of interests that is reflected in the Convention on Biological Diversity and the Kyoto Protocol, and the importance of this balance for the legitimacy of these agreements, such effects, arising out of legal procedures under the MAI, could hamper the co-operation in achieving the environmental objectives.' Ebbesson, Jonas, MAI and multilateral environmental agreements, Report to the Swedish ministry 31 July 1998, p. 25.

83 The possible 'free rider' situation was identified during the negotiations of the MAI, and since the situation cannot in any binding way be dealt with in the context of the environmental agreement, the OECD secretariat noted that 'If this kind of "incompatibility" is considered sufficiently possible and to be avoided, the MAI itself may need to address it.' See Relationships between the MAI and selected MEAs, Analysis of OECD secretariat, 1998.

84 ICJ Right of Passage, reports 1957, p. 142.

85 Sands, Phillipe, Treaty, Custom and the Cross-fertilization of International Law, *Yale Hum. Rts. & Dev. L.J.*, vol 1, 1998, pp. 85–105.

86 *Ibid.* The analysis is directed at the much -debated field of WTO-MEA relationships, which in some extent is similar to the situation of the IIA–environmental standards relationship discussed here; for a summarised report on the WTO-MEA debate, see Langlet 2009, p. 269–274.

body in such situations may assume that the treaty previously at hand (which in our case would be the IIA) is consistent with a subsequent customary rule (for example, a recognised environmental norm) and that the latter rule applies to the situation, unless it can be shown that such application would undermine the object and purpose of the governing treaty (the IIA).<sup>87</sup> The consequence of such interpretation in our situation is that the investor who opposes the application of the environmental standard needs to explain why it should not be applied in the particular case, that is, there should be an assumption that the environmental norm should be upheld unless there are well-founded arguments against such interpretation.<sup>88</sup>

Such interpretation puts a presumption of harmony between international norms and corresponds well with the general assumption against conflicts of international norms.<sup>89</sup> It implies that a subsequent international norm, if it does not oppose the object and purpose of the treaty, may modify the content of the treaty provision. It corresponds with the reasoning of the ICJ in, *inter alia*, the *Gabcikovo-Nagymaros* case and the *Iron Rhine* case, where it was held that environmental norms that evolved after a state agreement were relevant for the subsequent implementation of the treaty.<sup>90</sup> Hence, environmental norms are

87 Sands, 1998, p. 104.

88 Another view on resolution of potential conflicts between environmental measures and international economic law, less bound to conventional legal reasoning, is presented by Christina Voigt, who argues there is a need for additional legal arguments rather than rules of interpretation or hierarchy, a principle of integration which would be able to disapply treaty norms and prioritise the norms according to their significance to the objective of the shared vision of sustainability, Voigt, Christina, *Sustainable Development as a Principle of Integration in International Law – Resolving Potential Conflicts between WTO Law and Climate Change Mitigation Measures*, Oslo University Faculty of Law (thesis), Oslo, 2006, pp. 420–211.

89 Pauwelyn notes that the presumption against conflicts is not a presumption in favour of the earlier rule, but against the existence of conflict – why the first option is to reconcile the norms, Pauwelyn, Joost, *Conflict of norms in public international law*, Cambridge University Press, 2003, pp. 240–244. Also see Jennings, Sir Robert (Ed.), *Oppenheim's International Law*, II, 9th, Longman, Harlow, 1992, p. 1275.

90 Gabcikovo-Nagymaros Project (Hungary-Slovakia), ICJ Reports 7, 1997, paras 112, 140; Iron Rhine Arbitration, PAC, 2005, para 60.

applied alongside other relevant norms and will influence the interpretations of both specific IIA provisions and the understanding of IIAs in general. Of special interest in this work is to the extent to which environmental norms of global soft law, including norms of corporate conduct, may constitute safeguards against private actors having legitimate expectations of less ambitious environmental standards; see sections 3.2.2., 4.7.3 and 6.5.1.

## 1.6 Overview of the structure of the book

To fulfil the aims and analysis outlined above, the text is structured as follows: In chapter 2 international investment law is generally introduced and the role of the investor–state dispute settlement mechanism is examined. Chapter 3 gives a brief background on environmental law. It focuses on six concepts connected to investments, which elucidate principles, approaches, instruments, and structures of implementation and enforcement. The chapter discusses why environmental law works with prevention and risk assessment and positions it in relation to concepts of stability and expectations of private actors; further, it discusses how it relates to multi-tiered governance structures and third party participation and access to justice, how it avoids discrimination in treatment of similar actors, and how it relates to property rights and the compensation of its interference.

Chapters 4, 5, and 6 each contain an examination of one core IIA provision considering two, three, or four relevant concepts of environmental law and situate it in relation to policy space as referred to above.

Chapter 4 investigates the investment provision ‘fair and equitable treatment’ and analyses the potential constraints of environmental policy space with focus on prevention and risk assessment, stability, and expectations, and in relation to multi-tiered governance and to third parties’ participation and access to justice. Chapter 5 takes on the investment provision ‘national treatment’ and its related items, and analyses the potentially constraints of environmental policy space with focus on how to avoid discrimination of similar actors and in relation to multi-tiered environmental governance. Chapter 6 takes on

the investment provision on expropriation and analyses the potential constraints of environmental policy space with focus on split views between investment law and environmental law on property rights, as well as on prevention and risk assessments and predictability and stability. In chapter 7 the three previous chapters are summarised in such a way that the policy space analysis questionnaire is elaborated further.

Chapter 8 contains a discussion of various strategies to safeguard or widen environmental policy space more generally within the international investment treaties, and in the process of their negotiation. This chapter also reflects on proposals to reform IIAs into instruments which more directly promote sustainable development measures.

Chapter 9 summarises and discusses the findings, especially related to the policy space analysis questionnaire. Some recommendations are given, directed to host states already committed to investment treaties, parties negotiating investment treaties, and private parties in investment arbitration.

# 2 International investment treaties

## 2.1 Introduction

The law of international investments is increasingly shaped by bilateral or regional investment agreements (IIAs).<sup>91</sup> This means that the primary source of law becomes the investment treaty, while the general principles of international customary law play a complementary, however still important, role. This chapter gives a background to the development of international investment treaties as an evolving legal regime. It discusses features that make IIAs powerful tools in the hands of transnational investors, the wide definition of investments and thereby wide applicability of the treaty, and the investor–state dispute settlement mechanism as the main tool to enforce the investor rights granted by the treaties. The introduction to international treaty law in this chapter also serves as a foundation for the presentation and analysis of three core substantive investment treaty provisions in

91 Muchlinski, Peter, The diplomatic protection of foreign investors: A tale of judicial caution, Binder, *et al.* (Eds.), *International investment law for the 21st century*, chapter 19, Oxford University Press, Oxford, 2009, p. 341. UNCTAD estimates there were 3,116 BITs and other international investment agreements by the end of 2010 (the double taxation agreements not included); see World Investment Report 2011, UNCTAD, 2011, p. 100.

chapters 4, 5, and 6 on fair and equitable treatment, national treatment, and expropriation.

## 2.2 Background on foreign investment protection law

### 2.2.1 Brief history

As long as there have been trade and investments across state borders, there has been law governing it in some ways (i.e. there have in some sense been African and Asian, as well as European, investment rules).<sup>92</sup> In European conquistadorian centuries legal writers expressed two different views on investment protection: the foreign investor's natural right to be equal to nationals, and the right to be treated in accordance with an external and higher standard. During the colonial time the European powers did not need international law to protect investments in the colonies; guarantees for the investors were set directly by the colonial powers. Outside the colonial context force was frequently used to settle investments disputes, and the investments made in Latin America by North Americans put the issues of international investment protection on the agenda for international law. In this relation the Latin American view was that foreign investors had the right to be treated as equal to nationals (expressed by the Argentinean foreign minister and jurist Carlos Calvo), and the US view was that they should be treated in accordance with an external and higher standard.

The foreign direct investments in these times were mainly exploitations of natural resources (i.e. cash-crop agriculture and mining) and the presence of merchants and their businesses. The conflicts that arose concerned attacks by mobs or capricious grabbing by juntas in power. Hence, the protection and security of physical assets were in

92 This background follows to some extent chapter 1 in Sornarajah 2004.



focus.<sup>93</sup> Around these issues the international laws on diplomatic protection and state responsibility for injuries to aliens were elaborated.

A predecessor to the modern trade and investment treaty is the Friendship, Commerce and Navigation Treaty (FCN). The first FCNs were concluded by the United States of America and France in 1778, and the USA continued to make similar agreements with several of their allies. The early FCN treaties gave protection to the other party's nationals and their property, as the presence of merchants was important to trade. The early FCNs also covered military interests like access to ports. The USA continued making FCNs after Second World War and then included provisions on rights for foreign investors to incorporate a company, which then was to be treated as other companies in the host country. Another similarity with today's investment treaties is the common FCN provision of 'most favoured nation (MFN) treatment'. The FCNs are described as non-reciprocal, concluded by a strong economic and political power with weaker states, with the aim to spread the influence of the more powerful state.<sup>94</sup>

Much of the international investment law system we have today was born out of the situation which culminated in the late 1960s when states in the south, in the era of more widespread socialism and/or freedom from colonialism, undertook extensive nationalisation of land and property owned by foreign nationals, mainly land for agriculture or titles of natural resources. This were general reforms, and not, as earlier, appropriations by mobs or illegitimate elites. However, the investors' home countries claimed that these actions did not match international law. The judicial fight again stood between the doctrine of a treatment based on national law, and the doctrine of an international standard setting. The former doctrine emphasised the principle of territorial sovereignty, and the latter emphasised the principle of nationality, involving the state's interest in the proper treatment of its nationals abroad. The US Secretary of State in 1938, Cordell Hull, contributed to the latter doctrine by claiming an international standard to

93 As the situation show in the case *Neer v. Mexico* 1926, UN Reports of International Arbitral Awards IV p. 60, 1926.

94 See Lowenfeld, 2002, chapter 13. Also Sornarajah 2004, pp. 209.

give the foreign investor the right to ‘prompt, adequate and effective compensation’.<sup>95</sup> The debate was focused on the expropriation regulation. What some writers describe as the least common denominator between the two doctrines (though unacceptable as a whole to many investment-exporting states) was expressed in the UN Resolution on Permanent Sovereignty over Natural Resources,<sup>96</sup> in which the view of sovereign rights was combined with the view that expropriations were only for public interests, should be regulated in law, and ‘appropriate’ compensation was to be paid. The amount of compensation was, however, to be decided in domestic courts, if the host country had not agreed to other means. This was also the view on investments that the developing states, empowered by the oil crisis and generally greater support, called for in the UN in the mid-1970s with the New International Economic Order (NIEO).<sup>97</sup>

The multinational approaches to investments before the NIEO era were inconsistent and did not result in any worldwide commitments concerning protection of foreign investments. There were, however, several attempts to find a global standard: the League of Nations draft convention on treatment of foreigners in 1929;<sup>98</sup> the Havana Charter in 1948;<sup>99</sup> the Abs-Shawcross Draft Convention on Investments Abroad in 1959,<sup>100</sup> which introduced the investor–state arbitration right; and also attempts at the OECD-initiated Paris Conference on International Economic Cooperation in 1975, but none of those efforts

95 Further on the development of customary law on expropriation see Lowenfeld, 2002 chapter 13.

96 UN General Assembly Resolution on Permanent Sovereignty over Natural Resources, A/RES/17/1803 (1962).

97 See, for example, article 2 of the UN GA Resolution on Charter of Economic Rights and Duties of States, A/RES/29/3281 (1974).

98 League of Nations, Responsibility of States for Damage Caused in Their Territory to the Person or Property of Foreigners (1929).

99 The Havana Charter, concluded at the United Nations Conference on Trade and Employment 1947–8, available at the website of WTO, [www.wto.org](http://www.wto.org).

100 Abs, Herman & Shawcross, Hartley, ‘Draft Convention on Investments Abroad’, in The Proposed Convention to Protect Private Foreign Investment: A Round Table’, *Journal of Public Law* (now *Emory Law Journal*), vol 1, Spring 1960, pp. 115–118.

was successful in getting states to agree to binding legal principles for foreign investments.

Discussions in the 1970s on multinational corporate behaviour sprung off and initiated the work later presented as the 1988 UN Draft Code of Conduct on Transnational Corporations and the important soft law instrument OECD Guidelines for Multinational Enterprises.<sup>101</sup> In contrast to the aforementioned draft conventions, those instruments did not aim to protect investment interests, but rather public and state interests.

Parallel to this ideological debate in the 1970s, the bilateral investment agreements started to gain foothold. Motivated by both economic and political reasons was an increasing interest to promote foreign investments, both from investment-exporting countries and from some of the investment-importing countries. Germany was early out, and as a non-colonial state, was interested in concluding agreements. These agreements were open to including the higher Hull standard on compensation for expropriation and acceptance of international dispute settlement for foreign investors. The provisions in these bilateral investment treaties were to a large extent elaborated in the OECD, where a draft convention on protection of foreign property was elaborated in 1962.<sup>102</sup> This convention was approved by the OECD council in 1967, but never opened for signatures. However, the text inspired many capital-exporting countries in their formulation of clauses for bilateral investment agreements.<sup>103</sup>

The OECD restarted negotiations of a global multilateral investment agreement (MAI) in 1995. In 1998 the negotiations moved to the WTO, where they became one of the grounds to the 'battle in Seattle', and the negotiations stalled 1999.<sup>104</sup> In the WTO meeting in 2003 in

101 OECD Guidelines for Multinational Enterprises, 2011, first released 1979.

102 OECD Draft Convention on the Protection of Foreign Property 1967, (hereafter OECD draft IIA).

103 See, *inter alia*, Mann, F.H., British Treaties for the Promotion and Protection of Investments, originally published in BYIL 1981, *Further Studies in International Law*, Clarendon Press, Oxford, 1990.

104 The WTO ministerial meeting in Seattle, USA, 1999, could not agree to the MAI.

Cancun the developing countries once again refused the push from the USA and EU to include investment protection (part of the so-called Singapore issues) in a new round of WTO negotiations. Hence, there is no global-wide multilateral agreement on investment issues beyond the limited rules of non-discrimination and market access of the 1994 WTO agreements of TRIMS<sup>105</sup> and GATS.<sup>106</sup> However, regionally in North America and West–East Europe two other important agreements were made in 1994: the North American Free Trade Agreement (NAFTA), which in chapter 11 includes a full investment treaty, and the European Energy Charter Treaty (ECT), which covers investments and cooperation in the energy sector. These two early multilateral investment treaties also bear signs of an increased concern for environmental issues.

### 2.2.2 IIAs and the development policy debate

In the global debate on economy and development there has been a comprehensive discussion around the important role of foreign direct investments. International investment agreements have been assumed to attract such investments and therefore to be crucial for development in developing states. It has, however, been difficult to demonstrate a clear connection between an increase of overall foreign direct investments in developing countries and the existence of IIAs in those countries.<sup>107</sup> Several assessments conclude that countries that have concluded IIAs in general have got more foreign investments than those that have not.<sup>108</sup> But, does having many IIAs lead to more foreign

Several mass demonstrations during the meeting expressed disapproval with the discussion on economic globalisation and environment and job issues.

105 Agreement on Trade Related Investment Measures, 1994.

106 General Agreement on Trade in Services, 1994.

107 UNCTAD concluded that 'IIAs alone can never be a sufficient policy instrument to attract FDI. Other host country determinants, in particular the economic determinants, play a more powerful role.' See *The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries*, UNCTAD/DIAE/IA/2009/5, 2009, pp. xi-xii.

108 Hallward-Dreimeier, M, Do bilateral investment treaties attract FDI? Only a bit...

investments, or is it that mainly states with a great deal of foreign investment choose to conclude many IIAs?

Foreign direct investments, compared to foreign portfolio investment or plain speculation capital, have a great potential to support economic development through the import of foreign capital, know-how, and providing of jobs. But while some debaters argue that fewer restrictions increase the inflow of capital and that this inflow is the main determiner of the potential for development,<sup>109</sup> others say the potential is best realised with more carefully tailored investment policies of the host states, policies making use of joint ventures and requirements to use domestic products and labour.<sup>110</sup>

Concerning more specific issues like social conditions and environmental impacts, few evaluations have been made of the effects of a general inflow of foreign investments.<sup>111</sup> Obviously, the environmental risks depend on the types of operations; there is a higher risk of negative environmental impacts from the foreign establishment of a mining operation than from foreign capital buying parts of an ongoing telephone company. Thus, to calculate the developing effects, including environmental quality, one probably needs to look beyond a figure of capital flow and at least assess the types of investments.

The investment treaties in general take a universal approach to investments and make no distinction as to the type or sector.<sup>112</sup> Accord-

and it might bite, World Bank, 2003; Salacuse, Jeswald W. & Sullivan, Nicholas P., Do BITs really work? An evaluation of bilateral investment treaties and their grand bargain, Sauvart & Sachs (Eds.), *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties and investment flows*, Oxford University Press, 2009.

109 This has been the dominant view expressed since the 1980s until the mid-2000s by potent international organisations like the World Bank, the IMF and the WTO.

110 For example, economists like Dani Rodrik at Harvard University and Ha-Joon Chang at Cambridge University. This view is also sometimes expressed in international forums by Asian countries; the informal coordination body of southern states, South-Centre in Geneva (the coordination body of southern states), and in various UNCTAD reports.

111 Conclusion by the Netherland center for research on multinational corporations, SOMO, *Is Foreign Investment Good for Development?*, SOMO November, 2008.

112 The Energy Charter Treaty covering only the energy sector is an exception.

ingly, as tools for development they correspond more to the view of quantity or ‘the more the better’, than to that of restrictions tailored to single out the qualitatively best investments.

International investments made with support from special development institutions like the World Bank branch for foreign investment guarantees, (Multilateral Investment Guarantee Agency, MIGA), or its domestic counterparts, national export credit or promotion agencies (the American Overseas Private Investment Corporation (OPIC) being the most powerful and well-known), give companies insurance against political risks in the host state. Sometimes the existence of IIAs between the host state and the investor’s home state is a requirement for those guarantees.<sup>113</sup> However, the support of an export agency is a different kind of protection of investments than protection only through IIAs. When an export credit agency is involved, there is always an individual contract with the investor on the specific investment. The export agency may screen the investment project beforehand and usually sets up some minimum standards of environmental performance.<sup>114</sup> This makes investments protected through export agencies easier to control for the home state than investments covered only by IIA protection.

### 2.2.3 The developments of IIAs —some current trends

Before 1970 there were still fewer than 100 international investment agreements concluded in the world and most of them were bilateral. The real boom in numbers of IIAs came during the 1980s and 1990s. In the final years of the 1990s there were over 1,700 IIAs, and as mentioned above, at the end of 2010 UNCTAD could verify 3,116 IIAs in the world.<sup>115</sup> This rapid increase of investment treaties partly relates

113 For example, OPIC demands that.

114 See, for example, ‘MIGA Environmental Guidelines and Performance Standards’ at the MIGA official website [www.miga.org](http://www.miga.org).

115 World Investment Report 2011, p. 100. Note that UNCTAD also includes double taxation treaties as one group of investment treaties; those taxation treaties are not

to strong competition for foreign investments in the aftermath of the 1990 debt crisis and a more stringent view of the World Bank and the IMF as creditors. As part of the so-called structural adjustment programmes, the World Bank and IMF loan conditions for a long period favoured the liberalising of investment legislation in developing countries, and it was recommended that those countries conclude IIAs with investment-exporting countries.<sup>116</sup>

The 'standard' IIA consists of a set of paragraphs regulating investments of nationals of the other party, concerning protection and non-discrimination. The clauses on treatment guarantee fair and equitable treatment, full protection and security, and no less favourable treatment than that accorded to investments made by its own investors (national treatment) or by any other foreign investor (most favoured nation treatment). There are also clauses on compensation for direct and indirect expropriation, compensation for losses in case of war, guarantees to repatriation (the investor's right to transfer money back to the home state), and recourse to international dispute settlement, both between the investor and the host state and between the parties.

Since the 1990s IIAs have developed in language, techniques, and scope. While the same changes can be seen in many new agreements, there is also more divergence arising.<sup>117</sup> There is no longer a single model BIT that most of the capital-exporting countries use, but there are groups of countries following more or less the same lines. The groups of states follow, to some extent, economic partner organisations: APEC, ASEAN, CARICOM, EFTA, EU, MERCOSUR and NAFTA. Some of those groups of states even jointly negotiate IIAs with states outside the partner group.<sup>118</sup> In the core IIA provisions and approaches

included in the number here.

116 Sornarajah, p. 208, note 16.

117 International Investment Arrangements: Trends and Emerging Issues, UNCTAD Series on international investment policies for development, 2006.

118 ASEAN concluded in 2009 its first joint investment agreement with Australia. Negotiations are ongoing for a Trans-Pacific Partnership Agreement (TPPA) that also will cover investments evolving from the Trans-Pacific Strategic Economic Partnership Agreement concluded by Chile, Singapore, Brunei, and New Zealand in 2006. The current negotiations involve also Australia, Peru, Vietnam, and Malaysia

the most apparent differences are, however, found between European and North American treaties. The approximately 1,400 bilateral investment treaties EU member states have concluded<sup>119</sup> are for the most part not liberalising treaties and have not gone through any substantive development in relation to environmental regulation, as many of the US and Canadian BITs and free trade agreements (FTAs) have.

In the EU the member states had the competence to conclude their own BITs until the Lisbon Treaty came into power in late 2009. Since then the EU Commission has had the exclusive competence on behalf of the union to conclude investment treaties with third states, just as it has to conclude trade agreements.<sup>120</sup> This shift of competence opens the way for future EU trade agreements which include investment protection and establish the EU Commission as the main EU power in external relations in the area of trade and investments.<sup>121</sup> However, how the EU will act after this shift of competence between the member states and the Commission is still unclear in many respects.<sup>122</sup> Even before

in a first round and Japan, Canada, and Mexico in a second round; hence, the TPPA is the broadest IIA negotiation since the MAI, regarding the diversity of states involved. For an updated analysis (January 2012) see Kelsay, Jane, *Investment Developments in the Trans-Pacific Partnership Agreement*, *Investment Treaty News*, Issue 2, vol 2, 2012.

119 EU Parliament Resolution on the future European international investment policy 22 March, A7-0070/2011, 2011, A7-0070/2011, explanatory statement, p. 10.

120 Articles 3(1), 206, and 207 of the Treaty on the Functioning of the European Union (TFEU).

121 The central EU powers (the Commission and the Council) as early as 2006 pushed for stronger investment elements in the EU negotiations on economic partnerships agreements and developed a Minimum Platform of Investments as part of the negotiating mandate (EU Council 15375/06, 27 November 2006). The platform includes, inter alia, rules for market access in services and non-lowering of environmental standards, but does not cover a 'full' IIA, as provisions on expropriation and investor-state arbitration are not included; see communication from the Commission to the 133 Committee 31 July 2006 (the platform itself is kept secret and has not been made public on demand, decision by the EU Council 6456/10 15 March 2010). For the ongoing negotiations on free trade agreements between the EU and India, Singapore, and Canada, the negotiating instructions have been amended to incorporate a full investment chapter (12 September 2011, EU General Affairs Council).

122 The World Investment Report 2010 notes the following: 'Questions remain over: (i)



the Lisbon Treaty EU law prescribed that member states must make their external bilateral investment treaties compatible with EU regulations, for example, on restrictions for capital transfers and agriculture policies.<sup>123</sup> One troublesome matter is the intra-EU IIAs. Eastern European states which have joined the EU have had BITs with other EU states, which results in parallel procedures, as companies and persons of the other EU state have preferred to make use of the investor–state arbitration process, rather than relying on EU law.<sup>124</sup> Notwithstanding such practice, only a few EU states have acted to abrogate intra-EU BITs.<sup>125</sup> The EU Commission has started the work to form a future European international investment policy and treaty standards; however, many issues need to be solved before the member state BITs are altered by EU-wide IIAs.<sup>126</sup>

the fate of the high number of existing IIAs concluded by EU member States in the past; (ii) how to ensure coherence and compatibility in case the EU concludes IIAs with the same countries as member States, resulting in an overlap of treaty obligations; (iii) how to determine the standards to be favoured by the EU; (iv) how to approach investor-State dispute settlement (noting that the EU is not a member of ICSID and, as a supranational organization, cannot become one under current ICSID rules).’ p. 84.

123 The Understanding Concerning Certain US Bilateral Investment Treaties signed 22 September 2003 between the USA, the EU Commission and eight accession states (Czech and the Slovak Republics, the three Baltic states, Poland, Bulgaria, and Romania). In judgments 3 March 2009 (C-249/06) the ECJ decided that Sweden and Austria had failed to comply with their duties as member states to make sure the agreements with third countries are compatible with their commitments as EU members, regarding restrictions to free movements of capital.

124 For example, *Eastern Sugar v. Czech Rep.*, *Mittal Steel Company N.V. v. Czech Republic*, *Invesmart*, *Union Banka v. Czech Rep.* (all the Netherlands–Czech Rep BIT) , *Ioan Micula, Viorel Micula and others v. Romania*, ICSID ARB/05/20 Decision on jurisdiction 24 September 2008 (Sweden–Romania BIT), and *Vivendi v. Poland* (France–Poland BIT). For analysis of intra-EU BITs and the EU law, see Söderlund, Christer, *Intra-EU BIT Investment Protection and EC Treaty*, *Journal of International Law Arbitration*, vol 24, 2007 and Burgstaller, Markus, *European Law and Investment Treaties*, *Journal of International Arbitration*, vol 26, 2, 2009, pp. 181–216.

125 Czech Republic, which has experienced many IIA cases, has started the procedure to abrogate all its BITs with other EU states.

126 In its communication in 2010 the commission highlighted some of the issues it wished to include in future EU BITs or FTAs. It noted that ‘Investment agreements

An interesting trend is that there are more and more IIAs concluded between countries that are both importers and exporters of investments. However, the vast majority of the agreements are still between an investment exporter and an investment importer. Some old agreements might be used ‘in the reversed way’ as countries develop. One example of that is India, which now exports services to the USA on the basis of the old FCN agreement.

In recent years there have been few setbacks in the increase of numbers of IIAs. However, three economically strong countries have declared doubts about concluding investment treaties that include the investor–state dispute settlement mechanism: Brazil, which has chosen not to sign IIAs at all; Norway, which is blocking investment protection and investor–state arbitration being part of future EFTA free trade agreements; and Australia, which in 2011 declared that investor–state arbitration should not be part of future investment treaties (see further in section 2.5). A more oppositional approach has been taken by Bolivia and Ecuador, which have started to phase out some of their IIAs and have withdrawn from ICSID.<sup>127</sup> These actions show that for

should be consistent with other policies of the Union and its Member States, including policies on the protection of the environment [...] health and safety at work, consumer protection.’ Towards a comprehensive European international investment policy, EU Commission, COM(2010)343 final, 2010, p. 9. The EU parliament’s response to the communication, however, expressed strong concern for the right to regulate and reforms of the investor–state dispute settlement mechanism, EP resolution on the future European international investment policy 2011.

127 In 2007 Bolivia withdrew from the Convention on the settlement of investment disputes between states and nationals of other states (hereafter ICSID convention) 1965, and Ecuador limited its consent, in accordance with article 25(4), for dispute settlements not to cover cases concerning natural resources. Effective January 2010 Ecuador took a step further and withdrew from the convention. For a discussion on other interpretations and the context of the ALBA (Bolivarian Alliance for the Americas) states’ criticism of ICSID, also see Vincentelli, Ignacio, *SSRN (Publ.)*, The Uncertain Future of ICSID in Latin America, 2008. Venezuela announced its withdrawal from ICSID convention in January 2012 and cut off its BIT with the Netherlands in November 2008. Ecuador has denounced 9 of its 25 BITs, and has launched renegotiations with the remaining 16 countries after the constitutional court concluded some of the provisions contradicting the constitution, see Recent Developments in International Investment Agreements (2007 – June 2008), UNCTAD IIA Monitor, 2, 2008.

some countries, for different reasons, the freedom of considerations on the sovereignty of natural resources and the right for the state to regulate are appreciated more than the potential good of the evolved IIA regime.

The standard IIA did not interfere in the right of states to freely admit or deny foreign investors to establish in the state, that is, it did not prescribe 'liberalisation' of investments.<sup>128</sup> Most BITs by European states still stay away from prescribing liberalisation, but the trend is that more IIAs do. This trend goes hand in hand with the trend to put trade and investment agreements together, so-called free trade agreements. In 2010 eleven new FTAs included rules on investments, and the total number of FTAs with investment rules was 309 at the end of that year.<sup>129</sup> The *World Investment Report 2011* also noted that more than 100 free trade agreements were under negotiation. The increase in the interest in FTAs, sometimes expressed as a turn from BITs to FTAs,<sup>130</sup> has been recognised for some years. This might lead to a stronger influence on investment treaty provisions by trade law in both formulations and interpretation. Some writers, however, note that the treaty areas for trade and for foreign investments do 'not mix that easily'.<sup>131</sup>

As a final remark on the trends of IIAs, one may note that modern IIAs are getting more complex also in another sense, namely, by increasingly referring to areas like health, environment, national security, and public order.<sup>132</sup> This is done using a range of methods: guiding

128 However, the FCN treaties included a right to establish, and the USA has followed that tradition.

129 World Investment Report 2011, p.100. Note that in UNCTAD accounting for 'other IIAs' (multilateral free trade agreements), there are also some economic partnership agreements which do not include common IIA provisions of treatment and compensation for expropriation, but which it has not been possible to extract from the numbers here.

130 Chile announced after the conclusion of the Chile–USA FTA 2003 that it was only going to sign new FTAs and no more BITs, Recent Developments in International Investment Agreements (2008–June 2009), UNCTAD IIA Monitor 3, 2009, p. 4.

131 Sornarajah 2004, p. 235.

132 International Investment Arrangements: Trends and Emerging Issues, UNCTAD 2006, p.11.

language in the preambles, explanatory notes to substantive provisions, and allowance for different kinds of exemptions (see further in chapter 8). Hence, as the investment treaty regime has evolved, the main concern of foreign investments in host states has shifted from physical and legal protection to issues of public treatment. This shift means the challenges to regulatory sovereignty increase.<sup>133</sup>

## 2.3 Scope of investment treaties

To determine the risks of investment treaties limiting environmental policy space one should first analyse the situations where IIAs can be applicable. In the IIAs the definitions of ‘investment’ and ‘investor’ by and large establish the scope for the applicability of the treaty.<sup>134</sup> The scope affects the impacts on environmental policy space, since a wide applicability of the investment treaty enhances the potential for constraints on the host state in implementing and developing environmental law and policy. The following sections analyse the definition of investment commonly used in IIAs and discusses methods to narrow the scope so as to safeguard policy space.

### 2.3.1 The IIA definition of investments

The definition of ‘investment’ in IIAs is inherently vague and is expressed in different manners in different IIAs. In tribunal interpretation ‘investments’ has got a rather wide meaning, leaving out only pre-contract expenditures and ordinary commercial transactions. The distinctions normally used in the policy debate between foreign direct investments, portfolio investments, and indirect investments are not maintained by the current IIA regime.<sup>135</sup>

133 Bilateral Investment Treaties in the Context of Investment Law, Speech by Patrick Julliard at OECD Roundtable on BITs in South East Europe, May, 2001.

134 Scope and definition, IIA series, UNCTAD/DIAE/IA/2010/2, 2011.

135 Dugan, Christopher F., Wallace Jr., Don & Rubins, Noah D., *Investor-State Arbitration*, Oxford University Press, New York, 2008, p. 248.

Most European BITs use a broad definition of investment, with a non-exhausted list of examples that include movable and immovable property, shares in companies, intellectual property rights, and natural resource concessions.<sup>136</sup> North American IIAs have restricted the scope so that portfolio investments are explicitly excluded,<sup>137</sup> and a requirement for ‘investment characteristics’ is included.<sup>138</sup> This explicit exclusion of short-term lending instruments and assumption of economic risk may allow tribunals to dismiss unfounded claims, and cut off some of the most distant parts of the corporate chain from the possibility of making a claim based on the IIA.

In IIA jurisprudence four criteria are considered to define an investment: contribution of the investor, duration of the project, the existence of economic risks in the project, and a contribution to the host state’s development. These criteria, also called the Salini test after a

136 See, for example, the German model BIT 2005 art. 1, published in Dolzer & Schreuer 2008, p. 368:

1. the term ‘investment’ comprises every kind of asset, in particular:

(i) movable and immovable property as well as any other rights in rem such as mortgages, liens or pledges;

(ii) shares in companies and other kinds of interest in companies;

(iii) claims to money which has been used to create an economic value, or claims to any performance having an economic value;

(iv) intellectual property rights, in particular copyrights, patents, utility model patents, industrial designs, trade-marks, trade-names, trade- and business secrets, technical processes, know how and goodwill;

(v) business concessions under public law, including concessions to search for, extract or exploit natural resources;

any alteration in form in which assets are invested shall not affect their classification as investments.

137 NAFTA, art. 1139:

a loan to an enterprise

(i) where the enterprise is an affiliate of the investor, or

(ii) where the original maturity of the loan is at least three years (short-term loans and lending institutions are excluded).

138 USA model BIT 2004, art. 1:

‘investment’ means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.

case where they are clearly stated,<sup>139</sup> are embodied in the jurisdictional article 25 of the ICSID Convention and are, thus, considered together with the IIA definition.<sup>140</sup> The fourth criterion has led to a few IIA tribunals dismissing jurisdiction over the claims, the case *MHS v. Malaysia*<sup>141</sup> being one of the most debated. In this case the claimant was fulfilling a contract to rescue historical items from a wreck. When the dispute arose, the sole arbitrator concluded that the contributions of the activity to the local economy were not more than with the fulfilment of any service contract and declined jurisdiction over the claim. The decision in *MHS* case was, however, annulled by an annulment committee, which did not agree that economic development of the investment was a condition for jurisdiction.<sup>142</sup> The *MHS* annulment decision has been interpreted by lawyers based in developing countries to reflect a trend among the IIA arbiter majority, who are nationals of developed states, not to consider economic development as an important criterion for investments.<sup>143</sup> A ‘north–south divide’ was also manifested in the dissident opinion to the decision in the *Abaclat* case granting jurisdiction to tens of thousands of Italians who claim to hold securities linked to Argentine sovereign bonds.<sup>144</sup>

139 *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco* ICSID ARB/00/4 Settled, 2004.

140 The ICSID Convention restricts the use of the forum for other than a ‘legal dispute arising directly out of an investment’; also see Schreuer, Christoph, Malintoppi, Loretta, Reinisch, August & Sinclair, Anthony, *The ICSID Convention : a commentary ; a commentary on the Convention on the Settlement of Investment Disputes between States and Nationals and Other States*, 2 ed, Cambridge University Press, 2009. Also see Dugan, Wallace & Rubins 2008, pp. 280–281.

141 *Malaysian Historical Salvors, SDN, BHD v. Malaysia* ICSID ARB/05/10, 2007.

142 *Ibid.* decision 16 April 2009.

143 See Vis-Dunbar, Damon, *Malaysian Historical Salvors jurisdictional award annulled; committee split on question of economic development as criteria of ICSID investments*, *Investment Treaty News*, 23 April 2009. In the annulment decision there was one dissenting opinion in favour of the original decision by the arbitrator from Singapore; the dissenting arbitrator was from Guyana, while the two constituting the majority were from Europe and the USA.

144 *Abaclat and Others v. Argentine Republic*, ICSID ARB/07/5 Decision on jurisdiction 4 August, 2011; Dissenting Opinion of Professor Georges Abi-Saab (Egyptian), 28

Concessions to natural resources are traditionally included in the list of examples of investments covered by the IIAs. Also, 'licenses, authorizations, permits, and similar rights conferred pursuant to domestic law'<sup>145</sup> may be included in such a list. Here problems may occur if the IIA definition diverges from the way national law recognises a property interest or vested right (see further in section 6.3.3 analysing matters of expropriation).

Many BITs state that covered investments must be made 'in accordance with the laws and regulations of the other Contracting Party' or similar.<sup>146</sup> The requirement that the investments be made in accordance with the national law may also be included elsewhere in the agreement, that is, in clauses on admission of investments. One may read this requirement as excluding from the protection of the IIA activities which do not act in accordance with domestic law, and for example, requiring actors to comply with environmental law.<sup>147</sup> However, writers and some tribunals have rejected such a view and rather interpret the phrase as exempting protection of activities based on fraud.<sup>148</sup> Along with principles of the law not to support unlawfulness, such as enforcing debt payments from illegal betting or upholding contracts with illegal content, it is likely that also in cases where the IIA does not include the phrase 'in accordance with the laws and regulations

October 2011.

145 USA model BIT 2004, art. 1.

146 By others, Chile–New Zealand 1999, El Salvador–Spain 1995, U.K–Oman 1995, Belgium and Luxemburg–Rwanda 1983; Swedish model BIT 2003, and Indian model BIT 2003. The India–Japan FTA 2011 restricts investments from investor–state dispute settlement if they do not comply with laws and regulations that are consistent with the treaty, art. 83, para 2.

147 Such interpretation is made by the work team behind the UNCTAD Environment, IIA series, UNTAD/ITE/IIT/23, 2001, p. 24, commenting on the Netherlands–Costa Rica BIT 2001, art. 10, which states: 'The provisions of this Agreement shall [...] apply to all investments made [...] in accordance with the laws and regulations of the latter Contracting Party, including its laws and regulations on labour and environment.'

148 Inter alia, *Salini v. Morocco* 2004, para 46, *PCL Nova, Plama Consortium Limited v. Republic of Bulgaria*, ICSID ARB/03/24 Award 27 August, 2008, paras 126–131, *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID ARB/03/26 Award August 2, 2006 paras 190–207, commented on in *Dolzer & Schreuer* 2008, p. 65.

of the other Contracting Party', IIA tribunals would reject jurisdiction in a case where the business activity is clearly unlawful. For cases concerning environmental regulation, it can be important that illegal activities are not protected by IIAs, since national enforcement can be weak. One might even make the argument that a foreign company investing in an activity that harms the environment and deliberately not seeking permits for its operations should be barred from seeking protection from IIAs.

Hence, the term investment is usually defined in a broad manner in the IIAs and IIA dispute settlements and constitutes a broad scope for the IIAs. However, various ways to make the term more specific exist, both through formulation of the IIA and in its interpretation.

### 2.3.2 Protection of indirect investment—the door opener for anyone in the corporation chain

International investments are often done by establishing or acquiring a local subsidiary in the state where the activity is to take place. Investments that may come in conflict with environmental regulations evidently have some sort of physical presence. The public measures concerning the activity are therefore in most cases directed at a national company, not at a foreign national.<sup>149</sup> As a general rule of international law the host state governs its own nationals while international rules apply when the host state deals with foreign nationals.<sup>150</sup> However, IIAs include, as discussed above, shareholder and financing entity rights as part of the protected interests, and this means that foreign shareholders may claim rights for the domestic company on the basis of the IIA.

This means that IIA case law has not made an analogy with the ICJ reasoning in *Barcelona Traction*,<sup>151</sup> which denied Belgian sharehold-

149 For some activities states may require national presence to allow the activity, for example mining activities, or to manage public infrastructure.

150 *Oppenheim's International Law*, 1992, chap. 8.

151 *Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain)*, ICJ Reports 1, 1970.



ers of a Spanish company to claim rights on behalf of the company.<sup>152</sup> The path taken is more similar to that of the ICJ ruling in the *ELSI* case<sup>153</sup> where the court allowed US shareholders of an Italian company that had been temporarily taken over by the local authorities to claim rights. In the *ELSI* case there was an FCN agreement between the state parties. Also, early IIA cases accepted shareholders making claims based on the value of their shareholdings.<sup>154</sup> It therefore seems to be an established custom of the IIA regime that the veil of separate corporate identities can be pierced to allow shareholders to bring claims concerning measures towards the corporation in their own name.<sup>155</sup> This accommodates the IIA regime to work alongside the transnational corporate structures. Hence, IIA tribunals have refused to 'have the corporate personality interfering with protection of the real interests associated with the investment'.<sup>156</sup> In some IIA cases the claimant has been a fairly empty legal person incorporated in a suitable state that has an IIA with the host state of concern.<sup>157</sup> This has led to a debate

152 Belgium was denied standing on behalf of the Belgian shareholders when a Canadian company operating in Spain went bankrupt because of actions taken by Spanish authorities. The court said, '[W]here it is a question of an unlawful act committed against a company representing foreign capital, the general rule of international law authorize[s] the national state of the company alone to make a claim' *ibid.* p. 3. The principle to make a hard separation between the legal person of the company and the shareholder is upheld in later judgment, see Ahmadou Sadio Diallo (Republic of Guinea v. Democratic Republic of the Congo), ICJ Judgment 30 November 2010. See also McLachlan, Campbell, Shore, Laurence & Weiniger, Matthew, *International Investment Arbitration – Substantive Principles*, Oxford University Press, Oxford, 2007 (Oxford International Arbitration Series), p. 184.

153 *Elektronika Sicula SpA (United States v. Italy) (ELSI)*, ICJ Reports 15, 1989.

154 McLachlan, Shore & Weiniger, 2007, p. 185, refer to the AAPL and AMT cases.

155 *Ibid.* pp. 186 and 192. Dolzer & Schreuer 2008, pp. 57–59. Smutny, Abby Cohen, Claims of Shareholders, Binder, *et al.* (Eds.), *International investment law for the 21st century*, chapter 20, Oxford University Press, Oxford, 2009.

156 *CMS v. Argentina* 2005, para 505.

157 One high profile case is *Aguas del Tunari v. Bolivia*, where the US water company Bechtel was the full owner of the company holding the private concession for water services in Cochabamba that was disputed, but since there was no BIT between the USA and Bolivia, a Dutch holding company was used to start the investor–state dispute settlement.

about 'corporations of convenience' and 'treaty shopping', referring to the procedural rule of *forum non conveniens* and the practice of 'forum shopping'.

The approach by the IIA regime to embrace transnational corporate structures and focus on 'the real interest' is the very opposite to the jurisprudence of transnational environmental damages, which rather follows the view of strict divisions between different legal personalities of the owning parent and the subsidiaries. Legal personality is one of the major obstacles for claims on damages occurred in developing countries by subsidiaries to companies in developed countries.<sup>158</sup> Home state courts' power to decline jurisdiction could also bar litigation on environmental damage being brought to the parent company's domicile. The *forum non conveniens* doctrine in the common law system allows courts to dismiss cases of environmental damage and send the cases to the courts in the host state, where the responsible part of the business group most likely has little money to redress the damage.<sup>159</sup> In civil law systems there is, in principle, no room for such manoeuvres.<sup>160</sup> Still, with the USA as a common law state and one of the major home states for transnational corporate groups, there is a paradox that, while the IIA approach empowers the transnational structure of global companies and allows them to act legally through that structure, the law of

158 Ebbesson, Jonas, Piercing the state veil in pursuit of environmental justice, Ebbesson & Okowa (Eds.), *Environmental law and justice in context*, chapter 14, Cambridge University Press, Cambridge, 2009, pp. 270–293. More generally, on the problems of international environmental liability, see Birnie, Boyle & Redgwell, 2009, pp. 316–326.

159 A highlighted case was that of victims of the Bhopal gas tragedy in India in 1984 who tried to sue the parent company Union Carbide in the USA and were faced with these procedural difficulties, Perez, Oren, *Ecological Sensitivity and Global Legal Pluralism – Rethinking the Trade and Environment Conflict*, Hart Publishing, Oxford, 2004, pp. 192–202.

160 The principle that the defendant can be sued at its domicile is stated in the 1968 Brussels Convention on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, and the following Council Regulation (EC) No 44/2001.

international environmental damages often ignores that structure and denies victims legal possibilities to claim the real interest.<sup>161</sup>

IAs may allow for almost any actor in the corporate chain to make a claim, including minority shareholders,<sup>162</sup> holding companies,<sup>163</sup> and investors of those actors,<sup>164</sup> The protection extends not only to the ownership of the shares but also to the corporate assets as such.<sup>165</sup> Since almost any bigger company in countries with open economies has incorporated foreign actors in the corporate chain, the IAs give wide opportunities to those actors to challenge public measures directed towards the operating company by the host state.

## 2.4 Substantive provisions widening the applicability of the IIA

The wide applicability of IAs also depends on the interpretation of some substantive provisions. The provision on 'most favoured national treatment' and the 'umbrella clause' work so that rules in other IAs may become applicable or that commitments in state contracts become part of the international arbitration. Such expansion in legal material increases the possibility that environmental measures directed towards a private actor fall under the scope of an IIA. These clauses may also limit the effects of reforming future IAs in limiting the scope. Thus, broad interpretation of MFN provisions and umbrella clauses increase the risk for host states to be bound by unintended wide obligations that constrain its environmental policy space.

161 Perez makes a comparison of the legal regimes in this regard. Perez 2004, pp. 200, 227.

162 CMS v. Argentina 2005.

163 CME v. Czech Republic 2001.

164 Sedelmayer v. Russia, SCC Award 7 July, 1998.

165 Dolzer & Schreuer 2008, p. 59. CMS v. Argentina 2005, discussed in McLachlan, Shore & Weiniger, 2007, pp. 188–193.

## 2.4.I Most favoured nation treatment

The most favoured nation treatment provision implies an obligation for the host state to accord no less favourable treatment to investors of the other party than accorded to other foreign investors. Hence, treatment accorded to other foreign investors shall be provided also to the investors of this party. It is a common provision in IIAs as well as in modern trade law and originates from the FCN agreements. Similar to the national treatment provision, the MFN treatment provision requires a comparison of the treatment afforded on the basis of nationality and regarding similar objective situations; see further in chapter 5. There are, however, disagreements as to whether the provision only covers 'state measures and regulatory conduct', or if a broader approach should apply 'under which the MFN clause would have the potential to attract content from a third IIA.'<sup>166</sup> This disagreement is reflected in an inconsistent jurisprudence, especially concerning the importation of more favourable arbitration provisions. Several cases show that the claimant can make use of shorter time limits for the right to call upon arbitration by making use of arbitration clauses in other IIAs the host state concluded.<sup>167</sup> Investors also want to use the MFN treatment provision to allow for arbitration of a whole expropriation issue and not only the amount of compensation, as many IIAs still in force by Russia and other former socialist states limit the investor–state dispute settlement to determination of compensation of expropriation. Such widening applicability of an IIA through more favourable arbitration

166 UNCTAD IIA team summary of the discussion in the IIA expert network during 2009, information about the network on UNCTAD official website [www.unctad.org](http://www.unctad.org)

167 For example, *Emilio Augustin Maffezini v. Kingdom of Spain*, ICSID APR/97/7 Award 13 November, 2000, entitled the investor to shorter time limits found in an arbitration provision in another IIA concluded by the host state. The investors in *Wintershall Aktiengesellschaft v. Argentine Republic*, ICSID ARB/04/14 Award 8 December, 2008, and *Siemens A.G. v. Argentine Republic*, ICSID ARB/02/08 Award 6 February, 2007, both called for the application of shorter time limits that Argentina offered in other IIAs on the basis of the MFN treatment provision in the Germany–Argentina BIT; one of the tribunals allowed for such import of the procedural provisions, while the other did not. See *Latest Developments in Investor-State Dispute Settlement*, UNCTAD IIA Monitor, 1, 2009.

clauses in other of the host state's IIAs has sometimes been successful, but not always.<sup>168</sup> Partly as a result of the inconsistent jurisprudence, some IIAs have explicitly limited the provision of most favoured nation to only relate to substantive provisions of the IIA and not to the provisions of dispute settlement.<sup>169</sup>

To secure environmental policy space for the host state, it is important to be certain of the effects of such 'import' of more investor-friendly provisions, whether substantive or procedural. If states develop their IIA models by adding specific language regarding environmental protection clarifying the non-conflicting intent with national environmental regulation (see chapter 8), there is a risk that this more restrictive approach could be superseded by a wider and more investor-friendly approach in an older IIA which the same state has concluded with another state. The most favoured nation treatment provision may imply that the environmental reforms in the new IIA could be circumscribed in a particular situation where the investor claims the right to receive treatment of the same standard as granted in the older IIA. If the MFN treatment provision allows the investor to 'import' more favourable substantive provisions from other IIAs, the MFN will have this effect and thus constrain the host state from implementing the wanted changes in the new IIA. Fauchald views this as a major concern of the MFN provision in relation to environmental regulation.<sup>170</sup> Dolzer and Schreuer note that the determinative question is whether a specification of a provision is made with the state parties' intention also to exclude the more favourable treatment from investments of in-

168 In *RosInvestCo UK Ltd. v. The Russian Federation*, SCC V079/2005 Award 12 Sept, 2010, the tribunal extended jurisdiction to issues of occurrence and validity of expropriation by applying provisions in another BIT, making use of the MFN clause. Such interpretation was rejected, for example, in the cases *Plama v. Bulgaria*, *Telenor Mobile Communications A.S. v. Republic of Hungary*, ARB/04/15 Award 13 Sept 2006, and *Austrian Airlines v. Slovak Republic*, Award 20 October, 2009.

169 For example, *Argentina–UK BIT 1990*, art. 3(2); *US–Colombia FTA 2006*, art. 10.4; *Canada–Colombia FTA 2008*, art. 804(3); *Japan–Switzerland FTA 2009*, art. 88(2).

170 Fauchald 2006, p. 15.

vestors of the other party, and that the case law so far has not addressed that issue in any detail.<sup>171</sup>

A way to avoid this uncertain result of a new and more restrictive IIA, and possible policy constraint, is to make an exemption for most favoured nation treatment provisions in relation to all other IIAs not including the new formulations. Thereby, a state can safeguard that more restrictive provisions in newer IIAs are not overruled in an arbitration of a dispute; for example, the Canada model 2004 BIT excludes the application of MFN to already existing agreements.<sup>172</sup>

In the *World Investment Report 2010* UNCTAD raised the question whether it is rather more desirable that modern developments of IIAs with specifications of environmental concerns should influence the interpretation of older provisions which lack the specific language.<sup>173</sup> Such an approach implies that later IIAs change the content of an earlier one, without any explicit agreement between the state parties to the older IIA, but would allow more flexible interpretations towards modern environmental law. However, it is reasonable that, at least for new IIAs in which environmental specifications of substantive IIA provisions are included, it should not be possible to disregard those specific provisions in the settlement of a dispute by referring to an older IIA lacking such specifications.

## 2.4.2 Umbrella clauses

Some international investment treaties include a so-called umbrella clause.<sup>174</sup> In this clause the host state guarantees to ‘observe any obliga-

171 Dolzer & Schreuer 2008, pp.186–191.

172 Annex III, para 1. Others, like APEC FTAs, do not include the MFN provision at all.

173 ‘Modernizing treaty content raises the question whether arbitral tribunals, when interpreting older IIAs, would take guidance from clarifications found in the same country’s newer IIAs concluded with other countries.’ p. 88.

174 Far from all IIAs include umbrella clauses; for example, NAFTA lacks such provision, and some capital-exporting states do not commonly include it in their BITs. According to Newcombe & Paradell 2009, the clause is rare in BITs by France, Spain, Australia, Italy, Japan, Canada, and the US BITs of the 2000s, p. 444. Neither does Sweden make use of umbrella clauses in its BITs. However, they are frequently found

tion it may have entered into with regard to investment'.<sup>175</sup> The purpose of the clause is to elevate some violations of investment contracts to a violation of the IIA, meaning to lift up a contractual breach to international law.<sup>176</sup> There are, however, different views and inconsistent case law on whether contract commitments made this way can be disputed in IIA arbitration.<sup>177</sup> Some IIA cases have denied a wide applicability of the umbrella clause,<sup>178</sup> while others quietly have widely allowed for contract obligations to be settled via the IIA.<sup>179</sup> One reason for the different interpretations is that the clause is formulated in different ways in the different IIAs. Another source of inconsistency is the different views on whether the clause shall be interpreted with its ordinary meaning and be given full effect or whether such interpretation would go beyond the rule that IIA arbitration deals with sovereign acts of the state and give an unbalanced result concerning the interest of the host state and the interest of the investor.<sup>180</sup>

The state party of a contract with an investor concerning, for example, the distribution of drinking water, acts under the responsibility of the contract as *jure gestionis*,<sup>181</sup> the obligations of the state are limited to those specified in the contract. If the foreign investor and the state, as contracting parties, disagree about how to fulfil the obligations, the contract usually stipulates a dispute settlement procedure,

in BITs by, inter alia, the UK, Germany, and the Netherlands. Dolzer and Schreuer estimate that 1,000 IIAs include umbrella clauses, Dolzer & Schreuer 2008, p. 153.

175 Art. II(3), USA–Morocco BIT 1991, referred to in Dolzer & Schreuer 2008, p. 153.

176 Ibid.

177 Ibid. pp. 153–162.

178 For example, SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan, ARB/01/13 Award on jurisdiction 6 August, 2003, and Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. v. Republic of Paraguay, Decision on objections to jurisdiction 29 May, 2009, both decided that the contractual obligations should be dealt with in national courts, *inter alia*, because the contract itself said so.

179 CMS v. Argentina 2005; Eureko v. Poland, Award 19 August, 2005.

180 Dolzer & Schreuer 2008, pp. 153–162.

181 As opposed to the state acts of *jure imperii*, the role of state as regulator and sovereign entity.

which could be the local courts or *ad hoc* arbitration governed by local or international law. Without an umbrella clause, a mere breach by the state party of the contract is not a violation that could lead to state responsibility. The IIA umbrella clause changes this situation so that breaches of contractual obligations can also cause international liability for the state.

Hence, the umbrella clause widens the applicability of the IIA to include obligations of a commercial nature for the host state in contracts regarding foreign investments. This would constrain the environmental policy space of the host state, if it increases the risk for the state to act under contracts in essential services such as drinking water, sewage treatment, electricity, or energy production and management of natural resources, as those acts may become part of IIA arbitration. The umbrella clauses have played an important role in IIA arbitrations of the Argentinean cases, making economic obligations in energy and water contracts open to dispute in IIA arbitration. The uncertainty as to what kinds of violations against contract obligations can amount to state responsibility via the umbrella clause makes it hard to predict the consequences for the host state concerning such sensitive contracts.<sup>182</sup>

## 2.5 Investor–state dispute settlement

The main reason investment treaties are so powerful in the hands of transnational corporations is the investor–state dispute settlement. The vast majority of today’s IIAs provide foreign investors an international forum for direct dispute settlement with the host state.<sup>183</sup> The

182 It is, however, outside the reach of this work to evaluate whether the commercial arbitration commonly available in those contracts gives the host state better capacity to settle the dispute about safeguarding environmental concerns.

183 There is no exact figure on how many of the IIAs lack this provision, as the compilation made by UNCTAD does not sort out treaties that lack this clause. However, there is no doubt the investor–state dispute settlement now is a standard provision, and IIAs not including it are exemptions and mostly older treaties which have not been renegotiated. Some countries, mostly with socialist governments, did not give a universal acceptance to international investor–state dispute settlement in their BITs until the late 1990s or 2000s. For example, the China–Sweden



provision for investor–state dispute settlement can be restricted, and in some IIAs it only covers certain parts of the substantive IIA provisions. As mentioned above, former socialist states often limited the investor arbitration clause to cover only disputes over the amount or modality of payment of compensation for expropriation.<sup>184</sup>

The major argument for the need of investors to settle disputes with host states in international forums rather than being directed to the courts of the host state are inefficiency, impartiality, and the risk of injustice of host state courts.<sup>185</sup> With the provision on investor–state dispute settlement, the foreign investor has recourse to a ‘state-neutral’ forum with a flexible procedural framework. This means that the traditional procedure of international law, that investors in cases of injustice need to convince their home states to act in the international arena to restore the meaning of the treaty provisions and seek damages, is altered by a system where private actors are empowered to act on the basis of inter-state agreements.

One may look for a parallel in the development in human rights law, where victims have been allowed to submit claims to an international court based on international human rights treaties. Such comparison

BIT 1982 did not include such provision, but in 2004 the parties agreed to amend it; see Protocol Amendment to the Agreement on Mutual Protection of Investments Between the Government of the Kingdom of Sweden and the Government of the People’s Republic of China of March 29 (SÖ 2004:13). A modern example of an IIA without an investor–state dispute settlement provision, which will be discussed in this section, is the Australia–USA FTA 2005.

184 For example, Russia–Spain BIT 1990, art. 10, an article discussed, *inter alia*, in the case *Renta 4 S.V.S.A et al. v. Russian Federation*, SCC 24/2007 Award on preliminary objections 20 March, 2009.

185 While it is hard to find more precise analyses of this problem in the legal doctrine, Dolzer and Schreuer make this laconic statement: ‘In many countries an independent judiciary cannot be taken for granted and executive interventions in court proceedings or a sense of judicial loyalty to the forum state are likely to influence the outcome of proceedings.’ Dolzer & Schreuer 2008, p. 214. See, however, the Australian Government Productivity Commission analysis on investor–state dispute settlement provisions, which refer to a number of economic and business analyses contradicting these risks, section 14.2 in *Bilateral and Regional Trade Agreements*, Australian Government Productivity Commission, <http://www.pc.gov.au/projects/study/trade-agreements/report> (visited 2012-01-15).

becomes, however, false in three ways, as victims to offences to human rights normally are domestic and not foreign, the human rights courts or committees in general reject claims from legal persons,<sup>186</sup> and the human rights courts only take claims after a failure to receive remedy within the domestic legal system. The IIA investor–state dispute settlement has in this regard gone further in allowing individual claims from legal persons, also upstream the corporate chain, and without the criteria that all remedies in the domestic system must be exhausted. By that, the IIA arbitration mechanism indeed breaks new land in the transnational legal sphere and makes IIAs a truly powerful instrument.<sup>187</sup>

The investor–state dispute settlement mechanism in IIAs is basically a system developed for international commercial arbitration, *ad hoc* arbitration tribunals<sup>188</sup> delivering awards that are final and enforceable according to international agreement on recognition.<sup>189</sup> The parties' consent to arbitration, which in commercial arbitration is expressed in the arbitration clause in the contract, differentiates in the IIA arbitration between the state and the investor. The state gives universal consent to arbitration in the IIA, which is thus not specific to any particular private party or known area of conflict. The investor expresses its consent, requiring arbitration for a concrete dispute. This 'arbitration

186 The European convention however also sees legal persons as victims with the right to claim breaches of certain rights, *Agrotexim and others v. Greece*, Serie A 330, 1995, see further section 9.1.

187 This fact is commented on by many. See, for example, Orrego Vicuña, Francisco Regulatory Authority and Legitimate Expectations: Balancing the Right of the State and the Individual under International Law in Global Society, *International Law Forum*, vol 5, pp. 188–197; van Harten, Gus, *Investment Treaty Arbitration and Public Law*, Oxford University Press, Oxford, 2007 and Hobér, Kaj, *Investment Arbitration in Eastern Europe: In Search of a Definition of Expropriation*, JurisNet LCC, New York, 2007.

188 The procedural rules offered by the ICSID convention [hereinafter the ICSID Convention] and its Regulations and Rules; or by UNCITRAL Arbitration Rules, UN Doc GA/RES/31/98, 1976 [hereafter UNCITRAL Arbitration Rules]; usually complement any procedural rules made explicit in the IIA.

189 UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 [hereafter New York Convention].

without privity' has remarkably changed the international settlement of investment disputes, making it much more favourable for transnational investors to use.<sup>190</sup> This has strongly enhanced possibilities for foreign investors to get an international dispute settlement directly with the host state, and has, of course, implications for how to evaluate the policy space. Comments on environmental policy concerns follow in the subsections.

The appropriateness of using the commercial arbitration system can be questioned.<sup>191</sup> A major difference between commercial and IIA arbitration is that the latter reviews regulatory acts and measures concerning public matters, while commercial arbitration concerns a specific commercial relation.<sup>192</sup> The public acts relate not only to the investor but also to third parties. Indeed, when environmental matters are disputed, many third-party objections are at the very focal point.

Multinational companies today are well aware of their rights deriving from international investment agreements. This has resulted in an increase in litigation. In 1995 the international cases between investor and host state outside a contractual relationship were something rare and new. Ten years later UNCTAD estimated the number of cases based on IIAs at almost 250, and in 2010 the figure has risen to 357.<sup>193</sup> Since 2002 between 30 and 50 cases have been filed every year. The majority of those are using the arbitration rules of ICSID, UNCITRAL, or of the Arbitration Institute of Stockholm Chamber of Com-

190 Paulsson, Jan, Arbitration Without Privity, *ICSID Review Foreign Investment Law Journal*, vol 10, 1995, p. 232.

191 van Harten expresses strong criticism of the arbitration of IIAs; see van Harten, 2007, chap. 3.

192 Blackaby, Nigel, Investment Arbitration and Commercial Arbitration, Mistelis & Lew (Eds.), *Pervasive Problems in International Arbitration*, Kluwer Law International, Amsterdam, 2006pp. 218–229. Note that the state party in the investment arbitration does not act in its commercial capacity, *jure gestionis*, but as public representative, *jure imperii*. Another essential difference between commercial and investment arbitration is that the latter to a high degree is governed by international law.

193 These figures are derived from the UNCTAD IIA Monitor series. Since IIA arbitration lacks a public register or rules on transparency, it is not possible to know how many IIA cases there are; see section 1.3.1.

merce (SCC). Around half of the cases have been concluded by a final decision of arbitrators or discontinued after settlement between the disputing parties, while the other half are still pending or of unknown status. UNCTAD estimates that at least 83 governments have faced investment treaty arbitration as of 2010, around 66 of those being developing countries or countries with an economy in transition.<sup>194</sup> Of course, there are still extremely few laws, administrative regulations, or public measures that are disputed in the light of IIA commitments. But the risk for states to have a claim against a regulatory measure increases with every new IIA and with more private parties having access to the dispute settlement and learning about the system.

Hence, there are some major concerns about the appropriateness of the IIA investor–state arbitration. Reflecting concern for environmental policy space, there are calls for reforms like referring the primary responsibility for administrative reviews and the search for remedies in environmental matters to the domestic level,<sup>195</sup> fine-tuning investment rules to better balance the situations of weak governments and operations of high environmental risks,<sup>196</sup> creating a special developing-country regime in the investment treaties,<sup>197</sup> and implementing contextual interpretation where environmental principles are considered as the treaty’s overall purpose.<sup>198</sup> These ideas for reforms are discussed further in this study.

There are many aspects one may investigate and discuss with regard to the investor–state dispute settlement system, yet many are not of a particular interest in considering environmental policy space, but equally concern all administrative or public law in sovereign states.

194 IIA Issues Note 1(2011).

195 von Moltke, Konrad, *The Environment and the Principle of Non-discrimination in Investment Regimes: International and Domestic Institutions*, Gallagher & Zarsky (Eds.), *International Investment for Sustainable Development: Balancing Rights and Rewards*, Earthscan, London, 2004.

196 Wälde & Kolo, 2001.

197 Chalker, 2006.

198 Cordonier Segger & Kent 2011; Wagner, J. Martin, *International Investment, Expropriation and Environmental Protection*, *Golden Gate University Law Review*, vol 29, 1999.

The survey here will concentrate on four aspects: (1) the relation to local judicial review of environmental decisions, (2) the outcome of the arbitration and its relation to the environmental rule, (3) the access of affected persons or concerned NGOs to the arbitration process, and (4) whether there is a risk that investors can abuse the legal proceedings to act against environmental policies for various reasons and not mainly with the aim to solve a specific dispute or individual unfairness.

## 2.5.1 Relation to the local legal review

Exhaustion of local judicial remedies is not a prerequisite to IIA arbitration. Most IIA dispute settlement provisions give the foreign investor recourse to international arbitration after three to six months of respite and time for conciliation after notification of the dispute. Hence, this is opposite to the non-treaty situation in which an alien investor normally has to exhaust available legal remedies in the host state before the investor's home state will agree to espouse the claim to an international court or tribunal. Also, contrary to the procedure for individual claims in international human rights law, the IIA system gives the investor the right to go directly to international dispute settlement.<sup>199</sup> The aim of such approach is that the IIA investor–state arbitration shall replace the local remedies and not set up a subsidiary system, if local systems fail.<sup>200</sup>

However, in forming national coherence of environmental standards and assuring rule of law in environmental decisions, legal reviews play a vital role; see further section 3.6. Few initiatives have been taken concerning IIA provisions to acknowledge the difficulties that arise when the local review process is abandoned. In the Canada–Colombia FTA 2008, however, the investor–state dispute settlement provision includes a footnote on this issue:

199 Smutny 2009.

200 Kriebaum, Ursula, Local Remedies and the Standards for the Protection of Foreign Investment, Binder, *et al.* (Eds.), *International investment law for the 21st century*, chapter 23, Oxford University Press, Oxford, 2009.

With a view to encouraging the review, confirmation or modification of administrative acts prior to such acts becoming final, the Parties recognize that disputing investors should make every effort to exhaust administrative recourse under Colombian law. A disputing investor that fails to exhaust administrative recourse, where applicable, shall submit its Notice of Intent nine months prior to submitting a claim to arbitration.

(Canada–Colombia FTA 2008 (not in force), art. 821 (2)(c), footnote 8)

According to this IIA, the investor still has the option to go directly to international arbitration, but must wait an extra three months, if it fails to exhaust administrative recourse. In the German BITs from 1991 with Argentina and Chile, respectively, the investor is obliged to make use of domestic courts for 18 months before it may turn to international arbitration.<sup>201</sup> An even more radical proposal to accommodate the call for an international dispute forum with the desire not to bypass national systems of legal corrections was made in the proposed Norwegian draft model BIT in 2007.<sup>202</sup> Here the investor–state dispute settlement provision puts up three criteria to be met before a claim can be submitted to the international forum: 36 months have passed since a local court heard the dispute for a decision on local remedies, any administrative remedy must have been exhausted, and no other reasonable and effective redress is available.<sup>203</sup> This provision was tailored in such way that international dispute settlement takes the form of a safety valve and not an equal alternative to national systems, hence the opposite of the aim for IIA arbitration expressed earlier. The reasons for this were arguably to support effective rule of law and foster strong

201 Argentina–Germany BIT 1991, art. 10(3), and Chile–Germany BIT 1991, art. 10(3).

202 Text of the proposed draft and commentary can be viewed at <http://ita.law.uvic.ca>. The proposal was referred for public review, but was not approved by the government, which declared it would consider the design of provisions currently in negotiations free trade agreements, <http://www.regjeringen.no/en/dep/nhd/tema/frihandelsavtaler/investeringsavtaler.html?id=438845> (visited 2011-12-27).

203 Norwegian draft model BIT 2007 art.15(3)(i)(ii).

national institutions.<sup>204</sup> Also writers, *inter alia*, Konrad von Moltke, have noted the importance that domestic remedies be used prior to international ones.<sup>205</sup> When the EU parliament was responding to the EU commission proposal forming future EU international investment agreements, deep concerns over the dispute settlement mechanism were expressed, and the parliament resolution argued for an obligation

204 'There is also an important systemic argument in favour of a requirement regarding exhaustion of national legal remedies. In Norway, as in a number of other democratic states, the courts are entitled to review and set aside the decisions of the administration, and also to a certain extent to assess and interpret legislation in relation to our international obligations. Unconditional access to international legal action weakens the functional distribution and dialogue between the three branches of government that balance the relationship between them. Without a requirement regarding exhaustion of national legal remedies, the national courts are not given the opportunity to consider the exercise of authority by the legislators or the administration. A large proportion of the cases involving review of the authorities' decisions are precisely cases concerning economic rights, and such cases will increasingly involve the rights of foreigners. In other words, without a requirement regarding exhaustion of national legal remedies, a proportion of the cases previously included in the dialogue between the three branches of government would be considered by an international judicial body without the national courts being given the opportunity to consider the matter first. Another important factor relating to this is the interaction between the national courts and the international tribunals. If national legal remedies must be exhausted first, the international tribunals will to a greater extent be required to address national views as stated in national judgments. National courts are conscious of the fact that their judgments will be reviewed internationally, and will then probably be heedful of signals given by international tribunals.'

'The principal argument for enabling international arbitration is that many developing countries and economies in transition fail to provide investors with the necessary protection owing to weak, nonexistent or biased legal institutions. The development of strong institutions takes place in collaboration with other branches of government and in connection with cases brought before the court. Legal institutions do not develop of their own accord but in response to external requirements regarding functional legal remedies. By requiring exhaustion of national legal remedies it is thus possible to contribute to strengthening of the institutions.' Commentary to Norwegian draft model BIT 2007, pp. 31–32.

205 von Moltke 2004, p. 191.

for investors 'to exhaust local judicial remedies (where appropriate) before initiating international arbitration'.<sup>206</sup>

Another effect of the direct access to international arbitration is a shift from administrative review process to governmental response. In international arbitration the state party government acts as respondent in the arbitration. Thus, in IIA cases with direct recourse to the international forum, central governments need to respond without local courts or authorities having made their review. In politically sensitive situations where it is the subnational government that mainly has acted in favour of the disputed decision, the international arbitration clearly is a more favourable forum for the investor also in a political sense.<sup>207</sup> There is a risk that the notice of such dispute from the investor in some situations can push central governments to smooth the decision in order to settle the dispute.<sup>208</sup> While an administrative court may review the case from applicable environmental and administrative law, the government could easily take a political approach to the case.

However, the direct access to international arbitration does not mean that actions by domestic courts or by the domestic company are of no importance for the IIA case. In assessing the situation, and in its judgment of the case, the IIA tribunal may consider various actions related to the domestic legal system. If the case concerns claims of denial of justice, a review of court actions is obvious, but also in other judgments on the merits the IIA tribunal may consider for facts whether the investor has acted properly regarding its interests to safeguard its investments and made use of accessible actions of redress. Some IIA tribunals have made clear that substantive provisions in the IIA cannot alter all regulations 'for which the investor may normally seek redress before the courts of the host State'.<sup>209</sup> Notwithstanding this,

206 EP resolution on the future European international investment policy 2011, p. 13.

207 As an example, the Vattenfall case forced the CDU government in Berlin to act in an issue dealt with in the CDU-Green coalition agreement in the subnational state of Hamburg.

208 See, for example, the debate around the Ethyl case and the Vattenfall case describe in section 2.5.4.

209 *Saluka Investments BV v. Czech Republic*, Award 17 March, 2006 para 442: 'The Treaty



there are several uncertainties around the impact of IIA dispute settlement mechanisms on national environmental governance structures and thus on environmental policy space for the host state.

## 2.5.2 Outcome of the dispute settlement —awarding damages or changing law?

Could an IIA dispute settlement result in environmental regulation in the host state being abolished? This is unclear. Whether the award in an IIA disputes includes direct or indirect policy recommendations, or whether it implies plain damages will matter to the policy space of the host state. Clearly, notwithstanding the form of remedy, an award concluding that the host state has breached its commitments in an international agreement would push strongly for a change of the rules triggering the dispute. However, if the dispute concerns a denial of a permit for a specific activity, the arbitration tribunal is undoubtedly the wrong actor to decide on a new permit, lacking environmental expertise and legitimacy to balance between the private and public interests at stake.

According to international law the state responsibility for an internationally wrongful act is to cease the act, if it is continuing, and provide full reparation in the form of restitution, compensation, and satisfaction.<sup>210</sup> The commentary to the articles on state responsibility makes clear that restitution in kind is only an alternative if it is materially possible or involves proportional burden to the benefit deriving from restitution instead of compensation. To grant restitution in kind instead of compensation is remarked by Shaw as ‘unlikely to prove acceptable to states since it appears a violation of sovereignty’.<sup>211</sup> However, in a growing number of IIA cases the investors claim restitution

cannot be interpreted so as to penalise each and every breach by the Government of the Rules or regulations to which it is subject and for which the investor may normally seek redress before the courts of the host State.’

210 Articles on responsibility of states for internationally wrongful acts, ILC, 2001, art. 31–36. See Shaw 2008, pp. 800–804.

211 Shaw 2008, p. 804.

in kind, parallel to damages.<sup>212</sup> The question is therefore whether IIA tribunals may award non-pecuniary remedies and, for example, order a host state to change an environmental rule or to grant the investor the permit asked for.<sup>213</sup>

In IIA cases when it is concluded that the host state has breached its obligations, the award generally rules that the host state has to pay damages to the investor. When the question of non-pecuniary remedies has been raised by the claimants, the host states have often argued that restitution in kind cannot be awarded, since it would be inappropriate in the case and impinge the state's regulatory sovereignty.<sup>214</sup> However, some IIA tribunals have declared that they, as principle, have the same power as any competent international court to order reparation other than monetary means.<sup>215</sup> Still, there are no IIA cases where

212 In *Antoine Goetz v. Burundi*, ICSID ARB/95/3 Settled 1999, the claimant requested annulment of the decision to withdraw free zone rules, and the tribunal ordered Burundi to conform with the IIA provision on expropriation and either annul its decision to withdraw free zone rules or pay compensation (Interim Award 2 September 1998); however, the parties were finally able to settle the dispute, Award 10 February 1999. In *Tecnicas Medioambientales SA (Tecmed) v. United Mexican States*, ICSID ARB(AF)00/2 Award 29 May, 2003, the claimant requested restitution in kind, i.e. prolongation of their operating permit, secondarily to the payment of damages, Award 29 May 2003; the tribunal did not, however, find it necessary to discuss non-pecuniary relief after concluding a payment of damages. In *Enron Corporation and Ponderosa Assets LP v. Argentina*, ICSID ARB/01/3 Award 22 May, 2007 the claimant asked the tribunal to declare certain taxes unlawful and issue a permanent injunction against their collection, Decision on Jurisdiction 14 January 2004, para 79, but the claimant did not uphold its request for non-pecuniary relief at the time of the final award, Award on the Merits 22 May 2007, paras 346 and 347. Likewise, in *Micula v. Romania* 2008, where the claimant asked for the restitution of certain withdrawn free zone rules, and the tribunal said in the decision on jurisdiction that restitution was a remedy available under the Sweden–Romania bilateral investment treaty—while stressing that the appropriateness of restitution would be a question for the merits phase of the proceedings—the claimant lifted that claim, para 158.

213 See Douglas, Zachary, Nothing if not critical for investment treaty arbitration: *Occidental, Eureka and Methanex*, *Arbitration International*, vol 22, 1, pp. 27–51.

214 *Enron v. Argentina* 2007, Decision on Jurisdiction 14 January 2004 para 76. *Micula v. Romania* 2008, paras 160 and 163.

215 'The Tribunal accordingly concludes that, in addition to declaratory powers, it has

host states been ordered to annul public rules or measures or admit permits earlier denied.

It could be noted that the IIA it self may limit the forms of relief available to the tribunal. Some North American IIAs include such limitations; the North American Free Trade Agreement (NAFTA), article 1135, provides for restitution only in relation to property, as does article 10.25 of the US FTAs with Chile and Jordan. The Energy Charter Treaty explicitly prescribes the form of the remedy awarded if the case concerns measures taken by a subnational government or authority to be monetary.<sup>216</sup> However, most IIAs are silent on this issue.

Enforcement of non-pecuniary remedies is not supported by the ICSID Convention, as its article 54 limits the state's commitments to enforce awards to pecuniary obligations. This has, however, not been seen as an absolute restriction for tribunals to award non-pecuniary remedies, but rather a recommendation that such remedies are complemented with damages in case of non-compliance of the state.<sup>217</sup> As noted above, during the merit phase of the proceeding tribunals seldom have reason to consider the appropriateness or possibilities of awarding any other form of remedy than damages.

Nonetheless, there are writers who argue that IIA tribunals should make more use of non-pecuniary remedies.<sup>218</sup> In a situation where the investment relation in the host state is going to continue, the investor might be better helped by an annulment of decisions that have

the power to order measures involving performance or injunction of certain acts.'  
*Enron v. Argentina* 2007, para 81.

216 ECT art. 26(8) 'An award of arbitration concerning a measure of a sub-national government or authority of the disputing Contracting Party shall provide that the Contracting Party may pay monetary damages in lieu of any other remedy granted' Also, the Canada-Colombia FTA 2008 Art. 821(2)(c), footnote 10, which notes that 'In accordance with international law, and where relevant and as appropriate, a Tribunal may take into consideration the law of the disputing Party. However, a Tribunal does not have jurisdiction to determine the legality of a measure, alleged to be in breach of this Agreement, under the domestic law of the disputing Party.'

217 See Schreuer, Christoph, Non-pecuniary Remedies in ICSID Arbitration, *Arbitration International*, vol 20, 4, pp. 325–332.

218 See *ibid.*, p. 332, and Subedi, Surya P, *International Investment Law – Reconciling Policy and Principle*, Hart Publishing, 2008, p. 218.

breached IIA provisions than by simple compensation.<sup>219</sup> Subedi compares IIA awards with the awards delivered by the WTO system concerning states' compliance with trade agreements and notes that it is often recommended that a 'losing state' in WTO dispute settlement revoke or modify its rules, rather than pay compensation.<sup>220</sup> Such a recommendation does not seem to have been considered as having negative implications for the policy space of the respondent WTO state. But here one shall note that the dispute settlement systems and its implication for states' right to regulate diverge substantively between the quasi-diplomatic procedure in the WTO and the private investor–state arbitration of IIAs. It is hard to see how the comparison works.

In any case, for situations when environmental regulations or permits are at stake, it would not be proper, if at all materially possible, for the IIA arbitrators to recommend modifications of the national law or the conditions for permission of a harmful activity. If such were the outcome of an IIA dispute, it would place a constraint to environmental policy space of the host state.

### 2.5.3 Transparency and access to the legal proceedings

Heavy criticism is directed towards the non-transparency of the IIA investor–state arbitration mechanism. The commercial arbitration model chosen for these arbitrations is by tradition a non-public, non-transparent proceeding, for which there are no public records, and as a general rule, no public hearings, and which does not recognise third-party participation.

The general rule is that the parties decide on whether the award is made public or not, as long as the underlying IIA or rules of the arbitration forum do not prescribe for any wider transparency. This

219 This situation existed in *Vattenfall v. Germany*, and the investor considered requesting restitution in kind, i.e. the water permit without some of the constraints, but according to the request for arbitration chose not to. Hobér Interview .

220 Subedi 2008, p. 217. Subedi seems to assume that IIA tribunals formally lack the flexibility to award non-pecuniary remedies.

situation, where non-transparency is the default option, contributes to potential problems regarding environmental law; affected persons and concerned NGOs are denied access to proceedings which concern vital environmental interests, and the lack of knowledge of IIA jurisprudence leads to uncertainties in conflicts between environmental measures and IIA provisions.

In environmental law affected communities or NGOs concerned in the matter of polluting industries or other environmental concerns often have legal rights to participate in the processes regulating the pollution. In general, transparency in the public process and the right to participation are significant institutions in environmental law and based on good governance. To depart from this rule in IIA arbitration would in itself constrain environmental policy space for the host state.

NGOs are calling for public records of IIA proceedings and awards, as well as an obligation for arbitrators to consider relevant material sent to the tribunal from third parties (*amicus curiae*).<sup>221</sup> Those demands are directed towards both a change of arbitration rules of the arbitration organisations, and a change of investor–state dispute settlement provisions in IIAs. Still, of the arbitration organisations, only ICSID keeps a record on its website of the cases administered by the organisation.<sup>222</sup>

Some IIAs have included requirements for certain transparency of arbitration procedures; Canadian and US model IIAs provide for that hearings and the awards be public, and unless the parties disagree, all documents are also made public.<sup>223</sup> The tribunals under such provisions may also grant leave for submissions of documents (*amicus curiae*) from any person or actor of civil society in the territories of the IIA states.<sup>224</sup> The NAFTA states have also agreed to let hearings in dis-

221 See IISD & CIEL proposal on UNCITRAL rules. For more general discussion see Francioni, Francesco, Access to Justice, Denial of Justice and International Investment Law, *European Journal of International Law*, vol 20, 2009, pp. 729–74.

222 The Permanent Court of Arbitration keeps a list of cases, but only if the parties agree to be public with certain information, <http://www.pca-cpa.org>. The Arbitration Institute of the Stockholm Chamber of Commerce only provides general statistics, <http://www.sccinstitute.se>.

223 Canada model FIPA 2004, art. 38, US model BIT 2004, art. 29.

224 Canada model FIPA 2004, art. 39, US model BIT 2004, art. 28(3).

putes of chapter 11 to be held in public.<sup>225</sup> This kind of reform of the arbitration design would grant affected persons and NGOs concerned in the matter a minimum access to the proceedings. Public records of IIA awards would also allow for greater knowledge of IIA jurisprudence among government officials, especially in states with small resources to spend on high-profile law agencies.<sup>226</sup> Such knowledge might contribute to more effective defence of the host state right to regulate and create less uncertainty of possible conflicts with IIA provisions that might arise from environmental measures.

IAs may also provide for the state parties to make interpretations of treaty provisions that are binding for a tribunal,<sup>227</sup> or give the non-disputing party access to documents and the right to submit opinions to a tribunal formed for a dispute based on the IIA.<sup>228</sup> Such reforms strengthen the inter-state control of the interpretation of the IIA and provide for quicker response to inappropriate interpretation of provisions. An active participation in arbitration of the home state of the investor might also reveal facts on similar or harsher environmental regulations for the investor in its home country.

## 2.5.4 Risk for abuse of the legal procedures by investors?

The recourse to international arbitration makes IAs a very powerful tool for foreign investors to claim the investor rights granted by the treaty. For countries with great need of foreign investments and a weak economy IIA arbitration may imply special risks:

- a bad reputation as a place for investments, thereby potentially losing some foreign investment opportunities, and

225 Official press statements cited in IISD & CIEL proposal on UNCITRAL rules, pp. 9–10.

226 See Tienhaara, Kyla, What You Don't Know Can Hurt You: Investor-State Disputes and the Protection of the Environment in Developing Countries, *Global Environmental Politics*, vol 6:4, 2006, p. 77.

227 As, for example, the NAFTA Free Trade Commission.

228 See, for example, Canada model FIPA 2004, art. 33–35.

- costly arbitrations, which besides the risk of paying damages to the investor also may include considerable costs for lawyers.<sup>229</sup>

Those disadvantages, together with the uncertainty of the interpretation of IIA provisions *vis-à-vis* public environmental regulation, increase the risk that a developing state having an IIA claim brought against it would try to settle the case, even if there were no clear breach of IIA provisions. Such settlements can clearly constrain the environmental policy space of the host state. This means investors might succeed in persuading a state to change its environmental decisions in a favourable way, or to pay compensation for losses due to restrictions by environmental regulation. For an investor an IIA claim might contribute to corporate goals, even if it fails in arbitration, because of progress in other relations between the company and the state.<sup>230</sup>

The risk of legal procedures being abused to accommodate powerful interests involved in environmental conflicts is not an unknown problem. In US doctrine it has been recognised as a phenomena called ‘SLAPPs’, standing for Strategic Lawsuits Against Public Participation, and involving legal suits claiming defamation, business tort, conspiracy, administrative process violation, violation of constitutional

229 According to UNCTAD the costs of dispute settlement in 2008 were pending between 1 and 4 million USD in arbitration costs, and 4 and 13 million USD for parties’ costs, IIA Monitor 1 (2009). This means that a developing country being ‘sued’ risks 5–17 million USD in costs for arbitration. In arbitration it is common that the parties pay their own legal costs, even if they prevail, but there have been cases where the failing party is assessed all legal costs, or at least the full cost for the arbiters (for example, the Methanex case and the Telenor case). The picture that the costs of arbitration is a substantial problem for some states is confirmed by Jorge Cabrera, who worked on the side of Costa Rica in the Santa Elena case, Interview, Cabrera, Jorge Lawyer and Professor of environmental law, Heredia, Costa Rica, 2009-01-09. Also see Tienhaara 2006i, pp. 80–81, and Nordrum, Jon Christian, Suveräniet og internationale investeringsaftaler, papers presented at the 38th meeting of Nordic jurists. Kevin Gallagher and Elen Shrestha show that the average award against a developing country amounts to 0.53 percent of government expenditure, while the average damages against Canada amounts to 0.003 percent of the government expenditure, Gallagher, Kevin P & Shrestha, Elen, Investment Treaty Arbitration and Developing Countries: A Re-Appraisal, Global Development and Environment Institute working paper 11–01, May 2011.

230 Nordrum 2008, p. 367, note 36.

rights such as taking of property, or other violations in order to silence protests against a project for environmental reasons.<sup>231</sup> In developing countries pressure in this regard can be widespread and, for example, involve local forest inspectors who report illegal clearings of forest, who are then accused by the reported land owner of defamation and thereby exposed to high personal economic risks (which could be half a year's salary) and exposure to multiple court actions.<sup>232</sup>

From reading the literature and following the IIA cases, it is clear that the IIA dispute settlement mechanism sometimes is used by investors for purposes other than seeking redress for bad treatment in a specific situation.<sup>233</sup> However, it is difficult to determine what constitutes a clear irregularity in investors' use of the IIA arbitration in environmental matters. The questions are nevertheless important, except that to verify any signs of possible abuse of the investor–state arbitration mechanism, the question is whether the IIA arbitration system has any safeguards against such abuse of power.

Some high profile environmental IIA cases have been registered for arbitration and later on settled after some redress from the host state. In the settlement of the *Ethyl* case,<sup>234</sup> Canada paid 13 million USD and withdrew the regulation prohibiting trade with a hazardous additive

231 See the writing of George Pring and Penelope Canan; Kravchenko, Svitlana & Bonine, John E., *Human rights and the environment – cases, law and policy*, Carolina Academic Press, Durham, 2008, chap. 11.

232 Problems are known even in less corrupt countries like Costa Rica; such actions effectively decreased the reporting by forest inspectors, according to one of the forest officers at the Costa Rican NGO CEDARENA.

233 The experienced reporter on investment arbitration Luke Eric Peterson upholds, inter alia, that IIAs sometimes are used in seeking to indemnify a foreign investor from any future adverse rulings in the local courts of the host state, Peterson, Luke Eric, Chevron goes all-in against Ecuador; New claim reflects latest BIT usage, Kluwer Arbitration Blog, 24 September. He gives the example the Mexican cement multinational CEMEX, which has threatened to sue the US Government for indemnification over any losses arising out of a 588 million USD lawsuit brought by officials in the State of Texas, and one of the cases the multilateral oil company Chevron has against Ecuador, which is linked to a huge law process on environmental and health damages from oil extraction in Amazonia, see further section 4.6.

234 *Ethyl Corporation v. Canada*, Settled 1998, see Sands 2003, pp. 1064-1065.



in gasoline. In the *Shell* case<sup>235</sup> the company withdrew its claim when the Nicaraguan court reversed an embargo order on Shell's trademark, used to enforce damages awarded to 500 people with health problems from fruit production. In the *Vattenfall* case<sup>236</sup> the company settled its IIA case on the condition of a modified water permit being issued by the regional German authorities, in which the original decision had restricted the amount of cooling water taken from the river Elbe to the new coal-fired power plant.<sup>237</sup> However, in the *Dow* case<sup>238</sup> the settlement left the contested decision by the state of Quebec to restrict the marketing and use of certain chemicals for preparation of house lawns unaltered; nor did it give Dow any compensation. Had the company carried out the claim to frighten off other Canadian provinces which had announced they were to follow in the steps of Quebec? If so, the strategy did not work this time.<sup>239</sup>

Investor claims in situations closely linked to political reforms are of special concern, as transnational companies are strongly advised not to interfere in domestic political activities.<sup>240</sup> Several environmental IIA cases are, however, closely linked to companies cooperating with local politicians or otherwise related to domestic political reforms. In the *Vattenfall* case the company wanted to rely on assurances made by representatives of the CDU party of Hamburg, although this party lost

235 *Shell Brands Int AG and Shell Nicaragua S.A. v. Republic of Nicaragua* ICSID ARB/06/14 Settled, 2007; see vis-Dunbar, Damon & Peterson, Luke Eric, Shell drops ICSID suit against Nicaragua over seizure of trademarks, *Investment Treaty News*, 9 May 2007.

236 *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG & Co. KG v. The Federal Republic of Germany*, ICSID ARB/09/6 Settled 2011.

237 The award on settlement 11 March 2011.

238 *Dow AgroSciences v. Canada*, Settled, 2011.

239 Or as Luke Eric Peterson expressed it 'If the case was filed as an exercise in so-called regulatory chill, the response by regulators appears to have been merely to shrug and pull on a sweater.' Peterson, Luke Eric, Dispute over pesticide phase-out ends ambiguously, with investor abandoning case, measures remaining in place, but Canadian province offering statement which may be brandished in other jurisdictions, *Investment Arbitration Reporter*, 9 June 2011.

240 OECD Guidelines, part II, A.15, stating that companies should 'abstain from any improper involvement in local political activities'.

its self-majority position after elections.<sup>241</sup> In the *San Sebastian* case<sup>242</sup> and the not concluded *El Dorado* case<sup>243</sup> the companies challenged the newly elected government of El Salvador and its reform to stop open-pit mining. However, one corporation group using this method even more flagrantly is tobacco giant Philip Morris, which has started several cases in order to influence policy reforms on public health and restricting tobacco.<sup>244</sup> In two non-concluded cases against Uruguay and Australia the company is seeking to put pressure on legislators to change political reforms.<sup>245</sup>

In other situations the company talks about making use of IIA arbitration, or even notifies the host state of the dispute, but never accomplishes a formal registration as things go the company's way. Those cases are notoriously hard to follow in any systematic way but a few of them are revealed in the literature by writers studying certain regions or sectors. Four examples from extractive industries and energy projects in Indonesia, Bulgaria, Costa Rica, and Australia give a picture of the problem and the risk to constrain environmental policy space:

- Mining companies with concessions in Indonesia communicated that they might use available dispute settlement mechanisms to challenge a 1999 prohibition of open-pit mining in protected forests, but restrained from action when most of them in the end

241 Request for arbitration 30 March 2009.

242 Commerce Group Corp. and San Sebastian Gold Mines, Inc. v. Republic of El Salvador, ICSID ARB/09/17 Award 14 March, 2011.

243 Pac Rim Cayman LLC (El Dorado) v. Republic of El Salvador ICSID ARB/09/12, 2009.

244 Philip Morris threatened to start IIA arbitration against Canada when discussions on similar policies took place in 1994 and 2001. In 2010 and 2011 it has started legal proceedings with Uruguay, Norway, and Australia to battle against, *inter alia*, plain package regulation, Peterson, Luke Eric, Philip Morris puts Australia on notice of treaty claim, but both parties decline to release documents; claim over tobacco regulations would be third treaty-based investor-state claim filed by Philip Morris since 2010, *Investment Arbitration Reporter* 30 June 2011.

245 Philip Morris Brand Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay, ICSID ARB/10/7, 2010; Philip Morris Asia v. Australia, 2011.

received various kinds of exceptions which made it possible for them to fulfil their activities nonetheless.<sup>246</sup>

- In 2009 it was reported that a Canadian mining firm, Dundee Precious Metals, had warned Bulgaria about a potential IIA claim due to an alleged ‘silent refusal’ by Bulgaria’s ministry of environment to reach a decision on the environmental impact assessment of a politically sensitive project and backed off when it received remedies in domestic court and saw improved relations following elections in Bulgaria.<sup>247</sup>
- In 2005 Costa Rica experienced two conflicts with foreign investors that were ready to use international arbitration after being denied permits to operate oil and gold concessions. US-based Harken Energy asked for international arbitration on its investment contract (although it stipulated domestic dispute settlement), as the Costa Rican EPA turned down its environmental assessment for its oil drilling project outside of the world’s largest sea turtle reserves on the Atlantic coast of the country. Without consent from the Costa Rica government the international arbitration was stopped, and in the end the state is reported not to have paid Harken any compensation.<sup>248</sup> By contrast, when the Canadian mining company Vanessa Ventures, holder of a gold concession suitable for open-pit mining at Las Crucitas close to the Nicaraguan border, the same year showed its intent to make use of the compulsory mechanism in the Canada–Costa Rica 1998 BIT and, *inter alia*, claim damages for lost profits of 240 million USD plus interest, it only took a couple of month until the environmental permit was approved by the Costa Rican

246 Tienhaara 2009, pp. 217–227.

247 Peterson, Luke Eric, Slow Gov’t decision-making, on environment & approvals, a breach of treaty obligations to foreign investors?, Investment Arbitration Reporter 19 September 2009.

248 See Jenkins, Benjamin W., Next Generation of Chilling Uncertainty: the Indirect Expropriation under CAFTA and its Potential Impacts on Environmental Protection, Ocean and Coastal Law Journal, vol 12, 2, 2007, pp. 269–304, and Tienhaara 2009, pp. 239–243.

environmental agency. To be noted, the constitutional court had in an earlier sentence ruled that Las Crucitas was in breach of the Central American Biodiversity Agreement and the Costa Rica constitution.<sup>249</sup> Las Crucitas has continued to be debated in Costa Rica and was referred to when warning citizens to vote no in the national referendum on the CAFTA some years later.<sup>250</sup>

- In November 2009 the *Investment Arbitration Reporter* reported that mainstream media in Australia said that one or more foreign investors had threatened to bring BIT claims if the controversial climate change legislation which was under political discussion did not include markedly enhanced compensation for certain coal-fired plants and other heavy polluters. The carbon emission reduction policies were of sensitive value to the government and then Prime Minister Kevin Rudd hoped to have the legislation passed prior to a major UN summit on climate change slated for December in Copenhagen.
- The energy company TRUenergy, part of the CLP Group based in Hong Kong made its voice heard in the media and said the federal government was in danger of breaching a bilateral investment treaty with Hong Kong, if the carbon reduction scheme severely reduced the value of company's assets (*inter alia*, the brown coal-fired Yallourn power station in Victoria).<sup>251</sup>

Which steps could then be taken to decrease the risks of abuses of the arbitration system? Few safeguards are in place in the investor–state dispute settlement system. Apart from opening up dispute forums dealing with public regulation to let more critical light from civil society and academia reach those disputes, there are some arguments on the structure, for example, to find measures to keep arbitration cost for host states to a minimum, and also to grant international support

249 Tienhaara 2009, pp. 236–239.

250 Ibid.. Jueza exonera a minera de tala ilegal en Crucitas, *La Nación*, Costa Rica, 26 January 2009.

251 Peterson, Luke Eric, Coal-fired power plant investors reportedly threaten Australia with BIT claims, *Investment Arbitration Reporter*, 30 November 2009.

for economically weak states within the framework of the IIAs in order to fulfil their defence in case of disputes.<sup>252</sup> One should also consider how the other state party of the IIA, that is, the home state, could take responsibility for ensuring that disputes based on the agreement are settled in line with the international obligation for transnational corporations not to interfere in domestic politics.<sup>253</sup>

## 2.6 Summary of the general aspects of policy space analysis

To summarise the findings on relevant general aspects to consider in an analysis of environmental policy space for host states in the context of international investment treaties, there are three kinds of issues to focus on: first, the capacity of the host state (for this, see the discussion in section 3.2.3); second, the general scope of the investment treaty; and third, the investor–state dispute settlement mechanism. This chapter has discussed various aspects of each of the two latter issues and we can now outline, in the form of a questionnaire, a specification of the policy space analysis tool on those general aspects. The whole questionnaire is reproduced in Appendix 2.

### Specification 1 of Policy Space Analysis Questionnaire: General Aspects

#### **Capacity of the host state:**

252 Garcia notes that the present system may reward prolonged proceedings with high costs, p. 352, Garcia, Carlos, *All the Other Dirty Little Secrets: Investment Treaties, Latin America, and the Necessary Evil of Investor-State Arbitration*, *Florida Journal of International Law*, vol 16, 2004, pp. 301–369. Tienhaara notes that the arbitration tribunal can order an unsuccessful disputing party to reimburse both the cost for the arbitrators and the legal costs for the other party, as was done in the Methanex case, Tienhaara 2006i, p. 80.

253 See Sornarajah 2004, p. 174–175. The obligation expressed in the OECD Guidelines for Multinational Enterprises 2000, part II General Policies, para 11.

- Is the administrative capacity of the host state environmental authorities weak?

*Yes to this question indicates there is an increased risk of policy space constraints.*

**General scope of the investment treaty:**

- Is there a wide definition of ‘investment’?
- Is there unlimited ‘most favoured nation treatment’?
- Is there an ‘umbrella clause’?

*Yes to these questions indicates there is an increased risk of policy space constraints.*

**Investor–state dispute settlement mechanism:**

- Does it allow for the domestic judicial system to have a clear role in legal reviews of environmental measures?
- Are there rules on transparency?
- Are there any safeguards against improper use against weaker states?

*An investor–state arbitration mechanism significantly raises the risk for policy space constraints. However, yes to these questions indicates that the policy space constraints are somewhat mitigated.*

# 3 Environmental law and the control of economic activities

## 3.1 Introduction

The previous chapter gave a background of the international investment law and some analysed characteristics on the wide applicability to foreign investments. With this chapter the purpose is not so much to give a comprehensive picture of the legal landscape called environmental law as to describe and investigate the functions of that law as it relates to the six areas chosen in chapter 1. These areas reflect the core provisions of investment protection and important aspects of environmental law in the control of economic activities:

1. Managing risks and prevention of harm
2. regulatory stability and predictability
3. multi-tiered governance structures
4. public participation in regulation and access to justice
5. avoidance of discrimination of similar actors
6. property rights and compensation of its interference.

From each of these areas the chapter outlines some of the main principles, approaches, and instruments commonly used to control economic activities in different areas of environmental law, such as preservation of biodiversity, pollution control, natural resource manage-

ment, and human health. The purpose is to illuminate essential parts of the policy space needed for host states in relation to foreign investments. As was said in section 1.2.2, analysing and estimating environmental policy space is different from evaluating which environmental regulation or instrument needs to be developed to further handle the local and global challenges. This means that the environmental principles, approaches, and instruments raised in this chapter will only to a limited extent be analysed in any depth. The purpose is not to compare the environmental rules as to the effectiveness to control economic activities. Rather, the purpose is to establish an understanding and structure for the coming analysis in chapters 4, 5, and 6, where these environmental principles, approaches, and instruments are placed beside investment rules in the policy space analysis. The chapter starts by giving some background relevant to the subject and, *inter alia*, giving an understanding of how national and international sources of law are plaited together and could be used in 'globalised' disputes.

## 3.2 Background on environmental law

### 3.2.1 Outbreak of modern environmental law

Every society has had some norms about the means to maintain a healthy population, avoid environmental damage, and regulate the use of land and natural living and non-living resources.<sup>254</sup> However, much of today's environmental legislation has its origin after the industrial transformation and urbanisation which in many countries took place in the beginning of the twentieth century. Those reorganisations of society created new environmental problems, and thus, brought new challenges to environmental law. The regulation created to meet those challenges by large took the form of public law.<sup>255</sup>

254 As shown by others, by Clive Ponting in *A Green History of the World: The Environmental Collapse of Great Civilisations*, Penguin Books, 1991 (cited in Bodansky, Brunnée & Hey 2007, p. 2).

255 The 'old' norms often had the character of private law, for example, rules on



During the 1960s and 1970s there were strong movements in Western Europe and North America demanding protection of the environment. Richard Lazarus calls it 'an outburst of democratic participation and ideological politics' in his analysis of the background of the environmental legislation in the United States of America.<sup>256</sup> In many countries general laws on environmental protection were adopted for the first time during the 1970s: the act on environmental protection in Sweden, 1969; the National Environmental Policy Act and Clean Air Act in the USA, 1970; and the acts on protection of nature and the environment and act on classified installations in France, 1976, are only a few examples. Further, important institutions were formed during those years; environmental ministries and national agencies were given the task to develop, supervise, and enforce the new laws. Licence systems for stationary pollution sources were implemented, and the states imposed restrictions for land use and private and public activities to protect endangered species and try to control waste and chemical diffusion. Step by step, environmental protection found its way into many areas of regulation.

In some developing countries the start of more intense legislation on environmental issues can also be dated to the 1970s; for example, India's acts of prevention and control of pollution in water and air are dated 1974 and 1981. In other developing countries the years of the 1960s and 1970s were still marked by the end of colonialism, fights around national power, or efforts to provide the population with basic human needs. The political stability to legislate on industrial and urban environmental problems did not arrive in many developing countries until the 1990s. For example, Costa Rica formed its environmental ministry, MINAE, in 1990, and approved its general environmental law in 1995.<sup>257</sup> However, today a number of developing countries still lack comprehensive environmental legislation and major environmental agencies or ministries especially responsible for environmental issues.

neighbouring real estate owners.

256 Lazarus, Richard J, *The Making of Environmental Law*, The University of Chicago Press, Chicago, 2004, p. 43.

257 Ley Orgánica del Ambiente, no 7554, 4 October 1995.

The interest of states in forming environmental law and policy at the international level has to a large extent been parallel in time and interrelated with the national development. A number of conventions were negotiated during the 1960 and 1970s, such as protections of the non-territorial marine environment from oil pollution and hazardous waste dumping, protection of wetlands, and trade in endangered species. A specialised UN body was also created, the UN Environment Programme (UNEP) in 1972. Following on these activities, there are today almost a countless number of environmental agreements between two or more states, which create over two thousand treaties and almost one hundred international institutions or secretariats.<sup>258</sup> The UN environmental conferences in Stockholm in 1972 and Rio de Janeiro in 1992 did not only codify general principles of the law but also become catalysts for international environmental law and cooperation, as well as inspiring national development of the law. For both developed and developing countries those international conferences encouraged the states to strengthen regional cooperation and modernise national environmental law.<sup>259</sup>

However, the development of environmental law was not free from conflicts with the law already established. One general conflict was due

258 The growing field of international environmental law is often referred to as 'international environmental governance' to indicate the multiple treaty regimes which regularly generate law making, Brunnée, Jutta, The United States and international environmental law: Living with an Elephant, *European Journal of International Law*, vol 15, 4, 2004, p. 617. The International Environmental Agreements Database Project counts over 1,000 MEAs and 1,500 bilateral agreements with over 300 secretariats; (Ronald B. Mitchell, 2002–2010, Version 2010.3), available at <http://iea.uoregon.edu/> (visited 2012-01-03). Also see Birnie, Boyle & Redgwell, 2009; Kiss & Shelton 2007; and Sands 2003.

259 As reflected, *inter alia*, in amendments in the constitutions of India in 1976 and Costa Rica in 1994; the formation of the Central American Alliance on Sustainable Development shortly after the Rio Conference, Aguilar & Iza 2005, p. 24; India making its 42nd amendment to the constitution shortly after the Stockholm conference, Tiwari 2006, p. 10; Costa Rica formulating the fundamental article 50 in the constitution in an era of strong environmental consciousness, Molina, Marianella Alvarares, Cambronero, Yasmín Aragón, Stoviak, Jennifer Flores & Vega, Gustavo Solís, *Jurisprudencia constitucional sobre medio ambiente*, Editorial Investigaciones Jurídicas S.A, San José, Costa Rica, 2001, p. 18.

to environmental legislation's increase of the power of the state, which imposed restrictions on many economically important operations and set boundaries for property rights. The content and performance of those conflicts were contextual and surely differed from country to country. While in some countries this shift coincided with greater public control in all areas, in other states such a shift was more complicated, with the most distinct example perhaps being in the USA.<sup>260</sup> The conflict between environmental protection and restrictions on economic activities or use of property is also a conflict between collective and individual interests and between short-term and long-term perspectives. Seen in this perspective, much of environmental law can be understood in the context of the modern state, which is preoccupied with risks and security and rather ill-suited to the model of the liberal state, to borrow the models of Habermas.<sup>261</sup> Hence, from this aspect environmental legislation is highly political. To strike the right balance between those interests has continued to be one of the most delicate issues in environmental law and policy, at the national level as well as at the international level. This 'political' characteristic may, however, also be one of the things that makes it venerable to international investment rules.

### 3.2.2 Environmental law in the era of globalisation

If the first decades of modern environmental law were mainly focused on environmental problems which appeared locally (yet the causes of which could cut across state borders), the 1980s and 1990s started to highlight environmental problems also arising at the global scale:

260 'Because environmental law challenges many of the scientific, economic, and sociological assumptions underlying much private property doctrine, environmental law's rise in the 1970s and 1980s seemed to portend a corresponding erosion of private property rights in natural resources. Yet, because property rights enjoy constitutional protection, that confrontation led to a series of claims that environmental protection laws were themselves unconstitutional.' Lazarus 2004, pp. 114–115.

261 See in the concluding chapter, section 9.1, and Ebbesson, Jonas, The rule of law in governance of complex socio-ecological changes, *Global Environmental Change*, vol 20, 2010, pp. 414–422.

ozone layer depletion, climate change, and the global loss of biodiversity disrupting life-supporting ecosystems. However, not only the environmental problems revealed themselves beyond local and national boundaries; corporate actors transformed themselves into transnational, or multinational, actors in the new 'globalised' economy, this latter phenomenon being part of economic globalisation.<sup>262</sup>

While the work against international environmental problems is the core interest of international environmental law,<sup>263</sup> the effects on environmental governance of the globalisation of corporations have in general not been dealt with in an internationally coordinated manner, at least, not in a way resulting in hard law. In spite of the many international discussions on standards of corporate conduct, and proposals on making some kind of convention,<sup>264</sup> the agreements of states so far are of a non-binding character, in other words, soft law.

The global environmental instruments that set the most specific standards of conduct directed at private corporations are the OECD Guidelines on Multinational Enterprises<sup>265</sup> and the standards of con-

262 Economic globalisation is the description of a process to create a borderless world economy shown in the international trend of liberalisation, deregulation, privatisation, and fiscal constraints, which is considered as the predominant policy orientation in western countries since the beginning of the 1980s; see Scholte, Jan Aart, *Globalization – a critical introduction*, 2:nd, Palgrave Macmillan, 2005, pp. 15–17.

263 This work contains its own characteristic problems in building global consensus of the extent of the problem and finding fair and effective ways to join efforts in mitigation.

264 The Council of Europe draft convention on civil liability for damage resulting from activities dangerous to the environment concluded in Lugano 1993 is the only comprehensive effort made it to a concluded text, however failing to receive ratifications, not even from EU-member states. During the UN world summit in Johannesburg 2002 (Rio+10) there were many discussions on responsibilities of corporates, reflected in article 49 in one of the final statements of the meeting, the Johannesburg Plan of Implementation. Several international NGOs presented around this time elaborated proposals on further rules for corporate responsibility, inter alia, World Development Movement, Friends of the Earth International, Greenpeace International and Christian Aid.

265 These guidelines were agreed on by the OECD governments after extensive drafting work, together with business and labour organisations. The scope of the guidelines includes all entities of the corporation, both in adhering and other states, and after

duct required by the International Finance Corporation (IFC)<sup>266</sup> in World Bank lending to the private sector in middle- and low-income countries. However, in the rich flora of multilateral environmental treaties, and their constant development through amendments and decisions,<sup>267</sup> there are many specific rules which concern the conduct of business. There are, for example, the early environmental treaties in the field of nuclear energy<sup>268</sup> and oil pollution,<sup>269</sup> in which the state parties commit to regulate private actors' responsibility for damage. There are also MEA decisions on the phase-out of certain chemicals.<sup>270</sup>

the 2011 review process a comprehensive supply chain responsibility is included.

266 IFC is the private sector part of the World Bank, and 182 countries have signed on to its constituting agreement. The requirements and recommendations for private actors are specific and were developed through active cooperation with both business communities and non-profit NGOs. Moreover, the Equator principles, with around 70 banks and private financial institutions, also require compliance with IFC standards for projects in non-OECD countries, and those located in OECD countries not designated as high-income countries; see <http://www.equator-principles.com> (visited 2010-05-28). Since the reform of the environmental, health, and safety work of the IFC in 2006, the policy documents make clear that the requirements and recommendations in the performance standards and the guidelines are not strict conditions for IFC support, but help the institution to prioritise and help the investing clients to carry out sustainable projects. These documents are, however, complemented with a short list of activities the IFC excludes *per se*, among them, driftnet fishing in the marine environment using nets in excess of 2.5 km in length, commercial logging operations for use in primary tropical moist forest, and production or trade of unbounded asbestos fibres; see <http://www.ifc.org/ifcext/sustainability.nsf/Content/IFCExclusionList> (visited 2010-05-28).

267 The techniques with framework conventions and active procedures at regular meetings of the parties to the convention (so called COP or MOP meetings) to amend the convention with protocols and decisions being binding for the parties if not explicitly opting out, or even binding after a qualified majority vote in the COP/MOP (Montreal protocol, art. 2.9), have led to much of the standard setting of MEAs; see Ulfstein, Geir, Treaty bodies, Bodansky, Brunnée & Hey (Eds.), *The Oxford Handbook of International Environmental Law*, chapter 38, Oxford University Press, 2007.

268 OECD Paris Convention on third-party liability in the field of nuclear energy, 1960.

269 Convention on civil liability for oil pollution damage, 1969 (amended 1984 and 1992).

270 Stockholm Convention on persistent organic pollutants, 2001. The substances included in Annex A or B for elimination or restriction are (after amendments in

The declarations concluded at the UN summits in Stockholm, Rio, and Johannesburg, in 1972, 1992, and 2002, respectively, are also directed towards *all* stakeholders and contain general standards of conduct relevant for business actors. It has become clear, in the reasoning by the UN Security Council and UN Sub-Commission on the Promotion and Protection of Human Rights, that the international demand on corporate actors and their conduct includes both hard law and soft law and makes no firm distinctions of those legal categories.<sup>271</sup>

It is not necessary in this work to include lengthy reviews of different positions whether transnational corporations should be subjects to international law<sup>272</sup> or the inadequacy of international bodies in gener-

August 2009) aldrin, chlordane, dieldrin, endrin, heptachlor, hexabromobiphenyl, mirex, toxaphene, PCBs, DDT, pentabromodiphenyl ether (pentaBDE), lindane, perfluorooctane-sulphonate (PFOS), alfaHCH, betaHCH, pentachlorobenzene (PeCB) and octabromodiphenyl ether (oktaBDE).

271 The UN Panel of experts on illegal exploitations of natural resources and other forms of wealth in the Democratic Republic of Congo made use of standards in OECD Guidelines when pointing out companies contributing to the situation which was legitimised by the UN Security Council Resolution no 1457, 2003. For further analysis of this case in light of corporate responsibility, see Fauchald, Ole Kristian & Stigen, Jo, Corporate Responsibility before International Institutions, *The George Washington International Law Review*, vol 40, 4.

The UN Sub-Commission on the Promotion and Protection of Human Rights has adopted norms which call upon companies to, apart from following the relevant domestic regulation, carry out activities 'in accordance with relevant international agreements, principles, objectives, responsibilities and standards with regard to the environment as well as human rights, public health and safety, bioethics and the precautionary principle, and shall generally conduct their activities in a manner contributing to the wider goal of sustainable development'. Art. G/14, Norms on the responsibilities of transnational corporations and other business enterprises with regard to human rights (hereafter UNHCR norms on the responsibilities of transnational corporations), E/CN.4/Sub.2/2003/12/Rev.2, 26 August 2003, Aslo see, Report of the Special Representative of the Secretary-General on the issues of human rights and transnational corporations and other business enterprises [the 2008 Ruggie report], UN Doc A/HRC/8/5, 2008.

272 According to 'the orthodox positivist doctrine' only states can be subjects of the international law, but although their status has been much debated in later years, transnational corporations are still not assigned international legal personality; see Lauterpacht, cited in Shaw 2008, pp. 197 and 250.

al dealing with corporate responsibility, since the analysis here will pay interest foremost to norms on what conduct the company legitimately can expect to undertake to prevent environmental harm.<sup>273</sup> It is, however, important to recognise that there has been increasing activity by global actors of various kinds—international organisations of states, transnational companies, internationally wide NGOs, and constellations with mixes of those actors—in generating standards of conduct for private actors in the global context.<sup>274</sup> Ratner and others have noted that private companies as a group participate extensively in decision-making concerning the standards of environmental performance, both directly by setting industry-wide standards of good practice and indirectly by participating in international standard-setting organisations like the ISO and being active in influencing national and international policies.<sup>275</sup> Hence, standards set by multinational enterprises, within a concern or a sector of industry, often called codes of conducts, are yet another form of standard setting to the family of soft law instruments.

Indeed, the interrelationship between international and national environmental law has continued in the era of globalisation. New instruments and approaches picked up in national environmental law stem from experiences in neighbouring countries, best practice pointed at and supported by international organisations like the FAO, UNEP,

273 If corporate misbehaviour leads to withdrawal of benefits provided in IIAs, it is, of course, one way also to strengthen corporate responsibility, in general; see Fauchald & Stigen 2009. Schrijver talks about obligations or duties in international law as legally relevant, even if no enforcement in court can be made, Schrijver 1997, p. 307. Also see section 7.5.2.

274 See Morgera, Elisa, *Corporate accountability in international environmental law*, Oxford University Press, 2009; Gupta, Joyeeta, Improving the Instruments of Global Governance, Winter (Ed.), *Multilevel Governance of Global Environmental Change*, chapter 18, Cambridge University Press, 2006; Fowler, Robert, International environmental standards for transnational corporations, *Environmental law*, vol 25, 1995, pp. 1–30; and Ratner, Steven, Business, Bodansky, Brunnée & Hey (Eds.), *The Oxford Handbook of International Environmental Law*, chapter 35, Oxford University Press, 2007.

275 Ratner 2007, pp. 816–821. One may consider these instruments as parallel to the trend of self-regulation in national environmental law.

and IUCN.<sup>276</sup> Top-down implementation of commitments made in international environmental treaties is not the most common linkage of international and national environmental law.<sup>277</sup> Rather, since most MEAs organise information sharing and capacity building, they influence national policies in a broader sense than the traditional model of command on international law implementation. In this ‘globalised’ environmental law structures have started to develop respecting ways to control transnational economic activities. Hence, in this work there will be norms referred to as ‘global’ environmental norms, indicating the background from sources not international in the strict sense.<sup>278</sup>

### 3.2.3 Environmental law in developing countries —some things to keep in mind

As shown above, developing countries have to various degrees and at different times followed the industrialised countries in developing modern environmental law. There are, however, some general characteristics about environmental law and policy in developing countries that deserve to be mentioned in the context of international investment rules. First of all, developing states are to a greater extent dependent on foreign investments to exploit minerals or increase productivity in industrial production or in agriculture sectors than are non-developing states. At the same time the people most vulnerable to environmental damage live in developing countries, as the majority of the world’s economically poor people and indigenous peoples do so. This makes the environment–investment context even more urgent to discuss in the context of developing states.

276 Gupta 2006.

277 Tews, Kerstin, *The Diffusion of Environmental Policy Innovations*, Winter (Ed.), *Multilevel Governance of Global Environmental Change*, chapter 9, Cambridge University Press, 2006. Tews finds it is international debates and organisations that inspire policy development in many states, rather than commands from MEA.

278 See Hey, Ellen, *Justice and fairness in global water law*, Ebbesson & Okowa (Eds.), *Environmental law and justice in context*, chapter 18, Cambridge University Press, Cambridge, 2009, pp. 351–370, referring to ‘global’ water law for similar reasons.



There are often a number of structural weaknesses concerning environmental administration in developing states: inexperienced and underpaid staff, often unclear jurisdiction of different authorities, and risk of corruption.<sup>279</sup> Also, the knowledge of the environmental authorities about the quality of the environment can be lacking, due to the costs and skills needed to monitor such quality. It is not unusual that environmental monitoring in poorer developing countries is carried out by foreign academic institutions or NGOs. Further, environmental knowledge and production standards of local business in some sectors are assumed to lag behind those of industrialised countries. Those weaknesses may contribute to the favouring of direct regulations, plain prohibitions, and sanctions, instead of administratively complex systems like cap-and-trade systems. Also, budget constraints make the use of subventions a less feasible environmental instrument.

There are some approaches in environmental law that more often are proposed or discussed within the realm of developing states or movements in 'the south'. Two such approaches are environment as a human right and environmental justice. These approaches are briefly introduced here.

A general observation is that the Pan-African and Inter-American human rights systems have elaborated more on the concepts of environmental rights, beyond the western tradition of the right to life and procedural civil rights to participation and access to justice in environmental issues. These second and third generations of rights recognise the right to a healthy and sound environment, as such, and the right for communities to determine how their natural resources should be managed.<sup>280</sup> For example, the African Charter on Human and Peoples' Rights protects peoples' rights to the best attainable standard of health and a generally satisfactory environment favourable to their development.<sup>281</sup> Both the African Commission on Human and Peoples' Rights

279 Alpízar, Francisco, *Essays on Environmental Policy-Making in Development Countries: Applications to Costa Rica*, Gothenburg University (thesis), 2002.

280 Following the distinctions in Boyle, Alan, Human Rights or Environmental Rights? A Reassessment, *Fordham Environmental Law Review*, vol 18, 2006/07, pp. 471–496.

281 African Charter of Human and Peoples' Rights, 1981, art. 16, 24.

and the Inter-American Commission and Court for Human Rights have been instrumental in establishing environment as a social and economical right and extending the individual focus to groups of indigenous peoples and vulnerable communities.<sup>282</sup> In some developing countries the constitutions also includes environmental rights and there are constitutional courts that act on individual claims to implement those rights.<sup>283</sup>

Environmental justice is a concept that revalues the distributional and participatory impacts of environmental decisions on different groups in society, being a critical voice against 'environmental racism' in the USA in the 1970 and 1980s, but spreading as a concept to many countries.<sup>284</sup> At the national level environmental justice poses questions on who is living next to polluting industries, and who is able to participate in the decisions of such location. Applying environmental justice on a global level, developing states strive to negotiate international environmental treaties to recognise the unequal impacts of global environmental problems, like climate change, and the need for developing states' participation in shaping global policies.<sup>285</sup>

A connected perspective, however, put forward mainly outside a narrowly framed legal discussion, is the concept of north states having an ecological debt to the south. This is foremost an economic concept referring to an ecologically unequal exchange in the trading relation between countries (mainly raw material export from the global south), and to the disproportionate use of 'ecological space' occupied by developed states.<sup>286</sup> The 'debt' consists of costs for restoration and

282 For example, by the cases Center for social and economic rights (Ogoni case) v. Nigeria, OAU CAB/LEG/67/3 rev.5, 2005; Maya Indigenous Community of the Toledo District v. Belize, IACHR case 12.953, 2004; Mayagna (Sumo) Awas Tingni v. Nicaragua, IACtHR Judgement 31 Aug, 2001. See further section 6.4.2.

283 For example, in Costa Rica, environmental jurisprudence discussed in Molina *et al.* 2001.

284 Ebbesson, Jonas & Okowa, Phoebe, *Environmental law and justice in context*, Cambridge University Press, Cambridge, 2009, Introduction.

285 *Ibid.* pp. 15–17.

286 Martinez-Alier, Joan, *The Environmentalism of the Poor*, Edward Elgar Publishing, 2002, chapter 10.

future lack of availability of natural resources not paid for by the export from developing countries, value of the knowledge of genetic resources existing foremost in developing countries not compensated by the revenues in commercialisation in the north, and by the costs of reparation and compensation for the free, historical disposal of CO<sub>2</sub> by developing countries assuming equal rights to sinks and reservoirs ('carbon debt', or as the more legal term would be, 'global climate justice'<sup>287</sup>).

Ecological debt has been discussed in some literature and proposed by NGOs.<sup>288</sup> At the Rio summit there was proposed a 'Debt Treaty', discussed at the unofficial parallel conference. The concept, notwithstanding calling it ecological debt or global environmental justice, calls for an actual or moral rearrangement of the world economy and world power, where countries in the north compensate for the resource degradation in the south. If applied on present and historical export and ecological footprints, it legitimises claims from developing countries on liability, which also could be directed towards foreign investors, as those have been and are actors in the exploitation and use of fossil and natural resources in the global south.

Hence, for policy space analysis the developing state context highlight three issues. (1) A weaker administrative capacity increases the risk of less-skilled workers handling permits and fulfilling administrative decisions. (2) Great dependence on foreign investments makes the host state vulnerable to pressure by investors. (3) The need to develop environmental law and policy is even greater among developing states, and the paths taken in such development are probably going to be both

287 See Brunnée, Jutta, Climate change, global environmental justice and international environmental law, Ebbesson & Okowa (Eds.), *Environmental law and justice in context*, chapter 16, Cambridge University Press, Cambridge, 2009.

288 The Chilean Instituto de Ecología Política is one of the originators of the term. Economists such as Martínez-Alier elaborate on the concept (see Martínez-Alier 2002), but also more conventional economists and scientists such as Sterner and Azar have discussed the carbon debt, Azar, Christian & Sterner, Tomas, *Discounting and Distributional Considerations in the Context of Global Warming, Ecological Economics*, vol 19, pp. 169–185, as did the somewhat influential campaign for debt relief 'Jubilee 2000', supported by the World Council of Churches.

to copy what developed states have done, and also, to take some paths of their own, bringing new perspectives to environmental law.

For example, Costa Rica has explored their own concepts to protect the environment and to form sustainable use of natural resources. Several legal tools are inspiring for a nordic environmental lawyer: The constitutional and enforceable human right to a sound environment, the national environmental fund which collects damages set out by courts based on 'global damages' and thereby includes loss of biodiversity and carbon sequencing, and the ecological servitudes which can be registred in accordance with the civil law to preserve areas around strategic watersheds, landscape view, arcological places or to preserve the current land use. Thus it would be a great loss to the development of environmental law if such new concepts would be hampered because of a more narrow policy space.

### 3.2.4 Environmental policy design

As shown in the sections above, environmental law and policy are strongly linked, and even if this work mainly focuses on laws and regulation, the picture would be incomplete if the laws and regulation's role in wider policy design were not mentioned. Hence, before analysing the possible constraints on environmental policy space, one also needs to get a picture of some general problems arising in environmental policy design. There is a risk that IIA constraints interplay with these policy design problems, and thus, further constrain the environmental policy making, or lead to the so-called 'chilling effect'.<sup>289</sup>

#### Criteria for good environmental policy design

There are a number of considerations to be taken in designing environmental policies. For example: Is the aim for the regulation to reach

289 The term chilling effect is used to describe the risk that regulators abstain from implementing new environmental rules, due to uncertainties in the legal framework of international investments; it is also used in similar debates around trade law. In the context of IIAs and environmental regulation, see Wagner 1999 and Ebbesson 1998.

a defined ecological status, or is it to mitigate pollution as much as possible with the current activity still being economically feasible? How important is it to stimulate innovation of mitigating methods? What will be perceived as a fair burden shared by the actors, or by the citizens? Which authority, and based on which information, should decide on the balance between conflicting goals in individual cases?

There is not one particular element that is singled out as the most prominent of a good environmental policy design, but effectiveness, efficiency, and fairness are the most commonly mentioned. Presuming to fulfil the environmental goal, Sterner<sup>290</sup> make the following list of different favoured outputs of a policy instrument:

- *Cost-effectiveness*, which means that if the instrument operates as planned, it would achieve the environmental goals at the lowest cost;
- *Efficiency*, which is a more ambitious concept including the optimality of the goal, that is, the level of abatement or of resource stock;
- *Sustainability*, which refers to long-term feasibility and fairness;
- *Incentive compatibility*, which means that the agents involved (particularly the polluters, but also regulators, victims, and others) have an incentive to provide information and undertake abatement and so on;
- *Distributional and equity concerns*, which means that the distribution of costs or responsibilities should be seen as fair; and
- *Administrative feasibility*, which includes the avoiding of excessive financial or informational costs for the operation of the instrument.

Another useful approach is taken by Gunningham and Grabosky,<sup>291</sup> selecting four elements for 'optimal' policy design: The policy should be effective in improving the environment, efficient in using the mini-

290 Sterner, Thomas, *Designing Instruments for Environmental Policy*, Bergh, van den (Ed.), *Environmental Economics*, Eolss Publishers, Oxford, 2004, p. 8.

291 Gunningham, Neil & Grabosky, Peter, *Smart Regulation – Designing Environmental Policy*, Clarendon Press, Oxford, 1998, p. 26.

imum of cost and administration, fair in burden sharing, and politically acceptable concerning liberty, transparency, and accountability. Thus, it is a complex task, which requires the consideration of many perspectives (to some extent a typical political task) to form both effective and just protection and management schemes.

## Instrument choice

Instruments of modern environmental policy are commonly categorised in three major groups: direct regulation or ‘command and control’ (typically general administrative regulation, permit, and notification systems), economic incentives (typically taxes, fees, and subsidies), and information-based or voluntary approaches.<sup>292</sup>

There is a debate about effectiveness and efficiency of the different instruments. Direct regulation has been criticised for lack of flexibility towards new technical and management solutions. It is also acknowledged that direct regulation might be less appropriate for reducing diffuse pollution from mobile pollution sources, because it requires the regulator to have comprehensive knowledge of the workings and capacity of the industry, and may become costly in administration for both the regulator and the industry.<sup>293</sup> Economic instruments are argued to be more cost effective, superior in promoting innovation to achieve higher than expected reductions, and less demanding in terms of information burden.<sup>294</sup> The disadvantages lie in difficulties regulating environmental problems characterised by specific times and places, and difficulties estimating the correct cost of pollution and whether prices being set by markets makes the costs less foreseeable by the actors. Economic incentives also have difficulties signalling moral con-

292 For discussion of the classification, see *ibid.*; Backer, Inge L., *Innföring i naturresurs- og miljörett*, 4 ed, Gyldendal, Oslo, 2002; Stewart, Richard B., Instrument Choice, Bodansky, Brunnée & Hey (Eds.), *The Oxford Handbook of International Environmental Law*, chapter 8, Oxford University Press, 2007.

293 Harrington, Morgenstern & Sterner, *Choosing Environmental Policy: Comparing Instruments and Outcomes in the U.S. and EU*, RFF Press, Washington, 2004; Gunningham & Grabosky, 1998.

294 Harrington *et al.* 2004.

tent.<sup>295</sup> Therefore, a combination of direct regulation and economic incentives has been the most common approach in developed countries. And it is stressed that both direct regulation and economic regulation need an adequate regulatory framework and equipped institutions to work.<sup>296</sup> It is important to stress that the choice of clear-cut prohibitions may be as effective for the problems relevant to developing countries.<sup>297</sup>

There seems to be an evolution in instrument choice, where direct regulation targeting specific pollution problems often comes at a first step, more complex regulation combining different kinds of environmental problems and incentives for technological innovation comes at a further step, enhanced in a next step with economic and informative instruments.<sup>298</sup> To relieve some of the formalistic approach of traditional direct regulations, there is in the systems of environmental permits a trend towards more flexibility in the permit provisions (for example, conditions are set for total emission, instead of specifying the technique for cleaning) and towards more reflexive elements (conditions on the operator's internal control). However, at the same time, there is a trend towards broader scope, as with 'life cycle responsibility' for products. These trends might contradict each other.<sup>299</sup>

Many argue that one should combine the instruments and tailor them after comprehensive understanding of the environmental problem, the standards to apply, which actors will be affected, and how to implement a new system efficiently.<sup>300</sup> The analysis in this work does not aim to evaluate the effectiveness of different environmental instruments and will therefore not compare different instruments to this end. However, the arguments for allowing a wide diversity of environ-

295 McLoughlin, J. & Bellinger, E.G., *Environmental Pollution Control, An introduction to Principles and Practice of Administration*, Garham & Trotman, London, 1993, pp. 61–63; Stewart 2007, p. 156.

296 Alpízar 2002 in the summary and Macrory 2008, p. 162.

297 See Gupta 2006.

298 Stewart 2007.

299 Abbot 2006, p. 85.

300 Gunningham & Grabosky, 1998; Bell 2006 p. 272.

mental legal instruments appear to be important. Most legal systems actually make use of many different instruments. Further, it has been noted that the choice of different instruments in different countries has potential to give equal environmental results.<sup>301</sup>

Hence, the general problems arising in environmental policy design stem from the complexity both in the 'physics' of our environment and in the different demands of the society. This short overview showed two problems to keep in mind, especially when looking further into the multi-tiered structures of environmental governance and investigating the policy space:

1. It is a complex task, which require the consideration of many perspectives to form both effective and just protection and management schemes; and
2. States use different policy instruments in combinations to impose environmental control on economic activities.

### 3.3 Prevention of environmental harm and the understanding of risks

This section starts the exploration of the six important areas of environmental law related to investment protection by focusing on prevention of harm and managing of risks, which clearly are fundamental aspects in environmental law that must not be restricted. The risk with international investment rules is that public demands for preventive actions are challenged as arbitrary restriction. since no harm is done and scientific proof of risk might be lacking. But why are preventive actions so important in environmental law, and which instruments are used? Are there disproportional demands of preventive actions, and how is that concluded? This latter question leads in to the analyses in

301 An analysis of North American and European pollution control mechanisms concluded that all mechanisms were combinations of direct regulations and economic elements, and even if the European regulators tended to prefer direct regulations the effective emission reductions were almost the same; Harrington *et al.* 2004, concluding chapter.



chapter 4 and 6 of the relation to the specific investment provisions on fair and equitable treatment and on expropriation.

Environmental law is preoccupied with preventing environmental harm and does not stop with the prescribing of consequences for the occurrence of harm, as does the typical criminal law. The risks of irreversible damage and degradation of life-sustaining ecosystems call for rules which are able to reform human actions as a pre-emptive step, before damage occurs. Further, the costs to repair a natural habitat or ecosystem are in most instances far greater than the short-time profits generated by a damaging exploitation project. Thus, the principle of prevention, identified in both international and national environmental law, has taken over the curative approach when dealing with environmental problems likely to be irreversible or too insidious or diffuse to be effectively dealt with through civil liability.<sup>302</sup> This approach underpins the general obligation also for private actors to do 'no harm', and to prevent, mitigate, and control the effects in the environment of the activities they carry out.<sup>303</sup> It also legitimises many of the administrative environmental regulations on more specific requirements.<sup>304</sup>

### 3.3.1 Managing risks

At the heart of preventive action lies the predictability of the damage: how do we know certain actions lead to environmental damage? It took years to understand that the dying forests in northern Europe were injured by emissions of sulphur in coal power plants. Substances used in agriculture, mining, or manufacturing have caused many people sickness or even death, before the connection to environmental pollution

302 Sadeleer, Nicolas de, *Environmental Principles – From Political Slogans to Legal Rules*, Oxford University Press, Oxford, 2002, p. 61.

303 The principle of prevention is included in global soft law on corporate conduct: OECD Guidelines, section VI, art. 3–5, and commentary, paras 67–70; UN Global Compact Principle 7.

304 For example, the environmental impact assessment (EIA).

has been established. The assumption of risks and assessments of its magnitude and probability become essential.<sup>305</sup>

However, technical risk assessment bears many problems. First, scientific uncertainties are constantly present. There are different forms of uncertainty; methodological problems in assessing long-term effects, causal links of different kinds which are not always linear but dynamic, and other factors that are unknown or unpredictable with any certainty. Second, it is recognised that science is not sufficient to grasp all dimensions of risks. There is also a social dimension; the decision also includes a question as to what is acceptable for the community. Therefore, scientific work and democratic procedures must cooperate in assessments of risks.<sup>306</sup> Further, the understanding of risks differs, depending whether it relies on an analysis of the costs and benefits or on participatory qualities.<sup>307</sup>

The general principle of precaution expresses this anticipatory approach.<sup>308</sup> In the modern society constant risk assessment and evaluation is applied in several special, areas such as production and consumption of food, medicine, and chemicals. As a widespread environmental principle, it prescribes that decision-making processes must take all risks into account, regardless of the degree of certainty.<sup>309</sup> Also the possibility of a reversed burden of proof reflects this understand-

305 Kiss, Alexandre & Shelton, Dinah, *International Environmental Law*, Transnational Publishers, New York, 2004, p. 22.

306 Fisher, Elizabeth, *Risk Regulation and Administrative Constitutionalism*, Hart Publishing, Oxford, 2007, p. 8.

307 On the differences in the rational–instrumental and deliberative–constitutive paradigms, see *ibid.* pp. 29–33. For an analysis of the WTO jurisprudence of different understanding of risk assessments, see Perez 2004, pp. 121–122.

308 Sadeleer explain that the precautionary approach differs from the remedial and preventive 'in that the authorities are prepared for potential, uncertain, or hypothetical threats: indeed, for all cases where no definitive proof exists that a threat will materialize. The most recent phase in the evolutionary process, precaution is the end point of a range of public measures meant to counter ecological damage. Not only has damage not yet occurred, but there is no irrefutable proof that it will occur.' Sadeleer, 2002, p. 91.

309 See *ibid.* for an overview of the use of the principle in both national and international law.

ing of precaution.<sup>310</sup> The management of risks in society legitimises strong public interference in the control of economic activities. For international investors this control sets a framework for their investments. It must therefore be recognised that while these approaches are crucial from an environmental point of view, they make calculation and prognoses for future business operation difficult.

### 3.3.2 Instruments and approaches for prevention of environmental harm

The main instruments and approaches used for prevention of environmental harm are direct regulation in the form of general prohibitions or restrictions of toxic or unhealthy substances or behaviour, and permit systems allowing individual actors to carry out activities under specified restrictions. Additional means are economic incentives as eco-taxes or subsidies and combined regulatory systems as cap-and-trade, where individual permits to emit polluting substances are traded at a market place, while the total number of permits is limited by the regulator. Further instruments are prescriptions on regularly reported information on environmental impacts and management systems, and various incentives for actors to reduce their environmental impact by voluntary means.

The fact that much of human activity has an impact on the environment, together with the uncertainties about the limits of the bearing capacity of ecological systems or their resilience to absorb stress

310 The standard of proof in a situation, or who bears the burden of proof, is reflecting the concept of precautionary approach as it is practiced in national law and defined in principle 15 of the Rio declaration. In international environmental law parties alleging a risk of serious environmental harm is required to present evidence to establish at least a prima facie case, Birnie, Boyle & Redgwell, 2009 p. 158. It is also discussed whether the burden to prove that a chemical is harmless, and fulfill set norms of formal scientific assessments and material safety levels, to greater extent should lay on the distributor of the product to motivate a development of less harmful substances, see, Zetterberg, Charlotta, Miljöfarliga produkter och fördelning av ansvar för utredning och bevisning i handelskonflikter, *Europarättslig Tidskrift* 2, 2010.

and complex changes, leads to the approach of best practical means.<sup>311</sup> Every actor has to use all practical ways to mitigate its negative impact on the environment. This approach underpins the design of direct regulations, but is also directly addressed to the actors. The OECD Guidelines include a recommendation that enterprises should continually improve environmental performance, *inter alia*, by adopting technologies and operating methods which reflect 'best practice'.<sup>312</sup> Information on what constitutes best practice might be found in business codes of conduct, which could be industry wide and sometimes monitored by third parties. Trade associations may also keep records on the performance standard of certain sectors. The OECD Guidelines further include requirements that the private actor ensure that the products or services carried out are efficient in their energy consumption and the use of natural resources.<sup>313</sup>

In national regulation, for example, in European Union member states, the standard used is the 'best available technique'(BAT).<sup>314</sup> The working process to compile the technical terms of the standards is commonly carried out in committees entirely or partly composed of national representatives of the relevant business sector.<sup>315</sup> As the wording 'practical' or 'available' indicates, the required technique or process method does not necessarily mean it is the technique or method used or economically available for the operator concerned in the specific

311 This means a general request of actors to minimize pollution in an economical optimal way. As the synonymous concept Best Available Techniques (BAT), best practical means aims to limit pollutant discharges with regard to abatement strategies of the operator.

312 Section VI(6)(a).

313 Section VI(6)(b).

314 Directive 2010/75/EU on industrial emissions.

315 For example, the BAT standard for certain industrial processes in the EU is specified in reference 'BREF' documents; see further on the EU IPPC directive and the working process to specify BREFs on the EU Commission home page: <http://ec.europa.eu/environment/air/pollutants/stationary/ippc/index.htm> (visited 2012-01-03). In Costa Rica the national companies also participate in the committees for standard setting of environmental performance, which in practice means a risk that, for example, the national board of bananas decides on which pesticides should be allowed on the large crop fields in the country.

case, but rather a technique or method used or economically available to a typical operator of that kind. Techniques and methods existing in other countries should also in general be considered. The approach of best practical means allows for a host state to prescribe techniques equivalent to those used in an operator's home state. However, as a general rule the same standard shall apply to all operators of similar operations in the country. This may imply that if domestic actors lack capacity to meet a standard equal to transnational companies' home states, and these domestic actors influence the committees specifying the standard of techniques and methods prescribed by the regulation, these regulations would not match the level of the TNCs' home states. Therefore, even if host states apply best practical means, the standard in the national regulations might be lower than in typical home states.

However, to force all actors to do their best to not harm the environment is no guarantee that there will be no environmental degradation. Therefore, an important complementary approach to best practical means is to start out from a desirable status of environmental quality and force actors to adjust to the levels of impact that the ecosystem can cope with. Such an environmental quality approach is often taken at the level of overall environmental planning or within certain areas where specific environmental problems and their sources must be dealt with; see further section 3.4.1.

One of the key concepts in sustainable development is, as pointed out in the introduction of this work, that environmental concerns should be considered in all relevant decisions, that is, the principle of integration. As an obligation on private actors, this means self-monitoring and adequate evaluation of the activities. The OECD Guidelines speak in terms of environmental management systems,<sup>316</sup> and the IFC Performance Standards identify the important elements of such a management system: 'The client will establish and maintain a Social and Environmental Management System appropriate to the nature and scale of the project and commensurate with the level of social and environmental risks and impacts. The Management System will incorporate the following elements: (i) Social and Environmental Assessment;

316 OECD Guidelines, section VI, art 1.

(ii) management program; (iii) organizational capacity; (iv) training; (v) community engagement; (vi) monitoring; and (vii) reporting.<sup>317</sup> The obligations to assess environmental effects and communicate with affected stakeholders are fundamental to fulfilling the standard in this regard. This includes, *inter alia*, carrying out an environmental impact assessment (EIA) that scientifically describes effects, including the cumulative impacts of the activities in the area and considerations of a no-action alternative, as well as possible mitigation to the impacts on the environment.<sup>318</sup> Hence the risk assessment and the mitigation planning should go hand in hand. The EIA secures that all relevant actors as well as the authorities have information on the environmental risks before the project gets permission to start, and regulation of self-monitoring requires the actor to employ reflexive responses on changes in the environmental status.

Hence, to prevent harm and manage risks, environmental law incorporates rules restricting the marketing or use of toxic or unhealthy substances, puts polluting activities under the duty of permits, and enforces detailed assessments and risk analysis before an activity can start. All this may affect foreign investments, as the legal settings for the investment are connected to assessments of environmental status and the acceptance of risks. Thus, investors' freedom to design their activities diminishes. Much of the ability to foresee the legal setting for an individual investment is transferred to individual decisions of authorities and the enforcement of permit procedures. It is therefore relevant to move on to the environmental law understanding of regulatory stability and predictability for private actors.

317 Performance standards on social and environmental sustainability 2006, standard 1, para 3 (requirements).

318 See, *inter alia*, the Convention on Environmental Impact Assessment in a Transboundary Context, 1991 (Espoo Convention); the Addis Ababa Principles no 5 within the Convention on Biological Diversity (CBD), 1992; and the IFC Performance Standards 1(5) and 6(4).

### 3.4 Environmental law perspective on regulatory stability and the predictability for private actors

A stable investment environment and predictability of the regulations for private actors are important factors for investors' interest and ability to invest, and part of the core objectives of international investment treaties. However, it is somewhat a contradiction in terms to describe environmental regulation and the idea of regulatory stability as meaning that standards, allowed behaviour, and restrictions should be stable and not change. Environmental regulation aims at safeguarding environmental goods and therefore has to change human behaviour, as long as there are environmental problems. It prescribes new standards for conduct when better methods exist, or prohibits certain behaviour damaging the environment when knowledge of the problems appears. However, environmental policies do include systems to prepare actors for change and disclose the rationales of the regulation in such a way that false expectations of regulatory stability are not made. In these rules of good governance one finds a common aim of providing operations by private actors with clear rules for the game. How do the environmental instruments deal with changes, and what rules of stability are offered to operators?

There are different triggers for the change of environmental regulation; however, three interrelated triggers may be identified: the environmental quality as such, new knowledge about an environmental problem or mitigating technology, and changes in the acceptance of an environmental problem. In the following two sections these subjects are investigated, changes due to environmental quality considered separately.

## **Standard setting in environmental law<sup>1</sup>**

‘Standards are prescriptive norms that govern products or processes or set limits on the amount of pollutants or emissions produced.’<sup>2</sup> Four different kinds of standards regulate different subjects:

### **Emission standards/performance standards**

Emission standards focus on the emission of certain substances from a fixed source. This kind of standard is commonly used as parameter for emissions to air or water in permits for industry. The standard could be calculated on the basis that the aggregated emissions comply with public goals. Since the performance standard is directed to a single operator, it is feasible for that operator to monitor and comply with the standard, but the impact on the environment is harder to predict, because the environment reacts to aggregated emissions. The operator may be free to choose how the activities are carried out to comply with the emission standard.

### **Process standards**

Process standards prescribe which process an operator must comply with, or require a certain performance of the process used. In modern manufacturing a crucial way to cut polluting emissions is to change the process methods. Examples of process standards are that the height of a chimney has to be x meters, the hulls of oil tankers have to be double, or the treatment of wastewater has to have at least two stages. The right process may prevent pollution from being created in the first place, but the freedom for the operator to choose its own way to fulfil the objectives of the standard diminish. The standard is also easy to comprehend and could therefore be more effective. On the other hand, process standards may slow down progress in technology development, as process methods are ‘frozen’. Process standards are typically regulated either in individual operational permits or as a general regulation for certain activities. As with emissions standards,

1 Following Kiss & Shelton 2004, pp. 229–231.

2 Ibid. p. 229.



the impact on the environment is hard to predict, since the environment reacts to aggregated emissions.

### **Product and use standards**

Product and use standards focus on the content, emissions, and use of products, for example, requirements that the product may be recovered and recycled when disposed of or that it meet certain energy efficiency standards, or restrictions on the use and marketing of certain chemical substances. A new approach is to make producers responsible for the whole life cycle as a mean to bring out the full environmental costs and promote recycling of materials.<sup>3</sup> Standards for products are typically regulated as a market regulation to be obeyed by all actors on the national or supranational market.

### **Environmental quality standards**

Environmental quality standards are a type of standard set for an ecological area, either as the preferred quality of the environment or as the maximum stress/pollution the area can take. Environmental quality standards are not directly binding for individual actors, but may constitute a basis for various regulatory measures directed at an operator.

3 The EU WEEE directive is one of the most far-reaching examples. See also Abbot 2006, p. 86.

## **3.4.1 Changes due to environmental quality —environmental quality standards**

An observation of an unacceptable environmental status is a strong trigger to insert new rules or make changes to the existing environmental regulation. It is logical, if a state, or the international cooperation of states, is granting citizens a ‘sound environment’ as a human or constitutional right, that an unacceptable environmental degradation should be cause for changes in regulation.

At the regulatory level there is a mechanism that is used for specific ‘environmental quality standards’, which are based on a systematic review of environmental parameters in order to certify a regulatory output; see Box 1 in section 3.3.2. These standards are set for an environmentally integrated area (for example, a river basin), either as preferred quality of the environment or as the maximum stress or pollution the area can take.<sup>319</sup> The standards focus on the quality of the environment as it appears with all negatively affecting factors, including diffuse pollution and distant airborne pollutants from far away. If a specific standard is fulfilled, the decided quality in that regard is granted. The standard can be set at ‘limit’ or at ‘warning’ levels linked to different duties to act. In areas where the preferred quality is not fulfilled, the standard acts as a trigger for changes of regulation, such as changes in general rules for spatial planning or changes in permits for point sources adding to the environmental problem, or imply new direct regulations concerning certain activities.

To be operational, environmental quality standards are dependent on additional regulations directed towards actors. They are often directed at the regulating authority itself and only indirectly affect operators. An environmental quality standard is, for example, used in both the US and the EU as a cap in connection with permissions for point sources.<sup>320</sup> Environmental quality standards are also frequently used in the advising and quasi-regulating activities by national agencies or to specify policy goals. Implemented in this way, the environmental quality standards are a direct part of the legal framework for operators. A less legalistic form is the ‘environmental quality objective’, which also aims at identifying the preferred environmental status and moving regulation towards this goal.<sup>321</sup>

319 A method prescribed for in the EU Water Framework Directive 2006/60/EC.

320 The EU directives on air quality prescribe a process where such links are made in the form of an action plan.

321 See for example the Swedish environmental quality objectives which are not part of the environmental legislation but presents interpretative arguments for sustainable development as the aim of the environmental code, further information on the objectives see <http://www.miljomal.se/Environmental-Objectives-Portal>.

It is thinkable with a development in environmental law to let environmental quality also become some sort of automatic trigger for regulatory changes for economic activities.<sup>322</sup> In such a system the rationale of regulatory change is placed outside the political field, and the change is linked only to the process in nature. Such linkage would give the regulatory change a truly objective basis, free from discrimination between individual actors. However, an automatic regulatory change would be very uncertain for operators, as environmental quality is a reaction to all sources of human and natural impact on the water basin, air unit, or piece of land. It would be inherently difficult for individual actors to predict the change and how it relates to their particular impact on the environment, parallel to other actors having their impact.

### 3.4.2 Changes due to new knowledge, new technology or change in environmental acceptance—concessions, individual permits, and general regulation

Dominant triggers for changes in environmental regulation are new scientific knowledge or the change in acceptance of an environmental problem. Ideally, there is a change in the general acceptance of a community or in a country when new knowledge comes from science, but that is not always the case. It can take a long time before people and politicians regard an environmental problem as unacceptable and take decisions for a change, while scientists may have been addressing the problem for a long time. To bridge the gap between new knowledge and public awareness international environmental agreements often include scientific cooperation to assess the environmental quality or outcomes of mitigating measures.<sup>323</sup> Sometimes a key issue for non-

322 For example, withdrawing the permit for emissions if certain indicating species in a catchment area decrease in number. On environmental quality standards and operability, see Gipperth, Lena, *Miljö kvalitetsnormer – en rättsvetenskaplig studie i regelteknik för operationalisering av miljömål*, (thesis) Uppsala, 1999.

323 See for example Convention for the Protection of the Marine Environment of the North-East Atlantic (OSPAR), 1992, art. 6 and Annex IV.

acceptance of an environmental problem is that new technology or new methods may mitigate the impacts on general behaviour, as when stricter standards on phasing out ozone depletion substances were decided, when it was shown to be possible to replace the hazardous gases in refrigerators and other essential tools.

Regulatory changes occur throughout the system of environmental law. Some areas involve intense regulation and constant change, such as health prescriptions concerning how to handle the production of food or use of chemicals; others receive less intense attention by the regulator. For example, the new scientific knowledge about the anthropogenic impact of earth's climate system has led to the introduction of a new instrument in the EU, the cap-and-trade system for emission quotas of carbon dioxide.<sup>324</sup> Regulatory changes may, obviously, impact business actors and their profitability. With the cap-and-trade system the uncertainty around the number of free quotas and the level of the future price on quotas might impair some operators' ability to foresee the profitability of their activity. A common method to reduce this regulatory uncertainty is to decide on phase-in periods of the reform package and thereby give individual actors a chance to adjust. In the example of climate emission quotas, the EU had decided by 2009 on principles for the level of the climate emission's cap and quotas for the trading period 2013–2020.<sup>325</sup>

Environmental concessions to natural resources<sup>326</sup> and permits to individual private actors<sup>327</sup> can produce expectations of the operator to be allowed to carry out the activity. The national rules on changes in

324 Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003, establishing a scheme for greenhouse gas emission allowance trading within the Community.

325 Directive 2009/29/EC of 23 April 2009, amending Directive 2003/87/EC, so as to improve and extend the greenhouse gas emission allowance trading scheme of the Community.

326 For example concessions which give sole rights to explore and extract minerals or water during a period of a number of years.

327 For example Directive 2010/75/EU on industrial emissions (integrated pollution prevention and control) which obliges EU member states to make sure certain industrial stationary pollution sources are regulated by permits.

conditions and revocation of such permits show in which way environmental regulation balances the need for change with rules and predictability for the actors. This balance might be different in different states depending of the legal tradition or political preferences.<sup>328</sup> Relevant for the coming analysis two opposite traditions or views in constructing environmental permit system. 1) The concession or permit gives in it self a strong position for the holder which is protected against interference by third parties or the state during the time of the permit. In this view the permit can be seen as a kind of property or vested interest in it self. 2) The permit gives less strong protection against interference by third parties or the state regarding new issues and is seen as an individualised regulation. The latter types has been more flexible in integrating modern development of environmental law.<sup>329</sup>

Concessions to natural resources, like extraction of gravel, oil or water, can be regarded as a time limited lease of the full disposal of a specific resource, and thus a strong vested interest in itself. However, the exploiting operations must obey to regulations which normally are prescribed in an operational permit.

If a permit of pollution control is unlimited in time the question arises as to how the authorities can imply new restrictions, if there is new knowledge about the impacts of the activity, or if the preferences of environmental protection change. For example, in Denmark operating permits are 'safeguarded' for a period of eight years, after which the supervisory body may issue new orders on safeguarding measures. However, before eight years have passed, the Danish authorities may issue new orders concerning the activity if new knowledge arises concerning its harmful effects.<sup>330</sup> This arrangement shows how the state

328 See Darpö, Jan, Rätt tillstånd för miljön – Om tillståndet som miljörättsligt instrument, rättskraften och mötet med nya miljökrav, Report to Swedish Environmental Agency 2010 for analysis in some of the differences in Swedish, German, Dutch and British law in this respect.

329 Ibid. pp. 66–67.

330 Environmental Protection Act 1974, Section 41a(1). For analysis, see Auby, Jean-Bernard, Public Environmental Law in France, Seerden (Ed.), *Public Environmental Law in the European Union and the United States*, Kluwer Law International, Amsterdam, 2002, p. 105.

may introduce new health and environmental standards to an ongoing industrial activity, while honouring the needs of the investor to plan for the operations.

Permit procedures, or other forms of individual decisions, are often necessary to implement environmental policies. The national law regulates how decision-making procedures for permits must be carried out within a general administrative system based on rule of law and granting fairness, *inter alia*, through coherent policies, transparent rules, timely procedures, and justified decisions, or in other words, through good governance and due process. This means that environmental regulation always integrates administrative law into the national context, just as any exercise of public authority is an exercise of administrative law and its implementation of good governance and rule of law. One may say that an administration that effectively enforces environmental policies must balance the environmental effectiveness with respect also for the individual affected economically; in other words, the authority must pursue good governance. As its very essence, rule of law implies that the exercise of authority must be carried out within the law. Hence, it looks as if there is no discrepancy between the understanding of due process between international investment law and environmental law on the general level. Important to note, however, is that, while 'rule of law' normally is a notion of protection of individuals from excessive public power, the concept in the field of environmental law is discussed as having an additional meaning, to protect individuals against environmental degradation.<sup>331</sup> Moreover, rule of law in the perspective of environmental law also acknowledges that there are uncertainties and needs to adapt to changes.<sup>332</sup>

An important tool to bring all operations within a sector in line with best practice or requirements based on new knowledge is general

331 See Backer, 2002, p. 127, who argues that rule of law in environmental law must be seen in the light of the purpose to protect the environment and thus individuals' rights not to have environmental degradation. Also, Basse, Ellen Margarethe, *Retssikkerhed i miljøretten – hvilke begreber kan anvendes?*, *Miljørettens grundspørgsmål*, Copenhagen, 1994.

332 Ebbesson 2010.

regulations. If the operations in the sector do not have permits, environmental requirements are implemented by the general regulation, while if there are permits for the operations, the general regulation can serve as a common ground for operations and overriding of the permits in specific issues.<sup>333</sup> In this way the general regulation may implement new requirements on existing activities carried out under a permit. The possibilities of using general decisions to alter, for example, the requirement of a production method for a sector of industry or the use of land, are important for phasing out old and environmentally damaging practices. States may balance such phase-out against the costs of changing methods before the operational time of previous investments has ended.<sup>334</sup> To clarify that general legislation complements the rights and obligations given in permits, this should be explained explicitly in the legislation or in the individual permit.

Special public support for private actors to develop their operations in the direction of environmental soundness is common in environmental policy and takes the forms of subventions, tax reductions, or other economic incentives. Such supporting schemes can be necessary for some business reforms, at least, initially. Yet, operators cannot rely on this support, beyond the specific decisions granting the support for the individual operation. Changes of schemes of economic incentives in general must be expected by the actors. There is a general understanding that individuals cannot for the future rely on the continuation of benefits they receive today in the absence of specific representation.<sup>335</sup>

Hence, the unpredictability of regulatory change is somewhat inherent in environmental law. However, by granting stability within certain time frames and enhancing transparency, regulation some-

333 For example, the British State Secretary direct regulation according to SI 2000/1973 Regulations 2000 (PPCR) 14 (cited in Darpö 2010).

334 Some countries have taken a more 'gradual approach' and allowed for quite long time periods for operators to comply with new standards, the UK, for example; see Bell 2006, pp. 256–257.

335 For example, the fact that a landowner had a permit for a gravel pit was in it self no guarantee for this never to change in the EctHR case *Fredin v. Sweden*, E.H.R.R., 1991, p. 784, para 50.

times makes the world a bit less unpredictable for operators, especially when the reform is triggered by a change in acceptance, rather than an immediate change in the environment itself or previously unknown scientific facts. Perhaps one can use a terminology of ‘environmental rule of law’, pointing to the fact that the mechanisms used to secure a certain amount of stability for actors regarding unpredictable natural phenomena are forms of rule of law. In chapter 4 these findings are discussed in the context of IIA provisions, which require respect for legitimate expectations of foreign investors.

### 3.5 Public participation in environmental decision making and access to justice

The previous section touched upon the ways changes in environmental regulation could stem from a change in the acceptance of certain environmental problems. Many environmentally harmful activities that once were accepted by society are today prohibited or forced to change their production methods to decrease their impact on the environment. Public participation is a key concept when environmental law seeks to balance the interests of an operator who exploits nature with those of inhabitants of the land and the society’s wish to preserve nature and resources for the future.<sup>336</sup>

The earth provides the services of ecosystems on which all life depends. Nature gives, amongst other things, healthy air, fruitful soil, and beauty of landscapes. The interest of the environment is thus a public interest, not limited to anyone with a particular involvement, such as ownership of land or a neighbour relationship. Neither is it an interest solely for the present generation, but belongs also to the future ones. The notion that environmental interest is universal drives environ-

336 There are three pillars of participatory and procedural rights in environmental matters: access to information, public participation, and access to justice. In this work access to information is considered to be included in public participation, as those two are closely linked; see Ebbesson, Jonas, Public Participation, Bodansky, Brunnée & Hey (Eds.), *The Oxford Handbook of International Environmental Law*, chapter 29, Oxford University Press, 2007.



mental regulation to take a procedural approach. This means there are various instruments which involve the public to participate in decision making, require wide disclosure of environmental information, and give wide legal standing in cases concerning the environment.<sup>337</sup> To some extent this approach makes environmental regulation a moving target—maybe in a way that challenges predictability of operators in the understanding of international investment law? This section explores some of the instruments in environmental law related to public participation, and some of the barbarities between different states. Chapter 4 discusses this in relation to the specific investment provision on fair and equitable treatment.

In international law the citizen's right to act in environmental matters is stressed in various documents; principle ten of the Rio Declaration says:

Environmental issues are best handled with participation of all concerned citizens, at the relevant level. At the national level, each individual shall have appropriate access to information concerning the environment that is held by public authorities, including information on hazardous materials and activities in their communities, and the opportunity to participate in decision-making processes. States shall facilitate and encourage public awareness and participation by making information widely available. Effective access to judicial and administrative proceedings, including redress and remedy, shall be provided.

This principle, which the more than 170 participating nations at the Rio Conference approved, expresses rights which to some extent has been recognised in international human rights regimes: the 1941 Universal Declaration of Human Rights, the 1966 International Covenant on Civil and Political Rights, the 1969 Inter-American Convention on Human Rights (IACHR), the 1981 African Charter on Human

337 For example UN ECE Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters [Aarhus Convention], 1998, Also see Aguilar & Iza 2005 pp. 483–495.

and Peoples' Rights, and the 1989 International Labour Organisation (ILO)'s Indigenous and Tribal Peoples Convention. One can thus observe a clear overlap between environmental law and human rights law in issues of public participation, disclosing of information, and access to justice. This can also be recognised when environmental conflicts between local communities and foreign investors are brought before international human rights courts. Human rights courts or committees seldom condemn the environmental risks of business operations, as such, but rather criticise governments' disrespect of the citizen's rights to information, participation, and access to justice in relation to business concessions or contracts.<sup>338</sup> The convention on access to information, public participation in decision making, and access to justice in environmental matters (Aarhus Convention) links public information, participation, and access to justice to governmental accountability and environmental protection.<sup>339</sup> The convention prescribes that the public concerned about a project (having certain potential to impact the environment in negative ways) in planning must be invited to participate in the decision-making procedure 'early in the process and in an adequate, timely and effective manner'.<sup>340</sup>

Requirements on public participation in the planning of environmentally risky projects are one fundamental part of the globally used tool of environmental law, environmental impact assessments. It is within the framework of EIAs that most states make sure that concerned members of the public, as well as the authorities, have all relevant information about the environmental risks before a project gets permission to start. The overall goal of an EIA is to improve the analy-

338 For example, when governments withholding environmental information found in contracts between the state and foreign companies have been condemned as not respecting human rights; see the case *Claude Reyes and others v. Chile*, Inter-American Court for Human Rights, 19 Sept 2006, about the deforestation project Río Condor by the Trillium company in the south of Chile, and other cases referred to in *Guía defensa ambiental – construyendo la estrategia para el litigio de casos ante el sistema interamericano de derechos humanos*, AIDA, 2008, pp. 62–63.

339 Aarhus Convention. The convention has 44 signatory parties, mostly from the ECE region and including EU as a party in its own right.

340 Art. 6(2).

sis of environmental impacts underpinning the decisions on the project. Opinions and views from the persons concerned are expected to contribute to such improvements.<sup>341</sup> It does not matter if these people live close to the place of the operations or at a different place, perhaps in a foreign state that might also be affected by the operation.<sup>342</sup> Consultations with affected indigenous communities concerning activities in areas of traditional living are required to include 'free, prior and informed consent'.<sup>343</sup> However, the specific requirements of such consultations are debated.<sup>344</sup> It could, in any case, be concluded that it is widely established that the operator proposing an activity likely to have a significant impact on the environment must compile an environmental impact analysis and let citizens react to it in a meaningful way before the authority take the decision on approval.

341 Improving the quality of decisions is one recognised benefit of public participation, and helping to solve competing values around environmental problems is another; see Bell 2006, p. 318.

342 UNECE Convention on Environmental Impact Assessment in a Transboundary Context (EIA Convention), 1991, art. 2(6). Also see *Pulp Mills on the River Uruguay (Argentina v. Uruguay)*, ICJ Judgement 20 April, 2010.

343 The Indigenous and Tribal Peoples Convention, article 16, expresses the principle of free and informed consent in the context of relocation of indigenous peoples from their land. The United Nations Declaration on the Rights of Indigenous Peoples (GA Res 61/295 13 September 2007), article 10: 'No relocation shall take place without the free, prior and informed consent of the indigenous peoples concerned and after agreement on just and fair compensation and, where possible, with the option of return.' Article 19 covers other impacts: 'States shall consult and cooperate in good faith with the indigenous peoples concerned through their own representative institutions in order to obtain their free, prior and informed consent before adopting and implementing legislative or administrative measures that may affect them.' The Fifth Conference of Parties (COP) to the Convention on Biological Diversity (CBD) Decision V/16: 'Access to traditional knowledge, innovation and practices of indigenous and local communities should be subject to prior informed consent or prior informed approval from the holders of such knowledge, innovations and practices.' Also see CDB Akwé Guidelines, paras 21–22, 30, 33.

344 The IFC compliance advisor/ombudsperson has dealt with several cases where, *inter alia*, in projects building big dams (for example, the Ralco dam in the Bio Bio River in Mapuche area in Chile) the revised IFC Performance Standard 7 (indigenous peoples), requirement 9, obliges 'free, prior, and informed consultation', not 'consent'.

Decisions other than those for approval of environmental permits also make use of public participation. Characteristic of urban planning instruments are decentralised decision making and wide public participation. Whether it is a good idea to build a house or factory at a certain spot could also be a decision with wide discretion; thus, a broad range of views and aspects may be considered in the planning decision. Several states also practice forms of public participation for plans and programmes of various kinds.<sup>345</sup> The strategic impact assessments required in those processes follow to a large extent the cycle of EIAs.

The practice of allowing persons or NGOs to bring challenges of decisions on environmental matters to court, or to some sort of impartial review, differs widely between states.<sup>346</sup> There are also variations in legal procedures used for environmental cases. A brief study of the legal standing in Sweden and Costa Rica shows immediate differences. For example, while Sweden allows for legal reviews of some environmental decisions by persons with qualified interests and NGOs meeting certain standards,<sup>347</sup> Costa Rica provides for wide access to judicial procedures for review of decisions having an impact on the citizen's constitutional right to a sound environment in ecological balance.<sup>348</sup> The Aarhus Convention prescribes rights for persons with sufficient interest in an environmental matter to have a legal review of both the participation procedure and the substantive legality of the decision concerning the matter.<sup>349</sup> The public should also have access to a way to challenge decisions of general environmental law and private actors' compliance with such law.<sup>350</sup> To ensure that these rights can be used in

345 The Aarhus Convention prescribes for public participation also for decisions on plans, programmes and policies, art. 7.

346 Darpö, Jan, Environmental justice through environmental court? Lessons learned from the Swedish experience, Ebbesson & Okowa (Eds.), *Environmental law and justice in context*, chapter 9, Cambridge University Press, Cambridge 2009

347 Costa Rica all citizens have the right to act in court to defend their constitutional right to a sound environment in ecological balance.

348 In Costa Rica all citizens have the right to act in court to defend their constitutional right to a sound environment in ecological balance.

349 Art. 9(2).

350 Art. 9(3).

practice, the Convention also states that a legal challenge must be fair, equitable, timely, and not prohibitively expensive.<sup>351</sup> In accordance with the latter, it has been recognised that access to legal reviews and fair legal procedures is essential to reach distributional justice also in environmental law.<sup>352</sup>

Hence, the state of the environment is a universal interest requiring that all concerned members of the have public rights to information and access to participation and legal reviews. The scope of environmental impact assessments and subsequently requirements in environmental permits may depend heavily on views expressed in the participatory process, since environmental law assigns particular value to these kinds of expressions. For the investor this means an additional complexity in its aim to carry out the activity of the investment. In chapter 4 these findings are discussed in the context of IIA provisions on fair and equitable treatment, as this provision at some points may restrict the state from listening to what are considered as local political opinions; see section 4.5.2.

## 3.6 Multi-tiered environmental governance

Multilevel governance is a suitable term used by Winter for the complexity requested of institutional structures for dealing with present environmental global impacts; see section 1.1.<sup>353</sup> Although conceptually related, the complexity of the national environmental governance structure facing investors is rather termed ‘multi-tiered’.<sup>354</sup> Simply put, this structure implies that several different authorities are involved in

351 Art. 9(4).

352 Ebbesson & Okowa 2009, p. 12.

353 Winter 2006.

354 The compliance committee of the Aarhus Convention refers to ‘tiered [environmental] decision-making’ which is linked to ‘consecutive decision-making procedures’, Aarhus convention compliance committee (ACCC) report on compliance by Lithuania with its obligations under the convention, UN Doc ECE/MP.PP/2008/5/Add.6, 2008.

monitoring and controlling the activity, in issuing permits, or enforcing administrative decisions. Those authorities may have different expert roles or different geographic focus, or interact at different levels in the chain of enforcement. Over and above the multifaceted administrative landscape, the use of wide discretion within areas like planning could lead to difficulties for investors to oversee the implications for the investments' viability or profitability. This has bearing for the fair and equitable treatment and protection against discrimination, which are granted by the IIA.

There are several reasons that environmental governance is carried out in this complex and multi-tiered way, resulting in innumerable authorities being involved. First, to decide on the different environmental aspects of an operation, different expertise might be needed, and this expertise may be split among different agencies, for example, a water agency and a more general environmental agency. Second, different steps in decision making might demand the involvement of different authorities, for example, the decision to establish a new activity which requires decisions to be taken consecutively. Third, different parts of the activity carried out by the investor may require decisions by different authorities because of its impact on local society, the health of workers, or national security. Fourth, environmental impacts are often spread across geographical administrative borders, which may bring regulation of the action in question to the attention of more than one local authority.

Environmental governance is of vital importance for environmental law. Governmental administrations or agencies with explicit responsibility regarding the environment play a crucial role both in developing and enforcing adequate regulation. It is therefore no surprise that the development of environmental law in many countries comes about in parallel with the creation of environmental ministries, agencies, and other expert bodies; see section 3.2.1. Policy design and policy reform require substantial resources for scientifically complex, highly qualified, and cost- and time-consuming work by public administrations. It is therefore vital that public authorities have the resources to un-

dertake investigations, keep competent staff, and resist corruption.<sup>355</sup> Administrative constraints have been recognised to strongly weaken the implementation of environmental policies.<sup>356</sup> Both *capacity*, in the meaning of an adequate supply of lawyers, bureaucrats, and scientists, and *capability*, in the meaning of quality of the administrative resources, are essential to successfully implement environmental policies. Developing states are assumed to have deficits in both capacity and capability of environmental administration; see section 3.2.3.

The complexity of environmental governance is increased by the fact that the role of the modern state in environmental matters is two sided, both protecting the environment on behalf of its present and future citizens, and allowing companies and persons to carry out activities with their impacts on the environment in the best way for the society as a whole.<sup>357</sup> In the latter role some public authorities may side with the industry in cases where citizens are complaining about degradation of the environment, while other authorities produce arguments for the cause of the affected citizens. Further, the multifaceted role of public bodies is amplified by the fact that there might be various concerns about the environment with respect to the same activity, for example, concerns about the rational land use and concerns about pollution and impacts on biodiversity. The conflicts between different environmental objectives are clear in several areas of environmental policy, *inter alia*, between the preservation of natural habitats and production of renewable energy such as wind power, hydroelectric power, or agriculture of biomass. As experts on different environmental issues are split on different authorities, coordination and cooperation

355 Lundqvist, Lennart J, *Sweden and ecological governance*, Manchester University Press, 2004, chapter 1.

356 Perkins, Richard & Neumayer, Eric, Implementing Multilateral Environmental Agreements: An Analysis of EAU Directives, *Global Environmental Politics*, vol 7, 3, 2007, pp. 13–41.

357 See Backer, 2002, p. 127, who argues that rule of law in environmental law must be seen in the light of the purpose to protect the environment and thus individuals' rights not to have environmental degradation. Section 3.4.2.

between different environmental authorities might then be an intricate task for superior administration, courts, or governments.<sup>358</sup>

For investors waiting for decisions the lack of integration might result in contradictory signals from different authorities. However, there is a trend in some countries to coordinate, for example, the permit system, and include emissions to air, land, and water in the same permit, and sometimes also coordinate this permit with construction permits and other regulation.<sup>359</sup> Environmental authorities must, then, be able to handle many different environmental aspects and different kinds of activities in a complex process leading to the permit. Lack of administrative capability may be one reason why separated permits are more common in developing countries.

An additional layer of complexity for coherent environmental governance is that both national and subnational, local, public bodies are involved. Local decision making is especially common for individual permits for less risky activities, planning decisions, and sometimes supervision. Knowledge of local environmental conditions, the huge number of public decisions which need to be taken, or no need for central control are three reasons that have been mentioned for local decision making.<sup>360</sup> Decentralised decision making may require the same project to apply for permits from both a central and a local level.

Further, many environmental authorities, especially municipalities and other subnational bodies, are often granted rather wide discretion in their environmental decision making.<sup>361</sup> Decisions in spatial planning often include wide discretion for the decision making body; however, regional or national planning instruments sometimes can force certain national objectives to be considered. Thus, even though spatial regulation strives at continuity and involves long-time decisions, as the exploitation of land, local decision making, and sometimes parallel

358 Lundqvist 2004, chapter 1.

359 See for example 2010/75/EC Directive on industrial emissions (integrated pollution prevention and control)

360 Basse 2004, p. 280.

361 What discretion authorities have varies. The Austrian and Danish systems are, for example, very different in this aspect; see Seerden, Heldeweg & Deketelaere 2002.



structures of spatial planning and local political work to enhance jobs and economic development show, there are risks that investors may get different signals about the viability of a positive planning decision. This decreased predictability of the project of the operator has led to disputes between foreign investors and states; see section 4.7.4. The wide discretion in some environmental decisions also increases the risk of activities which seem similar getting different judgments, something which might alert the protection against discrimination; see section 5.6.2.

The IIAs and rules of international law look upon the state as one and the same body, and not a diverse universe of different stakeholders; see section 4.5.1. This means that it is vital for the state to coordinate environmental administration, so that the obligations of the IIA can be fulfilled also by special agencies and subnational bodies. One problem, however, is that one of the main instruments for coordination of the environmental administration, the legal review, is cut off by the IIA dispute settlement, as the investor in principle often can take the dispute directly to international arbitration, without asking the national courts to review the administrative actions first; see section 2.5.1. With such a complex structure of administration and large numbers of decisions taken every day, a legal review process is important to enhance decision coherence. The scope for the review of environmental decisions is different in different legal systems.<sup>362</sup> Some states have special courts dealing with environmental cases to enhance coherence in the system of environmental governance.<sup>363</sup> Vital for the development of coherent administrative decisions is that courts reviewing the decisions get responsibility for the whole area of decisions. The situation, as in the case of Vattenfall referred to in section 2.5.1, where the

362 For example, Jan Darpö has investigated and compared the administrative system related to environmental permits in England, the Netherlands, Germany and Sweden, Darpö 2010.

363 For example Sweden's land and environment courts have jurisdiction of the appeals of environmental permits and planning decisions as well as claims of environmental damage and expropriation. The administrative environmental court of Costa Rica rather work as complementary body in enforcing environmental laws towards both public and private actors.

operations of a foreign investor get a route for legal review different from that of similar operations, is counterproductive for development of environmental governance.

Hence, multi-tiered structures of environmental governance imply that operators carrying out potentially damaging activities often must deal with multiple authorities for monitoring and control, as well as for permits or other decisions. Different authorities dealing with different aspects or decisions concerning an activity might come to different conclusions, giving the investor different messages about the environmental viability and consequent difficulties of clearly foreseeing the future capability of the investment within the regulatory framework. Moreover, discretion for the decision-making body may result in different judgments in cases which look similar. The legal review process is vital to shape efficient administrative work models in line with good governance. In chapters 4 and 5 these findings are discussed in the context of IIA provisions.

### 3.7 Equal treatment and justifications to favour local actors in environmental law

The four previous areas have related to public treatment of economic activities in a broad and general sense. This section will discuss environmental legal concepts relating especially to the equal treatment of different actors and their activities. The area reflects the investment treaty provision on national treatment, a provision focusing on non-discrimination between national and foreign investors, which is further analysed in chapter 5.

Environmental regulation in general does not differentiate the treatment of operators on nationality, but rather on the environmental effects of their activities. However, policies on natural resource management and biodiversity that are integrated into policies on social development may favour local actors, community actors or indigenous peoples. Within modern methods of preservation of biological diversity, members of a community might be given exclusive access to

public land or marine resources to harvest plants, use pasture, fish, or hunt, under the framework of a management agreement with the community. The reason is that management of resources like forests, wetlands, and water basins must involve local communities, as the human interaction with the resource plays a key role in sustainable management of the resource.<sup>364</sup> Exclusive rights concerning natural resources granted to local communities may also be part of rural development strategies, as shown by some examples in Costa Rica: water services in rural areas are provided by local water committees; only local NGOs are allowed to run camping facilities, cafés, or shops for tourists in national parks, and only local fishermen may fish in some of the marine reserves.<sup>365</sup> Also, countries with highly developed economies may use a similar kind of regulation to promote introduction of green technology. For example, in Denmark wind power establishments by local cooperatives were favoured in regulations as part of a Danish strategy to increase renewable energy production and develop the wind power industry.<sup>366</sup> The reason was that, if people living near the wind turbines had ownership in the energy production, the acceptance of introducing wind power in general increased, and the production of wind energy could increase more rapidly. Hence, to grant some sort of exclusive access to natural resources to local actors may be part of integrated environmental and social policies.

In pollution control the concept of equal treatment of similar operators applies. Environmental rules restricting emissions to air, ground, or water do not distinguish the ownership of the operator. The origin of the operator is only significant for the regulation if it is directly linked

364 See for example Dale & Haeuber, *Applying Ecological Principles to Land Management*, Springer, 2001.

365 Ley de Creación del Servicio de Parques Naturales No 6084 del 25 agosto de 1977.

366 See Cho, Albert H. & Dubash, Navroz K., Will Investment Rules Shrink Policy Space for Sustainable Development? Evidence from Electricity Sector, Gallagher (Ed.), *Putting Development First – the Importance of Policy Space in the WTO and in International Finance Institutions*, Zed Books, London, 2005. This was, inter alia, made through an obligation on actors establishing wind turbines to offer 20 per cent of the shares to local citizens. Danish Act on the Promotion of Renewable Energy, art. 3 (cited in Rönne 2010, p. 72).

to the purpose of the regulation. In regulations concerning financial guarantees for cleanup in the closing of mines or for future damages in high-risk businesses like nuclear power plants, the possibilities to enforce environmental conditions are directly linked to assurances of money. This means that, if the capital of the mother company is not located in the host state, authorities may want special assurances; see also section 5.4.1. Origin-neutral regulation might, however, differentiate the treatment for a number of reasons concerning the environmental effects, primarily the sensitivity at the location, the time for an administrative decision, or the size of the environmental impacts from one operator.

The sensitivity of the location may lead to more restrictive regulation on emissions from an activity, for example, permits for two different petrol stations may differ, if one of them is close to a sensitive groundwater aquifer. Regarding the environmental objective to prevent all forms of contamination of groundwater, the two stations are not in similar situations, since one of them needs to put more safeguards in place to mitigate the risks of pollution of the water. Or, if a specific location has already received much pollution by historical and now present operations, this may lead the authorities to prohibit further polluting operations in the area.<sup>367</sup> A newcomer is therefore restricted from establishing an operation, because of the environmental conditions.

New polluting activities often get more restrictive conditions than old ones, even if operating in the same sector. Regulation of pollution control usually requests higher standards for reducing emissions from a new facility than from an old one. New facilities must comply at least with the best available technology, while already established industries sometimes are allowed to emit pollutants according to older permits; see the discussion on changes in permits in section 3.4.2. A newcomer might even have to pay to reduce discharge from existing

367 Von Moltke takes the example of London phasing out lead in petrol much earlier than elsewhere, because of the high background level in the soil after centuries of burning coal. von Moltke 2004, p. 178.

facilities.<sup>368</sup> Pollution control systems, including the requirements of best available technique, used in the EU, aim to reduce the differences in requirements on emission reductions on industries. When better techniques or process methods are available in a sector, all operators have to comply. However, different time frames can still exist, allowing old operators to carry on with their older techniques, and thus in practice, work under different conditions, if compared to new operators. The reason for this practice is, of course, that many industries are considered important for the economy and for the society, and that imposing too stringent requirements too fast would risk their existence. It is also considered much easier for a new industry to comply with tougher conditions, as the costs to choose the more efficient techniques are less for the new operator, compared to using old techniques.

A third form of differentiation between operators, which is often made in systems of pollution control, is between different sizes of operations or industries. The small scale production, at household level or in small business, which typically emit less pollution per operator (but likely more per unit), might be exempted from obligations to apply for permits or the restrictions in general regulation. Different rules may also apply between medium-sized and bigger operations, for example, requiring operators with a production capacity over a certain amount to have a permit, while smaller operators need only notify the authorities.<sup>369</sup> However, if emissions are measured per production unit, some small-scale business, for example, small-scale mining, may cause greater contamination than large-scale production. Reasons for lenient

368 Within cap-and-trade systems quotas for emitting the regulated substances must be required from operators having a surplus of quotas. For a comprehensive of emissions quotas and cap-and-trade system for reduction of emissions see Olsen-Lundh, Christina, *Att ransonera utsläppsutrymme. En miljörettslig studie om utsläppshandel enligt Kyotoprotokollet och EU ETS*, Handelshögskolan, Göteborgs universitet (thesis), Göteborg, 2010.

369 The Swedish permit regulation is not unique in specifying different procedurals for different types of operators, Governmental regulation (1998:899) on hazardous activities and health protection list 450 types of operations as 'A', 4 200 as 'B' and 18 750 as 'C' requiring A to seek permit from the court, B to seek permit from regional authorities and C to notify its operations in local authorities, see Darpö 2010 p. 56.

standards for small-scale production might then be based on considerations of which actor is best placed to take the burden of reducing emissions, and which actor is best suited to reform the production methods. Both financially and in terms of know-how, big companies are often better suited to reform their production. From the enforcement perspective it might also be considered that the environmental authority can more easily supervise a small number of big operators than very many small operators, the choice of regulation thus being an argument of administrative efficiency.

One can in this context note that it has been suggested that multinational companies should apply the same standard of operation independent of the location and thus in some way be forced to keep, for example, the same emission standards on industrial plants in developing countries as they are bound to in their home country.<sup>370</sup> This criticism of double standards of transnational corporations implies, if one applies it to law and policy, that if the company is a foreign investment, the authority in the developing state should apply the standards prescribed in the company's home country, so-called 'home country standards'. Towards the domestic companies the same authority would still apply domestic standards during the time it takes to gradually develop more stringent standards in the developing state. Such a system was suggested, *inter alia*, by the UN body on transnational corporations in 1990.<sup>371</sup> Home country standards mean that foreign companies would be forced to keep up with a higher standard, which would transfer technology to the host state. However, it would certainly prove difficult for the regulating authority to apply different standards at different facilities, depending on the citizenship of the owners.<sup>372</sup> Further, developing host states have shown little interest to go this route, and

370 Companies originating from West European states with operations in developing countries are often accused for 'double standards' if the standard used in the developing country is inferior to what is used in Europe. For regulation see Home Country Measures, IIA series, UNCTAD/ITE/IIT/24, 2001.

371 A study by the UN Centre on Transnational Corporations (now at UNCTAD); see Fowler 1995, at 26, footnote 144.

372 UNCTAD 2001iii, p. 47; also see section 8.5.2.

any attempts to persuade those countries to raise their public environmental demands to levels set by developed states would 'smell' of neo-colonialism.

Hence, regulation on pollution control might differentiate the treatment for a number of reasons, concerning the environmental effects or the potential to develop better methods of production. As many regulations are implemented in respect of the operators individually through permits, unequal treatment may also occur as an effect of other individual aspects. The flexibility to consider many different aspects is sometimes argued as an advantage in relation to general regulation, which is hard to fit to all situations, especially when there is a need to balance the environmental gains against the economical costs.<sup>373</sup> The way to grant equal treatment in environmental permit systems is to make operators subject to the same procedural standards, rather than try to subscribe them to exactly the same environmental standards.<sup>374</sup> Thus, the appropriate and equal access for domestic and foreign investors to administrative and legal review processes plays an important role in granting operators equal treatment in permit systems.

Finally, in systems of economic incentives, such as tax reductions or subventions, there are often problems with making sharp distinctions between categories to which the regulation shall apply and those to which it should not. There are, in such situations, risks that operators with similar activities and environmental impact may be found on both sides of a regulation, for example, the categorisation of the sectors which need to hold emission quotas within a cap-and-trade system or to pay a certain tax.<sup>375</sup> From an environmental point of view, it is important that the system is seen as a whole, and that it is considered relevant to put more effort into restricting the actors polluting

373 This was explicit in the preparation of the Swedish environmental code; see SOU, 1991:4.

374 'The first and most fundamental right of the foreign investors is equal access to all domestic procedural safeguards against discrimination.' von Moltke 2004, p. 180.

375 For example, the case in Europe, where operators claimed they were discriminated against because of the obligation to hold emission quotas, while competitive actors for their CO<sub>2</sub> emissions were not: *Arcelor S.A. v. European Parliament and Council*. Discussed in Boute 2007. The claim was, however, overruled in court.

the most, in line with the principle that the polluter pays, and favouring those actors making use of cleaner technologies and methods.

### 3.8 The understanding of property rights and the compensation for interference by environmental law

The sixth and final area to be discussed concerns environmental perspectives on property rights, and the general obligation for states to compensate individuals when expropriating their property. The area reflects the investment treaty provision on expropriation, which has rendered an intense debate with regard to environmental regulation. The provision also covers indirect expropriation, which investors sometimes claim is the result of environmental regulation affecting the operation. This section explores different environmental perspectives on property rights relevant to the analysis of the relation to investment rules, which takes form in chapter 6.

In environmental law the property right concept is not clear-cut; there is no 'environmental doctrine' of property rights. Rules of environmental protection and sustainable use of natural resources correspond to the concept of property in various senses. Three different aspects are relevant to distinguish in looking at property rights from the view of environmental law: first, the preservation of nature, where landowners are bought out or otherwise compensated for the loss of property (environmental law making use of private property rights); second, health and environmental regulation, which targets the use of property and may make some operations less profitable, but where no compensation is paid (environmental law setting the boundaries for ownership freedom); and third, systems of collective rights of holding, or stewardship, of land or resources to retain a sustainable use (environmental law calling for collective property rights).

As for the first aspect, property rights can be used as instruments for environmental concerns. Bell and McGillivray give the example of the Royal Society for the Protection of Birds, one of Great Britain's most



powerful environmental NGOs, which sometimes buys land for protection since it considers land ownership a more reliable method for preservation of nature than statutory protection.<sup>376</sup> The ownership of land or coastal areas can be used to protect biodiversity both by private actors and by public bodies. The owner may then decide against exploitation and use management methods to conserve or restore the area to support biological diversity or other means to safeguard beneficial ecosystem services, such as the preservation of forests in catchment areas important for purification of water. The public interest of such measures may imply that the state, through a public body, take over areas owned by private persons through the means of expropriation. Compensation is then paid in accordance with domestic expropriation rules, and they are usually the same rules as those used when the state expropriates land for other public purposes, like exploitation for strategic infrastructure such as highways or railways. In some countries the state keeps the ownership of great areas of land to allow for public access and guarantee good order of preservation.<sup>377</sup>

In those cases the environmental instrument makes use of property rights in accordance with, or similar to, the liberal ideas of individual and exclusive rights.<sup>378</sup> However, much of the environmental concern towards contamination and sustainable use of natural resources rather emphasises the public function of property and explores pluralist ideas of property rights and obligations. A precondition to those perceptions holds that property in itself is a social construction reflecting the social and economic ideas of the society.<sup>379</sup>

The classic distinction between regulating the use of property or interfering with the property right itself becomes important as health and environmental regulation often may influence some or the whole

376 Bell 2006, p. 10.

377 France has used this form, Auby 2002.

378 Barnes, Richard, *Property rights and natural resources*, Hart Publishing, 2009, arguing that public property is disposed of by the public body in a similar way to private property.

379 And thus, there is no a priori reason to favour private rights over public interest in the regulation of property. See *ibid.* pp. 162–163.

of the profitability of an operation. Higher standards for health protection in goods or at workplaces may imply some higher costs for the operator, but they should not be seen as an interference with the operator's ownership. Nature protection policies often include measures where the state does not expropriate and take over the title of the land, but restricts the use of the land in various ways, for example, a general prohibition to cut trees which stand closer than ten metres from a river as protection of the water. There is in those measures no clear or universal practice of compensation. Sometimes the state offers compensation to the landowner for some of the infringements, as done, for example, in countries like Sweden and Costa Rica, when private landowners agree to special preservation rules for the land, and monetary compensation come as part of the agreement. However, the restrictions in use of the land may also be seen as a normal constraint of the property right in accordance with societal needs, and as such, the state will not render compensation. The difficult distinction between the property owner's right to compensation for infringements in the property and which regulations must be accepted without compensation is one of the hard questions coming under the spotlight in analysing IIA provisions on direct and indirect expropriation. From the perspective of environmental law, the obligation to compensate the owner for a regulation aiming at environmental protection may be counter to the polluter pays principle.

It is in this context, however, also relevant to look deeper into how property rights are understood in the area of natural resource management. The modern debate on property law tends to focus on private property. However, the Roman law distinctions between private property (*res dominium*), public property (*res publica*) and common property (*res communes omnium*) are still useful in some senses, as the latter two categories could be used in the field of natural resources.<sup>380</sup>

380 See Hamilton, Jonnette Watson & Banks, Nigel, Different Views of the Cathedral: The Literature on Property Law Theory, McHarg, *et al.* (Eds.), *Property and the Law in Energy and Natural Resources* chapter 2, Oxford University Press, Oxford, 2010, and Barnes 2009, for an overview of modern property law theory, especially that applicable to the field of natural resources.

In human rights law the notion of collective and community rights to land has been recognised as an accurate form of property in traditional or indigenous societies. Concessions to extract minerals or lumber in forests within areas of collective property cannot be accorded without the prior informed consent of the collective holding such rights.<sup>381</sup> This collective property is not exclusive in the way private property is perceived, for those persons included in the collective all have access to and benefits of the use to the resource, although this can be regulated within the collective by formal or informal or cultural rules.

Environmental regulation has been preoccupied by the difficulties of regulating common pool sources, for example, grazing land or fishes in a sea or lake, in an appropriate way. If the owner is the state, the community or an individual person (physical or legal) has not been the prime reason for the difficulties, but rather it is the fact that open access risks causing degradation of the resource, as shown by Garrett Hardin in his famous article in 1968.<sup>382</sup> The conclusion of Hardin that individual property rights were the only way to overcome the tragedy of the commons has been criticised by both modern economists<sup>383</sup> and historians<sup>384</sup> for neglecting to scrutinise traditional forms of resource management and to distinguish between open access and various forms of collective property. Rather, private property rights are criticised to be inappropriate in various ways from the viewpoint of the management of natural resources. The transferability of private property rights is conceived as problematic, as it drives for the maxi-

381 *Saramaka People case v. Suriname*, IACHR (serC) No 172 Judgment 28 November, 2007. Also see India's Forest Rights Acts 2006, which recognises tribes' and traditional forest dwellers' community rights, Rajamani, Lavanya, *Community Based Property Rights and Resource Conservation in India's Forests*, McHarg, et al. (Eds.), *Property and the Law in Energy and Natural Resources* chapter 22, Oxford University Press, Oxford, 2010.

382 Hardin, Garrett, *The Tragedy of the Commons*, *Science*, vol 162 (1968), p. 1243.

383 Ostrom, Ellinor, *Governing the Commons: The Evolution of Institutions for Collective Actions*, Cambridge University Press, Cambridge, 1990.

384 Pretty, Jules N., *Farmers' extension practice and technology adaptation: Agricultural revolution in 17–19th century Britain*, *Agriculture and Human Values*, vol 8:1–2, 1991

misation of individual preferences and thus may counteract long-term goals of sustained productivity for future generations.<sup>385</sup>

Ownership of subsoil minerals and energy resources are often vested in the state rather than the surface landowner. They could be extracted by concession from the state, with the surface landowner having more or less influence on concession and operation conditions. This system also applies to the continental shelf within a state's economic zones of the sea.<sup>386</sup>

Hence, property rights are a vital issue in environmental law, used and looked upon in different ways. Environmental regulation often takes the role as the boundary where the freedom for the owner to freely use his or hers property ends, to secure the health or prosperity for others otherwise affected. In natural resource management narrowly defined private property rights show their limits when the aim, instead of private freedom, is cooperation and sustainable use. To fully allow environmental policy space, these different aspects of property rights must be respected.

### 3.9 Summary of environmental law aspects of policy space analysis

The discussion in the sections above shows, in each of the six chosen areas, the kind of policy space host states need to maintain, implement, and develop environmental law. That serves as background for the analysis on policy space constraints in chapters 4, 5, and 6. This section goes further in analysing two aspects of environmental measures and regulations which challenge the ambition in investment law of stable investment conditions. These aspects may in some situations

385 See Barnes 2009, pp. 159–160, referring to Lucy, William N.R. & Mitchell, Catherine, *Replacing Private Property: The Case for Stewardship*, *Cambridge Law Journal*, vol 55, 1996, pp. 566–600.

386 See Rønne 2010, p. 65, where it is also noted that Denmark has based its permit system for offshore wind power on a concept of exclusive rights of the state, p. 70.

reveal the kind of regulation which runs the greatest risk of being constrained by this investment law ambition.

First, is the regulation or measure following a globally recognised standard of environmental protection, or is it an effect of a policy-maker that plays a frontrunner?

It is relevant to ask whether the regulation or measure in question is in line with some sort of common and global recognition of environmental legal instruments or minimum standards for corporate behaviour,<sup>387</sup> or if it develops new ground and makes the state a frontrunner that raises the standard beyond what can be considered a globally harmonised minimum. It is generally assumed in political-economy that states do not have any rational reasons to implement policies on production methods above the level in other countries.<sup>388</sup> If such assumption holds true, the concept of 'frontrunner' would be without meaning. However, as Gerd Winter notes, this cannot be a valid assumption.<sup>389</sup> There are several reasons for a state to break new ground and become a frontrunner in some environmental aspects, a favourable position for competition not the least. But also, reactions to cultural or social concerns may be more compelling for the state in forming its environmental policies than a theoretical economic rationale.<sup>390</sup> Unions demanding better working conditions or city citizens calling for better air quality may put a more heavy pressure. Therefore, it is meaningful to analyse the policy space for host states to set their own environmen-

387 For a discussion on the development of global environmental minimum standards, see section 3.1.2.

388 This holds for transnational environmental problems where all states gain from decreased pollution but states not implementing higher environmental standards on polluting industry may gain more (so called free rider).

389 Winter 2006 p. 19.

390 What is the economic rationale is also questioned, see *Towards a Green Economy – Pathways to Sustainable Development and Poverty Eradication*, UNEP, 2011 'One of the major findings of this report is that a green economy supports growth, income and jobs, and that the so-called trade-off between economic progress and environmental sustainability is a myth, especially if one measures wealth as stocks of useful assets, inclusive of natural assets, and not narrowly as flows of produced output.' p. 628.

tal standards above any international agreed ones. Indeed, in environmental law development many instruments and standards have been copied from a state or region that has moved ahead of global norms.<sup>391</sup>

Second, does the regulation or measure pay due regard to good governance, or is such considerations lacking in the implementation?

Good governance in the general meaning of accessibility, accountability, predictability, and transparency in public administration is considered instrumental for the overarching aim of sustainable development.<sup>392</sup> Good governance is used in a more specific meaning here (see section 3.4), covering administrative rules and principles that ascertain predictability and transparency for individual actors affected by public regulation. Administrative environmental law usually incorporates rules of good governance and various ways, for example, in clear time frames for validity of permits or concessions, transparency of assessment results, and reasonable transitions periods to adjust to more radical reforms. These rules of good governance build a common ground between environmental regulation and investment protection; see further in chapter 4. It is thus relevant to distinguish between environmental measures which reflect good governance and measures that may be lacking such reflection, for example, prohibiting all emissions from a central part of the operations without notifying in advance. For the latter category only the urgency in security regulation has legitimate reason to override some normal demands by good governance.

A general and relevant question is also how big the need is for policy development about certain issues by the host state. The more need there is for development, the stronger arguments for avoiding constraints or risk of constraints of policy space. If it is an issue where there is a big need for policies to be developed, it is relevant to consider whether a general exemption of that issue from the investment treaty would be possible. Hence, for the second category in policy space analysis, three

391 Tews 2006.

392 Morita, Sachiko & Zaelke, Durwood, Rule of law, good governance, and sustainable development, Paper on the 7th international conference on environmental compliance and enforcement, Marrakech, Morocco 2005.

questions are added to the list. The whole questionnaire is reproduced in Appendix 2.

## Specification 2 of Policy Space Analysis Questionnaire: Environmental Law

### Average global conduct or frontrunner?

- Are the regulations and measures at stake following a globally recognised standard of environmental protection, or is it an effect of a policymaker that plays a frontrunner?

*A regulation in line with global conduct should run less risk of being constrained by investment law, while a frontrunner regulation might run a greater risk.*

### Good governance

- Do the regulations and measures at stake provide for accessible, transparent and predictable decisions for the operator?

*Yes indicates there should be less reasons to worry about a conflict with investment law.*

### General need for policy development

- Is the host state in need of development of environmental law and policy?

*Yes indicates that policy constraints must be avoided.*





# 4 Fair and equitable treatment

## 4.1 Introduction

The provision of fair and equitable treatment (FET) is included in most international investment treaties and is the provision most frequently invoked in IIA disputes, both generally and among the disputes challenging environmental regulations or measures.<sup>393</sup> The obligation on host states to accord foreign investments 'fair and equitable' treatment implies that the way states carry out their environmental regulation must fulfil standards of good governance.<sup>394</sup> It is, for example, a common interpretation that the provision grants investors respect by the host state for their legitimate expectations concerning the regulatory environment for the investments. The provision has implications for wide areas of environmental law.

This chapter will describe and analyse the IIA substantive provision on fair and equitable treatment in relation to general environmental law. Recognised elements of the FET provision are due process, non-denial of justice, and respect for legitimate expectations. Those ele-

393 Dolzer & Schreuer 2008, p.119. Subedi 2008, p. 63.

394 Newcombe and Paradell mean that fair and equitable treatment serves ' [...] a key role in promoting and protecting foreign investment by assessing government conduct based on internationally accepted standards of good governance.' Newcombe & Paradell 2009, p. 234.

ments are analysed further and considered in relation to four of the six selected concepts of environmental law (see chapter 1): the understanding of prevention and risk assessment, stability and predictability, third-party participation and access to justice, and multi-tiered governance structures. From this analysis conclusions are made regarding the environmental policy space of host states. The analysis starts by considering the main varieties in the formulation of FET that exist in IIAs and discusses whether any formulation puts less restriction on environmental policy space.

### Perspective on the provision on fair and equitable treatment

Fauchald says that, when interpreting awards of IIA tribunals, we may distinguish between three main approaches of arbitration tribunals to fair and equitable treatment provisions.<sup>395</sup> One approach is to regard the requirement as a general standard that provides tribunals with great freedom to decide a dispute regarding equity in its most general sense, *ex aequo et bono*. A second approach would be to regard the standard as equivalent to general administrative law standards developed to prevent abuse of public power. The third approach would be to regard the standard as referring to rules of customary international law on the treatment of aliens. While the first approach may explain some of the diversity in IIA jurisprudence concerning fair and equitable treatment, it is not accepted by most commentators of IIAs.<sup>396</sup> The third approach is what tribunals often say they use, especially in interpreting an IIA where the fair and equitable treatment provision explicitly is linked to international customary law (see further in section 4.3). However, when relating historical sources of customary international law to situations of modern time, tribunals inevitably set a standard in relation to existing national administrative measures. Schill means that tribunals have a casuistic instead of a linguistic method of identify-

395 Fauchald 2006 p. 16.

396 Fair and Equitable Treatment Standard in International Investment Law, OECD Working Papers on International Investment 2004/3, 2004, p. 40.

ing certain public behaviour as fair or unfair.<sup>397</sup> According to him, the overarching theme of the identification process is rule of law and its obligation for states to perform good governance. While the concept of good governance also lacks clear and globally identified content, the argument still supports the view that IIA jurisprudence reflects an administrative standard to prevent abuse of public power. That is also the perspective of this work.

## 4.2 Background

The provision on fair and equitable treatment is today one of the key provisions in IIAs.<sup>398</sup> The provision sets a standard for host state treatment of foreign investments and can be seen as a treaty version of the customary law standard ‘international minimum standard of treatment’; see section 6.2. The standard sets an absolute level of what is ‘fair’ treatment, which is not directly related to how the host state treats domestic investments or foreign investments from other states, which are the concerns of the specific provisions on discrimination, national treatment, and most favoured nation treatment. The impacts for public measures and environmental regulation essentially depend on which level of standard of fair treatment is used. If the standard used is high and detailed and, for example, prescribes certain time frames and rules of communication by the authorities in permit procedures, it may imply comprehensive restrictions for public measures and national environmental administration.<sup>399</sup> On the other hand, if

397 Schill, Stephan, Fair and Equitable Treatment under Investment Treaties as an Embodiment of the Rule of Law, International Law and Justice Working Papers 2006 no 6.

398 For general commentary on fair and equitable treatment, see Newcombe & Paradell 2009; McLachlan, Shore & Weiniger, 2007; Dolzer & Schreuer 2008; Sornarajah 2004, OECD Working Papers on International Investment 2004/3; Fair and Equitable Treatment UNCTAD Series on issues in international investment agreements, 1999; and Tudor, 2008. Some IIA do not include a provision of fair and equitable treatment; a survey of 365 BITs found that 19, mostly Japanese treaties, did not include the provision, *ibid.* p. 23.

399 van Harten, 2007, pp. 86–90.

the standard used only prescribes that states shall not deny foreign investors access to justice and shall restrain from acts of hostility, the impacts on ordinary and sound environmental measures are limited. Dolzer rightly observes that ‘Depending upon how it is interpreted and applied by the tribunals, the principle [of fair and equitable treatment] has the potential to reach further into the traditional *domaine réservé* of the host stat than any one of the other rules of the treaties.’<sup>400</sup>

The content of the provision of fair and equitable treatment is inherently unclear, an often commented fact that some writers suggest is the reason the provision has attracted much attention by investors regularly claiming breaches of this provision.<sup>401</sup> Fair and equitable treatment is often described as a general clause, filling ‘gaps’ from other more specific provisions.<sup>402</sup> As such, it may be interpreted to include a general principle of good faith in providing stable and consistent frameworks for investments.<sup>403</sup> This broad and undefined scope of the provision has given tribunals space to determine the standard of treatment inconsistently.

### 4.3 Expressions of the provision in IIAs

The concept of fair and equitable treatment was included in the proposal for the Havana Charter, in the wording ‘just and equitable treatment’ and ‘just terms’ on ownership of investments. The United States used similar wording in its FNCs during and after Second World War and later on multilateral, regional, and bilateral IIAs have included a provision for ‘fair and equitable treatment’ or used similar formulations.<sup>404</sup> In current IIAs the provision is expressed in various ways, and

400 Dolzer, Rudolf, *The Impact of International Investment Treaties on Domestic Administration Law, International Law and Politics*, vol 37, pp. 953–972, p. 964.

401 Newcombe & Paradell 2009, p.263; van Harten, 2007, p.87.

402 See, inter alia, Dolzer & Schreuer 2008, p. 122.

403 Ibid. p.122; Newcombe & Paradell 2009, p.277.

404 ‘Fair’ and ‘equitable’ are not to be seen as two standards but represent a single standard; see Dolzer & Schreuer 2008, p.123. Tribunals have found different formulations like ‘equitable and reasonable’ synonymous with ‘fair and equitable’

writers tend to distinguish between autonomous provisions, provisions expressing the standard as part of, or side by side with, general international law, and provisions more specifically expressing the international minimum standard of treatment.<sup>405</sup> In some of the IIAs in the 2000s, as will be shown in the end of this section, the provision includes language indicating that only denial of justice or treatment disrespecting due process could be invoked.

In the first category there are numerous European BITs which express the provision either on its own or together with language to restrain from unreasonable, arbitrary, or discriminatory behaviour towards the operations of the investment:<sup>406</sup>

Investments of investors of each Contracting Party shall at all time be accorded fair and equitable treatment in the territory of the other Contracting Party.

(China–Germany BIT 2005, art. 3(1))

Investments of investors of either Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party. Neither Contracting Party shall impede investors of the other Contracting Party by unreasonable or discriminatory measures in its territory as regards the management, maintenance, use, enjoyment or disposal of investments.

(Iceland–Lebanon BIT 2004, art. 2(2))

The fair and equitable treatment provision as a simple treaty clause could be seen as an autonomous concept of the IIA to which ordinary treaty interpretation in accordance with the Vienna Convention applies. As such, it has been suggested that it implies, or may imply, a

(Hungary–Norway BIT 1992, art. 3, interpretation in the case *Parkerings Compagniet*, para 278).

405 See *ibid.* pp. 121–122. More sophisticated categorisations are found in Tudor, 2008 (7 categories) and Newcombe & Paradell 2009 (8 categories).

406 See also Japan–Switzerland EPA 2009, art. 86(1); Chile–U.K. BIT 1996, art. 2(2); Guatemala–Sweden BIT 2004, art. 2(3); Costa Rica–Netherlands BIT art. 3(1); ECT art. 10(1); and OECD 1967, draft art. 1.

standard of good governance or good administration which is different from and sets a substantially higher level of treatment than the international minimum standard.<sup>407</sup> Others, however, suggest that international law offers good guidance to interpreting the content of that treaty clause literally.<sup>408</sup> Analysis of international law is, however, unavoidable, if the provision is expressed as in the second category, as, for example, in most of the French IIAs:

Chacune des Parties contractantes s'engage à assurer un traitement juste et équitable, conformément aux principes du droit international, aux investissements des investisseurs de l'autre Partie contractante sur son territoire et dans sa zone maritime, et à faire en sorte que l'exercice du droit ainsi reconnu ne soit entravé ni en droit ni en fait.

(France–Latvia BIT 1992, art. 3.)

However, irrespective of an expressed notion of international law, tribunals have often observed that, when applied in specific situations, the treaty standard of fair and equitable treatment at the same time is considered to be the international norm.<sup>409</sup> A more intense debate about the relation between the provision on fair and equitable treatment and international law has taken place in the North American IIA practice. Here the provision mainly is expressed as in the third category, that is, the international minimum standard of treatment of aliens, for example:

*Minimum standard of treatment:* Each Party shall accord to investments of investors of another Party treatment in accordance

407 *Azurix v. Argentine Republic*, ICSID ARB/01/12 Award 14 July, 2006, para 361, interpreting the Argentina–USA BIT which provides for fair and equitable treatment and treatment not less than that required by international law, commented on in Dolzer & Schreuer 2008, p. 126. Also see Schill 2006, p. 10, and Mann 1990.

408 Subedi 2008, p. 65.

409 *Saluka v. Czech Republic* 2006, para 291; *Occidental Exploration and Production Company v. Ecuador*, LCIA/UNCITRAL UN3467 Award 1 July, 2004, para 189–190; and *CMS v. Argentina* 2005 para 283–284. Commented on in Dolzer & Schreuer 2008, p. 126.

with international law, including fair and equitable treatment and full protection and security.

(NAFTA, art. 1105(1))

This provision in NAFTA was clarified by an 'interpretation note' from the NAFTA joint trade committee in 2001 declaring that the concept of fair and equitable treatment does not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.<sup>410</sup> Subsequently, the US model BIT 2004 incorporates a similar clarification, which also been exported into other IIAs.<sup>411</sup>

The customary international minimum standard includes the treatment of property of aliens.<sup>412</sup> However, writers in general international law have difficulties finding any clear and comprehensive content of this standard beyond constraints to state deprivation of property of aliens and severe discrimination.<sup>413</sup> One of the leading cases of the minimum standard of treatment is the *Neer* case from the beginning of the 1900s, dealing with the Mexican state's responsibility to investigate the death of a person from the USA. The claims commission adjudging the case held Mexico responsible and considered the treatment given to amount 'to an outrage, to bad faith, wilful neglect of duty or an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.'<sup>414</sup> Such basic standard of treatment has, however, not been required by IIA tribunals interpreting the FET provision which refers to the international minimum standard. Various NAFTA tribu-

410 NAFTA Free Trade Commission, 31 July 2001. Published at [http://www.sice.oas.org/TPD/NAFTA/Commission/CH11understanding\\_e.asp](http://www.sice.oas.org/TPD/NAFTA/Commission/CH11understanding_e.asp) (viewed 2010-07-27).

411 US model BIT 2004 art. 5(2); US–Chile FTA 2003, art. 10.4(2); and Jordan, Singapore, Uruguay, Peru, Colombia, CAFTA-DR art. 10.5.2. Also see India–Japan FTA 2011, art. 87.

412 *Oppenheim's International Law*, 1992, p. 910.

413 *Ibid.* p.931–933. Sornarajah 2004, p.148–151, argues that it is virtually only in the field of compensation for expropriation that the standard exists in treatment of property, and to apply it to regulatory mechanisms would be difficult.

414 *Neer* case, p. 61–62.

nals have stated that the standard must evolve over time and according to context: the standard is 'not static but is capable of being developed in a modern context'.<sup>415</sup> While some tribunals see it as the standard itself that has turned into something less demanding than the historical 'outrageous', others have concluded that the definition from the *Neer* case may still be valid, but what the international community views as outrageous may change over time.<sup>416</sup> There is a tendency for IIA tribunals to see the case law of previous IIA tribunals as directly constituting customary international law, and hence not give considerable attention to the fact that those arbitrations are based on treaties.<sup>417</sup> Some writers, however, discuss whether an 'evolving approach' is consistent with the traditional creation of customary international law, and maintain that the development in the field of IIA jurisprudence does not change the general international standard.<sup>418</sup>

415 *ADF Group Inc. v. United States*, ICSID ARB (AF)/00/1 Award 9 January, 2003, para 180.

416 'The Tribunal finds apparent agreement that the fair and equitable treatment standard is subject to [...] a change in the international view of what is shocking and outrageous.' *Glamis Gold Ltd. v. The United States of America*, Award 14 May, 2009, para 613, which refers to *Mondev International Ltd v. United States of America*, ICSID ARB(AF)92/2 Award 11 October, 2002, para 116. The lengthy survey on the subject in *Merrill & Ring Forestry L.P. v. Government of Canada*, 2010, also results in sympathy for this evolutionary form of the FET provision, 'Today's minimum standard is broader than that defined in the *Neer* case and its progeny', paras 209 and 213.

417 See, for example, the review of previous NAFTA tribunals' interpretation of article 1105 in *Waste Management Inc. v. United Mexican States*, ICSID ARB(AF)00/3 Award 30 April, 2004, paras 110–115.

418 For example, Sornarajah concludes the minimum standard of treatment: 'One knows that there is such a standard but what the standard contains and what its modern limits are, are unclear.' Sornarajah 2004, p. 329. Also Subedi 2008, p. 136. Vasciannie follows the same line and means that the fair and equitable treatment provision not expands the international minimal standard of treatment, see Vasciannie, Stephen, *The fair and equitable treatment standard in international law and practice*, *BYIL*, vol 70, 1999, p. 104. Also Brownlie expresses a critical view on the movement to extend the content of the standard, 'extending it to new subject matter, and relating internal affairs and local law to international responsibility to a degree which the majority of states would find intolerable'. Brownlie 2008, p. 505.



Hence, although the fair and equitable treatment provision is formulated as a minimum standard of international law, which at the outset sets a lower standard of treatment with more flexibility and space for the national administrative measures, this is apparently not always the result after the arbitration tribunal interpreted the FET. The standard of treatment prescribed by the FET provision may, in any case, be interpreted to go beyond the basic standard of 'outrageous', or acts of bad faith.<sup>419</sup> Nor is there any requirement of impairment for the investor.<sup>420</sup> Therefore, in the present state of IIA jurisprudence, there is not necessarily a difference in the constraint of environmental public measures whether an IIA includes the FET provision as a simple treaty standard or ties it to international customary law.

Proposals to limit the standard to treatment in bad faith have so far not been included in IIAs.<sup>421</sup> One argument is that IIAs in general express 'positive' requirements and do not prescribe avoidance of prejudicial conduct.<sup>422</sup> Another question is whether formulations that specify the FET provision towards procedural justice, that is, denial of justice and due process, would lead to more restrictive use of the provision. The US IIAs in the 2000s, including the CAFTA, contain such clarification:

'Fair and equitable treatment' includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world.

419 Newcombe & Paradell 2009, p. 277, referring to IIA cases CMS, Azurix, Loewen, Mondev, Occidental, and Tecmed. See also Schill 2006. There are, of course, possibilities for a tribunal to interpret the FET provision to require such a high standard; see Alex Genin, Eastern Credit Limited, A.S Baltoil v. Estonia, ICSID ARB/99/2 Award 29 June, 2001, para 367.

420 Newcombe & Paradell 2009, p. 26.

421 Fair and Equitable Treatment, IIA serie UNCTAD 1999, p. 12: 'It is possible to identify certain forms of behaviour that appear to be contrary to fairness and equity in most legal systems and to extrapolate from this the type of State action that may be inconsistent with fair and equitable treatment.'

422 Dolzer & Schreuer 2008, p. 131, referring to MTD, para 113.

Also, IIAs concluded by ASEAN in the late 2000s restrict the provision to procedural justice:

Fair and equitable treatment requires each Member State not to deny justice in any legal or administrative proceedings in accordance with the principle of due process.

(ASEAN–Australia IIA 2009, art. 11(2)(a))

Fair and equitable treatment refers to the obligation of each Party not to deny justice in any legal or administrative proceedings.

(ASEAN–China IIA 2009, art. 7(2)(a))

The FET provisions in those IIAs have so far not been the basis for any claim. However, restricting the provision to cover merely the procedural aspects may restrain the IIA interpretation from going into a valuation of the reasonableness of the substantive content of regulation and limit the legal question for the IIA tribunal to the issues of procedure.

Some IIAs add a provision stressing the sovereign right of a state to regulate. Such provision may influence the consideration of the appropriate level for the standard and how specific public actions should be interpreted.<sup>423</sup> The IIA provision of the right to regulate is discussed further in chapter 8.

## 4.4 Elements of FET and environmental IIA disputes

The provision on fair and equitable treatment is frequently invoked in IIA disputes. All of the environmental cases contain a claim of breach

423 The tribunal in the Saluka case concluded that ‘the determination of a breach [of a FET provision] requires a weighing of the Claimant’s legitimate and reasonable expectations on the one hand and the Respondent’s legitimate regulatory interests on the other’, *Saluka v. Czech Republic* 2006, para 306.

of the provision.<sup>424</sup> There have been mainly four different types of disputes where environmental measures are alleged to conflict with fair and equitable treatment: (1) environmental permits are denied or combined with constraints on arbitrary grounds or based on unjustifiable distinctions,<sup>425</sup> (2) environmental permits are unduly delayed by the authorities,<sup>426</sup> (3) environmental permits are revoked due to previous errors on the side of the actor or the authority,<sup>427</sup> or (4) change in environmental regulation restricts future profitability of the investment.<sup>428</sup> Hence, the environmental IIA case law indicates there can be conflicts between environmental regulation and the provision on fair and eq-

424 All ten awards on the merits in known environmental cases (except for *Saar Papier/Lutz Ingo Schaper*, for which only an appeal to the national court has been made public) discuss the provision in some depth, and in cases settled, withdrawn, or abandoned, and cases still pending at the time of publication, the notice of the claim usually invokes the FET provision; see Appendix 1.

425 *Abengoa, S.A. y COFIDES, S.A. v. United Mexican States*, ICSID ARB(AF)/09/2 2009 (not concluded at the time of publication); *Gold Reserve Inc. (Las Brisas) v. Bolivarian Republic of Venezuela* ICSID ARB(AF)/09/1, 2009 (not concluded at the time of publication); *Clayton/Bilcon v. Government of Canada*, 2009 (not concluded at time of publication); *Maffezini v. Spain* 2000; *Metalclad Corporation v. United Mexican States*, ICSID ARB(AF)97/1 Award 30 August, 2000; *MTD Equity Sdn Bhd. & MTD Chile S.A. v. The Republic of Chile*, ICSID ARB/07/7 Award 25 May, 2004; *Georg Nepolsky v. Czech Republic*, Award February 2010 (unpublished); *Pac Rim (El Dorado) v. El Salvador*; *Tecmed v. Mexico* 2003; *Vattenfall v. Germany* 2011; *Vieira/CONCAR v. Chile*, ICSID ARB/04/7 Award 21 August, 2007; *Inter-Nexus Consulting Services v. United States of Mexico*, 2011 (not concluded at the time of publication); *Dow Agro Siences LCC v. Government of Canada*, Settled, 2011; *Vitto G. Gallo v. Canada*, Award 16 September 2011(unpublished at the time of publication).

426 *Vannesa Venture (Las Crusitas) v. Costa Rica*, Withdrawn, 2003; *Las Brisas/Gold Reserv v. Venezuela*; *Pac Rim (El Dorado) v. El Salvador*; *Vattenfall v. Germany* 2011.

427 *Empresas Lucchetti, S.A. and Lucchetti Peru, S.A. v. Peru*, ICSID ARB/03/4 Award 7 February, 2005.

428 *Chemtura Corporation v. Canada*, Award 2 August, 2010; *Glamis Gold v. USA* 2009; *Parkerings Compagniet AS v. Republic of Lithuania*, ICSID ARB/05/8 Award 11 September, 2007; *Plama v. Bulgaria*; *Saar Papier/ Lutz Ingo Schaper v. Poland*, (Awards unpublished), 1995 (Award unpublished); *San Sebastian v. El Salvador* 2011; *S.D. Myers Inc. v. Government of Canada*, Award 13 November, 2000; *Inter-Nexus v. Mexico*; *Philip Morris v. Australia*.

uitable treatment in the administrative process of environmental authorities or at the change of environmental standards.

Understanding the provision on fair and equitable treatment, investment tribunals and writers have analysed various elements which may be inherent in the concept of 'fair and equitable', for example, non-denial of justice, due process of law, reasonability, non-arbitrariness, non-discrimination, and respect for legitimate expectations.<sup>429</sup> In disputes with the administrative process of environmental authorities or changes of environmental standard those elements interact in different ways. The most relevant FET elements to analyse in this regard are due process, non-denial of justice, and respect of legitimate expectations. Those elements will therefore be analysed in the following sections.

## 4.5 Due process

The general duty on regulatory authorities, bound by IIAs, to accord due process in the treatment of foreign investors encapsulates a range of associations about good administrative behaviour: transparency, lack of arbitrariness and inconsistency, non-discrimination, and abstention from use of powers for improper matters, coercion, and harassment by state authorities, as well as acts of bad faith. It should be noted that due process is used in different senses, from restriction to denial of justice to a broad concept of state responsibility. This work refers to it in an intermediate sense.<sup>430</sup> The more narrow sense is covered by the concept of non denial of justice, which is discussed in the following section. The different connotations of due process listed above seldom

429 OECD Working Papers on International Investment 2004/3. The elements identified are obligation of vigilance and protection, due process/denial of justice/arbitrariness, transparency, a combination of 'respect of basic expectations, transparency and lack of arbitrariness, and an autonomous fairness element'. See also McLachlan, Shore & Weiniger, 2007, pp. 226–247; Newcombe & Paradell 2009, p. 238–250; and Tudor, 2008.

430 See OECD Working Papers on International Investment 2004/3 p. 29 referring to Garcia-Amador *et al.* 1974. Due process may also be a notion of formal legality in terms of rule of law, McLachlan, Shore & Weiniger, 2007, p. 239.

function independently to construct a breach of the fair and equitable treatment provision, but rather describe the unfairness of administrative behaviour in combination. It is hard to find uniform descriptions for the level to which requirements for due process fail to the extent that a breach of a fair and equitable treatment provision occurs.

The obligation of due process in most senses includes an obligation not to discriminate. However, as IIAs often includes a special provision on discrimination, the national treatment, the analysis here does not go into that concept.<sup>431</sup> Discrimination, as in being subject to less favourable conditions than accorded other similar subjects, is subsequently analysed in chapter 5.

#### 4.5.1 Multi-tiered governance and complex administrative procedure

The elements of due process are directed at the administrative procedures affecting the foreign investor. When public authorities carry out permit procedures or make other individual decisions, due process must apply. To plan and carry out operations with impact on the environment normally requires extensive communication with the public and authorities concerning the environmental issues for information about regulation and standards, as part of permits or notification procedurals, and in supervision of the ongoing operations; see section 3.6. The acts of authorities may lead to extensive and costly demands for environmental inquiries or changes in production, long periods waiting for further decisions, or wearisome moments for the operator when operations have the needed permits rejected, perhaps on grounds for which the operator does not see any reason.

When dealing with foreign investments covered by an IIA and the standard of fair and equitable treatment, we are thus searching for an

431 The wider concept of discrimination including unjustifiable distinctions is covered by the FET provision in the same meaning as lack of arbitrariness and inconsistency. It is, however, my understanding that a breach of the specific non-discrimination obligation in national treatment would suffice for a breach of the fair and equitable treatment provision, if the IIA only included the latter.

international standard of due process. A conflict between international due process and domestic safeguards for the rule of law within administrative law applied in environmental matters should occur only in situations where international investment protection standards are considered to set a higher standard than the national standard of administrative law. This would be the case in states where there is a lack of administrative law, or more likely, where both the authorities and the courts are in no shape to uphold the law. However, the IIA cases we are seeing today seldom deal with those kinds of situations. They deal with exercise of authority in states like Mexico, Chile, and Germany. This is partly because the international standard of due process is applied in individual cases parallel to national systems of legal reviews and correction of administrative errors, since the practice in IIAs is to give recourse to international arbitration without domestic courts or an administrative review process having dealt with the case; see section 2.5.1 and the discussion in section 3.6. IIA tribunals are thus dealing with cases where the domestic safeguards would correct the situation for the claimant in accordance with domestic law.

The IIA tribunal is, then, applying the international provision of fair and equitable treatment to the same situations where domestic courts would have applied the host state's administrative law principles. As a respondent state in an IIA dispute, it might be provoking to see the tribunal depart from essential concepts in host state administrative law and end up understanding the acts of the authorities in a different way than a domestic court would. For example, in the much analysed *Metalclad* case the parties had very different views on the discretionary powers of Mexican municipalities when issuing construction permits; while *Metalclad* asserted that the municipalities must issue the construction permits purely on the basis of physical construction and defects of the site, Mexico held that the discretion of the municipality extended to various aspects concerning the appropriateness of the building. The view in this matter clearly had relevance for the consideration whether public authorities in Mexico had treated the company fairly and equitably. The tribunal partly agreed with *Metalclad* on this and held that, based on the totality of the circumstances,

there had been a lack of orderly process and timely disposition on the part of Mexico.<sup>432</sup>

The uncertain content of the standard provided for in the IIAs has also led to some quite extensive interpretations by tribunals. One often cited award is the *Tecmed* case, where the tribunal concludes what it regards as the obligation implied by the fair and equitable treatment provision in the Spain–Mexico BIT 1996 (this provision refers to international law):

The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations.<sup>433</sup>

Such a far-reaching obligation of consistency is surely a challenge for the environmental administration in any state of the world. Or, as Zachary Douglas described the tribunal's conclusion: 'a description of perfect public regulation in a perfect world, to which all states should aspire but very few (if any) will ever attain'.<sup>434</sup>

432 *Metalclad v. Mexico* 2000 paras 74–101. In the appeal process, however, the breach of the fair and equitable treatment provision was set aside, as the tribunal was found to have involved decisions on matters beyond the scope of the submission to arbitration (the obligation of transparency is placed outside NAFTA, chapter 11), *Metalclad v. Mexico*, Supreme Court of British Columbia, Canada, Appeal 2 May, 2001, para 136.

433 *Tecmed v. Mexico*, para 154. This far-reaching judgment was made on the basis of the principle of good faith, which the tribunal meant must guide the interpretation of the fair and equitable treatment provision.

434 Douglas 2006, p. 28.

Having different administrative procedures setting environmental standards and a mix of independent or coordinated local and expert authorities gives the field a complex structure and many challenges in providing strictly coherent decisions. It is important that experts of one authority may give their views on environmental risks of a project, notwithstanding that some other authority or state representative has welcomed the project in other aspects. Nor can the obligation on transparency be so strong that authorities, prior to their full assessment, need to specify the environmental standards which they are going to require. From the perspective of the IIA and the principle of unity of the state, all actions of public authorities, including municipalities, and public actions of publicly owned companies are attributions of the state party and concern a dispute on state responsibility.<sup>435</sup> However, since this is a principle in international law it does not regard the fact that within states, public authorities from their different tasks and perspectives, may express different opinions about the feasibility of projects as part of their assignments. Issues of consistent manner and transparency are closely related to whether the investor is aware of the assessment procedures and all approvals required by different authorities; see further in section 4.5.3.

Actions by public authorities exceeding domestic regulations do not in themselves entail state responsibility and a breach of the provision of fair and equitable treatment.<sup>436</sup> But IIA tribunals may take note of such unlawful conduct and sometimes discuss in great detail the administrative steps which should be taken by host state authorities.<sup>437</sup> Several environmental IIA disputes contain the concern of ex-

435 ILC articles on responsibility of states 2001, art. 4.

436 ILC articles on responsibility of states 2001, art. 7(10) and ELSI case: 'What is a breach of treaty may be lawful in the municipal law and what is unlawful in the municipal law may be wholly innocent of violation of a treaty provision.' para 73.

437 In the case *Middle East Cement Shipping*, concerning, inter alia, the seizure of a ship, the tribunal made quite detailed instructions: 'A matter as important as the seizure and auctioning of a ship of the Claimant should have been notified by a direct communication for which the law No. 308 provided under the 1st paragraph of Art. 7, irrespective of whether there was a legal duty or practice to do so by registered mail with return receipt requested as argued for by Claimant.' *Mondev v. USA* 2002, para 143.



ceeded time limits in EIA or permit processes: In the *Clayton/Bilcon* case the EIA for a marine terminal for basalt in Nova Scotia was set for special review, which, according to the claimant, exceeded normal procedure.<sup>438</sup> In the *Vattenfall* case the approval of a permit for a new coal-fired power plant exceeded the strict time limit of seven months in the German law and took almost two years.<sup>439</sup> However, one must note that parallel to upholding good service and keeping to its administrative time limits, the host state has a responsibility to properly examine the projects to prevent environmental damage. If an IIA tribunal lets an overriding of a national administrative norm amount to state responsibility and potential breaches of IIAs, it should also acknowledge this environmental responsibility.

The obligation of states to protect and preserve ecosystems has evolved in international law. For example, in the *Pulp Mills* case concerning the establishment of pulp mills at the Uruguayan beaches of the river border to Argentina without the foregoing consultations with the latter state, as pulp mills have a potential to do harm to the surrounding environment, the ICJ held that it 'may now be considered a requirement under general international law to undertake an environmental impact assessment where there is a risk that the proposed industrial activity may have a significant adverse impact in a transboundary context, in particular, on a shared resource'.<sup>440</sup> In the Energy Charter Treaty there is also a provision which requires the state parties to promote transparent environmental assessment and subsequent monitoring of environmentally significant energy investment projects.<sup>441</sup>

As argued above, it is problematic to define an objective standard of treatment including consistency and timely process at a higher level than the absolute failure of administrative procedures and the additional failure of national administrative courts to give redress. If it were to be an internationally acknowledged standard, it could hardly be set at the level of domestic regulation in Canada or Germany. If so,

438 Statement of claim, 30 January 2009, art. 36(c).

439 Request for arbitration, 30 March 2009, art. 15.

440 Pulp mills case, para 204.

441 ECT, art. 19. Fauchald 2006, p. 4.

host states with weaker administrative capacity constantly risk receiving IIA challenges based on national environmental decisions.

From the viewpoint of upholding environmental regulations, it is promising to see that in some IIA cases legitimate and objective public purposes have been accepted as justifying circumstances for less coherent administrative procedures. The cases have concerned scrutiny of Estonian banks<sup>442</sup> and enforcement of media law or regulation of the banking sector in Czech Republic.<sup>443</sup> Health and environmental protection are widely and generally acknowledged as legitimate public purposes. Thus, in such public matters as health and environmental protection it is clearly possible to interpret the provision in a way that public policies may be fulfilled, even if there is a less than perfect administrative process. Hence, if there is an interpretation of due process in environmental administrative procedurals that is respectful of the multi-tiered governance structure and differences in capacity existing among environmental authorities, there should be little risk of constraints of policy space.

### 4.5.2 Third-party participation and decentralised decision making

Operations with potentially large environmental impact may meet local opposition. Several environmental IIA cases have concerned the impact of local political resistance in the decision-making process of permits for polluting activities: The above-mentioned *Metalclad* case concerned the operation permit for a new landfill for hazardous waste, and while this permit was granted from a central authority in the federal state of Mexico, the local municipality denied a permit for construction after resistance from the local community arguing the landfill would be too close to the village. The tribunal noted that there was no clarity of the requirements for receiving a building permit, that is, lack of transparency towards the investor, and concluded that the municipality had taken into account improper considerations in deny-

442 *Genin v. Estonia* 2001.

443 *CME v. Czech Republic* 2001 and *Saluka v. Czech Republic* 2006.

ing a building permit, as well as having failed to apply an orderly and timely process for the permit (a thirteen-month process—the building was almost completed before the decision was taken).<sup>444</sup> Rather similar circumstances occurred in another case, *Abengoa v. Mexico*, where the Spanish constructor of a waste treatment facility complained of obstacles in the permit process, including arbitrary rejection of a key construction permit renewal and intimidating protests by local citizens. In yet another case, also concerning land fills for waste in Mexico, the *Tecmed* case, the tribunal set remarkably high standards of consistency and transparency, as was shown above. The case concerned a renewal process of a permit for a landfill for waste where the authority, after some period of local resistance, decided not to renew the permit. The tribunal, awarding Mexico to pay compensation to the operator of the landfill, had the view that the authorities should not consider local political circumstances, but base their decision on the company's earlier compliance and the factors explicitly mentioned in the national environmental legislation.<sup>445</sup>

In the case *Vattenfall v. Germany* the company was planning for a new coal-fired power plant, an activity that was much debated for its emissions of greenhouse gases and local environmental impacts. Before the permit procedure was finalised, there were local elections, and in part, new parties come into government. The permit which later on was decided included quite severe restrictions in the use of cooling water from the river Elbe, arguing the aquatic life would be threatened if the water levels became too low and the water temperature too high. The company claimed that the restrictions and the delay of the permit were caused by the new political situation, and by taking political considerations into account, the government contributed to breaching the fair and equitable treatment provision.<sup>446</sup>

Those examples show that investment law may have almost the opposite view to environmental law on how to deal with opinions of lo-

444 *Metalclad v. Mexico* 2000, paras 90–93; also see McLachlan, Shore & Weiniger, 2007, p. 241.

445 *Tecmed v. Mexico* 2003, para 127.

446 *Vattenfall v. Germany* 2011, request for arbitration, paras 15–40.

cal populations. Legal approaches and instruments in environmental law, such as the right to a healthy environment, public participation, and decentralisation of environmental decisions, justify local disagreement on how and where projects with negative impacts on the local environment take place. As was discussed in section 3.5, the means to consider third-party opinions are principally important for sound environmental governance. Local concerns may contain specific knowledge about the local environment that helps in the work of preventing damage. Participation in decision making and access to judicial review by persons concerned about a project are regarded as essential elements of both environmental and human rights law.<sup>447</sup> The participative dialogue promoted in environmental law does not disqualify certain opinions, but rather aims for a procedure where all opinions are heard, especially those of locally affected people. It also aims to answer all questions about health and environmental impacts and to make proposals on mitigation before the decision is taken, rather than dealing with consequences afterwards. This method in environmental law does not distinguish between legitimate and non-legitimate arguments, but aims at summarising the most relevant environmental concerns and exploring how to mitigate them. In other words, environmental rules generally contain an implicit request for decision makers to listen to opinions of affected people as part of their basis for decision. This contrasts with the view expressed in the above-mentioned IIA cases. However, other IIA tribunals have acknowledged that there is an expected task for public institutions and politicians to engage in the public debate.<sup>448</sup> Hence, nothing suggests that the provision on fair and equitable treatment must be interpreted in a way opposite to this fundamental understanding in environmental law. An interpretation of the IIA provision which acknowledges this understanding will avoid setting constraints of the policy space in this regard.

447 See screening of international documents in Ebbesson, Jonas, Participatory and procedural rights in environmental matters: State of the play, UNEP and OHCHR High level meeting on the new future of human rights and environment: Moving the agenda forward 2009.

448 *S.D. Myers v. Canada* 2000, para 161.

### 4.5.3 Prevention and risk assessments

Crucial to assessment of environmental impacts is the management of risks, as was shown in section 3.3. More or less uncertain knowledge about the effects of chemicals or industrial processes becomes imperative for authorities to manage risks. Better scientific knowledge and a modified acceptance of risks should change the risk management in society. The operator may disagree both to the depth of research required of the operator, which consumes both time and money, and to general decisions taken as the result of the authorities' review, which may stipulate a level of protection which has severe constraints to the operator's activities.

It is worth repeating that IIAs do not principally put any restrictions on host states to decide on the level of environmental protection. States are free to decide on a level of environmental protection in accordance with risk management and the precautionary approach. However, when changing general regulation that affects operations of foreign investors, for example, to prohibit the use of a certain chemical or production method, fair and equitable treatment requires that the authority does not base its decision on arbitrary or unjustified arguments.

Two NAFTA cases against Canada involving chemical companies illustrate the conflict. In the *Chemtura* case a US investor of a Canadian pesticide producer, *inter alia*, claimed that the Canadian Pest Management Regulatory Agency prohibited the use of the chemical lindane, which was used to prepare canola seeds, 'based on irrelevant considerations or a lack of sufficient evidence to support the decisions made'.<sup>449</sup> Canada responded that the general decision to prohibit the chemical was based on a review which 'was conducted in a fair and scientifically sound manner' and followed several international environmental agreements.<sup>450</sup> Canada proved to be right in this case. A similar case is

449 *Chemtura v. Canada* 2010, Statement of claim, 2 June 2008, para 325.

450 *Ibid.*, Counter memorial of the responding state, 5 October 2008, part V(b). Canada recalls its commitments to the bilateral Strategy for the virtual elimination of persistent toxic substances in the Great Lakes basin; UN ECE Convention on long-range transboundary air pollution chemicals; OSPAR Convention for the protection of the

the *Dow AgriScience* case, where the decision by Québec to prohibit use of certain pesticides on lawns was challenged. The company claimed that there was no scientific analysis showing the product is a direct threat to human health, but the Canadian Pest Management Regulatory Agency wanted to evaluate it further.<sup>451</sup> Hence, the scientific quality of knowledge and the conclusions to be drawn from it become important for the dispute. There have, however, so far not been any successful IIA claims questioning the standard of knowledge constituting the basis for decisions by environmental authorities or legislators. In the *Methanex* case the tribunal noted that the university investigations on water quality and possible causes to contamination ordered by the authority and the public hearings held to discuss the subject before decisions on future prohibition were taken had no sign of misconduct, rather the opposite.<sup>452</sup> As Orellana rightly points out, the arbiter or judge is not in position to decide on the truth of science, but that relying on transparency and self-evaluation in the scientific community could be justified as a common method to recognise scientific knowledge.<sup>453</sup>

marine environment in the northeast Atlantic and ongoing work under the NAAEC, to prohibit the use of lindane.

451 *Dow Agro Siences v. Canada* 2011, *Nocitce of Arbitration*, 31 March 2009.

452 *Methanex Corp. v. United States of America*, Award 3 August, 2005, 'The Tribunal accepts the UC Report as reflecting a serious, objective and scientific approach to a complex problem in California. Whilst it is possible for other scientists and researchers to disagree in good faith with certain of its methodologies, analyses and conclusions, the fact of such disagreement, even if correct, does not warrant this Tribunal in treating the UC Report as part of a political sham by California. In particular, the UC Report was subjected at the time to public hearings, testimony and peer-review; and its emergence as a serious scientific work from such an open and informed debate is the best evidence that it was not the product of a political sham engineered by California', Part III, chapter A, para 101. The report stated, inter alia: 'If MTBE continues to be used at current levels and more sources become contaminated, the potential for regional degradation of water resources, especially groundwater basins, will increase.' Cited in the award, Part III, chapter A, para 10.

453 Orellana, Marcos A., *The Role of Science in Investment Arbitrations Concerning Public Health and the Environment*, *Yearbook of International Environmental Law*, vol 17, pp. 48–72. Also *Methanex v. USA* 2005, Part III, chapter A, para 101.

When the operator is required to provide background and analysis of the risks of proposed activities, the issue of conflict with investment law is rather one of reasonableness. How extensive an analysis must the operator provide in the EIA or as a requirement for a permit? The potential of the conflict is illustrated by two IIA cases. In the *Clayton/Bilcon* case the US-based investor was planning for quarries in Nova Scotia, Canada, to transport basalt, but was rejected after some years of comprehensive EIA reviews indicating unacceptable impacts on the local environment. The operator claimed, *inter alia*, that the authorities during the reviews 'set arbitrary and unfounded criteria for the approval of test blasts'.<sup>454</sup> In the *Vattenfall* case the authority in Hamburg with references to fish habitats restricted the amount of water from the nearby river Elbe to be used by the new power plant and stated that the company must monitor the efficiency of the fish 'stairs' after two years. The investor claimed those conditions were unreasonable and thus breached the IIA provision of fair and equitable treatment.<sup>455</sup> However, IIA case law has clearly accepted the use of EIAs as such to control environmental impacts of projects and has not questioned the principle that the operator must provide and pay for risk assessments of their future plans. In the *Maffezini* case, about a chemical production facility in Galicia, Spain that was built before the approval of the EIA and then needed costly changes, the tribunal noted: 'EIA procedure is basic for the adequate protection of the environment and the application of appropriate preventive measures. This is true, not only under Spanish and EEC law, but also increasingly so under international law'.<sup>456</sup>

Thus it can clearly be argued that the provision of fair and equitable treatment accepts preventive measures set by rule makers. The requirement that decision making be based on scientific knowledge and being reasonable in the burden placed on the operators renders IIA disputes, but has not been shown to result in a questionable standpoint to environmental law. Constraints of policy space are hard to see,

454 *Clayton/Bilcon v. Canada*, Statement of claim, 30 January 2009, para 36(a).

455 *Vattenfall v. Germany* 2011, Request for arbitration, 30 March 2009, paras 37–39.

456 *Maffezini v. Spain* 2000, para 67.



as long as reasonable demands of assessments prior to a decision are respected.

The cases mentioned above show that applying the IIA standards requires consideration of environmental law principles of precaution and prevention to accurately balance them to the legal rights of the operator. The role of science is complex in this regard; the lack of sufficient scientific knowledge cannot be taken as a proof of no risks, but only as a proof of not knowing. For potentially risky activities some kind of reversed burden of proof is often set out in environmental law. This implies that it might be permissible to carry out an activity, either as long as prescribed analysis does *not* indicate any substantial impacts, or only if it is possible to produce reasonably scientific proof that it will not lead to substantial impacts.

One should further note that the wider concept of risk management also involves considerations of societal perceptions beyond what traditionally is referred to as science. This is much debated in the WTO–environment field, where the SPS and TBT agreements prescribe a harmonised standard for risk assessment with the aim to distinguish protectionist decisions from legitimate public measures.<sup>457</sup> Although the FET provision in IIAs calls for similar analysis, there is nothing in the present IIAs or the jurisprudence of environmental IIA disputes which indicates that the IIA regime is about to develop an imperative for harmonisation of risk assessments as in the WTO.

## 4.6 Non-denial of justice and access to justice in environmental cases

The provision on fair and equitable treatment in IIAs comprises the concept of denial of justice. This concept has historically led to state reasonability for harm to aliens.<sup>458</sup> Denial of justice has been given both

457 See Perez 2004, chap. 4.

458 Brownlie 2008, p. 506. Sohn, L B & Baxter, R R, 1961 Harvard draft convention on International Responsibility of States for Injuries to Aliens, *American Journal of International Law*, vol 55, pp. 545–584, art. 9, states: ‘Denial of justice exists when



extensive and narrower scope. An extensive interpretation overlaps with the concept of due process and many of the aspects dealt with in the section above. The interpretation followed here is that non-denial of justice foremost works as a guarantee for equal access to justice and a minimum standard of a judicial process. As such, it warrants effectiveness in administrative procedures through the access to legal review and thus also supports effectiveness and justice in environmental matters. The IIA obligation of non-denial of justice is in theory rather an element supporting legal safeguards of health and environment than potentially constraining the implementation of sound policies. It is, however, important to note that the actors that in practice may invoke the denial of justice through the recourse of IIA arbitration are foreign businesses, rather than the local residents which environmental and human rights law are directed to when providing access to justice.

Denied access to legal review is a rather rare claim in IIA cases due to the fact that IIA dispute settlement does not require exhaustion of domestic remedies. However, two IIA cases indirectly concerning environmental issues have exposed the concept. In *Azinian v. Mexico*,<sup>459</sup> the first NAFTA case to be judged by the merits, the claimant argued a breach of the fair and equal treatment provision on the basis that Mexican courts had held a contract for waste disposal invalid. The tribunal refused this ground (and also the ground of expropriation) and stated that claims against decisions by the courts must be based on a denial of justice, and 'A denial of justice could be pleaded if the relevant courts refuse to entertain a suit, if they subject it to undue delay, or if they administer justice in a seriously inadequate way. /.../ There is a fourth type of denial of justice, namely the clear and malicious misapplication of the law.' None of those four individual criteria were

there is a denial, unwarranted delay or obstruction of access to courts, gross deficiency in the administration of justice or remedial process, failure to provide those guarantees which are generally considered indispensable to the proper administration of justice, or manifestly unjust judgment. An error of a national court which does not produce manifest injustice is not denial of justice.'

459 Robert Azinian and others v. United Mexican States, ICSID ARB(AF)/97/2 Award 1 November, 1999.

met in the case. In *Mondev v. USA*<sup>460</sup> the claimant alleged that a decision in the Massachusetts Supreme Court which set aside a judgment rendered the claimant success in suing the city of Boston for breach of contract to build a shopping mall, which in the end never received a planning permit. The domestic court had declared that the local planning authority had immunity for such torts. The *Mondev* tribunal set up a test relying on the ICJ reasoning in the *ELSI* case:

The test is not whether a particular result is surprising, but whether the shock or surprise occasioned to an impartial tribunal leads, on reflection, to justified concerns as to the judicial propriety of the outcome, bearing in mind on the one hand that international tribunals are not courts of appeal, and on the other hand that Chapter 11 of NAFTA (like other treaties for the protection of investments) is intended to provide a real measure of protection. In the end the question is whether, at an international level and having regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subjected to unfair and inequitable treatment.<sup>461</sup>

The procedure of the Massachusetts court satisfied this test and the claimant lost the case. The test illuminates the procedural approach taken by IIA tribunals in those cases; it is similar to judgments to enforce foreign judgments and awards, or in carrying out domestic judicial reviews. While a judgment in substance is incorrect, this is merely evidence of lack of justice.<sup>462</sup> IIA tribunals have been cautious to set aside judgments in domestic courts.

IIA tribunals have been more critical in dealing with situations where the recourse to justice has failed. In *Chevron & Texaco I v. Ecu-*

460 *Mondev v. USA* 2002.

461 *Ibid.* para 127.

462 McLachlan, Shore & Weiniger, 2007, p. 229.

*dor*<sup>463</sup> the tribunal concluded that 13 years without making judgments was too ineffective to uphold the non-denial of justice obligation, which in the applicable IIA especially granted ‘means of enforcing legitimate rights within a reasonable amount of time’.<sup>464</sup> In the domestic lawsuits concerned the oil company accused Ecuador of taking delivery of large amounts of crude oil at a special rate set for domestic consumption, but then reselling the oil on international markets for much higher prices. More problematic is that Chevron initiated another IIA arbitration against Ecuador to stop further proceedings and enforcement of a judgment demanding that Chevron pay 18 billion USD in compensation for the severe health and environmental damage caused by oilfield activities in the Amazonia during the 1970s and 1980s.<sup>465</sup> Chevron claims that Ecuador breached the FET provision when Ecuadorian courts allow what Chevron calls by allowing corrupt and fraudulent court proceedings and should be ordered to declare to the national courts that Chevron is not legally responsible for the damage and that the ruling on damage is not to be enforced.<sup>466</sup>

463 Chevron Corporation & Texaco Petroleum I v. Ecuador 2010, PCA Award 30 March, 2010.

464 Ecuador–USA BIT 1992, art. II(7), which obliges states to ‘provide effective means of asserting claims and enforcing rights with respect to investment, investment agreements, and investment authorizations.’ Ecuador does not agree with the tribunal’s wide interpretation of this BIT article and has made a request to the USA for state-state dispute settlement.

465 Chevron Corporation & Texaco Petroleum II v. Ecuador, Award on jurisdiction 27 February, 2012 The environmental ruling from the appeal court in Lago Agrio, Ecuador, on 3 January 2012 came after 18 years of legal battles by 30,000 Ecuadorian indigenous peoples and farmers claiming compensation for cleanup of contaminated sites, clean drinking water, and health care; Tunnicliffe, Helen, Chevron loses Amazon pollution appeal – Record fine ruling is ‘corrupt’, says oil giant, *The Chemical Engineer*, TCE today, 4 January 2012.

466 Claimants’ notice of arbitration, 23 Sept 2009. When the original lawsuit was launched in 1993, it was launched in US courts, but then Chevron successfully challenged those claims on the grounds that the cases should be heard in Ecuador, not the US. In US courts Chevron has taken the position that the Ecuadorian system of justice is sufficiently effective and that US courts therefore are *forum non conveniens* for the cases. Vis-Dunbar, Damon, Chevron warns Ecuador on BIT claim as contract and environmental disputes persist, *Investment Treaty News (ITN)* 26 July

This demonstrates how IIA arbitration also may give companies an additional playground when defending from damages in the aftermath of devastating environmental damage. The IIA may contribute to the imbalance concerning access to justice for environmental damage, thus constraining policy space in this regard.

In environmental contexts access to justice refers to the need for individuals to be able to challenge activities by private entities and public decisions that potentially will affect their local environment negatively.<sup>467</sup> It is foremost physical persons, local communities, or NGOs which are in focus when discussing the needs for access to justice in such matters. However, foreign investors may, as well, have the need to challenge polluting activities or environmentally damaging decisions that affect their investments, and environmental law on access to justice applies also to corporations.<sup>468</sup> For example, the river by a sport-fishing lodge is at risk of being polluted when a dairy industry is established upstream, and in the domestic administrative procedure downstream landowners are denied legal redress. If the sport-fishing lodge has sufficient foreign interest, IIA provisions on non-denial of justice may offer a path to remedies. In this way an IIA obligation of non-denial of justice also may support legal safeguards of health and environment; see also section 6.4.2. The additional access to justice the IIA provision provides for foreign investors to claim environmental rights enhances policy space. The IIA provisions fair and equitable treatment and non-denial of justice can therefore be said to both restrict and enhance policy space, depending on the situation.

## 4.7 Respect for legitimate expectations

The analysis in chapter 3 revealed that environmental regulation may impair the investor's ability to foresee profitability and that the multi-tiered governance structure forms complex administrative routines

2006.

467 Rio Declaration, principle 10; See Birnie, Boyle & Redgwell, 2009, pp. 288–302.

468 Aarhus Convention art. 9.

which may contribute to uncertainties for an investor. At the same time, respect for the investors' legitimate expectations is said to be the most predominant element of the fair and equitable treatment provisions of IIAs.<sup>469</sup> An investor needs to rely on the regulatory framework when deciding to make an investment. Basically, the respect for legitimate expectations calls for honouring representations made to an investor on which the investor has relied at the time of the investing decision. The element further stresses the importance of foreseeability in rule making for actors to perform economic activities and is an outcome of the rule of law in public administration.<sup>470</sup>

Hence, it goes with the aim of international investment treaties to grant the investor some sort of stability, which may lower the risks connected with investments. But no state concluding an IIA with the general formulation of granting investors fair and equitable treatment commits itself to freezing all its regulations that may affect these foreign investments in the future. The communication of the state, or any regulatory body, needs to be more specific to give rise to legitimate, or reasonable, expectations on the side of the investor.

Implementation of environmental policies often challenges the regulatory stability for investors. Modifications in general environmental regulation and changes of individual environmental permits may change important factors for an investment project. The main question in this section is therefore whether the FET provision conflicts with the need to change general and individual regulations carried out by environmental authorities and legislators.

Respect for the investor's legitimate expectations is an element in both the provision of fair and equitable treatment and the provision concerning expropriation. Since the fair and equitable treatment provision has wider scope,<sup>471</sup> legitimate expectations will be discussed in

469 *Saluka v. Czech Republic* 2006, para 301.

470 For the connection between respect for legitimate expectations and rule of law, see Schönberg, Søren, *Legitimate Expectations in Administrative Law*, Oxford University Press, Oxford, 2000, chapter 1.

471 The FET provision does not, as the provision on expropriation does, include the requisite that the claimant also must have lost property.

this part, while comments on specific attributes of the concept in the situation of expropriation rest until chapter 6 and analysis on the provision on expropriation. The present section will start with the question of what the general understanding of the respect for legitimate expectations is in the administrative law applied in domestic legal systems.

#### 4.7.1 Criteria on representations by public actors to create legitimate expectations

At the national level the administrative law provides rules preserving respect for legitimate expectations by individuals. The problem concerns the situation when individuals by public representations have been led to expect that certain conditions prevail. In other words, the question is in which circumstances can the citizens rely on public representations and plan for their activities.

Schønberg divides representation into four categories: (1) formal decision made (revocation), (2) explicit or implicit representation in the individual case, which then differs from the final decision, (3) general representation or policy where the decision in the individual case then differs, and (4) change in general policy. He concludes that formal decisions that are favourably communicated and unconditional are in general irrevocable in European law.<sup>472</sup>

In cases of informal representation only reasonable expectations are upheld or, if altered, compensated for. To be 'reasonable' the representation must be precise, specific, and clear, and there should be a balance towards the reason to derive from it in the successive decision. Schønberg notes that informal representations are seldom upheld in practice and that there is a general freedom for administration to derive from their informal representations in making their formal decision.<sup>473</sup> Administration is normally limited to depart from general policy in individual cases on principles of equality, but if there are valid reasons for

472 Schønberg, 2000, p. 73. Here Schønberg studies English, French, and EC law, in particular.

473 *Ibid.* p.128.

the departure, expectations to rely on the policy may not be respected. Authorities are, however, free to change their policies from time to time and 'individuals can therefore not legitimately expect that a favourable policy or practice will be maintained, and a mere fact that a person is disadvantaged by a change normally does not give rise to any cause for complaint.'<sup>474</sup>

Schønberg notes a slightly different approach in Great Britain and France to the problem with expectations in cases of changed policies. While the French system considers the power to change policy as virtually absolute, the English courts have carefully stated that those likely to be affected by a change must be notified in advance; otherwise, it may be an abuse of power.<sup>475</sup> It is noted that in some areas of law, market development, for example, frequent policy changes are the common norm; thus, change may in some aspects be what to expect. Generally applied, such changes are not considered to violate legitimate expectations.<sup>476</sup> There are few situations, except for unlawful decisions, where individuals are awarded compensation for losses due to public regulations. The procedures concerning environmental and planning permits are often regulated as a specific system of administrative rules, adding to the general law. New decisions which imply changes in rights for individual actors, such as revocation of environmental permits or individual planning decisions, may demand that compensation is awarded, if it replaces the former decision within a certain period of time; see section 3.4.2.

It has repeatedly in IIA cases been held that investors cannot expect the regulations affecting their projects to freeze over time.<sup>477</sup> Writers point out that there must be a general balance between the interest of

474 Ibid. p.142. However, Schønberg argues for the sake of fairness that expectations that have been relied upon should be taken into consideration when changing policies in the way that transitional provisions and exceptions could be used, to the extent this does not defy the purpose of the changed policy.

475 Referring to the French principle of 'mutability' and the English case *Wednesbury*, *ibid.* p. 143.

476 *Ibid.* p.145.

477 See, for example, *Saluka v. Czech Republic* 2006, para 305, and *Parkerings Compagniet v. Lithuania* 2007, para 332.

the investor and the public interest.<sup>478</sup> And there is general support for a view that general representation by the state in the form of regulation does not legitimise expectations that there will not be changes in the regulation, but where there are specific representations directed at individual actors, there will be legitimate expectations of no change.<sup>479</sup>

In 2007 the tribunal in the case *Parkerings Compagniet* summarised the IIA jurisprudence concerning legitimacy of expectations:

The expectation is legitimate if the investor received an explicit promise or guaranty from the host-State, or if implicitly, the host-State made assurances or representation that the investor took into account in making the investment. Finally, in the situation where the host-State made no assurance or representation, the circumstances surrounding the conclusion of the agreement are decisive to determine if the expectation of the investor was legitimate. In order to determine the legitimate expectation of an investor, it is also necessary to analyse the conduct of the State at the time of the investment.<sup>480</sup>

The IIA jurisprudence also illuminates circumstances where deficiencies on the part of the investor disqualify the legitimacy of the

478 See, inter alia, Orrego Vicuña, 2003, who also refers to doctrine in national administrative law (England) as parallel in this sense.

479 McLachlan, Shore and Weiniger declare that expectations based on general or specific representations cannot be equated with a vested property right in the sense of protection, McLachlan, Shore & Weiniger, 2007, p. 239. Newcombe and Paradell note that legitimate expectations is used in three different ways in the IIA jurisprudence: in the specific form where the investor relies on some kind of specific representation, regarding general expectations of stability of regulation, and an even more general form as expectations that the host state comply with IIA commitments, Newcombe & Paradell 2009, pp. 279–280. Schill points out the difference between specific and general representations towards investors in that the specific representation affords confidence in the stability of certain rules, while for general policies the concept has only a marginal effect in this regard. He suggests that only legislation with retroactive effect would breach with investors' legitimate expectations, Schill 2006, p. 28.

480 *Parkerings Compagniet v. Lithuania* 2007 para 331.



expectations. For example, in the *Waste Management* case the investor had relied on misinterpretations of its bank guarantees and contracts with municipalities on waste services; those expectations did not require the Mexican state to respect them to comply with the IIA.<sup>481</sup> IIA cases thus uphold distinctions between formal and specific guarantees and vague or misunderstood promises.

However, balancing of actors' expectations and the state's need to adjust individual regulations over time is common work for legislators and national or federal courts. The balancing point is put down in explicit regulations or in domestic court practice. It is evident that the appropriate balance between the actors' expectations and the state's need to enforce changes in the regulations is set at different levels in different countries, and is also different in different times. In other words, what are considered to be legitimate expectations in specific situations is both state- and time-specific. The discussion on legitimate expectations within IIAs does not appear to acknowledge national differences, although it repeats reasoning similar to that of the discussion on national systems, regarding general representations not creating any legitimate expectations that rules never change. Hence, the situation might still exist in which the IIA tribunal concludes there are legitimate expectations in certain circumstances, where a national court might come to another conclusion.

The fact that legitimate expectations is such open ground in IIA cases indicates that there is a risk it will constrain policy space. The doctrine in administrative law on precise, specific, and clear representations creating reasonable expectations could be used in international investment law to clarify the FET provision and thereby safeguard environmental policy space. To elaborate further on the legitimate expectation element and its potential to restrict policy space, the coming sections deal with changes of general environmental regulation, changes of individual environmental permits, and multi-tiered decision making.

481 *Waste Management v. Mexico* 2004; also see *Saluka v. Czech Republic* 2006, paras 149–164.

## 4.7.2 Changes of general environmental regulation

As concluded above, the great focus on respect for legitimate expectations is partly due to the general objective of IIAs to secure a stable and foreseeable investment climate. IIA tribunals sometimes interpret the rather vague provision of fair and equal treatment ‘in the light of its object and purpose’.<sup>482</sup> Such wide interpretation may result in conclusions that the IIA in some ways restricts the host state from changing general regulation affecting covered investments. At a principal level this is a worrying sign for the correlation to environmental law. As described in chapter 3, environmental law is a relatively new field of law, and in many countries the legal system of environmental protection is undergoing extensive change, not seldom including reforms to incorporate activities previously excluded from responsibility for environmental protection into a more comprehensive system, where those activities get incentives to take precautions and obligations to prevent environmental damage.

Further, states and local communities continually develop new standards and goals for health and environmental protection. Substances, products, and management processes that were not previously thought to be problematic are often later proven to be harmful, and therefore are regulated to safeguard human health and the environment. Natural resources and ecosystems that were not subject to significant political attention in the past may now be considered of high value, for both national security and social welfare. As a result, environmental protection is implemented. The driving forces behind increased health and environmental legal standards come primarily from new scientific and technological developments. In addition, changes that may take place in the environment, either due to unforeseeable natural factors or as a consequence of human behaviour, can operate as catalysts in the development of health and environmental legal standards. Indeed, scientific forecasts of the global environment indicate that the need for health and environmental standards at all levels of society will not

482 In accordance with the accepted rule of interpreting treaties, Vienna Convention, art. 31(1).

decline, but rather grow stronger.<sup>483</sup> Therefore, it is critical that host states have the possibility and the policy space to develop their environmental regulatory systems. This development shall not be defined as something that disrespects investors' legitimate expectations in the IIA context. Such definition would hamper the development, and thus, the environmental policy space.

In the context of changing the rules for investors, it is relevant to make a short note on so-called stabilisation clauses in foreign investment contracts. Foreign investors sometimes have contracts with the host state to fulfil specific projects in, for example, the water, energy, or mining sectors, especially in developing countries. Such contracts might stipulate certain guarantees against changes in the regulations affecting the project, so-called stabilisation clauses or freezing clauses. Such guarantees cannot totally prevent operators from being faced with new environmental or human rights regulations, but regulations affecting the 'economic equilibrium' of the project could require payment of compensation.<sup>484</sup>

It is, however, important to point out that the IIA protection against changes in health and environmental regulation cannot be discussed in the same way as stabilisation clauses in investment contracts. The distinction between individualised representations and general representations analysed in previous sections has a parallel when distinguishing a stabilisation clause in a contract with a specific investor and an IIA. The IIA protection, which is general for all different investments from the other state party, must be more flexible for change in envi-

483 See the executive summary in Millennium Ecosystem Assessment, 2005. For comments on the legal consequences, see Romson 2011.

484 For a thorough analysis, see Tienhaara 2009, chap. 5, and Sheppard, Audley & Crockett, Antony, *Are stabilization clauses a threat to sustainable development?*, Cordonier Segger, Ghering & Newcombe (Eds.), *Sustainable Development in World Investment Law*, chapter 14, Kluwer Law International, Amsterdam, 2011. The latter also refers to a report by Andrea Shemberg, for the IFC and the UN Special Representative to the Secretary General on Business and Human Rights, Prof. John Ruggie, showing that stabilisation clauses in contracts by OECD countries do not cover environmental and social regulation, while contracts for extractive industries in sub-Saharan Africa, Eastern southern Europe, and Central Asia sometimes have such wide scope.

ronmental regulation than investor–state contracts with strict stabilisation clauses.<sup>485</sup>

Returning to the subject of IIAs and the question whether they protect investors from changed regulation, up until now there have been a number of IIA cases concerning ongoing business of water or energy distribution or concessions for extractive industries where the claimant has been awarded compensation for losses mainly caused by the change of regulation. In the case *CMS v. Argentina*<sup>486</sup> a US company had made investments in one of the newly privatised gas delivery companies in Argentina during the 1990s. By that time the Argentinean peso was bound to the US dollar, and the tariffs on gas to households the company used was changed every sixth month, in accord with an US dollar index. In 1999–2002 Argentina had an economic crisis. The peso devaluated radically, and the tariffs were not adjusted as before, since the government considered that citizens would not be able to buy gas for household use, if the prices were adjusted to the new price of US dollars. The IIA tribunal held that changes of the currency regulations broke the fair and equitable treatment provision in the US–Argentinian BIT, since it ‘in fact entirely transform[ed] and alter[ed] the legal and business environment under which the investment was decided’.<sup>487</sup> In the *Occidental* case<sup>488</sup> it was the Ecuadorian tax authority’s changed interpretation of the rules for VAT (which led to denying an US oil company a refund of those taxes) that created a breach of the fair and equitable treatment provision.<sup>489</sup> These two cases show that, at least, abrupt changes in the economic framework for ongoing investments

485 That conclusion has also been drawn by the tribunal in the *Parkerings Compagniet* case, para 332: ‘A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a stabilisation clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment.’

486 *CMS v. Argentina* 2005.

487 *Ibid.* para 275.

488 *Occidental v. Ecuador* 2004.

489 *Ibid.* paras 180–192.

might constitute a breach of the fair and equitable treatment provision.

Concerning changes of environmental law, there have also been a number of cases where investors have invoked the provision on fair and equitable treatment for situations that arise directly out of changes in general environmental law or regulation.<sup>490</sup> It has, however, been hard for investors to convince IIA tribunals that host states have breached their IIAs by changing regulation. Among the environmental cases which have reached an award on the merits and dealt with the issue in any depths, no one has awarded compensation to the claimant on the basis of changed environmental law.<sup>491</sup> To the contrary, tribunals have pointed out that change in general environmental regulation is something investors constantly live with, for example, in the *Methanex* case the tribunal noted:

Methanex entered a political economy in which it was widely known, if not notorious, that governmental environmental and health protection institutions at the federal and state level, operating under the vigilant eyes of the media, interested corporations, non-governmental organizations and a politically active electorate, continuously monitored the use and impact of chemical compounds and commonly prohibited or restricted the use of some of those compounds for environmental and/or health reasons.<sup>492</sup>

In the case *Glams Gold v. USA* the tribunal dealt with changes in mining rules leading to more restrictive operating permits. The tribunal noted that the claimant was ‘operating in a climate that was be-

490 For example, *Philip Morris v. Australia* ; *Dow AgroSciences v. Canada*; *San Sebastian v. El Salvador* 2011; *Gallo v. Canada* 2011. The *Philip Morris* case was not concluded at the time of publication; the other cases ended with the tribunal not having jurisdiction in the case or with settlement of the dispute; see Appendix 1.

491 *Chemtura v. Canada* 2010; *Glamis Gold v. USA* 2009; *Methanex v. USA* 2005; *Parkerings Compagniet v. Lithuania* 2007; *Plama v. Bulgaria*; *S.D. Myers v. Canada* 2000.

492 *Methanex v. USA* 2005, Part IV, D, para 9.

coming more and more sensitive to the environmental consequences of open-pit mining' and that the federal government had not made specific commitments not to change its mining regulation.<sup>493</sup> Hence, the IIA jurisprudence confirms that the provision of fair and equitable treatment and the inherent element of respect for legitimate expectations do not prevent general changes of regulation for environmental protection, if there is no specific undertaking by the host state. This means the policy space for host states is not affected in situations of changing general regulation in the area of environmental law.

However, IIA jurisprudence also indicates that economic frameworks acted on by authorities may create legitimate expectations for the investor and therefore must be respected or compensated for if they are changed in a way that substantially affects the investment. It is apparently so, even if the economic situation also has changed radically for the host state, as it had in Argentina. Changes in public policies for management and extraction of natural resources may affect the economic framework of ongoing projects substantially, and thus conflict with the IIA provision of fair and equitable treatment. Economic incentives for environmental good, such as environmental taxes and schemes for environmental liability, may constitute a key economic framework on which the investor relies. Thus, radical changes in public policies for management and extraction of natural resources, abrupt increases of environmental taxes, or retroactive rules on liability may intrude upon legitimate expectations. In this sense policy space for host states is somewhat restricted.

### 4.7.3 Changes of individual environmental permits

The individual decision making carried out to approve, renew, or revoke environmental permits offers a lot of opportunities for public authorities to give representations concerning specific projects and for operators to create expectations on which they rely in their investment decisions. The environmental permit in itself is a strong representation of the host state concerning the legality of the activity. Any

493 *Glamis Gold v. USA* 2009, para 767.

change of the permit therefore risks being challenged by the operator claiming it intrudes upon the respect for the legitimate expectations.

As explained in chapter 3, environmental permits are decided either for a certain number of years or for an unlimited time period. There are normally rules about how to change conditions or revoke the permit; if the permit is not limited in time, such changes may only be possible after a certain minimum time period. A time-limited permit is expected to last the full time, and there need to be rules for the renewing process. New knowledge or other significant and unforeseeable changes of situation may allow for changes in the conditions or revocation at an earlier stage, with or without compensation, depending on the domestic law. Domestic law may further regulate the scope for general environmental regulations applied alongside the permit and whether changes of those regulations could be compensable. An informal promise in advance to receive the permit does not give the right to start the operating activity. Hence, following the reasoning about representations above, investments made before the decision of the permit would normally be considered a business risk, and only specific promises which also lead to investments may be reclaimed as compensation for damages, if the permit finally is denied. There also seems a greater risk of creating expectations on the part of investors if permits are approved for an unlimited period of time, since the regulation or custom regarding how to change or revoke the permits might lack in preciseness.

One should, however, not draw the conclusion that the same regulation for changing conditions or revoking environmental permits must apply in all host states, just because the IIA provision of fair and equitable treatment implies a certain standard. It is, rather, the respect for legitimate expectations that should comply with the international standard. Understanding the FET in this way means that the standard is connected to what the investor reasonably can expect of the communication by public authorities in the context of a specific regulatory system. In other words, what is defined as a legitimate expectation in a particular situation will then depend on the very rules, and thus of rules that differ from host state to host state. No one can for, example,

expect to follow the British norm of doing an EIA when it concerns a project in Chile. Neither would any operator expect the same level of administrative service from the environmental authorities in Sweden and in Guatemala.<sup>494</sup>

Unlike the IIA jurisprudence regarding general changes of environmental law, which seemed to accept the host states policy space in this regard, the IIA jurisprudence of changes in individual permits is less reassuring. As has been revealed above (see section 4.4), several environmental IIA cases concern the approval, renewal, or revocation of environmental permits. The core issue in many of these disputes is whether the operators and foreign investors throughout the process have received communication from the relevant authority leading to legitimate expectations on which the operator and foreign investor has relied for its investment decisions. In the *Tecmed* case<sup>495</sup> the company had an operating permit for a landfill of hazardous waste that was limited to one year. Discussions with the authority to relocate the landfill had started, but got delayed due to the resistance from local citizens. The authority decided not to renew the permit. The tribunal found that the company had ‘reasonably trusted, on the basis of existing agreements and of the good faith principle, that the Permit would continue in full force and effect until the effective relocation date.’<sup>496</sup> The tribunal also noted that the federal environmental authority did not object to the communication from the company revealing its expectations to continue its operations in the current spot until it was referred to a new one.<sup>497</sup>

In the *Metalclad* case one crucial fact for a breach of the provision of the fair and equitable treatment was that a federal official had assured the investor at the time for the investment that the company had all the permits it needed to establish the landfill for hazardous waste and that a local construction permit was a formality restricted

494 Cf. Hobér, 2007, p.124.

495 *Tecmed v. Mexico* 2003.

496 *Ibid.* para 160.

497 *Ibid.* paras 158–159.



to the construction issues.<sup>498</sup> However, when the municipality hosting the landfill later denied the permit for construction, the project was stopped. The tribunal interpreted the IIA in question (NAFTA), in the light of its aim and purpose, as creating an obligation for the host state authorities to 'ensure that a correct position is promptly determined' if an investor shows any misunderstanding regarding applicable rules.<sup>499</sup>

Hence, the two tribunals in the Mexican cases generally ignored the viewpoints of local authorities and obliged them to make sure the operator has the correct understanding of the rules. Unfortunately, the *Metalclad* and *Tecmed* tribunals did not discuss the reasons for these conclusions in any detail.

One important question which the two cases raise but do not answer is whether the investor legitimately may rely on informal representations and representations by authorities outside of the competence, in other words, *ultra vires*. This question is also relevant in the *Vattenfall* case, where the Swedish company claimed it had legitimate expectations that the emission and water use permits would be granted without great change from their application after receiving the preliminary start permit, especially since the latter permit was communicated together with an explanatory message from the authority stating that 'according to a provisional assessment of the immission [sic] control application there are no obstacles that cannot be removed by covenants that stand in the way of approval'.<sup>500</sup> The company claimed it also received 'assurances' from representatives of the government of Hamburg, which gave reasons to expect the permits would be ap-

498 *Metalclad v. Mexico* 2000 para 80. This was taken as a fact by the tribunal, regardless of accusations of the witness to this having financial connections to the company, *Metalclad v. Mexico Appeal* 2001, para 106.

499 'Once the authorities of the central government of any Party [...] become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws.' *Metalclad v. Mexico* 2000, para 76. This part of the award was concluded to exceed the powers of the arbitration tribunal in an appeal procedure, *Metalclad v. Mexico Appeal* 2001.

500 *Vattenfall v. Germany* 2011, Request for arbitration, 30 March 2009, art. 23.

proved.<sup>501</sup> As Schönberg showed, the norm within some EU states is that informal representations normally do not constitute legitimate expectations, but sufficiently clear representations, although outside the competence of the authority, may do that. It is, however, doubtful that there exists any common norm in any broader international sense. IIA tribunals should therefore be careful in their analysis of such representations and take notice of any special regulation or practice in the domestic system regarding the administrative process of environmental permits. Without careful analysis in this regard the fair and equitable treatment provision risks putting unnecessary constraints on policy space for host states, preventing them from regulating individual operators harmful to the environment.

#### 4.7.4 Multi-tiered environmental governance

As discussed in section 3.6, projects with environmental impacts are often controlled in a multi-tiered governance structure, and legal rules from different areas of law are dealt with in separate public institutions. This means that the operator normally needs to be in contact with several authorities regarding the same operation. For the operator it is vital that the actions of these authorities are consistent and that they not give diverging opinions on key issues for the operation. However, it is difficult for states to effectively perform multi-tiered governance and coordinate many different administrative processes. There is a risk that the ruling of one authority might build expectations which subsequent rulings by another authority tear down.

These difficulties were illustrated in the *MTD* case.<sup>502</sup> In this case a Malaysian company was planning a housing development outside the Chilean capital Santiago. Receiving an investment permit from a commission coordinated at the ministerial level, the operator went ahead with the plans, until it was uncovered that the area was protected as a 'green lung' for the metropolitan area and that the planning legislation therefore only permitted agricultural and recreational use of the

501 Ibid. para 26.

502 *MTD v. Chile* 2004.

land. The IIA tribunal considered that a commission on the level of ministers' 'approval of a project in a location would give prima facie to an investor the expectation that the project is feasible in that location from a regulatory point of view'.<sup>503</sup> This was despite the fact that the ministerial commission's mandate was restricted to decisions on approval of inflow of foreign capital and the fact that the company was requested by the commission to seek the appropriate authorisations for the project. The IIA tribunal concluded that the support of the project by the commission was inconsistent with the government's own policy to preserve the environmentally important land for agriculture and recreation which was implemented in the planning legislation. It further ruled that the decision of the ministerial commission led to a legitimate expectation for the investor that the project was possible, and thus the host state had breached the IIA. However, the damages awarded were limited, since the company partly had contributed to the losses incurred by the project.<sup>504</sup>

If there are several public actors involved in the decisions regarding an activity, there are also multiple opportunities for one authority to give rise to some expectations on the part of the investor. This is not only done by negligence, when an authority gives the investor an answer which subsequently is proved to be wrong, and for which, of course, the authority must be held liable. Several environmental IIA cases show that problems also arise when an authority makes correct representations, and thus creates expectations that then are counteracted by measures made by another authority. In the *Tecmed* and *Metalclad* cases the federal environmental authorities gave positive signals to the investor, while the local authorities gave negative ones, and in the *MDT* and *Maffezini* cases there were public investment promotion bodies which gave the positive signals, while authorities responsible for environmental or spatial planning decisions gave negative signals about the projects.

This is no surprise. Activities that potentially impact health or environment must usually deal with various public agencies or authorities

503 Ibid. para 163.

504 Ibid. para 242–243, upheld in an annulment award, para 100.

to get all necessary permits. Inconsistent replies from different authorities are a problem for the operator: What's the point of being allowed to transfer money from Chile, as in the *MTD* case, if you are forbidden to use the land you bought for the project? As long as several different permits are needed for the same activity, it is hard to avoid the risk of having one permit approved and another permit denied. One authority is usually not allowed to bind another authority in its permit decision, but coordinated and transparent permit structures may overcome the risk that investors interpret one approved permit as approval of all parts of the operation, even though other permits are needed.

A difficult situation arises when authorities outside the sphere of environmental authorities give informal representations in individual cases concerning issues of environmental law, and the environmental authority subsequently comes to a different conclusion. If the first representation was clear enough, although wrong, and reasonable for the investor to rely upon, it is appropriate to hold the first authority responsible for a wrongdoing, rather than give the investor the right to do wrong.

The IIA rulings stress that the first authority to give an opinion must clearly explain for the investor what the procedure looks like and which role each authority has within the governance structure. By giving such clear communication, the authority can avoid creating legitimate expectations regarding aspects covered by other authorities. In the *Maffezini* case, in which the state prevailed regarding the allegations about the investment support creating legitimate expectations of approval of the project to establish a chemical factory, the tribunal noted that the authorities clearly communicated the different steps of the EIA procedural.<sup>505</sup>

Thus, the fair and equitable treatment provision requires that environmental authorities give clear communication regarding the limits for each and every decision, so that wider expectations are not formed by the investor. Clear communication also supports good structures of multi-tiered governance and contributes to the sound practice of environmental governance. So do rules on administrative liability for

505 *Maffezini v. Spain* 2000, para 70.

wrongful acts by authorities. However, it does not mean that environmental authorities should have the responsibility for investments which are made at the risk of the investor who goes on with the plans, disregarding the lack of final approval of essential permits. Rather, such responsibility would turn the whole permit process around. Also questionable is an international obligation for the authority to rectify the understanding of regulations and procedures if it becomes aware of a misunderstanding of regulations or procedures affecting the investment or coming to affect the investment. As some IIA cases (*Tecmed* and *MDT*) have shown, an omission of the authority to communicate, or giving communication too late in the process, has been taken as something contributing to a breach of the IIA. Such interpretation clearly risks putting constraints to policy space. This is not reasonable considering that operators, like anybody else in the community, have a responsibility to inform themselves correctly of the law.

## 4.8 The provision on fair and equitable treatment and environmental policy space

The previous analysis has shown that the fair and equitable treatment provision has potential to challenge regulations and public measures aiming to protect health and environment or sustainable use of natural resources. The elements due process and respect for legitimate expectations of the investor especially may trigger those conflicts. Therefore, this chapter analysed those elements in relation to the four related environmental law concepts of prevention and risk assessments, stability and predictability, multi-tiered environmental governance, and third-party participation in decision making. This section aims to conclude this analysis in terms of environmental policy space.

As to the formulations of the provision of fair and equitable treatment, the analysis did not show a significant difference in the level of the standard, depending on whether the provision was limited to the (minimum) standard of international law or not. It cannot, therefore, be concluded whether there is less risk for policy space constraints if

the IIA includes a FET provision which is limited to the (minimum) standard of international law or not. However, examples are found of IIAs with a FET provision defined as the more specific standard of non-denial of justice. Such limitations of the scope of the provision should be helpful in accommodating environmental regulation and offering less risk of constraining policy space.

The element of due process attached to the provision of fair and equitable treatment is open to interpretation. Constraints to policy space are mainly expected if the interpretation lacks in acknowledging key concepts of environmental law. For example, it was analysed that the active involvement of third parties in environmental law would be restricted if the IIA interpretation did not acknowledge that public institutions and politicians are expected to engage actively in the public debate. Further, the interpretation must put reasonable demands on decision making to be based on scientific knowledge to allow for preventive actions by the states.

The provision of fair and equitable treatment also includes granting investors of the other party access to justice. It was found that this might contribute to an imbalance in access to justice for environmental damage between foreign investors and concerned inhabitants, favouring foreign investors. However, the additional access to justice the IIA provision provides for foreign investors to claim environmental rights enhances policy space. This part of the provision therefore both restricts and enhances policy space, depending on the situation.

The analysis above made clear that policy space for host states is not affected in situations of changing general regulation in the area of environmental law. However, the fact that legitimate expectations is such an open ground in IIA cases indicates that there is a risk it will constrain policy space. The principles of administrative law on precise, specific, and clear representations to create reasonable expectations could be used in international investment law to clarify the FET provision and thereby safeguard environmental policy space. Some changes in general regulation may clash with legitimate expectations, such as radical changes in public policies for management and extraction of natural resources, abrupt and radical increases of environmental taxes,

or retroactive rules on liability. In this sense policy space for host states is somewhat restricted.

Specific promises or guarantees to individual investors by the public authority normally create legitimate expectations which the IIA provision binds the host state to respect. There is, for example, a great risk to create legitimate expectations on the part of investors when environmental permits are approved for a unlimited period of time. The regulation or custom regarding how to change or revoke environmental permits might lack in preciseness and thus make the enforcement of new and tougher standards look like a surprise to the investor.

It is further important that IIA tribunals are careful in their analysis of individual representations and take notice of any special regulation or practice in the domestic system, for example, regarding the administrative process of environmental permits. Without careful analysis in this regard the fair and equitable treatment provision risks putting unnecessary constraints on policy space for host states, preventing them from regulating individual operators harmful to the environment.

The provision of fair and equitable treatment also risks constraining policy space by neglecting the multi-tiered structure of environmental governance and its implications for host states with weaker administrative capacity. Acknowledging that operators have a general responsibility to inform themselves correctly of the law, an omission of the authority to correct a misunderstanding should not contribute to a breach of the IIA. Such interpretation clearly risks putting constraints to policy space.

Thus, as a short summary, a narrow interpretation of the provision on fair and equitable treatment could seriously restrict environmental policy space, as the understanding of prevention and risk, stabilisation and predictability, third-party and public participation in regulation, and multilevel governance structures in environmental law is neglected. In many situations it is, however, clearly possible, and therefore advisable, to widen the interpretation of investment treaties to include those perspectives.





# 5 National treatment

## 5.1 Introduction

The general obligation not to discriminate against foreign investments is specified in many investment treaties in two provisions: the provision on national treatment (NT) and the provision on most favoured nation treatment (MFN). An obligation on host states to grant foreign investments national treatment, or most favoured nation treatment, implies that the investments should not be accorded less favourable treatment than similar investments by domestic actors, or similar investments from other foreign investors. Some aspects and effects of the MFN provision were mentioned in chapter 2. The focus in this chapter will be on the NT, since the potential conflicts with environmental law are more clear-cut when the comparison is with domestic actors.

There are two main questions that arise with the provision on national treatment in relation to environmental regulation. First, to what extent does the granting of national treatment preclude regulation which designates the use and management of natural resources to local communities? An example of this is the situation where local communities in rural areas have been given special responsibilities concerning water services or the situation where local indigenous people are the only ones allowed to fish in marine reserves or establish commercial activities for tourists in national parks. Can the fact that foreign companies cannot get service contracts on water or permits to fish in those

areas be construed as discrimination in the meaning of the IIA provision on national treatment? Secondly, how does the NT affect a regulation which results in different conditions for a foreign corporation, but is based on differences other than place of origin, so-called origin-neutral differential treatment? For example, a new foreign-owned steel plant, tyre producer or textile industry gets stricter emission standards than an existing domestic actor, due to cumulative effects of the pollution in the local environment, new technology, or new knowledge about hazardous substances.

This chapter will analyse the IIA substantive provision on national treatment in relation to two of the six chosen concepts of environmental law: avoiding discrimination of similar actors, and multi-tiered environmental governance. It will also discuss the few IIA cases that so far have dealt with conflicts of the provision and environmental regulation, and the distinctions made between the NT provision in IIAs and the NT in WTO agreements. The analysis starts by considering the main varieties in formulation of NT which exist in IIAs and discusses whether any formulation puts less restriction on environmental policy space.

In this chapter the term 'liberalising clauses' means that NT covers the pre-establishment phase. Restrictions of 'performance requirements' will be discussed in the context of these pre-establishment IIAs. In the end of the chapter special focus is put on commitments in multilateral environmental treaties and national treatment.

## 5.2 Background

As observed in chapter 2, the concept of national treatment was historically proposed by developing countries as the main standard for state responsibility for treatment of aliens, as opposed to the minimum standard of treatment argued by developed states. However, today's provision on national treatment included in IIAs is not the historical alternative to the objective minimum standard, but a relative standard prescribing that investments by investors of the party state be accorded 'not less favourable treatment than that accorded to in-

vestments made by its own investors'.<sup>506</sup> Thus, the provision guarantees that investments made by nationals of the other party are not treated worse than investments made by the state's own nationals. The aim of the provision is, just as in the context of trade in goods, to give similar business opportunities and protect against discrimination and rules of disguised protectionism. Both *de jure* and *de facto* discrimination is covered.<sup>507</sup> This means that public measures which have a discriminatory effect could provoke a violation of the provision, even if on the face of it, it makes no difference in relation to domestic counterparts. This chapter distinguishes between origin-specific and origin-neutral regulation, between explicit and implicit discrimination; see sections 5.4 and 5.5.

## 5.3 Expression of the provision in IIAs

### 5.3.1 Post-establishment national treatment

The provision of national treatment is a common provision in IIAs, apart from APEC countries, which in some IIAs have omitted it.<sup>508</sup> The provision on NT often stands in connection to the provision on fair and equitable treatment and the provision on most favoured nation treatment. Sometimes all three provisions on treatment are formulated in one single article,<sup>509</sup> while sometimes they stand apart.<sup>510</sup> These different forms do not affect the obligation of national treatment, as such, but rather indicate a strong connection with the obligations of non-discrimination. The most important distinction between NT in

506 Sornarajah 2004, p. 234; Swedish model BIT art. 3(1).

507 Newcombe & Paradell 2009, p. 176; van Harten, 2007, p. 85.

508 International Investment Arrangements: Trends and Emerging Issues, UNCTAD 2006, p. 34.

509 The Netherlands–Cambodia BIT, 2006, puts all three provisions in the same article, however, separated into different paragraphs.

510 Many European BITs put national treatment and most favoured nation treatment in the same article, while fair and equitable treatment is put in its own article.

different IIAs is rather between the applicability in the pre-establishment phase and when limited to the post-establishment phase.

The majority of IIAs restrict the national treatment provision to investments that have already been established in the territory, admitted by the host state according to their national laws. The treatment is then accorded ‘investments made in its territory’<sup>511</sup> or restricted to ‘their management, maintenance, use, enjoyment or disposal of their investments’.<sup>512</sup> There are also BITs which add ‘acquisition’ and ‘expansion’ to the previous list and thereby take a step closer to a pre-establishment provision, applying the provision to mergers and acquisitions but not to the establishment of greenfield investments.<sup>513</sup>

### 5.3.2 Pre-establishment national treatment and lists of exemptions

The pre-establishment national treatment is common in IIAs concluded by the USA, Canada, and Japan, but is included in an increasing number of IIAs.<sup>514</sup> NAFTA prescribes:

Each Party shall accord to investments of investors of another Party treatment no less favourable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.<sup>515</sup>

511 Guatemala–Sweden BIT, 2004, art. 3(1).

512 Chile–UK BIT, 1996, art. 3(2).

513 Denmark and Finland model BITs, to accord ‘acquisition’ to foreign investors on equal terms with nationals will imply rights for foreign investors to buy national companies in all sectors, if not exempted elsewhere in the treaty.

514 International Investment Arrangements: Trends and Emerging Issues, UNCTAD 2006, p. 24, for example, see ASEAN–Australia IIA, 2009, art. 5 and Norway draft model BIT, 2008, art. 3(1).

515 NAFTA, art. 1102, para 2.

When discussing pre-establishment national treatment it is important to remember that states according to general international law are free to permit foreign nationals to establish or not.<sup>516</sup> A state's decision to allow foreign investments is part of its sovereign economic policy. Traditionally, national industrial and service sectors to various degrees have been protected against foreign competition, with the aims to develop the domestic industry or protect national interests in basic services such as health and education, or in natural resources. States can, however, commit themselves in IIAs to allow for the establishment of companies from the treaty party, either generally or in specific sectors. To grant national treatment in the pre-establishment phase is thus fully a preferential action towards other state partners. However, from a development perspective it has been argued that favouring rules for domestic actors has positive implications for industrial development. In the UN negotiations on a code on transnational corporations developing countries insisted on the need to allow for favouring rules for domestic enterprises on account of their development needs.<sup>517</sup>

The liberalising IIAs often include comprehensive lists of exemptions from the national treatment provision, since there are areas the state may consider too sensitive to foreign business. In addition to natural resources the often-mentioned areas for these general exemptions are public services, culture heritage, and national security.<sup>518</sup>

516 For a lengthy discussion, see Sornarajah 2004, pp. 97–114.

517 In the last draft of the code article 50 included the phrase 'without prejudice to measures specified in legislation relating to the declared development objectives of the developing countries' as a basis for exemptions to national treatment provisions. National treatment, UNCTAD Series on issues in international investment agreements, 2000, pp. 47–50.

518 As an example, the Grenada–USA BIT 1986, lists the following exemptions of national treatment in its annex: The list of industries with respect to Grenada consists of the following: air transportation, government grants, government insurance and loan programmes, ownership of real estate, and use of land and natural resources. The list with respect to the United States is considerably broader and consists of air transportation, ocean and coastal shipping, banking, insurance, government grants, government insurance and loan programmes, energy and power production, custom-house brokers, ownership of real state, ownership and operation of broadcast or common carrier radio and television stations, ownership of shares of

Listing sectors or specific areas of regulation in this way is the most common way to handle specific exemptions in IIAs.<sup>519</sup> Sometimes this method is called ‘negative listing’, since it is the sectors to which the provision does not apply which are mentioned. An opposite method is ‘positive listing’, in which the state parties instead list the sectors to which the provision applies. Positive listing is used in the WTO General Agreement on Trade in Services (GATS) agreement.<sup>520</sup> The difference between negative and positive lists is the implication for areas of business that are not mentioned in the IIA, that is, areas which were not thought of when concluding the treaty. In a treaty with a negative list of exempted sectors, the not-mentioned sector will fall under the scrutiny of the treaty provision, while in a treaty with a positive list of exempted sectors, the not-mentioned sector will fall outside the scrutiny of the provision. Thus, the positive-list method allows for the investment-importing state to liberalise only those sectors that are not considered too sensitive to expose to foreign influence or competition. The negative-list method is more demanding for the investment-importing state, since analysis of future options of policy is required before entering into the IIA. The positive-list method thereby gives more policy space and is easier for developing countries to administer.<sup>521</sup> The negative-list method, however, fulfils the treaty aim of extensive liberalisation, so that the scope of the NT provision expands over time. The negative-list method was proposed in the negotiations of the MAI.<sup>522</sup>

the Communications Satellite Corporation, the provision of common carrier telephone and telegraph services, the provision of submarine cable services, and use of land and national resources.

519 Although in some IIAs the list is a bit shorter: The Iceland–Lebanon BIT, 2004, art. 3(5)(6) exempts the treaty from applicability of one specific sector for each of the parties, real estate in Lebanese territory and fishing in Icelandic waters.

520 In GATS states are requested to list commitments to grant market access and national treatment in specific areas like ‘education’ or ‘environmental services’, art. XVI and XVII.

521 Villata, José María, *Federación Ecologistas en Costa Rica (Publ.)*, *El TLC-EUCA: Un Golpe de Gracia al Estado Social de Derecho Costaricense – El Caso de los Capítulos de Inversiones y Servicios*, CD-ROM 2007.

522 Draft Text on the Multilateral Agreement on Investment (MAI) – Chairman’s note

More general formulations of exemptions are used in other IIAs. In the Lithuania–Russia BIT 1999 the parties are free to determine in their laws ‘the branches of the national economy and the spheres of activities where the activities of foreign investors are restricted or limited’.<sup>523</sup> Also interesting, the China–Netherlands BIT 2001 exempts all existing non confirmative measures and any changes which do not increase the non conformity of those measures in China.<sup>524</sup> The Chinese exemption protects it from demands to change regulation already in place which at the time when the agreements was concluded was known or unknown to conflict with the IIA national treatment provision. However, it does not protect China’s policy space to issue new measures without having those measures scrutinised by the IIA.

## 5.4 Explicit discrimination

### 5.4.1 Natural resource management and rural development

The provision on national treatment prohibits regulations or measures which exclude foreign investors engaging in activities on equal grounds with national investors. Both regulation disqualifying foreign actors and regulation favouring domestic actors will explicitly put foreign investors in a worse position and thus discriminate.<sup>525</sup> Environmental regulation in general does not differentiate the nationality of the operator but the environmental effects of the activities, and thus stays clear of explicit discrimination. However, as shown in chapter 3,

on environment and related matters and on labour OECD DAFFE/MAI(98)7/REV1, 1998.

523 Lithuania–Russia BIT 1999, art. 3(3).

524 China–Netherlands BIT, 2001, Protocol Ad, art. 3(2)(3).

525 Following the line of argument put by Ehring, discussing national treatment in WTO agreements, Ehring, Lothar, De Facto Discrimination in WTO law: National and Most Favoured Nation Treatment – or Equal Treatment?, *Journal of World Trade*, vol 36, 5, p. 923.

policies on natural resource management and biodiversity may express great concerns for the social development connected to the resources, and regulation may favour local actors. Such favouring of domestic actors is hard to combine with equal rights for foreign actors, especially if the investor's rights shall apply in the pre-establishment phase.

A formal prohibition of foreign actors from acquiring land or exploiting natural resources is therefore not compatible with the provision of national treatment applied in the pre-establishment phase. When domestic regulation gives rights to residents in a certain area, to specific domestic judicial persons, or limits the preferential treatment to resident physical persons, it may effectively bar foreign actors from making investments and receiving economic benefits from those activities. This indicates that regulations requiring residency could be in conflict with a pre-establishment NT provision. However, the regulation could be considered origin neutral, if it is possible for foreign citizens to be residents in the area or to participate in domestic cooperative associations and thus gain access to those advantages on equal terms. Such interpretation, however, requires the acceptance of social development policies based on local residency as legitimate aims for the state. In the era of neo-liberalism this has not always been the case.

There are writers and NGOs that oppose pre-establishment of national treatment, pointing to the fact that the provision might mean that the host state is adversely restricted in regulating domestic use and ownership of natural resources for the benefit of social and environmental development.<sup>526</sup> As one example, Cho and Dubash argue that states giving companies concessions with exclusive rights to distribute water or electricity in certain areas, in combination with requirements to extend the networks, may be challenged with pre-establishment NT or MFN provisions.<sup>527</sup> Although some of those concerns can be met with transparent tendering procedures, there are without

526 GATS, Water and the Environment – Implications of the General Agreement on Trade in Services for Water Resources, CIEL & WWF International Discussion Paper, October, 2003. Also see Federación Ecologistas en Costa Rica arguing for NO in referendum about CAFTA, Villata 2007.

527 Cho & Dubash, 2005, analysing such concessions in Gabon, Chile, and Argentina.



doubt challenges to meet for a regulator carrying out social and rural development policies in a legal framework built on unlimited right to establishment.

Explicit discrimination for reasons of natural resource management or linked rural development, as discussed above, has not rendered IIA disputes so far. There could be various reasons for this, for example, liberalising IIAs with developing states were concluded first in the 1990s and 2000s, and are therefore quite new to the investors. The exemptions made in the IIAs often cover all existing non-compliant regulation, and few new rules of that kind have been brought into force; legislators and authorities may have refrained from actions explicitly in breach of the IIAs. Further, the case law of NAFTA shows that environmental regulations are seldom challenged in cases regarding the establishment of the investment, but rather concerning changed circumstances, or the rights for the investor to buy and sell, hire and fire, or use and dispose of resources.<sup>528</sup>

Another kind of environmental policy also explicitly differentiating the treatment by origin of the operator involves specific legal demands on foreign operators of certain activities to grant national representation and economic security, for example, in the mining sector. Such regulation is normally motivated by the fact that foreign companies may not be holding any large sums of capital or other securities in the country, unlike domestic companies. If such differentiation is considered legitimate in the circumstances, the regulation should be reviewed as compatible with the national treatment standard. This will depend on the circumstances in the sector and I leave more detailed analysis aside.

528 This was noted regarding the practice of NAFTA. von Moltke, Konrad, Investment and the environment, Kirton & Maclaren (Eds.), *Linking trade, environment and social cohesion – NAFTA experiences, global challenges*, Ashgate, Aldershot, UK, 2002, p. 148.

## 5.4.2 Restriction of environmental performance requirements

Performance requirements are requirements by the host state for investors to meet specific economic goals as preconditions for establishment of investments or for obtaining an advantage.<sup>529</sup> Compulsory use of local materials and hiring of local personnel, the duty to export certain amounts of products, or conducting the business in cooperation with national firms to transfer know-how and production processes are examples of such requirements. Historically, both developed and developing countries have used performance requirements as one instrument among others to enhance various development objectives.<sup>530</sup> Some IIAs, mainly those applying national treatment at the pre-establishment phase, explicitly prohibit specified performance requirements.<sup>531</sup> Various environmental measures act directly or indirectly as performance requirements, for example, permit conditions of technology standards or restrictions in access to raw material or land.<sup>532</sup> However, it is not common that IIAs prohibit such measures in the form of explicit prohibitions of performance requirements.

Specific requirements, on one foreign operator or directed towards all foreign operators, as a precondition for entry of the foreign investment, are likely to be in conflict with the provision on national treatment applied in the pre-establishment phase, notwithstanding the existence of an explicit prohibition of performance requirements. If such

529 Foreign Investment and Performance Requirements: New Evidence from Selected Countries, UNCTAD/ITE/IIA/2003/7, 2003, p. 2.

530 Performance requirements were used by developed countries in the 1970s and 1980s, but since then they have declined as a policy tool; still, some developing countries consider them useful and argue that the practice should not be prohibited, *ibid.*

531 IIAs of the USA and Canada depart from this approach; see comment in Zampetti, Americo Beviglia & Sauvé, Pierre, *International Investment*, Guzman & Sykes (Eds.), *Research Handbook in International Economic Law*, Edward Elgar, Cheltenham, 2007, p. 224.

532 Environment is listed as 'extensive interaction' in a list of interactions with other issues in Host Country Operational Measures, IIA series, UNCTAD/ITE/IIT/26, 2001, p. 55.

requirements regularly need to be upheld by public authorities, they may also conflict with post-establishment national treatment provisions.<sup>533</sup> Hence, to some extent the analysis of whether performance requirements are compatible with different IIA provisions is independent of explicit provisions to prohibit such requirements.

The WTO Agreement on Trade-Related Investment Measures (TRIM) incorporates prohibition of performance requirements on local content, export control, trade balance, and foreign exchange, but does not prohibit requirements on technology transfer. The WTO General Agreement on Trade in Services also prohibits a number of measures in the areas where the state makes commitments of market access.<sup>534</sup> Some IIAs incorporate the TRIM provision,<sup>535</sup> and thereby make it possible for investors to dispute the provision, since the dispute settlement mechanism in the WTO agreements only covers state actors. However, foremost the USA and Canada have included much wider prohibitions in their IIAs, prohibiting performance requirements that ‘transfer a particular technology, a production process, or other proprietary knowledge to a person in its territory’.<sup>536</sup> From this prohibition there is a general exemption for measures which are not arbitrary or disguised restrictions to trade and investment and ‘necessary to protect human, animal, or plant life or health . . . or related to the conservation of living or non-living exhaustible natural resources’.<sup>537</sup> Within this exemption one must include measures like

533 Writers express different opinions on this; Dolzer and Schreuer point out it is unclear, Dolzer & Schreuer 2008, p. 84, while Sornarajah suggests that such requirements can be compatible with national treatment, Sornarajah 2004, p. 326.

534 Art. XVI prohibits requirements on limits to the number of service suppliers, on the total value of service transactions/operations/service output, on the number of persons a service supplier may employ, on participation of foreign capital, and requirements of specific legal entities.

535 See, for example, Japan–Switzerland BIT 2009, art. 96, ‘For the purposes of this Chapter, the Annex to the Agreement on Trade-Related Investment Measures in Annex 1A to the WTO Agreement is hereby incorporated into and made part of this Agreement, *mutatis mutandis*.’

536 USA–Chile BIT 2004, art. 10.5.1(f).

537 Ibid. art. 10.5.3(c)(ii) and (iii). The latter article is identical to the general exemption

the protection of traditional knowledge in line with the Convention on Biological Diversity (CBD) or promoting ozone gas-free technology in line with the Montreal protocol,<sup>538</sup> if the IIA is not to conflict with multilateral environmental agreements.

Another way to impose restrictions to performance requirements is used in IIAs applying national treatment only in the post-establishment phase.<sup>539</sup>

Each Contracting Party shall not impose mandatory measures on investments by investors of the other Contracting Party concerning purchase of materials, means of production, operation, transport, marketing of its products or similar orders having unreasonable or discriminatory effects. (Azerbaijan–Finland BIT 2003, article 2(4))

It is difficult to predict how these prohibitive provisions may affect environmental regulation. I am not aware of any IIA case specifically concerning transfer of environmental technology or means of production. An illustrative example would be a developing state that, as a precondition for entry of an investment, requires certain environmental standards of the process or methods. Would such conduct be compatible with an IIA provision prohibiting performance requirements for technology transfer, like the one above? This depends on the interpretation of the exemption made for reasonable, non-discriminative measures, which according to NAFTA also must be necessary for protection or conservation of health and environment.

The NAFTA jurisprudence includes a few environmental or environmentally strategic cases on performance requirements. In both

in GATT art. XX(b) and (g). Note exceptions also for measures according to TRIPS and enforcement of competition laws, art. 10.5.3(b)(i) and (ii).

538 Protocol on Substances that Deplete the Ozone Layer, 1987.

539 Also see the French model BIT, 2006, art. 4, on fair and equitable treatment, an article copied in several French BITs.

the *S.D Myers*<sup>540</sup> and *Pope & Talbot*<sup>541</sup> cases the tribunal dismissed the claims in this regard, since the measures taken were not recognised as explicit performance requirements.<sup>542</sup> In three cases stemming from a Mexican tax on one type of sweetener used in soft drinks, which US producers perceived as favouring Mexican sugar producers, the tribunals have reached different conclusions regarding whether or not the measure breaches the NAFTA prohibition on performance requirements; in the *Archer Daniels Midland* and *Cargill* cases the tribunals found breaches in this regard, while in the *Corn Producers International* case the tribunal did not find a breach of those IIA provisions.<sup>543</sup> All these cases concerned measures aiming to decrease export or import of certain goods and the claimants being foreign investors having their operations affected because of their dependence on import or export of these goods. The legitimacy for such measures for environmental purposes requires coherency with domestic policies to neutralise the discriminatory effect.

## 5.5 Implicit discrimination —Less favourable treatment

This section leaves the field where regulation and policies explicitly make some kind of difference based on origin of the actors and turn our focus to situations where the practice of a regulation or policy not expressing any preferences on origin happens to affect actors differently. The origin-neutral measures are presumed to be the main problem for environmental law in regard to national treatment.<sup>544</sup> An assessment on origin-neutral measures' compatibility with the provision

540 *S.D. Myers v. Canada* 2000.

541 *Pope & Talbot Inc. v. Government of Canada*, UNCITRAL Award on the merits 10 April, 2001.

542 For criticism of this narrow view, see Newcombe & Paradell 2009, pp. 425–427.

543 The award in the *Corn Producers International* case is not public, while some general information about it is available at Investment Arbitration Reporter website.

544 Fauchald 2006, p. 11.

on national treatment can be structured in different ways; no specific manner of interpretation is prescribed by the IIAs, and tribunals thus assess it on a case by case basis.<sup>545</sup> However, one widespread structure for analysis, which has developed based on NAFTA jurisprudence and been taken on by some writers,<sup>546</sup> includes three steps: (1) determination of comparator or comparators to the foreign investment and comparison of applied treatment of; (2) if unequal treatment, assessment of the reasons for this; and (3) as an additional test, assessment of whether there is any intent to discriminate towards foreign investments. This analytic structure accepts that a measure leading to unequal treatment towards a specific investor may breach the provision of national treatment if no legitimate reasons for it are found. Thus, the model leads to interpretations which can overstate the risks for constraints of policy space. As the implications of this interpretation of environmental regulation and measures are important to clarify, it is, however, meaningful to use this structure to illustrate the challenges for environmental policy space. Therefore, in the forthcoming sections the three above-mentioned steps are discussed, and the different aspects which potentially conflict with environmental regulation are analysed.

A general question is whether the alleged public measure must be part of a pattern leading to less favourable treatment for foreign investors as a group, or if the circumstances for a single foreign investor are sufficient to prove a violation. It has, in the WTO context, been argued that national treatment rather protects imported products in general from less favoured treatment compared with domestic products, and therefore a pattern of conduct or effect should be requested.<sup>547</sup> If the

545 Case law revised in *ibid.* p. 12.

546 See, for example, Newcombe & Paradell 2009, p.162–164, and Dolzer & Schreuer 2008, p.179–184.

547 Ehring 2002; see also Fauchald, Ole K., Flexibility and Predictability under WTO's Non-discrimination Clauses, *Journal of World Trade*, vol 37, 3, June 2003. The 'asymmetric' approach proposed by Ehring implies that all relevant products should be compared, and only if there is an asymmetric relation in the effect of the measure between imported and domestic products can national treatment be breached. It should, however, be noted that the provisions on national treatment in GATT and in

provision on national treatment within IIA interpretation requires such a pattern of conduct or effect, this would narrow the applicability of the provision on origin-neutral measures and, hence, put less constraint on policy space.<sup>548</sup> Although reference to the similar concept in trade law makes sense, it is no panacea for interpretation of IIAs.<sup>549</sup> Concerning the comparableness of investments, IIA tribunals have shown that trade-law-independent interpretation may, rather, restrict the scope for the NT provision by setting tighter conditions on the likeness of the investors.<sup>550</sup>

### 5.5.1 How to define ‘in like circumstances’

Following the three-step structure in assessing national treatment, the analysis starts with the determination of the appropriate comparators. Which domestic operators are right to compare the foreign investment with? Some IIAs explicitly state that the treatment granted to foreign investments should be the same as to domestic actors ‘in like circumstances’,<sup>551</sup> or ‘in like situations’.<sup>552</sup> It is difficult to see any major differences in meaning between these formulations.<sup>553</sup> Still many IIAs, especially those of European countries, do not mention any criteria on the comparator.<sup>554</sup> This, however, does not change the meaning that one only should compare like with like.<sup>555</sup>

IIAs are not identical, and with different systems to settle the disputes it is hard to make appropriate translations.

548 van Harten, 2007, p. 85.

549 Dolzer & Schreuer 2008, p.184–186; Kurtz, Jürgen, The Use and Abuse of WTO Law in Investor – State Arbitration: Competition and its Discontents, *The European Journal of International Law*, vol 20, 3, pp. 747–771.

550 Methanex v. USA 2005, part IV, chapter B, paras 30–37.

551 NAFTA, art. 1102(1); CAFTA, art. 10.3(1). Also found in US and Canada current models and IIAs concluded by those states based on those models.

552 OECD draft IIA.

553 Newcombe & Paradell 2009, p. 161; however, Dolzer & Schreuer 2008, p. 179), suggest that states may reflect some difference in value by choosing different wording.

554 *Inter alia*, China–Germany BIT 2003, art. 3(2), Iceland–Lebanon BIT 2004, art. 3(1)(2).

555 A tribunal interpreting the Energy Charter Treaty, which lacks this language, noted

In IIA cases the comparators have by some tribunals been identified as the domestic actors in the most like circumstances, preferably from the same business sector.<sup>556</sup> The focus on finding the most like comparators separates the approach taken by IIA tribunals from that taken by dispute panels in the WTO system analysing the requisite 'like product' in GATT article III. The GATT assessment to a larger extent considers the competitive relationship of products.<sup>557</sup>

The *Methanex* tribunal, asked to rule upon the phase-out of a substance used in gasoline made with methanol, a measure which gave better markets for an ethanol-based substance, explicitly excluded the idea of comparison with all actors in the wide gasoline sector.<sup>558</sup> However, in the *Occidental* case<sup>559</sup> the tribunal compared the conditions for the foreign-owned oil exporter with domestically owned exporters of flowers, seafood, and bananas, in relation to the new practice for VAT refunds. The latter case has been criticised for departing from the jurisprudence of a rather narrow determination of comparators.<sup>560</sup> If the *Methanex* case marks the road for future IIA tribunals, the fact

that 'in evaluating whether there is discrimination in the sense of the Treaty one should only "compare like with like"', *Nykomb Synergetics Technology Holding AB v. Latvia*, SCC 13 dec, 2003, p. 34; 'The absence of a comparator clause, such as in like situations, is arguably not legally significant.' Newcombe & Paradell 2009, p. 161.

556 'The tribunal [in the *Pope & Talbot* case] selected the entities that were in the most "like circumstances" and not comparators that were in less "like circumstances". It would be a forced application of Article 1102 [of NAFTA] if a tribunal were to ignore the identical comparator and to try to lever in an, at best, approximate (and arguably inappropriate) comparator.' *Methanex v. USA* 2005, Part IV, chap. B, para 19; The *Pope & Talbot* tribunal considered all actors in the same economic sectors as comparators to the actor in question for the prima facie case. OECD policy also states that only companies in the same sector are in like circumstances, National Treatment for Foreign Controlled Enterprises, OECD, 1992 p. 22.

557 On the WTO jurisprudence of 'like products', see Matsushita, Mitsuo, Mavroidis, Petros & Schoenbaum, Thomas, *The World Trade Organisation – Law, Practice and Policy*, Oxford University Press, Oxford UK, 2003, pp. 158–162. For comments on the different approaches taken by IIA tribunals, see Mann, Howard, *The final Decision in Methanex v. US: Some New Wine in Some New Bottles*, IISD/Mann, Howard, 2005.

558 *Methanex v. USA* 2005, Part IV, chap. B, para 28.

559 *Occidental v. Ecuador* 2004.

560 McLachlan, Shore & Weiniger, 2007, p. 252; Newcombe & Paradell 2009, pp.169–170.



that other investors are put in a better commercial position because of a general prohibition, in this case a prohibition to use certain environmentally hazardous substances, should not affect the consideration of the relevant comparator. An interesting case is the *San Sebastian* case, where the claimant called for a broad view on comparators. The case concerned a US mining company which alleged that El Salvador and its authorities had breached various treaty provisions in the CAFTA, including those against non-discrimination, *inter alia*, by virtue of the fact that El Salvador tolerates other industrial activities (like coffee bean processing) which allegedly were 'more intrusive on the environment'.<sup>561</sup> Such far-reaching analogies between sectors would open the door for many claims. It is indeed a complex question how different sources of contamination are controlled in different sectors, and how to make all sectors do their share of environmental improvement. It would be difficult and misplaced for any international court or tribunal to make judgments on such matters.

## 5.5.2 How to define legitimate reasons for differentiated treatment

After establishment of the comparators and ascertaining of non-equal treatment, the next question is whether there are legitimate reasons for public authorities to differentiate their treatment between the actors.<sup>562</sup> This can sometimes be viewed as the other side of the coin as to what is the right comparator. In front of the IIA tribunal the foreign investor may be able to show that it effectively gets less favourable treatment than comparable domestic actors. Then the responding state must counterpose that there are legitimate reasons for this difference in treatment. Public health, safety, and preservation of the environment are typically aims for which the public authorities may

561 *San Sebastian v. El Salvador* 2011 Notion of Arbitration, para 26(a); also see IAR 19 September 2009 i.

562 Newcombe & Paradell 2009, p. 176.

take legitimate actions. To clarify that certain public measures justify differential treatment of actors, some IIAs include explanatory texts.<sup>563</sup>

Measures that have to be taken for reasons of public security and order, for the protection of life and health or public morality shall not be deemed ‘treatment less favourable’ within the meaning of Article 3.

(German model BIT 2005, Protocol Ad, art. 3(a))

The Parties agree/are of the understanding that a measure applied by a government in pursuance of legitimate policy objectives of public interest such as the protection of public health, safety and the environment, although having a different effect on an investment or investor of another Party, is not inconsistent with national treatment and most favoured nation treatment when justified by showing that it bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign owned investment.

(Norwegian draft model BIT 2008, art. 3(1) footnote 2)

Tribunals have held that: ‘The assessment of “like circumstances” must also take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest.’<sup>564</sup> This can be understood in such a way that an authority may use objective criteria to safeguard health or environment as legitimate means to apply different conditions on activities similar in other regards.<sup>565</sup> For example, an export restriction to preserve natural resources is not legitimate, if the domestic use is not restricted as well.<sup>566</sup>

563 Those texts do not change the meaning of the agreements, but play the role of clarifications, which may be of importance to guide tribunals in the interpretation.

564 *S.D. Myers v. Canada* 2000, para 250.

565 See also *ADF v. USA* 2003, para 139.

566 *Birnie and Boyle* take the example of the US Forest Resource Conservation and Shortage Relief Act, which bans exports of unprocessed logs from federal or state forests. As long as domestic subsidies exist for cutting the old trees, the export ban

### 5.5.3 How to assess discriminative intent or purpose

The aim of the national treatment provision is to guarantee non-discrimination of foreign actors. A motivation of public measures by arguments favouring nationals over non-nationals could indicate a breach of the NT provision, in other words, a discriminating intent or purpose can be a breach of the treaty. However, most tribunals stress that there also must be a discriminative effect.<sup>567</sup> Discriminative intent is not an indispensable requirement for the finding of a breach. If it can be shown there is discriminative intent, it is rather taken as a strong evidence of a breach.<sup>568</sup>

In the case of *S.D. Myers*, a US company that disposed of and recycled decontaminated components had a subsidiary in Canada from which they wanted to export PCB-contaminated oil. At a time when the USA decided to accept imports of PCBs, Canadian companies lobbied their government to stop export, so as not to lose part of their operations. In 1995 Canada prohibited the export of PCB waste. The tribunal noted that the protectionist intent of the minister in charge was reflected in decision making at every stage that led to the ban.<sup>569</sup> The export prohibition obviously also affected the company in con-

only justifies the economic interest in keeping value-added timber processing in the country. This was taken as an example in trade law and goods export, but the situation could easily be translated into investment discrimination, if the company wanting to export is a foreign affiliate having the processing activities in another country. Birnie, Boyle & Redgwell, 2009, p. 714.

567 See, for example, *S.D. Myers v. Canada* 2000, para 254.

568 'The Tribunal concurs that the intent is not decisive or essential for a finding of discrimination, and that the impact of the measure on the investment would be the determining factor to ascertain whether it had resulted in non-discriminatory treatment.' *Siemens v. Argentina* 2007, para 321; however, the OECD has in an earlier work expressed the opposite opinion: 'In any case, the key to determining whether a discriminatory measure applied to foreign-controlled enterprises constitutes an exception to National Treatment is to ascertain whether the discrimination is motivated, at least in part, by the fact that the enterprises concerned are under foreign control.' OECD 1992, p. 22; both cited in Newcombe & Paradell 2009, p. 175.

569 *S.D. Myers v. Canada* 2000 para 162.

crete terms. However, in this case there were environmental reasons to favour national actors in taking care of PCB waste, as the Basel Convention prescribes the management of hazardous waste domestically; see further analysis in section 5.6. Also, in the case of *Methanex*, the tribunal discusses at length the claim of the company that the intent of the prohibition of the petrol additive was to discriminate against foreign methanol producers, and not, as argued by the state of California, to reduce the contamination of ground water.<sup>570</sup> The tribunal could not find any discriminatory intent.

It is, however, not clear in the jurisprudence whether there can be more than one reason behind a measure, and how this should be reviewed. Many times the political debate on policy reforms shows a number of different arguments for and against the proposals. In environmental reforms, apart from better environmental conditions, economic advantages for new industry also are often stressed. Different ministers and decision makers have reasons to focus on different aspects of a reform when communicating in public. Instead of dismantling every subjective intent, tribunals have taken on analysis of whether the measure taken has been necessary or reasonable.<sup>571</sup> The existence of alternative, and for the private actor less burdensome measures, could indicate that the measure chosen is not reasonable. This may lead to difficult discussions on environmental policy design and choice of regulatory instruments; see section 3.2.4. A public measure that, in the eye of the tribunal, fails to fulfil the legitimate political aim in a reasonable way is likely to be considered to violate the IIA.

570 Chapter III, part B of the award discusses this issue and counts for 28 pages.

571 *Methanex v. USA* 2005; *S.D. Myers v. Canada* 2000; *Glamis Gold v. USA* 2009; Writers have observed the lack of clear jurisprudence and recommended the use of the proportionality test, as in the WTO appellate body; see *Newcombe & Paradell* 2009, p. 174.

## 5.6 Environmental regulation and less favourable treatment

Much of the focus in analysing less favourable treatment, as was shown above, is put on similarities and differences of the foreign investment and domestic business actors. However, what is more important for environmental policy space is that the analysis of similarities and differences also relate to the public measure taken and the differences which stem from the environmental protection objective. As shown in chapter 3, the level of environmental standards applied to operators might differ for a number of reasons: the sensitivity at the location, the time for administrative decision, the size of the environmental impacts from one operator, or different assessments by different authorities holding discretionary powers. Here follows a discussion of whether these reasons are legitimate in the view of the IIA provision on national treatment described above, or if the provision puts constraints to the policy space of such regulation.

### 5.6.1 Sensitivity at the location, time of decision, and size of operator

Different sensitivity of the location may lead to more restrictive regulation on emissions from one activity than from another. Hence, it is vital in the environmental regulation that differences in the physical environment differentiate the actors, who, accordingly, should be treated differently. Current IIA jurisprudence has not answered the specific question whether the provision of national treatment also considers those actors as different, or if they are in like circumstances. However, requests by tribunals in some IIAs cases for fixed criteria or transparent methodology as a foundation for authorities' decisions support the opinion that environmental measures based on objective criteria of environmental quality and risk would be accepted.<sup>572</sup>

572 *Nykomb v. Latvia*, p. 34.

As shown in section 3.7, environmental regulation often treats new polluting facilities differently than old ones, as more stringent standards are applied to the new facilities. Notwithstanding such differences in treatment for similar actors, no IIA cases have focused on that as a problem, and few commentators seem to consider the situation as a potential issue of discrimination.<sup>573</sup> There might be two reasons for this apparent lack of conflict. The time aspect for the public measure is one; permits issued at the same time are considered comparable, while the conditions for an ongoing industry with a permit issued years earlier (when different environmental standards did apply and other technology was available) cannot be said to be in like circumstances as an industry with a recent permit. The different economic burden for the operators is another reason to differentiate; the cost for a new industry to install cleaning or choose better production methods is substantially less burdensome compared to an old industry that is not planning to change equipment. However, both those explanations also lead to conclusions about certain situations in which new establishments and ongoing industries are in more like situations and therefore suitable as comparators; a renewed permit should be compared with a totally new one, and when the industry upgrades its main operation process, it may be comparable to a whole new industry. This is the principle behind the practice, as BAT environmental permit systems seem to be in line with the understanding of legitimate differentiations in the national treatment provision.

A third differentiation between operators, which, as was shown in section 3.7 above, is often made in systems of pollution control, is between different sizes of operations or industries. It is obvious that various kinds of companies for the sake of feasible management and control by authorities must be categorised into one group or another for which different standards of treatment apply. The big operators normally have the most stringent environmental standards and obligation of control. But what is the legitimate reason for less favourable treatment of the bigger operators? This issue has not been raised in the IIA context. Differentiations on size might reveal discriminative

<sup>573</sup> von Moltke 2004, p. 177.

intent, since in developing countries bigger companies often represent foreign interests, while the small-scale manufacturer most likely is local. However, stricter standards for big companies might be seen as a mix of both the assumption of greater impact on the local environment and having greater economic feasibility, the latter. One may argue that an assumption of a positive environmental impact should be enough to make the measure reasonable, and that additional arguments also of economic feasibility should not determine the measure as discriminative.

Formally different treatment of different actors might be necessary to create a level playing field for competition. Small manufacturers should therefore not in all situations and for all accounting practices be compared with big companies. It is not an extraordinary thought that treatment of actors of different capacity must be different to level the playing field. Human rights law takes this approach in viewing discrimination; it is rather trade law that tends to neglect such aspects.<sup>574</sup>

Hence, an absolute comparison between different actors, neglecting to consider the sensitivity at the location, time of decision, and size of operators would constrain the use of the tools that environmental law uses to regulate operators to do less harm without interfering too much with ongoing business. Further, an often-desired outcome of environmental policies is that new technology and better methods are developed. From that aspect more stringent rules for bigger operators are relevant, as those actors often are better suited to develop new technology than small ones.

574 The UN Human Rights Commission noted when examining national treatment provisions in trade law, 'Treating un-equals as equals is problematic for the promotion and protection of human rights and could result in the institutionalization of discrimination against the poor and marginalized. Under human rights law, the principle of non-discrimination does not envisage according equal treatment to everyone in all cases,' Globalization and its impact on the full enjoyment of human rights, UN Doc E/CN.4/2002/54, 2002.

## 5.6.2 Different assessments by different authorities with multi-tiered environmental governance

There is a growing concern that measures by subnational governments may breach international investment treaty obligations and thereby invoke state responsibility for the national state; see above at section 3.6. Some even argue that there should be constitutional rules making clear that local authorities have responsibility to the national level for actions leading to state responsibility.<sup>575</sup> If that is of any use, is up to national legislators. However, the development of IIAs show that some states have preferred to reduce the risk of challenges of measures commonly carried out by local authorities by exempting national treatment and performance requirements from any existing non-conforming measure that is maintained by a local level of government.<sup>576</sup>

Operators might perceive different treatment when dealing with different environmental authorities, even if their causes might be of similar kind. Sometimes the result is that the operator perceives that more burdensome procedures or more stringent standards are applied by one authority than another. For example, in the *Clayton/Bilcon* case the US claimant, *inter alia*, alleged that the project to mine and ship basalt in Nova Scotia was subjected to the most onerous of a series of possible reviews under Canada's environmental assessment legislation and that other, similar projects did not need to proceed in the same way.<sup>577</sup> There is no final award on the merits in an IIA case dealing with this particular issue. However, a somewhat analogous claim was judged by the European Court of Human Rights in the *Fredin* case,<sup>578</sup> where the claimant stated that, compared to similar actors under the supervision of other regional authorities, it was the only one which was forced to close down and therefore had been discriminated against. The court held that for a claim to succeed of violation of the European Human

575 Herman, Lawrence L., Federalism and international investment disputes, *Investment Treaty News*, vol 1, 4.

576 See, for example, CAFTA 10.13(1)(a)(iii), and Australia–USA FTA 2005, art. 13.11.

577 *Clayton/Bilcon v. Canada*, statement of claim, 30 January 2009, art. 36(c).

578 *Fredin v. Sweden*.



Rights Convention article 14 on protection against discrimination, it has to be established 'that the situation of the alleged victim can be considered similar to that of persons who have been better treated'.<sup>579</sup> It concluded that the mere statement by the claimant that it was the only ongoing gravel pit operator which had its permit revoked was not sufficient.<sup>580</sup>

If an IIA arbitration tribunal were to follow the same line of reasoning as the ECtHR, the existence of other operations being treated better is only significant if the claimant also can show that the situations are in fact similar. Since the situations in environmental cases normally encompass many specific circumstances that easily depart one case from the other, for example, sensitivity of location and amount of pollution, such claims would in most cases fall short.

## 5.7 National treatment and global environmental minimum standards

Before summarising the analysis above and discussing how the IIA national treatment provision impacts environmental policy space, I will discuss how global norms on environmental protection may effect the interpretation of NT and empower host states to use their environmental policy space.

There are today many norms on environmental protection and responsible behaviour which have global recognition, either by multilateral environmental treaties and their decision making bodies or by standards of corporate conduct set by government or corporate cooperation; see section 3.2.2. Public measures on corporate behaviour in accordance with globally accepted environmental minimum standards must, like with any environmental norm, be implemented towards domestic and foreign actors on an origin-neutral basis to fulfil the IIA provision of national treatment. The fact that an environmental standard of behaviour is globally accepted may, however, strongly point

579 Para 60.

580 *Fredin v. Sweden*

towards an interpretation of the purpose of the measure as public and legitimate rather than protectionist, in situations where this could be questioned. This was shown in one of the few environmental IIA disputes on the national treatment provision that have been concluded: the NAFTA case *S.D. Myers v. Canada*.

### 5.7.1 Basel Convention and the prohibition to export hazardous waste

The *S.D. Myers* case concerned a prohibition on exporting hazardous PCB waste that Canada decided to carry out in 1995, and which the US company viewed as discriminatory and a breach of the national treatment provision included in NAFTA. Canada argued that the export prohibition aimed to ensure that Canadian PCB waste would be managed in an environmentally sound manner and that any possible significant danger to the environment or to human life or health would be prevented, and also that such prohibition was ruled for in the 1989 Convention on the control of transboundary movement of hazardous waste and its disposal (Basel Convention).<sup>581</sup>

NAFTA explicitly gives priority to some international environmental treaties in the event of any inconsistency between the obligations.<sup>582</sup> The Basel Convention is listed as one such prioritised treaty, but only upon the entry into force for the USA, which has signed but not ratified the convention. However, priority is also given to the bilateral agreement between Canada and the USA concerning the transboundary movement of hazardous waste.<sup>583</sup> Besides those treaties, the environmental side agreement NAAEC expresses the parties' agreed views on the relation between environmental regulation and NAFTA. The

581 *S.D. Myers v. Canada* 2000 paras 105–107 and 123; Basel Convention, art. 4(2)(d) prescribes that the signatories 'ensure that the transboundary movement of hazardous wastes and other waste is reduced to the minimum'.

582 NAFTA art. 104 and annex to art. 104. For further discussion on those types of provisions and on environmental side agreements like the NAAEC, see section 8.4.3.

583 The Agreement Between the Government of Canada and the Government of the United States of America Concerning the Transboundary Movement of Hazardous Waste, signed at Ottawa, 28 October 1986.

tribunal found that the Basel Convention did not prohibit cross-border shipments in all situations and presumed that the bilateral agreement on hazardous waste fulfilled the criteria in the Basel Convention and did not provide 'less environmentally sound management' of such waste.<sup>584</sup> The tribunal further noted that the bilateral agreement did not restrict transboundary movement of hazardous waste but rather subjected it to prior informed consent from the importing state.<sup>585</sup> The tribunal finally reviewed the principles of the NAAEC and concluded that 'A logical corollary of [NAAEC principles] is that where a state can achieve its chosen level of environmental protection through a variety of equally effective and reasonable means, it is obliged to adopt the alternative that is most consistent with open trade.'<sup>586</sup>

In the light of the provision on national treatment, the tribunal viewed the prohibition against export of waste as an act intending to favour nationals over non-nationals, but stated that this could be legitimate, since it supported domestic treatment of hazardous waste in line with internationally recognised principles.<sup>587</sup> However, the tribunal could see a number of less restrictive alternative measures fulfilling the purpose, and gave examples of two: public procurement and subsidies to support national actors. Those alternatives should have been applied instead of the export prohibition, which subsequently was declared to breach the NT provision.<sup>588</sup> Hence, the rules of the MEA were

584 *S.D. Myers v. Canada* 2000 paras 205–213; Basel Convention, art. 11.

585 Paras 205–221. The North American Commission for Environmental Cooperation issued a report in June 1996 on the Status of PCB Management in North America stating: 'In fact, the CANADA–US–MEXICO hazardous waste agreements are predicated upon the free movement of hazardous waste between the parties subject to prior notice and consent by the importing country. The Base1 Convention principles that disposal facilities be established within the country generating waste and that transboundary movement of waste shall be reduced to the minimum do not apply to bilateral movements of hazardous waste between the US and Mexico or Canada because these would be governed by the principle of the freedom of movement, subject to notification and consent of the country of import.' Cited from the award, para 213, note 36.

586 Para 221.

587 Para 255.

588 Para 256.

duly considered, but did not in this case absolve the host state from the judgment by the tribunal to rethink its policies to safeguard foreign investors.

Would the result have been the same if, prior to the export ban, Canada had carried out a governmental assessment of different methods to secure environmentally sound practice in treatment of PCB wastes, which had shown the importance of domestic capacity of such treatment? Or would the result have been the same if Canada had initiated a 'self-submission' concerning its own compliance with the Basel Convention regarding the export of hazardous waste to the USA,<sup>589</sup> and the report by the compliance committee had showed that such export was against the rules of the Basel Convention? Public assessments of alternative measures and authoritative interpretations of the rules of Basel should have been important information for the IIA arbitration tribunal. Rather than doing its own considerations, the IIA tribunal should in such situation lean on well-founded conclusions by the expert body of the Basel Convention.

In any case, even if the outcome in the *S.D. Myers* case shows that global environmental treaties do not automatically overturn investment provisions, it shows that such norms empower the host state in arguing for environmental policy space.

## 5.7.2 Preferential treatment of parties to international environmental treaties

Other conflicting areas between investment treaty provisions of national treatment or most favoured national treatment and rules of international environmental agreements may occur when the MEA prescribes some sort of preferential treatment for actors of MEA states or

589 This is a hypothetical question, as the current compliance mechanism within the Basel Convention did not exist at the time of the *S.D. Myers* case, and the dispute settlement process for the convention is prescribed for parties, and the USA was not a party at the time. However, the possibility to get an authoritative interpretation of the Basel Convention exists today; see information on the Basel Convention web page <http://www.basel.int/legalmatters/compcommittee/brochure-xx0706.pdf> (visited 2012-01-13).

enforces MEA investment requirements.<sup>590</sup> There are several such examples: the access and benefit-sharing mechanism in the Convention on Biological Diversity, prescribing requirements of benefit-sharing in accordance with CBD rules on the access of genetic material;<sup>591</sup> the Clean Development Mechanism (CDM) of the Kyoto protocol, which provides that actors from Kyoto states invest in such a way as to produce credits equivalent to CO<sub>2</sub> emissions;<sup>592</sup> and the fund created by the Montreal Protocol, which support investments in technology that are better for the ozone layer, but which cannot be used to involve transnational corporations.<sup>593</sup>

Those mechanisms, which aim at facilitating investments in environmentally smarter technology, could easily be implemented in ways that conflict with restrictions of performance requirements, most favoured nation treatment, or national treatment. To some extent the risk of conflict can be mitigated through language in the IIA permitting environmental performance requirements and local subsidies; see section 5.4.2. Host states using CDMs may require the sustainability standards needed for CDM projects also on other energy investments to enhance sustainability of its energy sector and avoid discriminato-

590 Ebbesson 1998, pp. 7–15.

591 Convention on Biological Diversity, art. 15, on access and benefit-sharing, and art. 16, on technology transfer, both stipulate certain 'performance requirements'.

592 Protocol to the Framework Convention of Climate Change, 1998. The host country authority may approve a foreign investor (authorised by an Annex I party) to carry out an energy project connected to CDM, but refuse an investor from a non-Kyoto country to establish itself in the energy sector, on potential conflicts with IIA provision; see Werksman, Jacob, Baumert, Kevin A. & Dubash, Navroz K., Will International Investment Rules Obstruct Climate Protection Policies?, World Resources Institute: Climate Notes, April 2001.

593 See Multilateral Fund for Implementation of Montreal Protocol, Policies, Procedures, Guidelines and Criteria, 2007, at 277, <http://www.multilateralfund.org/policy.htm> (visited 2012-01-13). It is the host country that applies for financial support from the fund. As noted above, insofar as the host country has agreed to IIA obligations, including national treatment clauses, support to domestic corporations on terms discriminating against foreign (trans)nationals might qualify as discrimination. However, support from the multilateral fund may be regarded as a form of state subsidy that may be excluded in IIAs.

ry effects of its policies.<sup>594</sup> Still, MEA provisions providing different treatment between actors from other MEA parties and non-parties, or from developing states and developed states, easily conflict with the provision on national treatment.<sup>595</sup> That no IIA conflicts based on such MEA provisions have arisen is probably only an illustration of the miniscule role those investments still play in the world of investments. IIA tribunals must acknowledge the global aim of sustainable development which governs both MEA and IIA objectives.

## 5.8 The provision on national treatment and environmental policy space

The previous analysis has shown that the provision on national treatment has potential to challenge regulations and public measures aiming at sustainable use of natural resources or to effectively protect health and the environment. Especially when applied in the pre-establishment phase, regulations on the management of natural resources which favour all domestic or some local actors come into conflict with the IIA provision on national treatment. Those conflicts are often avoided by explicit exemptions made in the IIA, since the host state's need for policy space often is large in those situations.

There may, however, also be conflicts between investment rules prohibiting implicit discrimination and effective environmental regulation on pollution control. To elucidate those conflicts the chapter analysed the different understandings that investment and environmental law apply on how to avoid discrimination of actors and conflicts related to multi-tiered environmental governance. This section aims to conclude this analysis in terms of environmental policy space.

594 Romson 2011. Also see Baetens, Freya, The Kyoto protocol in investor-state arbitration: Reconciling climate change and investment protection objectives, Cordonier Segger, Gehring & Newcombe (Eds.), *Sustainable development in international investment law*, chapter 27, Kluwer Law International, Amsterdam, 2011.

595 MEAs protecting north–south cooperation usually distinguish between developed and developing states, a separation which is hard to uphold in IIAs, Ebbesson 1998, p. 23.

The understanding of what is a legitimate basis for differential treatment in environmental law challenges narrow interpretation of the IIA national treatment provision. Most important to acknowledge is that environmental law safeguards operators against discrimination mainly through procedural rules such as transparency, procedures to participate and be heard, and access to legal reviews. This may contrast with investment law, which tends to rely more on substantive guarantees. An important factor to safeguard environmental policy space is therefore that IIA arbitration acknowledges the environmental procedural safeguards against discrimination. Otherwise, legal elements to align enforcement of environmental law with rule of law concepts, could be rejected.

While the environmental view that there is no discrimination when regulations differentiate actors due to differences in the physical environment logically coincides with the view taken of investment rules, other bases for differentiations made as part of policies of pollution control, such as size of the operator, are less clear-cut in the correspondence with the national treatment provision of IIAs and also may challenge 'absolute' interpretations. This means that constraints of environmental policy space depend on flexibility in IIA interpretation.

The use of natural resources is a policy area where the interests of regional and national development are strong, and therefore, the policy design often reflects both the environmental interests of economising the resource and the economic interest of strengthening the local job market or business opportunities. Also, subsidies of different kinds may support both environmental interests of technology development and economic interests of more competitive business. It is difficult to separate the economic and environmental policies when interpreting the IIA national treatment provision, which makes a further challenge to the analysis of policy space. To safeguard environmental policy space, it should be recognised that many policies have more than one aim and that the environmental aim should not be looked upon as subordinated, when scrutinising the policy reform.

Considering multi-tiered environmental governance structures, the understanding diverges, as environmental law allows for different

praxis towards operators by different local authorities, within an area of discretion, while investment law as the point of departure takes the international law perspective that the state party of the IIA must grant the same standards throughout all of its authority. Here again, a narrow investment law perspective risks putting constraints on the enforcement of environmental law and policy.

Finally, in this chapter it was shown how global environmental norms found in environmental treaties and their subsequent legislation could empower the host state to make use of its environmental policy space. Such empowerment could be further enhanced if there were more authoritative interpretations of MEA provisions by MEA compliance committees, which could clearly present and motivate the environmental norm.



# 6 Expropriation

## 6.1 Introduction

Nationalisations and expropriations have historically been a key interest concerning the protection of property of foreign persons and investors; thus, the regulation of expropriation is a core obligation to ensure investment protections by IIAs. The provision on expropriation is commonly disputed in environmental IIA cases and has given rise to much debate concerning the impacts on environmental regulation. The obligation on host states not to expropriate foreign investments without compensation includes both direct and indirect expropriation. The two main areas of potential legal conflicts between the IIA provision of expropriation and environmental regulation are environmental regulation concerning nature protection and reforms to strengthen public ownership of natural resources, and environmental policies which substantially restrict economic profits from private operations (the issue of ‘regulatory takings’).

This chapter will analyse the IIA substantive provision of expropriation and compensation in relation to two of the chosen areas: environmental law understanding of property rights and the concepts of prevention and risk assessment. It will also discuss the IIA cases that so far have dealt with conflicts of the provision and environmental regulation and observe situations where the IIA protection has been called upon to protect environmental goals. As a start, there is a description of the main varieties in formulation of the provision in different IIAs

and an analysis of the different lines of views taken in interpretation of indirect expropriation: the 'sole effect doctrine', the 'doctrine of police powers', and the 'right to regulate approach'.

## 6.2 Background

The protection of property of foreign persons in current international investment treaties has its background in nationalisations and expropriations of agricultural land and factories under regimes of socialism or liberated colonial governments during the twentieth century. The lack of confidence in the neutrality of domestic legal systems towards foreign investors when assessing the fair compensation for such expropriations has led to state agreements directing the issue of compensation to international arbitration tribunals. Also, states which in other areas of investment law have refused to agree to investor–state dispute settlement have more often agreed to international arbitration in the issue of determining compensation for expropriation. Nowadays, most IIAs provide for international arbitration for the whole provision on expropriation, the classification of the measure, as well as the lawfulness and the compensation.

As described in section 2.2.1, the UN Resolution on Permanent Sovereignty over Natural Resources showed the least common denominator between developed and developing countries' views of sovereign states' right to expropriate foreign property in its territory under certain conditions. Modern IIAs follow the resolution insofar as they do not prohibit nationalisation or expropriation, as long as the conditions of lawfulness and compensation are upheld. However, obligations in IIAs may go beyond customary international law in the issues of adequate compensation and the general protection for 'indirect expropriation'.<sup>596</sup>

596 The opinions in the debate about whether obligations in IIAs are identical or differ from those of customary international law depend on whether IIAs in themselves express a development of customary international law or mark an area of specific law governed by treaties. As stated in section 2.1.1, this work considers the regime of international investment treaties as a regime of treaties, and not

The majority of all IIA claims which include the provision on expropriation concern indirect expropriation in the sense of the IIA. In this work these cases are referred to as ‘control of use’; see section 6.3.2.

## 6.3 Expressions of the provision in IIAs and their different meanings

The provision on expropriation generally touches on four aspects of consideration: classification of direct expropriation, classification of indirect expropriation, lawfulness of the act, and determination of the compensation. By way of examples,

Investments of investors of each Contracting Party shall not be nationalised, expropriated or subjected to measures having effect equivalent to nationalisation or expropriation (hereinaf-

directly constituting customary norms. Regarding expropriation protection, that view seems to be supported by McLachlan, Shore and Weiniger, who note that the German–Pakistan BIT from 1959 did not include any reference to indirect expropriation, which at least at that time, was not a customary principle, McLachlan, Shore & Weiniger, 2007, p. 282; Bring, who in his work, investigated the customary norm of expropriation protection in the late 1970s and then assumed that developing states concluding IIAs were doing that to create special rules with some states, Bring, Ove, *Det folkrättsliga investeringsskyddet – En studie i u-ländernas inflytande på den internationella sedvanerätten*, Liber, Stockholm, 1979; Sornarajah, who, *inter alia*, argues that partial compensation several times has been agreed by states in cases concerning large nationalisations and that full compensation therefore is not a customary norm, Sornarajah 2004, p. 437; and Subedi, who notes there can be differences in what is permissible under general international law and under IIAs regarding expropriations, Subedi 2008, pp. 161–162. The opposing view seems to be held by Lowenfeld, who takes the widespread inclusion of the expropriation provision in IIAs as an indication that such principles have become established as customary norms, Lowenfeld, 2002, chap. 15; and Dolzer and Schreuer and Hobér, who take the wide use of the Hull formula in IIAs as an indication that customary rules include this obligation Dolzer & Schreuer 2008, pp. 91 and 274, and Hobér, 2007, p. 43. Also Shaw notes in a more general statement that IIAs are ‘remarkably uniform in their provisions’, and that they ‘constitute valuable state practice’ and that the practice confirms the traditional principles regarding expropriation, Shaw 2008, pp. 837–840.

ter referred to as ‘expropriation’) in the territory of the other Contracting Party except for expropriations made in the public interest, on a basis of non-discrimination, carried out under due process of law, and against prompt, adequate and effective compensation.

(Denmark–Indonesia BIT art. 5(1))

Investments by investors of either Contracting Party shall not be [...] expropriated [...] unless the measures are taken for a public benefit related to internal needs in that Party in a non-discriminatory manner, by authorisation of a formal law and against prompt, adequate and effective compensation.

(Chile–U.K. BIT 1996, art. 4(1))

Investments by investors of either Contracting Party shall not directly or indirectly be expropriated [...] except for the public benefit and against compensation.

(China–Germany BIT 2005, art. 4(2))

A Member State shall not expropriate or nationalise a covered investment either directly or through measures equivalent to expropriation or nationalisation (‘expropriation’), except:

- (a) for a public purpose;
- (b) in a non-discriminatory manner;
- (c) on payment of prompt, adequate, and effective compensation; and
- (d) in accordance with due process of law.

(ASEAN–Australia FTA 2009, art. 14(1))

### 6.3.1 Classification of direct expropriation

Direct expropriation is when the host state or its representatives take control over an investment, and the title of property thereby transfers from the individual to a public actor. After the expropriatory act the property is used for the public purpose and is controlled by the public actor. Land reforms for redistribution of land, nationalisation of

extractive industries to take back the control over natural resources and their profits, and expropriation of parcels of land when building a railroad or motorway are all examples of direct expropriations. Policies of nature conservation also sometimes use direct expropriation to protect nature in specific areas from exploitation.

The different terms in the IIAs of ‘expropriation’ and ‘deprivation’ have analogous meanings.<sup>597</sup> Further, the use of the word ‘nationalisation’ refers to a major public takeover of companies or land, but such actions are in any case covered by the term ‘expropriation’, if the latter is standing alone.<sup>598</sup> The preconditions for a lawful expropriation—public purpose, due process of law including non-arbitrary or non-discriminatory behaviour, and compensation—are well established in international law.<sup>599</sup> The variations in formulation in different IIAs in this regard have not been given meanings different from the international law standard.<sup>600</sup>

### 6.3.2 Classification of indirect expropriation

Most IIAs use a formulation of the expropriation provision that explicitly recognises not only plain expropriation, but also some sort of indirect expropriation. The provisions of indirect expropriation concern situations where the investor’s use of the investment is restricted to such a degree that from the investor’s perspective the situation is similar to that of direct expropriation, except that the title of the property has not transferred to the public but rests with the investor. The concept of indirect expropriation or expropriation *de facto* is known in general international law where it has been expressed in words like, ‘not only an outright taking of property but also any such unreasonable interference with the use, enjoyment or disposal of property [...] that

597 Newcombe & Paradell 2009, p. 324.

598 Some IIAs only refer to ‘expropriation’, or give specified types of actions and state that shares of companies are included. *Ibid.* pp. 332–334.

599 Dolzer & Schreuer 2008, p. 91. See also Oppenheim’s International Law, 1992, pp. 919–920, with notes.

600 Oppenheim’s International Law, 1992, p. 911.

the owner thereof will not be able to use, enjoy or dispose of the property within a reasonable period of time'.<sup>601</sup> In general international law this concept has mainly applied to situations where public authorities have taken effective control of the whole property or started a process to formally take over the property without fulfilling the procedure or paying compensation for a long time.<sup>602</sup>

However, it is more crucial in analysing impacts for environmental regulation to look at situations where the measure mainly refers to the control of the use of the property and where the result of such control is economic losses for the owner. In these regard writers on IIA expropriation regulation have been analysing with great interest the jurisprudence on property rights evolved particularly in the USA, and the doctrine of regulatory takings, and the European Court of Human Rights (ECtHR) rulings on the property right protection based on the first protocol of the European Convention on Human Rights. Writers have highlighted similarities between NAFTA rulings and ECtHR rulings, but to some extent also deduced a different and more lenient way to set property protection standards in the European court compared to those used in US or NAFTA jurisprudence.<sup>603</sup> According to ECtHR

601 1961 Harvard draft convention on International Responsibility of States for Injuries to Aliens, art. 10(3)a.

602 *Starrett Housing Corporation v. Iran*, 85 ILR 349, 1983; Norwegian shipowners' claims, UN Reports of International Arbitral Awards I p.307, 1922; *Certain German Interests in Polish Upper Silesia* PCIJ Series A no 7 p. 42, 1926 (PCIJ 1926, Series A, no. 7); *Papamichalopoulos v. Greece*, E.H.R.R., 1993, p. 440. For further reading see Dolzer & Schreuer 2008, chap. 6, and Shaw 2008, pp. 830–832.

603 Baughen, 2006, Mountfield, Helen, *Regulatory Expropriations in Europe: the Approach of the European Court of Human Rights*, *New York University Environmental Law Journal*, vol 11, pp. 136–147. 'The approach by the Court [ECtHR], therefore, may inform the question how other supra-national courts and arbitral bodies should seek to harmonize national and international standards of law when these arise in other contexts—for example, in interpretation the North American Free Trade Agreement (NAFTA).' p. 137. Also see *ibid.* and Freeman, Elyse M., *Regulatory Expropriation under NAFTA Chapter 11: Some Lessons from the European Court of Human Rights*, *Columbia Journal of Transnational Law*, vol 42, p. 177.

jurisprudence<sup>604</sup> and the US doctrine of takings,<sup>605</sup> public measures might be compensated for only if there is a lack of balance between the aim of the measure and the burden for the individual. These legal traditions, however, distinguish between on one hand, measures leading to a situation very similar to expropriation (hereinafter called 'expropriation *de facto*') and on the other hand, measures of the control of use (hereinafter called 'control of use', even though in English IIA literature the term of the US counterpart to the European 'control of use' in property law, 'regulatory taking', is more common).<sup>606</sup> Unclear in the wording in the IIAs is the extent to which the demand for compensation includes only expropriation *de facto* or also the wider control of use.

Although there are differences in the wording of the IIA provision—expressed as measures 'equivalent', 'tantamount', or 'similar' to expropriation; *de facto* expropriation; or 'constructive', 'disguised', 'regulatory', 'consequential', 'virtual' or 'creeping' expropriation<sup>607</sup>—the interpretations by arbitrators have not reflected any major differences in meaning from those different formulations.<sup>608</sup> In other words, even

604 Leading cases: *Sporrong & Lönnroth v. Sweden*, Serie A 52, 1982; *James and others v. United Kingdom*, Serie A 98, 1986; *Pine Valley Developments v. Ireland*, E.H.R.R., 1992, p. 319.

605 Leading cases: *Pennsylvania Coal v.*, 260 US 393, 1922; *Penn Central v. New York*, 438 US 104, 1978; *Tahoe-Sierra preservation council v. Tahoe regional planning agency*, 535 US 302, 2002.

606 Newcombe means that international expropriation cases should be classified in three ways: direct and indirect expropriation, arbitrary deprivations where police powers do not justify the measure, and the state abrogating a granted permission, Newcombe, Andrew, *The Boundaries of Regulatory Expropriation in International Law*, *ICSID Review – Foreign Investment Law Journal*, vol 20, 1.

607 The same investment-exporting country may also use different formulations. Sweden uses 'any measures depriving, directly or indirectly direct' (BITs with Guatemala, Ecuador, Uzbekistan) 'measures having equivalent (with ex. India and Croatia)/same (with ex. Lebanon)/similar (with ex. Romania) effect' For regional and multilateral IIAs, see NAFTA, art. 1110(1); ECT, art. 13(1); and MAI, draft part IV, art. 2(1).

608 Newcombe 2005ii; McLachlan, Shore & Weiniger, 2007, p. 295; Newcombe & Paradell 2009, p. 326, argue that the provision is very vague, and those differences in wording still do not help the tribunals with the hard question concerning which

if the different formulations put focus on somewhat different kinds of indirect expropriation, IIA tribunals have not in general interpreted a distinction as proposed above between expropriation *de facto* and control of use. Rather, most tribunals dealing with situations where there is no direct expropriation seem to have accepted that the IIA relevant for the case covers indirect expropriation in the wider sense, thus including control of use. The tribunals then try to carry out a balancing act to determine whether the measure should be compensated for or not. The divergence in interpretation is often described as a divergence between the ‘sole effect doctrine’ and the ‘doctrine of police powers’.<sup>609</sup> This difference may also mark a difference in the understanding of the underlying public regulation.

## Sole effect doctrine

The sole effect doctrine on the interpretation of indirect expropriation focuses on the economic burden the public measure imposes on the investor. If a measure has a substantial effect on the economic benefits or value, or on the control of the operations, and where this effect is lasting in time, there is a *prima facie* case that an indirect expropriation has occurred.<sup>610</sup> Numerous IIA tribunals have concluded that the effects of the deprivation on the ownership and benefits of the property are what matter.<sup>611</sup> However, a measure only imposing some

public actions should amount to an expropriation and which should not.

Fauchald and Schiötz Thorud argue that the different wording could be used to derive different meaning concerning the effects of the beneficiaries, but conclude that case law does not support such interpretation, Fauchald, Ole K. & Schiötz Thorud, Kjersti, Protection of investors against expropriation – Norway’s obligations under investment treaties, Fauchald, Jakhelln & Syse (Eds.), *dog Fred er ej det Beste... Festskrift til Carl August Fleischer*, Universitetsforlaget, Oslo, Norway, 2006, p. 125. Also see Dolzer 2003, and Schreuer, Christoph, The Concept of Expropriation under the ECT and other Investment Protection Treaties, *Transnational Dispute Management*, vol 2, no 3.

609 These doctrines stem from property law jurisprudence in the USA, and the term ‘police powers’ refers to governmental regulatory powers.

610 Dolzer & Schreuer 2008, p. 101.

611 Tecmed v. Mexico 2003, para 70; Consortium R.F.C.C. v. Kingdom of Morocco, ICSID



higher costs for the company, which does not have the effect of making the property more or less useless for the owner, will not be severe enough to amount to an expropriation.<sup>612</sup> In analysing the effect of the measure, it is notable that it is not the effect for a third-party beneficiary, the public, or the efficiency of public authorities that is in focus, but the effect for the individual investor and the company.

A further argument for limiting the analysis to the effect of the measure, and thereby disregarding arguments about effects on the beneficiaries and the public authority, is that public purpose already forms part of what constitutes a lawful expropriation, and compensation would be a necessary requirement independent of the purpose of the measure.<sup>613</sup> In other words, if the effect of the measure is severe enough to take away the owner's control and economic enjoyment of the property, it must be compensated in the same way as a direct expropriation. The *Tecmed* tribunal held in this regard:

We find no principle stating that regulatory administrative actions are *per se* excluded from the scope of the Agreement, even if they are beneficial to society as a whole —such as environmental protection—particularly if the negative economic impact of such actions on the financial position of the investor is sufficient to neutralize in full the value, or economic or commercial use of its investment without receiving any compensation whatsoever.<sup>614</sup>

It has been claimed by various authors that the sole effect doctrine is the dominant interpretation in expropriation cases.<sup>615</sup> However, af-

ARB/00/6 Award 22 December, 2003, para 69. See also the cases at the US–Iran claims tribunal *Starrett Housing, Tippetts and Phelps Dodge*.

612 Dolzer & Schreuer 2008, pp. 102–103), discussing *CMS v. Argentina* and *Telenor v. Hungary*.

613 Schreuer 2005, p. 109, and Dolzer & Schreuer 2008, p. 95, citing Judge Rosalyn Higgins questioning the usefulness of distinguishing between non-compensable public measure and regulatory taking in 1984.

614 *Tecmed v. Mexico* 2003, para 12.

615 Dolzer 2003; Schreuer 2005.

ter the inclusion of a clarifying paragraph on the provision on indirect expropriation in the US model BIT 2004 and awards in some IIA cases against the USA, the debate may have shifted, and many writers now have the opinion that one could not only look to the effects for the private actor when determining indirect expropriations.<sup>616</sup> Thus, the reaction to the sole effect doctrine is the doctrine of police powers.

## Police power doctrine

Many argue against a method that only regards the effects for the investor, since an assessment of the situation cannot disconnect from a requirement of state conduct.<sup>617</sup> The doctrine of police powers puts focus also on the public measure and considers normal regulatory measures frequently affecting the control and economic enjoyment of companies. Thus, according to this doctrine, the analysis of the situation leading to the dispute must identify the line of distinction between normal regulatory measures and compensable indirect expropriations, the distinction that is at the core of the debate regarding environmental measures and the IIA provision on expropriation.

The different views on interpretation have generated explanatory text to the provision of expropriation in some IIAs. These texts clarify that general public measures on environmental or health protection are normally not indirect expropriation:

(a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:

(i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, stand-

616 Inter alia, Fauchald 2006, p. 19, who goes as far as stating that, 'The exception now in US treaties is likely to prevent successful challenges to environmental measures.' See also Fortier & Drymer, *ICSID Review— Foreign Investment Law Journal*, 19, 2004, pp. 293–327.

617 McLachlan, Shore & Weiniger, 2007, p. 292.

ing alone, does not establish that an indirect expropriation has occurred;

- (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
- (iii) the character of the government action.

(b) Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.

(US model BIT 2004, Annex B, para 4(b))

Except in rare circumstances, such as when a measure or series of measures is so severe in the light of its purpose that it cannot be reasonably viewed as having been adopted in good faith, non-discriminatory measures by a Party that are designed and applied to protect legitimate public welfare objectives, for example health, safety and the protection of the environment, do not constitute indirect expropriation.

(Article 2(b) of Annex 811, Canada–Colombia FTA 2008)

Similar formulations are found also in US–DR–CAFTA 2004 and ASEAN–Australia FTA 2009 and also in the MIGA convention on the risks covered by the public insurance.<sup>618</sup> The explanatory text follows the US doctrine on ‘takings’ and the requisites which have been formulated by the US Supreme Court in cases like *Pennsylvania Coal* and *Penn Central*. Paragraph (b) should make clear that ordinary *bona fide* regulatory measures are not indirect expropriations. The USA has taken a similar approach as respondent in IIA cases, *inter alia*, in the *Methanex*

618 The Convention Establishing the Multilateral Investment Guarantee Agency, World Bank 1985 (MIGA Convention), art. 11(a)(ii): ‘any legislative action or administrative action or omission attributable to the host government which has the effect of depriving the holder of a guarantee of his ownership or control of, or a substantial benefit from, his investment, with the exception of non-discriminatory measures of general application which the governments normally take for the purpose of regulating economic activity in their territories’.

case. Thus, the explanatory texts clarify that public regulation which is *bona fide* is not an expropriation, even indirectly. IIAs including such clarification should thereby have a lesser risk of being instruments by which private actors carry out legal challenges to health and environmental regulation.<sup>619</sup> The language is, however, vague ('except in rare circumstances') and does not in total exclude situations where public regulation gives rise to indirect expropriation. The same interpretation that the USA as respondent worked to obtain in the *Methanex* case, and to which the clarification in subsequent IIAs are pointing, is possible also concerning other IIAs. In the *Saluka* case, which was based on a BIT without any explanatory texts,<sup>620</sup> the tribunal affirmed the use of what broadly can be called the police power doctrine.<sup>621</sup>

Thus, the doctrine of police power is expected by many to become the main interpreting approach. However, as shown, this approach is also based on the assumption that the effect of the regulation on the investment is still the major element, but including a more open mind towards the reasons for the regulation.

## Right to regulate approach

The doctrine of police power still does not give a clear answer as to when regulations go 'too far' and must be compensated, and when the measure should be regarded as ordinary regulatory control of the use of the investment. Newcombe calls the doctrine of police power one and the same 'orthodox approach' as the doctrine of sole effects.<sup>622</sup> Fauchald and Schiötz argue that there is a fundamental difference, wheth-

619 Newcombe, Andrew, Canada's New Model Foreign Investment Protection Agreement, *TDM*, vol 2, 1, 2005. See Fauchald 2006, p. 22.

620 Czech Republic–The Netherlands BIT 1991, art. 5.

621 *Saluka v. Czech Republic* 2006, the tribunal was explicitly referring to the *Methanex* case when stating: 'In the opinion of the Tribunal, the principle that a State does not commit an expropriation and is thus not liable to pay compensation to a dispossessed alien investor when it adopts general regulations that are "commonly accepted as within the police power of States" forms part of customary international law today,' para 262.

622 Newcombe 2005ii.

er or not the expropriating clause balances the right to compensation against the right to regulate.<sup>623</sup> Therefore, as a third approach it can be argued that cases which deal with the control of use should highlight the host state's right to regulate. This is an approach similar to that taken in human rights law. Instead of analysing police powers, the European Convention on Human Rights (ECHR), article 1, in the first protocol, declares that states have rights to enforce laws 'to control the use of property in accordance with the general interest'.<sup>624</sup>

The European Court for Human Rights has, in its interpretation of the ECHR, given states a wide margin to regulate the use of property in the public interest. The background is to defend a democratic society:

The decision to enact laws expropriating property will commonly involve consideration of political, economic and social issues on which opinions within a democratic society may reasonably differ widely. The court, therefore, found it quite natural [...] that the margin of appreciation available to the legislature in implementing social and economic policies should be a wide one. The legislature's judgment should be accepted unless the judgment is manifestly without reasonable foundation.<sup>625</sup>

The ECtHR has further stated that the result of measures restricting property rights must reflect a fair balance of interests, and the court regularly uses a proportionality test to that end.<sup>626</sup> If the individual bears 'an excessive burden', the measure is not proportional according to the test. Thus, in its reasoning this approach may seem very

623 Fauchald & Schiötz Thorud, 2006, p. 126.

624 ECHR, protocol 1, art. 1(2). Similar formulation in IACHR article 21(1)(2): 'Everyone has the right to the use and enjoyment of his property. The law may subordinate such use and enjoyment to the interest of society. No one shall be deprived of his property except upon payment of just compensation, for reasons of public utility or social interest, and in the cases and according to the forms established by law.'

625 Macdonald 1993, p. 523.

626 Frowein conclude that with regard to legislation concerning control of use of property, it seems that 'only exceptional measures would be considered not proportionate'. Ibid. p. 527.

similar to the doctrine of police powers. However, the state's right to regulate is the point of departure for the ECtHR, and this contributes to a practice with much fewer tensions between public regulation and property right protection.<sup>627</sup>

So far no European BITs are using language that stems from the ECHR, article 1, P-1, or the leading cases concerning the matter from the Strasbourg court. There is only one example where a state discussed such formulations; the Norwegian draft model BIT in 2008 proposed the provision on expropriation resemble the ECHR article:

A Party shall not expropriate or nationalise an investment of an investor of the other Party except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provision shall not, however, in any way impair the right of a Party to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

(Art. 16(1 and 2))

Here the provision does not use any term for indirect expropriation and the second paragraph set off the right for states to regulate property without compensation. The second paragraph is identical to the

627 It is hard to find any large debate about the constraints for environmental or other public regulation in the field of ECHR, while even with interpretations in line with police powers the IIA regime is much debated, and new cases are regularly challenging new areas of public regulation. Boyle concludes that the Strasbourg court has consistently taken the view that environmental protection is a legitimate objective of public policy, and like other international courts, refused to allow individual property rights to trump environmental rights, Boyle 2007. Mountfield notes that the ECHR gives a wide margin of appreciation to the states, Mountfield, 2002. Schreuer and Kriebaum have analysed the concept of property in human rights law and in international investment law, and they rightly regret there is so little interaction between the fields, Schreuer, Christoph & Kriebaum, Ursula, *The concept of property in human rights law and international investment law*, Breitenmoser, *et al.* (Eds.), *Human rights, democracy and the rule of law*, Dike verlag, Zürich, 2007, p. 762.

second paragraph of article 1 in the first protocol to the ECHR.<sup>628</sup> Some non-European IIAs include a freestanding clause affirming the host state's right to regulate; see further section 8.4.1. The effect of such clause for the interpretation of the provision on expropriation is not yet clear. The right-to-regulate approach is, however, more open for the environmental law understanding of property rights as merely an issue of regulation of use (as discussed in section 3.8) than the previously described approaches of sole effect and police powers.

### 6.3.3 The protected interest

The interest protected against expropriation by the investment treaties is tied to the definition of investments in the treaty; see section 2.3.1. It is not only land and other physical belongings that may be expropriated but also intangible assets and property in the form of contracts. This does not differ from the view taken in general international investment law.<sup>629</sup> The Iran–US claims tribunal held that expropriation may extend to any right that can be the object of a commercial transaction.<sup>630</sup> The question is, however, whether the investment treaties include 'investments' other than those that can be the object of a commercial transaction for expropriation protection.<sup>631</sup>

In establishing an expropriation claim in an environmental case, various kinds of operating permits often play an important role. Several IIA tribunals have concluded that domestic law defines both the legality of the investment<sup>632</sup> and whether the rights connected with the investment exists.<sup>633</sup> The US model BIT explicitly notes that whether such instruments have 'the characteristics of an investment depends on such factors as the nature and extent of the rights that the holder

628 First protocol, art. 1.

629 For example, in the Norwegian shipowners' claims, the ICJ accepted the US's requisitions of the orders of ships as expropriation.

630 *Amoco International Finance corp v. Iran Award* 14 July, 1987, para 108.

631 Note Fauchald & Schiötz Thorud, 2006, pp. 120–121.

632 *Salini v. Morocco* 2004, para 46. Also see *Inceysa v. El Salvador* 2006.

633 *Saluka v. Czech Republic* 2006, para 184.

has under the [national] law'.<sup>634</sup> In those cases the defining of vested rights and assets of which the investor could have been deprived of control could be a crucial element. If a permit for extraction of gold is revoked, this could not in itself constitute an expropriation if the permit as such is not something the investor could be deprived of. It is dependent on the law establishing the characteristic of a permit in the specific situation.

Environmental permits can in domestic law be seen either as a kind of property or vested interest in itself or as an individualised regulation; see section 3.4.2. In the case of the latter a denial or non-renewal of a permit is not obviously a deprivation of property and possible expropriation. As Schreuer and Kriebaum noted in an analysis of the concept of property in human rights law and international investment law, 'When determining the existence of an "investment", tribunals have emphasized repeatedly that what mattered was not so much ownership of specific assets but rather the combination of rights that were necessary for the economic activity at issue.'<sup>635</sup> This holistic approach is valid also when determining the interest protected by the expropriation provision. According to this view, it is the effects of the economic activity at issue which are in focus in determining the interest protected by the IIA provision on expropriation. This may explain why international tribunals have not distinguished between environmental permits as vested interests and as individual regulations.<sup>636</sup> In both cases the effect for the operator is similar, and if the permit is a key component of the operation, it is likely that it can be deprived in the sense that the effect may amount to expropriation. In this way IIA expropriation provision may be broader than that recognised for intangible property in domestic legislation.<sup>637</sup> However, if intangible values

634 USA model BIT 2004, art. 1, definition of 'investment', note 2; Dolzer & Schreuer 2008, p. 65.

635 Schreuer & Kriebaum 2007, p. 760.

636 For example, *Fredin v. Sweden*.

637 Fauchald and Schiötz Thorud also note that the IIA expropriation protection in practice might cover a broader spectrum of property rights than domestic law, Fauchald & Schiötz Thorud, 2006.



like know-how or brands are not perceived as rights in themselves by the domestic law it would be a far-reaching interpretation that a brand or know-how could be expropriated by the environmental regulation leaving the core business untouched, even though the definition of 'investment' in the IIA covers intangible assets.<sup>638</sup>

### 6.3.4 Compensation

The specification of the compensation in the IIA provision is often but not always '*prompt, adequate, and effective*', which originates from the 'Hull formula' in the late 1930s; see section 2.2.1. Many IIAs also specify the meaning of 'adequate' by explicitly stating the compensation should be based on 'fair market value'.<sup>639</sup> Some IIAs also specify in more detail the formula for valuation, for example:

Compensation shall be equivalent to the fair market value of the expropriated investment [...]. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.

(Canada model FTA 2004, art. 13(2))

The value shall be determined in accordance with generally accepted principles taking into account, *inter alia*, the capital invested, replacement value, appreciation, current returns, the projected flow of future returns, goodwill and other relevant factors.

(Finland–Tanzania BIT 2001 (art. 5(2))

638 This issue could have been analysed in the case of *Shell v. Nicaragua* 2007, in which Shell alleged that a Nicaraguan court expropriated their property when the court decided on stay on the Shell brand as security in a case on serious health damages for banana workers using chemicals sold by Shell. The claims were, however, withdrawn later in the proceedings.

639 See Newcombe & Paradell 2009, pp. 383–384, mentioning four IIAs whose formulations might indicate a non-market value of the compensation, of which three were concluded by China in the 1980s. At p. 332, note 60, they specify the practice used for the surveys on treaties.

The 'going concern value' is commonly used as value if there is an ongoing activity which is expropriated. The value is then normally determined by a discounted cash flow method that considers future cash flow in the company discounted by a certain factor to decrease the value because of time and risk.<sup>640</sup> For situations where the operation have not started yet, or recently started, other methods may be used.<sup>641</sup>

IAs are not specifying valuation methods to reflect problems related to environmental issues in direct expropriations, such as if the calculation of the future value of a mine should disregard liability for pollution or damaging activities, or if the value of a tourist resort should include the increase in value which depends on public nature preservation measures in the surrounding area. In domestic law the practice concerning the compensation for environmental expropriatory measures differs.<sup>642</sup> One may question whether the IIA request for compensation of 'fair market value' in cases of environmental regulation precludes the calculation of compensation from including considerations on restrictions in the use for the owner due to nature protection regulation; see further in section 6.5.1.

## 6.4 Environmental regulation and compensation for direct expropriation and expropriation *de facto*

As discussed above, the IIA provision of (direct) expropriation covers measures where public authorities take over the title of property and very similar actions where the effective control of the property is

640 Dolzer & Schreuer 2008, p. 274.

641 In *Waguih Elie George Siag and Clorinda Vecchi v. The Arab Republic of Egypt*, ICSID ARB/05/15 Award 1 June, 2009, the tourist centre had been established very recently and therefore the discounted cash flow was not considered an appropriate method to measure the loss of value.

642 Even countries with similar legal traditions may differ remarkably in the practice, for example Sweden, Finland and Norway in compensation for environmental protected areas of privately owned forests.

taken from the private owner by a public measure. As was shown in section 3.8, environmental law confronts this perspective in two ways, making use of private property rights and calling for collective property rights (the third perspective elaborated in 3.8 of environmental law on setting boundaries for property rights corresponds to the discussion on indirect expropriation and is analysed in section 6.5 in this chapter). Environmental policies may also include instruments which aim to take over property or the control of the management of companies. This section will initially discuss how the IIA perception of property rights through the provision of expropriation challenges perspectives calling for collective property rights, and how a traditional protection of property rights can be used to protect the environment. Then, two types of environmental regulation, nature protection and eco-management, are explored in relation to the obligations included in direct expropriation. Those different topics have different impacts on environmental policy space.

#### 6.4.1 Stewardship or absolute property rights?

Many analyses of property from an environmental view conclude that there is limited scope for strong private property rights due to a number of aspects; see section 3.8. First, even the rights of neighbours under the old laws of property recognised that a prohibition against using the property in a way that harms others. Second, the owner's right to beneficial use and enjoyment of the property are always limited by inherent social and environmental obligations, as expressed in law and the cultural norms of the society.<sup>643</sup> The development of administrative environmental regulation from the 1970s onwards has thus substantially constrained the scope of private property. Further, as public functions of property vary across different states, the balance towards private interest also varies as states set property rules.<sup>644</sup> Third, the regulation of natural resources poses important questions about the

643 Raff, Murrey, *Environmental Obligations and the Western Liberal Property Concept*, *Melbourne University Law Review*, vol 22, 1998, pp. 657–692

644 Barnes 2009, p.113 and chap 4.

allocation of wealth and power in society, which implies extra interest of the public and alignment to social-political currents.<sup>645</sup> This is especially emphasised by the writers on environmental justice.<sup>646</sup> Fourth, for some writers the public interest of environmental non-degradation and the development of a global understanding of sustainable development lead to the conclusions that property rights to natural resources are best understood in terms of stewardship.<sup>647</sup>

Barnes defines stewardship as to some extent a different holding of property than private property rights, which emphasises the responsibility to preserve the resource from harm and manage it in a way that the benefits last for future generations, as well.<sup>648</sup> This means that the right to the 'capital' is constrained and harmful use prohibited.<sup>649</sup> It is sometimes suggested that stewardship is an individual holding that is subject to overarching public duties.<sup>650</sup> The individual holding must be consistent with other property rules, and the relation between public bodies' responsibilities and the individual stewards for the resource must be carefully tailored, in order to make it work as stewardship and not just a form of collective property.<sup>651</sup> The differences between a system of private property rights in the form of emission rights or quotas of fish in the management of clean air and living marine resources and

645 Ibid. p. 10.

646 Hey 2009.

647 To mention some, Barnes 2009, p. 402, proposes stewardship as a better framework for management of living marine resources due to the complex values, rights, and interests in that resource; consequently, he proposes that the calls for stronger private property rights and privatisation in the management of marine resources should be met with scepticism. Westerlund, Staffan, *Where Would Mankind Stand Without Land?*, IMIR 1998, published online at <http://www.imir.com/english/norfa98.pdf> (last visited 2010-08-31) does not explicitly mention stewardship but asks whether any degradation of the resource could be allowed if property rights were to be in compliance with sustainable development.

648 Barnes 2009, pp. 155–162.

649 Ibid. p. 157.

650 Ibid. p. 160, discussing common law concepts of 'equitable property' and the public trust doctrine.

651 Ibid. p. 162.

ecosystems and a stewardship system with individual holdings in relation to compensation for restriction in the use of the holdings are important, as private property rights push for compensation in accordance with classic property law. Hence, seen as a system of private property, tradable emission rights and individual transferable quotas for fishermen may construct a commoditisation of living marine resources, which, from a stewardship view, should instead be recognised as common resources belonging to humankind. Both perspectives would arguably find proponents within environmental law.

Hence, to fully allow environmental policy space, the perspective on collective property rights must be respected. It is, however, hard to see that the provision on expropriation in the present investment treaties provides for that to any extent. Sornarajah means that it is a concept of the right to property as an absolute right that is sought to be universalised in the IIAs.<sup>652</sup> However, he points out that such universalisation of the US and European notion of property right will be met with resistance by developing states.<sup>653</sup>

## 6.4.2 Protection of property as protection of the environment

Protection against expropriation may support the kind of environmental protection which is exercised through property rights, as when the owner of land takes action against pollution or degradation caused by surrounding activities. An enforceable right to property, as owner or user, also guard the interests of participation in decision making concerning that property. If a public measure causes environmental damage or health problems to private property, this could amount to expropriation. Likewise, if public authorities ignore a user's rights to land when permitting other actors to exploit resources, this might amount to a denial of the user's property rights.

Rulings by the Inter-American Court of Human Rights (IACtHR) show how state interference in indigenous peoples' land regarding ex-

652 Sornarajah 2004, p. 369.

653 Ibid.

traction or harvesting of natural resources may be a denial of property rights.<sup>654</sup> In the *Mayagna Awas Tingni* case the state of Nicaragua had given a foreign company the right to forest logging in an area of several indigenous communities. The court concluded that without the group's participation in the decision, and denying the group the right to demark the lands that were theirs according to tradition, national legislation, and the ILO Declaration No. 169,<sup>655</sup> this was denial of the communities' rights to property according to the article 21 of the American Convention of Human Rights.<sup>656</sup> A subsequent case before the Inter-American Commission on Human Rights initiated by logging and oil concessions by the state of Belize further emphasised the need for the state to safeguard land traditionally used and occupied by indigenous peoples and respect it as collective property of the community.<sup>657</sup> Thus, international protection of property rights may help protect land from environmentally destructive actions.

However, this kind of protection of property rights is hardly carried out by the provision on expropriation in IIAs. Not only are indigenous peoples in most cases inhabitants in the host state and thus without access to the IIA dispute settlement, it is, as said above, most doubtful that the IIA provision on expropriation would allow for such complex interpretation of the provision as to let it cover public ignorance of collective property rights based on social and cultural heritage.

Yet, if one keeps within the traditional concept of private property rights, one finds that IIAs and the provision on expropriation have been used to protest against environmentally harmful activities and what has been conceived as environmental injustice. At least two such cases have been initiated.

654 See the cases *Mayagna Awas Tingni v. Nicaragua* 2001; *Comunidad Indígena Yakyé Axa del Pueblo Enxet-Lengua v. Paraguay*, IACtHR Judgment 17 Jun, 2005, and *Sawhoyamaya v. Paraguay*, IACtHR Judgement 29 March, 2006. Cited in *Guía de defensa ambiental* 2008 pp. 60–61.

655 ILO Convention No. 169 on Indigenous and Tribal Peoples in Independent Countries, adopted 1989.

656 American Convention on Human Rights, 'Pact of San José, Costa Rica', adopted 1978.

657 *Maya Indigenous Community of the Toledo District v. Belize* 2004. Also see Boyle 2007.

In *Bayview Irrigation v. Mexico*<sup>658</sup> a group of Texas water districts commenced arbitration against Mexico, alleging that the state was responsible for the water districts on the US side of the border not receiving as much water as they had the right to, according to the bilateral treaty dividing the water in Rio Bravo and Rio Grande. Texan farmers alleged that they suffered huge losses as a result of Mexican authorities designating the water upstream for activities in Mexico. The IIA tribunal, however, rejected that the claimants had any water rights in Mexico which constituted a dispute of the IIA (NAFTA). It held:

One owns the water in a bottle of mineral water, as one owns a can of paint. If another person takes it without permission, that is theft of one's property. But the holder of a right granted by the State of Texas to take a certain amount of water from the Rio Bravo/Rio Grande does not 'own', does not 'possess property rights in', a particular volume of water as it descends through Mexican streams and rivers towards the Rio Bravo/Rio Grande and finds its way into the right-holders irrigation pipes. While the water is in Mexico, it belongs to Mexico, even though Mexico may be obliged to deliver a certain amount of it into the Rio Bravo/Rio Grande for taking by US nationals.<sup>659</sup>

There has further been a notice to the state of Barbados about an IIA dispute concerning the damage to an eco-tourism establishment owned by a Canadian citizen, Peter Allard. Mr Allard, according to this notice,<sup>660</sup> bought land of high ecological value and created the 'Graeme Hall Nature Sanctuary', which attracted many tourists with its ecological richness. But the repeated discharge of raw sewage into wetlands,

658 *Bayview Irrigation District and others v. United Mexican States*, ICSID ARB(AF)/05/1 Award 19 June, 2007.

659 *Ibid.* para 116.

660 Peter Allard v. Barbados, 2009, Notice of claim, 8 September. Cited in Whitsittonly, Elizabeth, Claimant seeks enforcement of environmental laws in notice of dispute alleging expropriation of Barbadian nature sanctuary, *Investment Treaty News*, 10 February 2010.

runoff of grease, oil, pesticides, and herbicides from neighbouring areas, and poachers that have threatened the wildlife have destroyed the environment and the business. Mr Allard claims that the failure of the authorities to stop that damage has led to an indirect expropriation. Further, a new development plan which aims to exploit the surrounding area risks causing damage to the eco-tourism establishment, since these exploitations will lead to further degradation of the ecosystem on Mr Allard's land also. Hence, if this dispute goes to arbitration, the tribunal needs to assess whether failure of the state to enforce environmental laws could amount to expropriation in the meaning of the IIA.

Thus, there are investors whose investments are environmentally harmed who try to claim compensation based on the provision on expropriation and thereby turn the IIA provision into an obligation for host states to act for the protection of the environment. However, it is uncertain whether the IIA provision can be used for this purpose. Environmental harm can without doubt affect businesses in an economic sense, but it is difficult to connect the harm with solid public obligations. Another obstacle for the investment provision to play such a role in protecting the environment lies in the restriction of foreign investors. To be used as a proactive tool, it has to be in the hands of the people most affected by inferior environmental regulation, and that is seldom foreign investors. Rather, the IIA provision granting investors 'full protection and security' might be used in these situations. This provision covers situations where operations are physically damaged as a result of failure of public governance.<sup>661</sup> An evolution of the protection and security provision may, as well, dwell on the sensitive issue of state responsibility for global environmental change, as there occur today many natural catastrophes with landslides, unpredictable flooding, or climate changes that damage foreign investment projects, and whose causes are human acts or omissions.<sup>662</sup>

661 Sornarajah 2004, p. 237.

662 See Robbins, Joshua, The Emergence of Positive Obligations in Bilateral Investment Treaties, *Miami International and Comparative Law Review*, vol 13, 2006, pp. 426–431.



### 6.4.3 Nature protection through compulsory public acquisition of land

This section shifts the view from how protection of property rights might force the host state to act in favour of the environment to how protection of property rights also can be used by the host state to safeguard protection of areas of nature. Compulsory acquisition of land is a rather common measure to preserve nature land of special importance as habitats of endangered species, and to ensure public access within the framework of creating healthy environments in city planning; see section 3.8. By taking title to the land, the state ensures public access and guarantees good order and long-term perspectives for the preservation activities. A state may also acquire land to control profits from natural resources. For public acquisition of private land domestic law generally offers systems to agree on compensation. Those systems would be in line with the provision on expropriation in IIAs, as long as ‘full’ compensation is offered.

Other measures to protect nature only restrict certain use of the land. Severe restrictions for the landowner, for example, a prohibition on exploitation, timber logging, or agriculture, is not unusual. If the only difference is that the title of the land does not leave the private owner, the measures still may be seen as expropriation *de facto*, in terms of an IIA. However, nature protection measures which leave more opportunities for the landowner to have economic output from the land, while restricting certain activities or safeguarding certain parcels of the land, are not so similar to expropriation, but rather resemble a control of the use of property, and hence, in IIA terms might be considered an indirect expropriation.

Compulsory public acquisition of land for the purposes of nature protection is a direct expropriation which requires compensation in the view of the IIA. This was shown in the *Santa Elena* case.<sup>663</sup> There are few IIA cases where direct expropriation for environmental purpose has been part of the conflict. In the end the *Metalclad* case boiled

663 *Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, ICSID ARB/96/1 Award 17 February, 2000.

down to the issue of area protection proclaimed by the municipality. The award is unclear regarding any compensation offered by the municipality for the public takeover or otherwise specific restrictions on the owner's further use of the land. However, the appeal decision is less surprising in its conclusions of this measure as exceeding the threshold of a direct expropriation in the meaning of the IIA (NAFTA).<sup>664</sup> A further illustration is the *Baulas* case concerning the establishment of a national park in Guanacaste beaches in the north of Costa Rica to protect breeding grounds for the leatherback turtle. In that case the claimants' proposal to enlarge their hotel was denied, and they asked to accept expropriations of land. However, the claimants disagreed with the decision to widen the protection zone, stating that their eco-tourism establishment did not disturb the turtles' nesting. In those cases the foreign investors used the IIA to have an international tribunal solve disagreements erupting from the authorities' wish to acquire the land and the domestic process on compensation following on that.

The process for compulsory acquisition of private land must comply with the standards of direct expropriation in the IIAs, notwithstanding an important public purpose like protection of endangered species. This became clear in the *Santa Elena* case, where a company owned by US citizens had bought a parcel of land and planned to develop tourist centres. Soon after, the state decided to establish a national park and to expropriate the land. The company, however, did not accept the compensation offered, and this issue was unresolved for many years.<sup>665</sup> The

664 *Metalclad v. Mexico* Appeal 2001, para 105.

665 The *Santa Elena* case was not based on any IIA instrument, but was solved by arbitration under the auspices of ICSID after the USA withheld 10 million USD in foreign aid to Costa Rica and opposed accepting the country for a 170 million USD loan from Inter-American Development Bank, if Costa Rica did not allow for international arbitration on the compensation for expropriation of property of the US nationals. The land in *Santa Elena* was bought from then Nicaraguan dictator Somoza in the mid-1970s and is situated close to the Nicaraguan border. Some of the land was later used for the US-supported *Contras* guerrillas. See Brower, Charles N. & Wong, Jarrod, *General Valuation Principles: The case of Santa Elena*, Weiler (Ed.), *International Investment Law and Arbitration: Leading Cases for the ICSID, NAFTA, Bilateral Treaties and Customary International Law*, Cameron May, London, 2005, p. 752, at footnote 17. Despite the sparking of international power politics, the case

tribunal concluded that ‘where property is expropriated, even for environmental purposes, whether domestic or international, the state’s obligation to pay compensation remains.’<sup>666</sup>

The case *Gold Reserve/Las Brisas v. Venezuela* could be seen as example of a situation where the state wished to acquire property for the purpose of having control of natural resources. The President of Venezuela decided to cancel the mining concession of a Canadian mining company and take control of the mine. Formally, the company was in the process of applying for an environmental permit which was never issued. The company filed a claim for international arbitration based on the Canada–Venezuela BIT 1996.<sup>667</sup> The situation in the case resembles the ‘classic’ nationalisations much debated in the young era of international investment law; see section 2.2.1. However, in the modern era arguments of environmental law may play a more active part also in the parties’ argumentation for a nationalisation.

While the classification as direct expropriation is clear for compulsory public acquisition of land, the question on calculation of the compensation is less so. The key question for the tribunal in the *Santa Elena* case was the calculation of compensation and which date to use for the valuation of the land. Although the disputing parties agreed that there should be full compensation based on the fair market value of the highest and best use of the land, their evaluations of the compensation differed widely.<sup>668</sup> The tribunal concluded that the date of the decision on the expropriation was to be used, and the value was estimated to be in between what the parties suggested for that time. The tribunal also stated:

is often referred to in regard of compensation when land is expropriated for the purpose of nature conservation.

666 Para 72.

667 Peterson, Luke Eric, Canadian gold miner sues Venezuela over environmental permit delays; Venezuela promptly takes over mine site, *Investment Arbitration Reporter* 30 October 2009.

668 Brower & Wong 2005. The company estimated the value at the time for the award to be 42.2 million USD, of which 39 million USD referred to the smaller piece of land where the tourism projects were planned. The government estimated the value at the time for the decision on expropriation to be 1.9 million USD.

If the relevant date were the date of this Award, then the Tribunal would have to pay regard to the factors that would today be present to the mind of a potential purchaser. Of these, the most important would no doubt be the knowledge that the Government has adopted an environmental policy which would very likely exclude the kind of tourist, hotel and commercial development that the Claimant contemplated when it first acquired the Property.<sup>669</sup>

With this *dictum* the tribunal seems to have accepted to include in the calculation the promises and constraints on development of the land known at the time of the decision of expropriation. In the *Southern Pacific Properties* case,<sup>670</sup> dealing with expropriation of a tourism development project close to the Al Giza pyramids in Egypt, the tribunal refused to award compensation based on profits that might have accrued to the developer after the date on which the area was registered under the UNESCO Convention.<sup>671</sup> This means that if a landowner has construction permits for non-realised developments and the land is expropriated, the value of those developments needs to go into the calculation. Further, if it is clear at the time of expropriation that the land holds high cultural or natural values and habitats for protected species, the calculation of the economic value of the land must consider the constraints a protection of the values implies. Such reasoning would be in line with the concept of legitimate expectations often referred to in IIA cases; for a comprehensive analysis of this concept, see section 4.7.

As domestic regulation on the calculation of compensation for compulsory public acquisition of land for the purpose of natural protection is divergent between states, most certainly some state regulation comes into conflict with the IIA obligation of compensation

669 *Santa Elena v. Costa Rica* 2000, para 84.

670 1992 *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt* ICSID ARB/84/3 Award 20 May, 1992; this case was not based on an IIA.

671 *Ibid.* para 250.

of the 'fair market value'.<sup>672</sup> This means that there is a risk that IIA interpretation might not respect arguments on compensation for expropriation of land for environmental purposes that national courts would apply; in other words, there is a risk for constraints of policy space. The amount of this risk is not possible to estimate, because of the lack of basic data.

#### 6.4.4 Eco-management as control of companies

To control and manage the company is the privilege of the owner(s), and public take over of the core management is equal to expropriation. Health or environmental regulation seldom interacts substantially in the control of the management of a company. However, eco-management schemes have as their target the management of the company.<sup>673</sup> Eco-management schemes with high environmental standards and implemented by a public actor in compulsory ways might, as well, be seen as taking some of the control of company management out of the hands of the owner. Looking at eco-management from this view raises some questions similar to those of expropriations of titles to land. One important element of the property right in owning a business is that the management of the company and substantial interference in management could therefore be considered as expropriatory.<sup>674</sup>

Some states prescribe certain level of self regulation for all operators of environmentally hazardous activities.<sup>675</sup> As long as these rules

672 Little is written on state practice in compensation for expropriation of land for environmental purpose outside domestic doctrine, and it is therefore hard to estimate the divergence. However, Fauchald and Schiötz Thorud conclude that the compensation granted by the Norwegian BITs seems to go beyond the compensation given by domestic law, Fauchald & Schiötz Thorud, 2006, p. 135.

673 Management standards are, for example, the ISO14000 and the EU certification EMAS.

674 Christie, G. C., What Constitutes a Taking of Property under International Law?, *Brittish Yearbook of International Law*, vol 38, pp. 307–338. 'The most fundamental right that an owner of property has is the right to participate in its control and management.' p. 337.

675 For example, Sweden, The Environemntal Code chapter 26 para 19 and general regulation no 1998:900.

only prescribe certain responsibility of the operator, like to measure impacts of emissions, registre chemicals or notify the authorities if accidents occur, the rules look like any other environmental measure. However, if a state legislates as part of general company law that all companies over a certain size must carry out environmental management schemes and, for example, appoint a person with certain knowledge on eco-management and environmental risks as a board member, there could be another situation.<sup>676</sup> Could an IIA tribunal make objections to such regulation? A likely consideration is whether the eco-management rules force the company to make a substantive change of its business concept, or if it only needs to change the way it performs its business. The latter would most likely be regarded as legitimate interference and not a public control of the core management tasks. The former way is more open to question. The views on what is legitimate regulation of the way corporations steer their acts of business may, however, diverge from state to state, and definitely between corporate owners and host state legislators.<sup>677</sup> Therefore, the issue whether eco-management schemes requiring environmental experts in the board of the corporation could be challenged by IIA expropriation provision is an open one.

## 6.5 Environmental regulation and compensation for control of use

Leaving behind the situations where environmental regulation might affect property rights as fundamentally as in direct expropriation or expropriation *de facto*, this section will examine the more common situations brought up in IIA cases on environmental measures where

676 For a comprehensive study on why and how sustainable development can be turned into the fundamentals for corporations, see Sjäffjell, Beate, *Towards a Sustainable European Company Law*, Wolters Kluwer, 2009.

677 An example is when the US toy company Toys'R'Us established in Sweden for the first time and at first refused to sign a collective agreement with the employees, which is standard in the Swedish labour market. The union made it hard for the company to continue to refuse the standard.

the environmental measure has an impact on the profitability of the activity.

IIA tribunals have found breaches of the indirect expropriation provisions in many different situations, and the tribunal in the *Telenor* case in 2006 made this non-exhaustive list of acts of government or government-controlled agencies that have been held to amount to indirect expropriation:<sup>678</sup>

1. Repudiation of the concession agreement.
2. Forced amendment of a Memorandum of Association so as to require relinquishment of the exclusive right of use of a licence which had the effect of destroying the commercial value of the investment.
3. Displacement of the investor's management.
4. The imposition of taxes which would substantially erode profits.
5. Denial of permits necessary to operate the concession, and associated measures.
6. Freezing of the investor's bank account and harassment of its staff.
7. Detention and deportation of key personnel necessary to run the business comprising the investment.
8. Acquisition of a majority shareholding in the concession company where subsequent measures adopted by the majority which destroy the economic value of the investment go beyond the legitimate exercise of a majority shareholder's right to manage the company.

Among these acts, health and environmental policies are most involved in concession agreements, taxes, and permits. The other types of acts do not typically attach to the environmental policy area.

678 *Telenor Mobile Communications AS v. Republic of Hungary* ICSID ARB/04/15 Award 13 September, 2006, para 69.

## 6.5.1 Prevention and risk management

Changing of environmental laws and regulation to prevent environmental damage or manage environmental risks may imply that certain economic activities no longer are practically possible to carry out. A denied permit, revocation of a permit, or other individual order may also lead to the shutdown of some businesses. The effects for the investor in businesses that have to close due to such decisions might well be the same as those where the state takes over the business in a direct expropriation. However, to the question of state responsibility, this situation is different, and only if the new regulation or the individual decision interferes with legitimate expectations or shows a disproportionate balance in the aim of the regulation and the burden for the individual, might it amount to an indirect expropriation.

This means that in normal situations reduced profit or partial and temporary public interference is not enough to amount to indirect expropriation.<sup>679</sup> To qualify, there should be ‘persistent or irreparable obstacles to the investor’s use, enjoyment or disposal of its investment’.<sup>680</sup> In domestic systems ‘partial expropriations’ of land may occur, meaning that only a part of the property is expropriated, but when looking only at that particular part, all the possible economic benefit of it has gone. However, there are difficulties in translating the idea of ‘parts’ in property rights outside the context of landowner rights, and partial expropriations are therefore not expected to cause problems in the area of indirect expropriation.<sup>681</sup>

Among the environmental IIA cases which have received an award so far, only denials of operating permits or new legislation wiping out

679 McLachlan, Shore & Weiniger, 2007, p. 299, points out that S.D. Myers considered a temporal measure possibly expropriatory, but tribunals in the Metalclad and Waste Management cases have used the terms ‘significant’ or ‘substantial’ for the part of the property that must be affected.

680 Schreuer 2005, p. 79.

681 Newcombe 2005ii, p. 33, ‘This test [‘parcel of the whole’], while useful in the context of land use regulation, is not easily analogized to the investment context where a business activity can be segregated into discrete economic activities (production, distribution, marketing etc.)’



the economical feasibility for the kind of production have reached the threshold of property interference.<sup>682</sup> Denials of building permits,<sup>683</sup> restrictions of the market for hazardous products,<sup>684</sup> and changed rules for mining operation<sup>685</sup> have not been considered as expropriations based on IIAs. Two claims on restrictions or denials to extract water for commercial use have for different reasons not reached the analysis of substance of a tribunal: In the *Sun Belt* case,<sup>686</sup> which was settled on unknown terms, a Canadian company made a joint venture with a company in California, USA, and planned to use the water permits which the Canadian company held to extract water in British Columbia, Canada, and transport it in tankers down the coast to California.<sup>687</sup> However, the authorities prohibited the export of water. The extracting and selling of water was also the focal point in the claim of the *Nepolsky* case,<sup>688</sup> where a German businessman bought land in Czech Republic with these ideas in mind. However, the local authorities had objections to the plans, considering the impact on the water use for the surrounding community.<sup>689</sup> Also, a claim alleging that denial of permission to fish in the external waters of Chile amounted to an expro-

682 *Metalclad v. Mexico* 2000, *Tecmed v. Mexico* 2003 and *Saar Papier/ Lutz Ingo Schaper v. Poland*, information about the latter has been spread through an appeal case and news.

683 *MTD v. Chile* 2004.

684 *Methanex v. USA* 2005

685 *Glamis Gold v. USA* 2009

686 *Sun Belt Water, Inc. v. Government of Canada*, Notice of Intent 27 November, 1998, the claimant did not complete the intent and the case was not registered for arbitration.

687 Gómez, Katia Fach, La protección del medio ambiente y el comercio internacional: ¿Hay que “pensar en verde” el arbitraje de inversiones?, SSRN 2009. See also Kibel, Paul Stanton, Grasp on Water: A Natural Resource That Eludes NAFTA's Notion of Investment, *Ecology Law Quarterly*, vol 34, 2, pp. 655–672.

688 *Nepolsky v. Czech Republic*. The case was concluded when the claimant could not pay for the arbitration expenses; see Peterson, Luke Eric, Water extraction claim dries up in absence of funds (*Nepolsky* case), *Investment Arbitration Reporter*, 16 June 2010.

689 IAR 30 November 2009.

priation did not reach the phase of the merits.<sup>690</sup> Hence, environmental regulation wiping out business opportunities connected to the use of natural resources continues to be challenged by IIAs and the expropriation provision, as do restricting regulation on hunting,<sup>691</sup> on trade marks,<sup>692</sup> and on environmental permits for mining.<sup>693</sup>

Disrespect for the investor's legitimate expectations is an important element of an indirect expropriation. As was discussed in section 4.7 about fair and equitable treatment, legitimate expectations is an element that disciplines administrative measures to give clear communication on the content and scope of different public decisions to secure predictability for investors. There is an overlap in the way that a disrespect of legitimate expectations may constitute a break with both the provision on fair and equitable treatment and the provision on expropriation.<sup>694</sup> In the expropriation context, however, legitimate expectations are examined when analysing the reasonableness of the expropriating public measure. In the *Methanex* case the tribunal held that:

A non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.<sup>695</sup>

690 *Vieira v. Chile* 2007. Chilean authorities justified the decision on economic and ecological grounds, including the need to control over-fishing of the Patagonian toothfish/Chilean sea bass.

691 *John R. Andre v. Government of Canada*, 2010, no final award at the time of publication.

692 *Philip Morris v. Uruguay*, no final award at the time of publication.

693 *San Sebastian v. El Salvador* 2011, *Pac Rim (El Dorado) v. El Salvador*, no final award at the time of publication.

694 See *Metalclad v. Mexico* 2000 and *Tecmed v. Mexico* 2003.

695 *Methanex v. USA* 2005 Award on the Merits, part IV, chapter D, para 7.

The tribunal indicates that only if special commitments on coming regulations are made and relied on do they have to be respected. Earlier regulations might form expectations, but can be abandoned, as long as to do so is not 'so unfair as to amount to an abuse of power'.<sup>696</sup> However, note that this reasoning becomes a bit circular, since a strong indication of abuse of power is disrespect for legitimate expectations.<sup>697</sup> For example, the expectation to develop the land into a traditional tourism site could be legitimate, if the planning regulation at the time of the investment allowed for such developments. If the regulation or other factors at the time of investment were clear, or indicated that the area was of important use for the surrounding villages, the investor cannot claim a legitimate expectation for the right to develop the site. If neither of the directions is clear in regulation, there is then a lack of specific planning regulations, and there might exist a silent assumption for landowners' right to develop their land in the legal culture of the state.<sup>698</sup>

A revocation of environmental permits essential for the operation of the investment could be the basis for allegations of indirect expropriation in breach of an IIA, for example, in the numerous cases on mining. Predictability for the investor is then set against the need for flexibility and new environmental standards. With clear rules and communication on revocation of permits, preferably with time limits on permits, the host state may balance those interests and shape its environmental policy space.

It is evident that authorities and legislators have a mandate, to some extent even an obligation, to prevent diseases, physical damage, or public order, even if the actions carried out by the authorities interfere strongly with private property. For such undisputed public needs, measures are not compensated (in accordance with the doctrine of police

696 Orrego Vicuña, 2003, p. 194.

697 Newcombe 2005ii, p. 36.

698 In the US doctrine one may see that conception of landowner's rights; see Rose, Carol M., Takings, Federalism, Norms – Book Review on Regulatory Takings: Law, Economics, and Politics by William A. Fischel, *Yale Law Journal*, vol 105, pp. 1121–1152, p.1143

powers or as outweighing private needs in a proportional test). However, more difficult questions arise in situations of more politically contested parts of environmental policy. Is the threat of severe climate change enough reason to prohibit fossil fuels in private cars? Is the conservation of a certain bird worth the prohibition against carrying out commercial forestry in a large part of the country? A model offered by Joseph Sax to distinguish which situations which should include compensation and which should not is that of the state as ‘mediator’ between different interests or as ‘enterprise’, suggesting that acts taken in the role of ‘enterprise’ should render compensation, while those in the role of ‘mediator’ should not.<sup>699</sup> Most health and environmental regulations are clearly motivated by the role of the state as mediator between individuals, rather than as an enterprise, and should according to this model not render compensation. However, so far there is no accepted ‘model’ for how to judge whether a change of regulation or individual decision for environmental reasons amounts to expropriation in IIA cases, and assessments are therefore carried out on a case-by-case basis. Hence, even if environmental regulation seldom leads to deprivation of all economic benefits and usually not can be said to upset legitimate expectations, there are nevertheless arguments that the environmental measures cause an effect of expropriation. This is also shown by the popularity of the expropriation provision as a basis for IIA claims. The number of claims may in itself create uncertainty about environmental measures and the compliance with IIAs. Such uncertainty may, as well, contribute to constraints of environmental policy space, or in other words, have a chilling effect on environmental law.

## 6.5.2 Should the polluter pay or be compensated?

To set a price on emissions and demand that polluters pay, as in the use of eco-taxes or the introduction of tradable emission rights, may

699 Referred to, inter alia, in Sax, Joseph L., Property rights and the Economy of Nature: Understanding *Lucas v. south Carolina Coastal Council*, *Stanford Law Review*, vol 45, pp. 1433–1455.

cost some actors much of the profit from their investments. There are several IIA cases where the imposition or variation of a certain taxes is the focal point.<sup>700</sup> However, no clear-cut eco-tax has so far been disputed (not surprising, as eco-taxes are not so common, and compared to other taxes not so economically important for operators). Some IIAs also exempt taxation measures from key parts of the treaty.<sup>701</sup>

A tax or a sudden price on something previously free of charge can be far-reaching in the effects on specific economic activities, and directly reflected in the profitability. Therefore, changes that are too sudden or surprising may challenge the standards of reasonableness and respect for legitimate expectations. Also, the mix of purposes of environmental taxes, both to mitigate increased harm and to strengthen public finances, may cause some trouble *vis-à-vis* the standard to have a proportional design of the measure. Consequently, radical use of economic instruments, as sometimes called for in the debate on climate change,<sup>702</sup> can come into conflict with the provision on expropriation, even though there are no signs of such regulations or conflicts today.

A principle matter regarding compensation to individuals in the context of environmental law is the polluter pays principle.<sup>703</sup> The principle is used in environmental economics as a rule of externalities that aims to internalise the costs of environmental degradation into the price for the activities causing it,<sup>704</sup> and in environmental law as a rule of allocating abatement or cleanup costs.<sup>705</sup> Both these approaches

700 Two cases where tax decisions led to breaches of IIAs are *Mr. Tza Yap Shum v. Peru*, ARB/07/6 Award on the merits 7 July, 2011, and *Occidental v. Ecuador* 2004.

701 US Model BIT 2004, art. 21, say that the treaty only covers taxation measures that the tax authorities of the state parties agree to regard as expropriation; also, Canada–Costa Rica 1998 BIT art. VIII(3); see section 8.4.2.

702 For example CO<sub>2</sub> taxes at a level where the use of fossil fuel is drastically drop in a short time.

703 As many as eleven different IEAs express the principle in a binding form, Sadeleer, 2002, pp. 23–24.

704 The economic thesis on externalities was presented by economist A.C. Pigou. A thorough discussion on the principle, its background, and its application in environmental law is found in *ibid.*

705 Bugge, Hans Christian, The polluter pays principle: dilemmas of justice in national

are relevant here. The elucidation of the costs of environmental degradation is the reason behind environmental regulations like eco-taxes and trade in emission quotas, and the issue of allocation of the cost is integrated in the decision on which actors should be the primary subject of these economic incentives, but also which actors should be liable and bear the risks of hazardous activities. There are only two ways to ensure that the price reflects the true cost of production and consumption: taxation/fees corresponding to the value of the environmental degradation, and regulatory standards that prohibit the damage or limit the degradation associated with the activity. Hence, an expropriatory compensation to the actor for public measures aiming to balance the price in this regard would be counterproductive in the view of the polluter pays principle. It would return the responsibility for environmental damage from the actors (where the polluter pays principle places it) back to the state (where the idea of compensation for expropriations for the public good places it).

However, this conflict may exist mainly on an abstract level. When analysing how economic incentives and administrative regulation are applied in practice, one may see that environmental economic incentives and allocation of liability in line with the polluter pays principle never go beyond the thresholds of the domestic expropriation standards. Since the polluter pays principle is recognised in international law, it is likely that national regulation, which can be argued to implement the principle in a reasonable way, carry some weight in an assessment also under an IIA. More radical use of economic instruments, like the imposition of additional royalties on natural resource export to compensate for the 'ecological debt', would, however, easily come into conflict with indirect expropriation.

and international contexts, Ebbesson & Okowa (Eds.), *Environmental law and justice in context*, chapter 21, Cambridge University Press, Cambridge, 2009.

## 6.6 The provision of expropriation and environmental policy space

The previous analysis has shown that the IIA provision concerning direct expropriation may come into conflict with perspectives in environmental law calling for a wider view on property, embracing collective rather than private property rights, and with some environmental regulations aiming at nature protection or sustainable use of natural resources. It was, however, noted that this provision may in a limited sense be used also to protect property holders, individuals or collectives, from environmentally damaging activities. Environmental law and international investment law put different perspectives on property rights. While environmental law mainly focuses on the use of the property, investment law puts interest in ownership as a full unity, including holding the title to the property. Environmental law may further see trusteeship or stewardship as fiduciary, instead of from the proprietary view of land and resources, which departs from the view of private property rights of the international investment regime. Those different perspectives could explain some of the conflicts that arise in the area. This section aims to conclude this analysis in terms of environmental policy space.

The IIA provision concerning indirect expropriation, which here is assumed to include the regulation to control the use of property and not only the more restricted *de facto* expropriation, is hard to apply to environmental regulation. General prohibitions or individual decisions wiping out profits of business cannot in normal situations raise demands for compensation. An interpretation in accordance with the doctrine of police powers does not eliminate the risks of environmental policy constraints. Therefore, an approach where the right to regulate is integrated into the expropriation provision would better secure space for environmental regulation.

Similar to the discussion on stability and predictability in the light of the provision on fair and equitable treatment (chapter 4), there are tensions between this perspective and the need for flexibility and new environmental standards, when analysing the provision on ex-

propriation. Thus, in interpreting this IIA provision, it is important to recognise the means used in environmental law to ensure certain predictability for operators, for example, clear rules and communication around the revocation of essential permits, time limits on permits, and reasonable transitional periods to adjust to more radical reforms. To preserve host state environmental policy space, such means should fulfil the demands for predictability laid down by the IIA.

One should note that in situations where environmental goals cannot be reached without eliminating certain property rights, IIA rules tie the effectiveness of the environmental regulation to the willingness of the property owners or the possibility of the society to pay compensation. Especially in states with small budgets, this may lead to negative impacts on the development of environmental law.

Although compensation for direct expropriation is an international customary right, the international investment regime has developed a special jurisprudence, which applies also when compensation for environmental measures is on the table. It is uncertain whether the valuation methods used by IIA tribunals pay respect to common problems in the valuation of compensation for public environmental protection measures.

Lastly, it was noted that, while environmental regulation not including direct expropriation continues to be challenged in IIA claims, the threshold for such measures to amount to expropriation seems to be high, and since 2003 no company has prevailed in such a claim. However, the jurisprudence is unclear, and being so, it generates uncertainty as to the impacts on environmental policy space.



## 7 Summary of investment law provisions' impact on policy space analysis

The three previous chapters, 4, 5, and 6, have focused on the three key provisions in international investment treaties, fair and equitable treatment, national treatment, and expropriation. It was discussed to what extent those provisions provide sufficient policy space for the host state to adequately protect health and environment, regulate sustainable use of natural resources, and develop new approaches to manage environmental risks and uncertainties. An overall conclusion is that there are a number of clear policy constraints in the field of natural resource management and limitations for rolling back privatisation policies in basic services. This conclusion is not surprising in the light of the aims of international investment treaties. However, in the field of classic environmental law, although there is a wide potential for the investment law provisions to restrict environmental policy space, much of the constraints can be removed, provided that the interpretation of the investment provisions respects environmental law practice on how to introduce necessary changes in conditions of economic operations and how to deal with unwanted discrimination.

To conclude these conditions for environmental policy space, a number of questions are added to the Policy Space Analysis Questionnaire, as laid down in the outline of the questionnaire in section 1.2.3.

and developed further in the specifications of the questionnaire regarding general aspects and environmental law development in section 2.6 and 3.9. The whole questionnaire is reproduced in Appendix 2.

### Specification 3 of Policy Space Analysis Questionnaire: Provisions on Investment Protection—Reflecting Environmental Aspects

#### Fair and equitable treatment

- Is the provision limited to only cover due process and non-denial of justice?
- Might the interpretation acknowledge that changing general environmental regulation does not *per se* disrespect investors' legitimate expectations?
- Might the interpretation acknowledge the principle of precaution in demands on decision making to be balanced and based on scientific knowledge?
- Might the interpretation respect that representatives of public institutions and politicians are expected to engage actively in the public debate?
- Might the interpretation respect that there are multi-tiered structures in environmental governance?

*Yes means that the constraints to environmental policy space are mitigated in some respect.*

#### National treatment

- Is the provision limited to post-establishment measures?
- Might the interpretation respect that procedural measures in environmental law can safeguard actors from discrimination?

- Might the interpretation allow for different praxis towards operators by different local authorities within the discretion given them by law?

*Yes means that the constraints to environmental policy space are mitigated in some respect.*

### **Expropriation and compensation**

- If the provision concerns indirect expropriation, is it limited to a 'right to regulate' doctrine?
- Might interpretation to some extent respect environmental perspectives on collective property rights?
- Might interpretation respect that actions to prevent harm to the environment or protect the health in normal situations do not imply compensation for public infringement?

*Yes means that the constraints to environmental policy space are mitigated in some respect.*

These questions should capture the specific issues around policy constraint connected with each investment provision. They will, however, not capture the impact of the legal uncertainties of real policy constraints on the development of new approaches of environmental law to manage environmental risks and scientific uncertainties. The analysis indicates that such development of environmental law may be hampered. This risk is in itself alarming, as many developing states still lack robustness in environmental administration and we face an age with increasing pressure on ecological systems.

The next chapter will shift perspective from the potential constraints to environmental policy space to possible enhancement of policy space by changing the investment treaties. Chapter 8 will broaden the analysis of investment treaty law beyond the three key provisions and explore explicit language in the investment treaties that reflects environmental concern.



# 8 Strategies to widen environmental policy space in the broader IIA context

## 8.1 Introduction

This chapter takes a wider approach to the international investment treaties than previous parts and investigates various strategies to accommodate an investment–environment conflict within the context of the IIA as a whole. The aim is to see in what way changes of the international investment treaties can enhance a wider environmental policy space for host states.

Three types of strategies to enhance environmental policy space through changes in IIAs are investigated. The first type concerns the carrying out of different kinds of impact assessments, a tool to enlighten the decision-making process and bridge opposing views which emerged as an effect of public environmental concern related to the negotiations of IIAs. The second type of strategy concerns a range of additional IIA provisions to safeguard environmental regulation, which explicitly form structures in and around the treaty and which strengthen environmental governance. Thirdly, the chapter investigates more radical strategies to turn IIAs into proactive instruments for sustainable investments and technology transfer. Thus, this chapter

deals with both strategies to minimise the risk of negative impacts on environmental law and policy and strategies that aim at proactive environmental actions which may strengthen states' possibilities of implementing environmental regulation in practice. First, however, the chapter gives a background to why the IIA texts have started to reflect explicitly on environmental concerns.

## 8.2 Background of the greening of IIAs

The classic BIT, with its roots in the OECD 1967 draft IIA, made no references to environmental regulation. Nor did the old Friendship, Commerce and Navigation Treaties (FCNs). It was only after the trade and environment debate and the critics of economic globalisation had started to flourish in the beginning of the 1990s that some IIA texts addressed environmental issues.

When North American environmental movements in the beginning of the 1990s rejected the trade and investment agenda of NAFTA as harmful to the environment, the main response of the governments was to include provisions and language explicitly on environmental matters in the agreement and also to make a special side agreement on environmental monitoring and cooperation. Even though it is still the USA and Canada that most clearly make use of this approach concerning IIAs, other states have followed to various degrees. Like NAFTA, the Energy Charter Treaty (ECT), which was negotiated during the same time period, included various references to environmental regulation or measures expressing that environmental protection and investment protection are in some sense mutually supportive aims.<sup>706</sup>

706 The policy that economic development through liberalised trade and investments and environmental protection is 'mutually supportive' has been vital for the trade and environmental debate in the WTO Doha negotiations round and was included in the declaration of the UN conference in Johannesburg on sustainable development in 2002. Noteworthy is that some writers are starting to consider this as a principle in international law; see de Chazournes, Laurence Boisson, Elizabeth Haub Prize Laureate lecture: Environmental Treaties in Time, *Environmental Policy and Law*, vol 39 (2009), pp. 290–299.

The negotiations in the OECD, and later in the WTO, on a multilateral investment agreement (MAI) in the years 1995–1999 also brought the discussion on integration of environmental texts in investment agreements to the global level. The MAI negotiations forced state delegations to reflect on the matter, and notes from the chairman of the negotiations show that a range of tools for ‘greening’ the investment agreement were reflected upon, for example, similar paragraphs on regulatory rights and non-lowering of standards as in NAFTA, general exceptions for environmental measures as in GATT, and specifications on the provisions of national treatment and expropriation also from the NAFTA experience.<sup>707</sup> However, the MAI was never concluded.

In the critical debate around economic globalisation and environmental concerns four main concerns are expressed about international investment protection and the environment: (1) fear of a race to the bottom (a reflection of the so-called hypothesis of pollution havens), (2) fear of a chilling effect on the development of environmental law, (3) a wish to guard the development and implementation of international environmental agreements, and (4) a wish to give transnational corporations more responsibilities concerning preventive measures. These issues have continued to engage during the 2000s, at least, in the debate in the USA.<sup>708</sup>

As a result of these debates the trend of ‘greening’ IIAs spread in the 2000s to a number of FTAs and some pre-establishment BITs.<sup>709</sup> It is, however, noteworthy that, among the traditional post-establishment BITs, it is still rare to find strategic environmental impact assessments preceding the treaty or any language in the treaty on environmental

707 Chairman’s note to MAI draft 1998.

708 An example is the debate around the trade-negotiating mandate in the USA, with the new US model BIT 2004. The US business community was annoyed, as it sought to downplay investment protection in relation to environmental regulation; see Gantz, David, *The Evolution of FTA Investment Provisions: From NAFTA to the United States – Chile Free Trade Agreement*, *American University International Law Review*, vol 33 (2004), p. 679 and pp. 764–765; and US Bipartisan agreement on trade policy, May 2007, [http://www.ustr.gov/sites/default/files/uploads/factsheets/2007/asset\\_upload\\_file127\\_11319.pdf](http://www.ustr.gov/sites/default/files/uploads/factsheets/2007/asset_upload_file127_11319.pdf) (visited 2010-06-21).

709 IIA Monitor 2(2008).

matters, either as general and independent provisions or as explanatory texts to main investment protection provisions.<sup>710</sup> The only sign of environmental issues in traditional BITs is occasional language in the preamble, recognising the concepts of mutually supportiveness<sup>711</sup> or sustainable development,<sup>712</sup> or stressing the aim of technology transfer.<sup>713</sup> Even if preambular text offers a framework for interpretation of the objectives of the treaty, it will not make much difference when interpreting core concepts of investment protection.<sup>714</sup> Hence, in the

710 None of the three European states having the most IIAs, Germany, France, and UK, include any environmental language or paragraphs in their model BITs from 2005–2006. The OECD survey concludes that only 6.5 percentage of the 1,593 BITs analysed include language referring to environmental concerns, but that over 50 percentage of new treaties (FTAs and BITs) include such concerns, Gordon & Pohl 2011.

711 For example, Sweden and Finland current model BITs recognise in the preamble that the objectives can be achieved ‘without relaxing health, safety and environmental measures of general application’. The background for those changes, which also included a reference to labour issues, is said to respond to a request from the Swedish national union organisation (Mail correspondence with Anna Maj Hultgård at the Swedish foreign ministry, 19 April 2007).

712 For example, Japan–Switzerland FTA 2009 preamble: ‘Determined, in implementing this Agreement, to seek to preserve and protect the environment, to promote the optimal use of natural resources in accordance with the objective of sustainable development and to adequately address the challenges of climate change’; Canada model FTA, preamble: ‘Recognizing that the promotion and the protection of investments of investors of one Party in the territory of the other Party will be conducive to the stimulation of mutually beneficial business activity, to the development of economic cooperation between them and to the promotion of sustainable development’; and Malaysia–New Zealand FTA 2009 preamble: ‘Aware that economic development, social development and environmental protection are components of sustainable development and that free trade agreements can play an important role in promoting sustainable development’.

713 For example, France model BIT 2006 preamble: ‘Persuadés que l’encouragement et la protection de ces investissements sont propres à stimuler les transferts de capitaux et de technologie entre les deux pays, dans l’intérêt de leur développement économique’.

714 A tribunal that needs to interpret an investment protection provision might let the objective influence the interpretation, and thus the preambular language affects how the investment protection provisions are interpreted. However, the formulations in preambles are often rather vague and policy oriented, which makes them



following sections mainly FTAs will appear as examples of the various strategies.

## 8.3 Environmental impact and regulatory assessments

Partly as a response to the debate on potential environmental implications of trade liberalisation in the 1990s, various national and international forums elaborated methodologies for reviewing environmental effects of trade policies.<sup>715</sup> The call for policy assessments of trade and investment treaties from NGOs and others aims at achieving informed policy coordination, assurances that environmental issues are taken care of, and a possibility for adjustments of the agreement based on the review.<sup>716</sup>

In 1999 the EU launched its first Trade Sustainability Impact Assessment (SIA).<sup>717</sup> The EU methodology includes all three pillars of sustainability: the environment, and economic and social development. It surveys impacts on both EU and partner developing states.<sup>718</sup>

hard to connect to a clear manifestation of its own. Nor will all tribunals consider it necessary to draw on contextual interpretation, if the ordinary meaning of the provision is found to be clear. See Vienna Convention, art. 31(1)(2).

715 The OECD distributed a document on methodologies for environmental and trade reviews in 1994 (OECD/GD(94)103), which included checklists for negotiators. The checklists were revised in 1997 and followed up at various seminars, inter alia, at the Workshop for environmental assessment of trade liberalisation agreements, WTO committee on Trade and Environment, WT/CTE/W/133, 2000. The Nordic Council held a seminar on the topic in 1998, documented in Environmental Assessment of Trade Agreements and Policy, Nordic council no 551, 1998. Both the USA and the EU set up frameworks for impact assessments of trade agreements in the late 1990s; see Gehring, Markus W, Impact Assessments of Investment Treaties, Cordonier Segger, Ghering & Newcombe (Eds.), *Sustainable Development in World Investment Law*, chapter 7, Kluwer Law International, Amsterdam, 2011.

716 Noted, inter alia, in the MAI discussion; Gunnel Nycander in Nordic council report 551:1998.

717 See <http://ec.europa.eu/trade/analysis/sustainability-impact-assessments/> (visited 2010-06-09).

718 Handbook for trade sustainability impact assessment European Commission

In the USA there are guidelines for environmental reviews of trade and investment treaties, but unlike the EU methodology, US reviews only take account of pollution or other environmental degradation directly affecting the USA.<sup>719</sup> However, the US methodology is influenced by a lively debate concerning the trade and investment agreements' impact on US environmental regulation, and the methodology used includes an assessment of the regulatory consequences.<sup>720</sup> Since the late 1990s UNEP has also worked in capacity building and assists governments to design assessments on environmental, social, and economic development impacts of trade-related plans and programmes.<sup>721</sup>

There are different kinds of assessments; however, the nomenclature concerning the reviews is not uniform. Concepts from general environmental law of environmental impact assessments and strategic environmental assessments (SEAs) are reused, or 'transplanted', in the context of trade and investment reviews,<sup>722</sup> but also other features are used to accommodate the broad application of trade and investment rules. For the purpose of the discussion here it is important to distinguish between the subjects of the assessment. What causes the effects investigated? For EIAs the subject is an activity or a project, while for

– External trade, 2006. The FTAs the EU is negotiating are not full-fledged investment agreements; they follow the GATS approach and require national treatment and the prohibitions on performance requirements in listed sectors, but do not include standards of fair and equitable treatment and compensation for indirect expropriation, or investor–state arbitration. The EU methodology for sustainability impact assessments is nevertheless interesting, as it is also expected to be used if the EU starts negotiating full-fledged IIAs; see section 2.2.3.

719 Guidelines for Implementation of Executive Order 13141: Environmental Review of Trade Agreements, 2000,

720 This was shown not least in the congressional debates on the Bipartisan Trade Promotion Authority Act in 2002 (Division B in Trade Act of 2002, 19 USC §3801), referred to in van Roozendaal, Gerda, The inclusion of environmental concerns in US trade agreements, *Environmental Politics*, vol 18 (2009), 3, pp. 431–8.

721 See UNEP official webpage <http://www.unep.ch/etb/areas/envInteAsses.php> (visited 2010-06-09).

722 The same principles as in EIA and SEA are relevant in those impact assessments: documentation, procedure, significance, alternatives, and transparency/public participation. See further in sections 3.3.2 and 3.5.

SEAs it is policies or plans, that is, the latter are most relevant, as we now will discuss the effects of trade and investment rules or policies.<sup>723</sup> Another important distinction is the objects of the assessment. What is affected? In EIAs and SEAs it is the impacts of the physical environment, the real life, that are relevant, while in regulatory assessments, it is the affects on regulation, as such, that are in focus. Therefore, this text uses the term *impact* assessments to indicate that the object is the environment, as such, and the term *regulatory* assessment when regulation is the object.

The trade and investment rules investigated here are generally expressed and applied across sectors. As international rules they have an indirect effect on individual actors within states, and therefore, environmental impacts should also be analysed as consequences of the phenomenon of trade liberalisation and not in a detailed manner describe the impacts of the rules for each sector. This is relevant, since most of the environmental impacts are considered to follow from trade liberalisation's relation to an increase of economic activities. Reflections, or presumptions, of theories of competitiveness between countries, like the pollution haven hypothesis (*i.e.* industry migrates to states with lax regulation), or complementary theories like the Kuznets environmental curve (*i.e.* environmental impact will decrease with higher income) and the Porter theory (*i.e.* the industry becomes more competitive when the regulations set higher environmental standards) are common in the EU and USA and Canadian reviews of trade and investment agreements. The standpoint taken on those theories sometimes influences much of the results of the assessment of specific rules proposed.<sup>724</sup>

The assessments can be undertaken during different phases of the decision of the IIA, before starting the negotiation (*ex ante*), during the negotiation, after the IIA has been concluded but yet not ratified, and

723 Note, however, that the USA executive order uses the term 'environmental review'.

724 NGOs expressed, regarding the tool originally used by the EU to build on, 'the assumption that growth will be promoted by trade liberalization and that this is desirable', but recognised in 2006 that a 'without free trade' baseline scenario was included, as well; however, commenting that the latter came in after the decision was taken to go ahead with the treaty, Nishant Pandey, Regional Policy Officer, Oxfam GB, at the EC SIA Conference, 21–22 March 2006, Brussels.

ultimately, when the IIA has been implemented (*ex post*). Evidently, assessments before or during the negotiations can bring new concerns into the trade or investment treaty more easily, while assessments after implementation can be useful for verifying physical effects and determining areas for further assessment, valuable for negotiations of future treaties.

### 8.3.1 Impact assessments

Both the USA and Canada undertake environmental impact assessments of FTAs which include investments, and BITs. Canada's Framework for the Environmental Assessment of Trade Negotiations from 2001 establishes a process for strategic environmental impact assessments with the objective of integrating environmental considerations into the decision-making process from the earliest stages of an initiative.<sup>725</sup> When applied during the negotiations of the Canada–Madagascar 2008 FIPA,<sup>726</sup> both the initial and the final environmental assessment documents concluded that, since the agreement was unlikely to make significant changes to inward investments in Canada from Madagascar, the environmental impact in Canada was therefore expected to be minimal.<sup>727</sup> All environmental impact assessments of IIAs by Canada and the USA under their assessment frameworks from 2000 and 2001 have come to similar conclusions regarding the 'real life' impacts of investment rules.<sup>728</sup> The fact that the US and Canadian envi-

725 Government of Canada (Publ.), Framework for Conducting Environmental Assessments of Trade Negotiations, February 2001, <http://www.international.gc.ca/trade-agreements-accords-commerciaux/ds/Environment.aspx?lang=en> (visited 2012-03-03).

726 The scope of Canada's Foreign Investment Promotion and Protection Agreements is similar to that of BITs.

727 Final Environmental Assessment of the Canada–Madagascar FIPA <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/final-madagascar-finale-madagascar.aspx?lang=eng> (visited 2010-06-10).

728 Tienhaara 2009, pp. 88–89. The environmental assessment of the Chile–USA FTA 2003, however, focused on the impact in the USA, stating that the impact in Chile would be positive due to better technology coming in because of the treaty.

ronmental reviews of IIAs mainly address environmental impacts in their own territories has been criticised as a major weakness of the impact assessment tool.<sup>729</sup> Some impacts on transboundary transmission of pollutants (air and water), and effects on habitat for wildlife and migratory species, were reflected upon more deeply in the USA review of CAFTA, however, concluding that, although increased economic activity in Central America was expected and might have indirect transboundary effects on the USA, the review could not find any specific and significant consequences.<sup>730</sup> The small comments the assessments make about impacts in the partner state may indicate difficulties in predicting the scale and timing of effects, but suggest that there will be positive environmental consequences, *inter alia*, through disseminating environmentally beneficial technologies.<sup>731</sup> Thus, the Canadian–US assessment model for strategic environmental assessments tends to find no significant environmental impacts in the capital-exporting state and positive or unpredictable environmental impacts in the capital-importing state. It has, however, been noted that the process engages with parts of civil society and that some of its recommendations are taken on board by negotiators.<sup>732</sup>

Strategic environmental assessments on FTAs or IIAs by developing states are not common. The importance of strengthening the capacity for those countries to be able to carry out impact assessments of international agreements has been identified at international meetings,<sup>733</sup> and several international organisations are now working to serve developing states' governments with analysis useful when negotiating

729 See Ghering 2011, and Tienhaara 2009, p. 89, which refers to NGOs expressing concern.

730 Final Environmental Review of the Dominican Republic–Central America–United States Free Trade Agreement (CAFTA), February 2005, <http://www.ustr.gov/trade-topics/environment/bilateral-and-regional-trade-agreements> (visited 2012-03-03), p. 2.

731 Final Environmental Review United States – Peru Trade Promotion Agreement, [http://www.ustr.gov/sites/default/files/Peru%20Enviro%20Review.Final\\_.pdf](http://www.ustr.gov/sites/default/files/Peru%20Enviro%20Review.Final_.pdf) (visited 2012-03-03)

732 Ghering 2011, p. 164.

733 One of the proposals at the WTO CTE workshop 2000.

trade and investments treaties.<sup>734</sup> There are some initiatives whereby strategic environmental assessments of negotiated trade agreements are made in developing countries with support from official development assistance. One such example is the strategic environmental assessment on the negotiations of the EU Association Agreement with the Central American states carried out in 2007–2009 by the regional IUCN office and the Central American Commission on Environment and Development (CCAD) in cooperation with the Dutch national EIA body and also supported by the Swedish International Development Cooperation (SIDA).<sup>735</sup> The objective of this assessment process was to have a more informative decision-making process by increasing the participation of stakeholders. An important step was having experts from environmental ministries or agencies participate and feel confident to speak at meetings where the negotiating position was discussed. This was, however, not an easy step to achieve.<sup>736</sup> Thus, the often repeated criticism about trade negotiations, that the environmental ministries or agencies are not participating in the preparation for partner state negotiations, was confirmed.

The EU assessment of its negotiations on an FTA with Korea 2009 concluded that ‘the projected expansion of trade is not predicted to utilise resources that are poorly managed or to increase production that will lead to expansion of pollution or other negative environmental externalities that are unregulated’.<sup>737</sup> Similarly, the EU assessment on the Central America FTA negotiations recommended as one of the main environmental policy suggestions to ‘strengthen institutional capacity

734 See, *inter alia*, UNEP at <http://www.unep.ch/etb/areas/envInteAsses.php> (visited 2010-06-09).

735 The project set up a method to evaluating the agreement during the negotiations with stakeholders; see Strategic Environmental Assessment – Evaluating the Association Agreement between the EU and Central America, Central American Commission for the Environment and Development (CCAD) & IUCN, 2007.

736 Interview, Pérez, Marta, Project coordinator at IUCN regional office, San José, Costa Rica, 2009-01-28.

737 Trade Sustainability Impact Assessment of the EU-Korea FTA: Final Report – (Phase 3), 2008, executive summary.

for Central American environmental agencies and policy-making'.<sup>738</sup> Thus, EU analyses of environmental impacts in partner states enhance policy dialogue and reveal useful knowledge for negotiations. The analyses show that the consequences of the trade rules are tightly connected to environmental governance and the administrative capacity of the state. The recommendations made are, however, only on the side of complementing the proposed treaty with capacity building; they do not aim to change the set of rules in the proposed treaty. This becomes logical, as the EU assessment model does not include assessments on how the proposed treaty rules affect the environmental regulation and administrative capacity in the partner state, that is, regulatory assessment. The next section investigates how such assessments work.

### 8.3.2 Environmental regulatory assessments

A regulatory assessment reviews how the suggested treaty rules would affect domestic regulations. It is common for government ministries to do an assessment of the legal implications of a proposed international treaty, just as they do with any proposal of new policy.<sup>739</sup> The quality of those legal assessments varies with the skills and resources of the governmental staff and with the complexity of the proposal. If incompatibilities are found, the state may call for a general exemption for a certain sector or for a prolonged implementation for certain treaty rules. This is to avoid immediate and short-term effects on the existing legislation. However, the complexity of an investment or trade agreement may make it hard, including for ministries of environment in developed countries, to assess even the immediate and short-time effects of such treaties in a comprehensive way.<sup>740</sup>

738 Trade Sustainability Impact Assessment of the Association Agreement to be negotiated between the EU and Central America, final report phase II, 2009, p. 19.

739 For example, in 1988 the US federal government executed an order to all branches of the federal administration to conduct takings impact analyses of all their regulations as a step to avoid the risks of expensive compensation claims.

740 Fauchald, in Nordic council report 551:1998.

Assessing consequences for environmental regulation in the medium- and long-term perspectives implies problems of how to predict the development of environmental regulations—how much room for manoeuvre is essential? A further difficulty is how to assess unclear obligations in the treaty. Then the mechanism interpreting the obligations must be included in the assessment, and if this is an investor–state tribunal over which the state part does not have any control, the predictions on which interpretation is likely must be based on the worst-case scenario.<sup>741</sup> Thus, regulatory assessments may conclude that some of the proposed treaty rules are problematic in conjunction with the regulatory framework.<sup>742</sup>

The US assessment model includes analysis of the extent to which the proposed agreement may affect US environmental laws and regulation, considering also state, municipal, and tribal regulation.<sup>743</sup> Since the inclusion in the US model BIT and FTA of several new provisions and changes in respect to clarifying the relationship to environmental law, the review of new treaties has stated that the new provisions ‘are significant improvements and would further reduce the possibility of a successful challenge under the investment provisions to a US environmental law or regulation’.<sup>744</sup> This conclusion was based on mainly three observations, the clarification that minimum standard of treatment not create any additional rights to customary international law, the clarification that indirect expropriations only in ‘rare circumstances’ can be construed by non-discriminatory environmental regulations or measures, and the innovations made to the arbitration tribunal proceedings increasing transparency and possibilities for state parties to act. Those observations are not free from objections, as has been shown in the chapters above.

In developing states the resources to carry out regulatory assessments are often in short supply. Consequently, there are seldom com-

741 *Ibid.*

742 An example; Ebbesson 1998.

743 See, for example, Final Environmental Review of the U.S.-Chile Free Trade Agreement, 2003.

744 *Ibid.* page 31.



prehensive assessments by ministries or agencies of developing states in the preparation for negotiations on new trade and investment treaties. This is a great shortcoming. However, when there are multilateral agreements on sensitive topics, NGOs and academics sometimes try to assess some areas of the potentially affected regulation and argue for changes of the treaty.<sup>745</sup> An interesting example was when Costa Rica held a referendum to ratify CAFTA. A scientific body was appointed to make a public presentation of the treaty to inform the public dialogue before the referendum.<sup>746</sup> The publication focused, *inter alia*, on potential consequences for environmental regulation and pointed to the fact that Costa Rica, having in general higher standards of environmental protection than the other CAFTA states, could be subject to indirect pressure not to raise its standards further, to be able to compete for attracting trade and investment within the CAFTA region.<sup>747</sup> Regulatory assessments of the CAFTA effects on Costa Rican environmental law were subsequently carried out by several Costa Rican environmental lawyers, addressing some of the harshest criticism against the investment chapter.<sup>748</sup> Similar criticism was delivered against the proposed free trade agreement of the Americas (FTAA) by the Association of Latin American environmental lawyers (ALDA), which after an assessment of the regulatory consequences, recommended including in the treaty that states have the rights to set their own level of protection

745 For example, the EU so-called EPA negotiations following on the Cotonou Agreement with former colonial states where NGOs both in the EU and partner states have actively worked on assessments; see EPA Watch at <http://epawatch.eu> (visited 2012-01-06).

746 Co(n)racón – Resumen del TLC, Estado de la Nación en Desarrollo Humano Sostenible, 2007 (supported by Facultad Latinoamericana de Ciencias Sociales, FLASCO), Costa Rica.

747 *Ibid.* p. 19.

748 González Ballar, Rafael, Pérez, Romero (Ed.), *Algunos problemas del TLC en materia ambiental*, Instituto de Investigaciones Jurídicas, San José, Costa Rica, 2008; Cabrera, Jorge, La protección de las inversiones en los tratados de libre comercio y el principio de quien contamina paga, *Revista de Gestión Ambiental* 2003; Villata 2007.

and that binding international dispute settlement would not apply to environmental legislation.<sup>749</sup>

Thus, regulatory assessments are useful to observe issues of policy space constraints and incoherencies. They can indeed play an important role in avoiding unwanted constraints to environmental policy space and facilitating policy coherence. It is, however, important that the administrative capacity and regulatory framework in the weaker of the economies participating in the agreement is assessed, not only the regulation in the richer of the states (even if the latter probably is the state with the more rigid environmental legislation).

## 8.4 IIA strategies to safeguard or enhance environmental regulation

Moving the focus towards the final product of the negotiations, the IIA, one may note that the IIA–environmental law conflict is reflected in many ways, as states have used a combination of different strategies to accommodate environmental issues in the IIA context. It was shown in chapters 4, 5, and 6 that core IIA provisions can be adjusted to reflect concerns over environmental regulation. The strategies accounted for in this section go beyond those provisions. The strategies are mainly defensive, in the meaning that environmental regulatory power of the host state is affirmed, exemptions are made for environmental regulations or carved out from the IIA, or that commitments of common international environmental agreements are explicitly safeguarded. However, some strategies are more ‘offensive’ *vis-à-vis* environmental policies and include methods to enhance environmental governance by prohibiting host states from lowering standards of environmental regulation and by integrating into the IIA environmental commitments of increased environmental protection and diligence, and some-

749 The authors also argued that the proposal was unbalanced *vis-à-vis* trade liberalisation and less supportive of environmental issues; Medio Ambiente y Libre Comercio en America Latina: Los desafíos del libre comercio para América Latina desde la perspectiva del Área de Libre Comercio de las Américas, Asociación Latinoamericana de Derecho Ambiental (ALDA) report for UNDP, 2000, p. 41.

times connect those commitments to enforcement mechanisms. An overview of these strategies is shown in box 2. Similar categorisations of IIA environmental regulations and measures have been identified in surveys by UNCTAD<sup>750</sup> and OECD.<sup>751</sup>

### 8.4.1 Affirmation of the regulatory power of the host state

As was shown in chapter 2, the objective for investment treaties is to encourage and protect foreign investments; it is not to solve environmental problems. Consequently, IIAs do not prescribe any standard for the environmental policies of the state parties. Also, IIAs do not oppose the general principle of the state's right to regulate. However, as has been shown above, one of the main criticisms of IIAs in relation to environmental issues is that investment protection policies enforced by the IIAs are diminishing states' ability or willingness to regulate activities affecting the environment (chilling effect).

One way for the states to affirm their right to regulate is to articulate in the IIA that they are not abandoning their sovereign power to act on public purposes. An unrestricted statement that the host state preserves all its regulatory powers would, of course, limit the investment protection provisions quite substantially and make the treaty pointless. Therefore, the affirmation of the right to regulate is, in most IIAs where it exists, restricted to measures already consistent with international investment protection:

Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.

(NAFTA, article 1114(1))

750 UNCTAD 2001i.

751 Gordon & Pohl 2011

Succeeding IIAs have followed NAFTA in this direction.<sup>752</sup> Since the measure must be otherwise consistent with the investment protection provisions, the affirmation of regulatory rights has been described as an ‘additional interpretative factor’.<sup>753</sup> This means that the affirmation of the host state’s right to regulate may remind tribunals to consider this right of states as defining the content of the investment protection obligations in a practical situation where public regulations are involved. Hence, the affirmation clause as an additional interpretative factor will not make the investment protection provisions meaningless, but remind the tribunals of the principle of sovereignty of states.

In this context we assume that the right to regulate emphasises the fact that the host state is allowed to have a higher standard on environmental protection or stronger rules on efficient use of natural resources than other states or internationally recognised norms. However, it should be noted that the right to regulate also might imply the right for states to have lower environmental standards and to use their natural resources in a short-sighted way. To avoid such behaviour, the right to regulate clause could be written in combination with an affirmation of a high or increasing level of environmental protection.<sup>754</sup>

752 The NAFTA formulation is included in several other US-based IIAs, but also in Korean FTAs, for example, with Chile and Singapore, article 10.18(1); also see Malaysia–New Zealand FTA 2009, art. 10.15.

753 Some writers note that the language ‘otherwise consistent with this agreement’ is tautological and in substance does not give more flexibility to environmental matters, but may serve as an interpretative presumption that non-discriminatory environmental measures made in good faith do not contravene the investment obligations; see Newcombe & Paradell 2009, p. 509. See also the Commentary of the Norwegian draft model BIT: ‘The provision signals that the parties have national regulatory needs associated with health, environment and safety that are legitimate and must be respected. It does not give the state the right to derogate from the protection provisions of the agreement, cf. the words “otherwise consistent with this Agreement”. From a legal point of view, the main significance of the provision is as an additional interpretive factor for the scope of the protection provisions of the agreement’ article 12 (Right to Regulate).

754 See for example CAFTA 2006, art. 17.1: ‘Recognizing the right of each Party to establish its own levels of domestic environmental protection and environmental development policies and priorities, and to adopt or modify accordingly its environmental laws and policies, each Party shall ensure that its laws and policies provide for

The affirmation of the right to regulate articulates the view by the IIA parties that states could be frontrunners in environmental policies. However, an affirmation alone does not encourage any states to take the lead to push their environmental policies ahead of others, and the argument of competitiveness of industrial sectors risks moderating any steps in that direction. Therefore, the affirmation of the right to regulate, with the restrictions used in the clause, is a clear but rather lenient method to safeguard environmental policy space for host states. However, it provides IIA arbitration panels some basis for deciding in line with preserved policy space.

### 8.4.2 Carve out clauses and general exemptions for environmental measures

Two other strategies to reduce the risk of chilling effects on environmental law are to restrict the applicability of IIA provisions on environmental matters and to make general exemptions to safeguard environmental measures applying the IIA rules. Many of the more comprehensive FTAs include various kinds of clauses to carve out the investment protection obligations from certain subject matters, certain industrial sectors, measures in certain geographical areas, or certain types of policy instruments. Measures related to security interests, culture industries or other industrial sectors of special interest, taxation, governmental procurement, or subsidies might be exempted from the IIA, or be acceptable in the view of the treaty only if they fulfil certain criteria.<sup>755</sup>

There are no examples where the whole area of environmental policies is excluded from the investment protections obligations in the same way as culture or national security. The reason is probably that

and encourage high levels of environmental protection, and shall strive to continue to improve those laws and policies.’

755 Newcombe & Paradell 2009, a categorisation of carve-out clauses is found at p. 484. Note that Newcombe and Paradell label both the clauses that limit the scope of the IIA and ordinary exemptions from some of the provisions ‘exceptions and reservations’, in accordance with many IIAs.

## Overview of IIA-strategies to safeguard or enhance environmental regulation

**S:** Safeguard of environmental policy space. (+ or ++ as an evaluation)

**E:** Enhances environmental policy space. (+ or ++ as an evaluation)

### 1. Affirmation of the regulatory power of host state (S +)

Ex: USA- Chile FTA 2003 article 10.18(1); Malaysia-New Zealand FTA 2009 art.10.15

### 2. Carve out clauses and general exemptions for environmental measures (S ++)

Ex: Canada – Peru BIT article 10; Russia – Sweden 1995 BIT art. 3(3)

### 3. Safeguarding or enhancing the implementation of international environmental agreements (S+, E+)

Ex: Peru – US FTA 2006 Annex 18.2; CARIFORUM – EU FTA 2008 art. 72(c)

### 4. Non-lowering of environmental standards (S+)

Ex: NAFTA article 1114(2); Japan – Switzerland FTA 2009, article 101;

### 5. Increased environmental protection and diligence in enforcing environmental law (E+)

Ex: Peru – US FTA 2006 Annex 18.2; Canada-Peru FTA 2008 environmental side agreement art.2.1.

### 6. Enforcement mechanisms of environmental IIA obligations (E+)

Ex: NAAEC art. 22(1); CAFTA 2004 (see note 798)

### 7. Enhanced environmental cooperation (E++)

Ex: Agreement on Environment, side agreement to Canada – Peru FTA 2008; Environmental cooperation agreement within the trans-pacific strategic partnership (New Zealand, Brunei, Singapore and Chile)

health and environmental risk management and natural resource use very much interact with policies of industry and economic development, thus linking to the very aim of the IIA. However, IIAs could exclude certain sectors with high risk of environmental damage, and IIAs with pre-establishment national treatment provisions usually provide lists of industry sectors exempted from the NT provision (see section 5.3.2).

Some organisations have suggested that public environmental measures should be carved out from the investor–state dispute settlement mechanism.<sup>756</sup> Such reform of the IIAs would not transform the formal obligations of investment protection, but make them reliant on a state–state dispute settlement guarding the compliance in environmental matters. A mechanism which to some extent reflects this aim has been included for tax issues in US and Canadian BITs.<sup>757</sup> There are, however, no IIAs that in a similar way exempt environmental issues from the investor–state dispute settlement mechanism, even though it should be possible to create for environmental regulation a clause similar to the US taxation clause. The reasons for this are probably that environmental regulation may imply many different kinds of constraints for investments, and a lack of trust between states regarding environmental regulation sometimes is used as disguised protection of national economic interests.

756 UNCTAD 2001i, pp. 76–78, ALDA report on Área de Libre Comercio de las Américas, 2000, p. 41.

757 See, for example, also Canada–Costa Rica 1998 BIT, art. VIII(3), or US model BIT 2004, art. 21:

Taxation:

1. Except as provided in this Article, nothing in Section A shall impose obligations with respect to taxation measures.

2. Article 6 [Expropriation] shall apply to all taxation measures, except that a claimant that asserts that a taxation measure involves an expropriation may submit a claim to arbitration under Section B only if:

(a) the claimant has first referred to the competent tax authorities of both Parties in writing the issue of whether that taxation measure involves an expropriation; and  
(b) within 180 days after the date of such referral, the competent tax authorities of both Parties fail to agree that the taxation measure is not an expropriation.' [reference omitted].

On the other hand, exemptions for environmental measures might be made more generally in many IIAs. Some of the IIAs formulate general exemptions in a manner similar to the well-recognised exemption clauses in the WTO agreements.<sup>758</sup>

Subject to the requirement that such measures are not applied in a manner that would constitute arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures necessary:

(a) to protect human, animal or plant life or health;

[...]

(c) for the conservation of living or non-living exhaustible natural resources.

(Canada–Peru BIT, art. 10)

This implies that these much debated GATS articles,<sup>759</sup> which still to a large extent are untested in the WTO dispute settlement system, may come to arbitration in the IIA context, where, opposite to in the WTO, a private actor may challenge host state regulation.

Other IIAs include a general exception which safeguards the right of governments to carry out measures necessary for the protection of human, animal, or plant life, or health, safety, and public morals.<sup>760</sup>

758 Foremost, GATT, article XX, and GATS, article XIV. For an early example, see ECT, article 24(2)(i), where provisions do not preclude states from adopting or enforcing any measure ‘necessary to protect human, animal or plant life or health’, if it does not constitute an arbitrary or unjustifiable discrimination between contracting parties or between investors.

759 Bernasconi-Osterwalder *et al.* 2006 p. 155; GATS, Water and the Environment 2003. Also see discussion above in section 5.3.1.

760 See, as example, in the Russia–Sweden 1995 BIT, art. 3(3), which provides for ‘limited exemptions’ of national treatment in national legislation, applying to investments established after the exception is made; however, if the regulation concerns, inter alia, protection of the environment, it can apply also to the already established investments.



There are no IIA awards interpreting those kinds of general environmental exemptions. However, the similarity in language of the exemptions used in the WTO agreements and IIAs may lead to an influence of the WTO appellate body on the interpretation of IIAs in this regard. The WTO appellate body has noted that the analysis under general exceptions places the initial burden of proof on the party invoking the exemption (in IIA cases this would mean the respondent state) and that the analysis includes both the justification of the measure under one of the enumerated exempt articles and conformity with the introductory provision of non-discrimination.<sup>761</sup> Furthermore, the understanding of 'necessary' has become important for the WTO analysis.<sup>762</sup> There is, however, a difference between WTO agreements and IIAs, in that the interpretation of IIA core provisions of protection, as was shown in the chapters above, already considers the host state's reason for its measure. This means it is uncertain whether these kinds of general exemptions for environmental regulation may allow for more regulatory flexibility for the host state than a reasonable interpretation of the investment protection obligations.<sup>763</sup> Sometimes an exempting clause may even limit reasonable interpretation, giving wider leeway for environmental policies.<sup>764</sup>

761 Bernasconi-Osterwalder et.al. 2006 p. 78.

762 WTO Appellate Body, Brazil-Tyres: 'To be characterized as necessary, a measure does not have to be indispensable. However, its contribution to the achievement of the objective must be material, not merely marginal or insignificant, especially if the measure at issue is as trade restrictive as an import ban. Thus the contribution of the measure has to be weighed against its trade restrictiveness, taking into account the importance of the interests or values underlying the objective pursued by it.' para 210.

763 Also see Newcombe & Paradell 2009, p. 505.

764 Mann, H., 2005, commenting on 'clarification' on the provision of expropriation in USA model BIT 2004, compared to the flexible interpretation in the Methanex case.

### 8.4.3 Safeguarding or enhancing the implementation of international environmental agreements

The fear of international trade and investment agreements constraining the development and implementation of multinational environmental agreements has been expressed loudly in the wider trade–environmental debate.<sup>765</sup> As was shown in chapter 3 in this work, several principles and performance standards included in MEAs may come into conflict with investment protection obligations, for example, the precautionary principle and the polluter pays principle. In chapter 5 special concerns were raised with respect to environmental obligations surrounding transfer of environmental technology and know-how. However, there have been very few direct conflicts between multi-lateral environmental agreements and IIAs in IIA dispute settlement practice.<sup>766</sup> The concerns raised put focus on how IIAs relate to other international environmental obligations, especially MEAs.

The fear of IIAs constraining MEA implementation takes its start in the fact that environmental measures implementing MEA obligations are not *per se* excluded from conflicting with the IIA; see sections 1.5 and 8.4.2. In this situation the text in some IIAs clarifies the relationship between its investment obligations and the environmental obligations of certain international environmental treaties to which both states are parties.

Some IIAs only make references to international environmental obligations in a more general way. The Energy Charter Treaty mentions some international environmental agreements in the style of a

765 The famous controversy leading to the GATT cases Tuna–Dolphin and Shrimp–Turtle, and the so-called PPM requirements make good illustrations. Also see Johnson, Pierre Marc & Beaulieu, André, *The Environment and NAFTA – Understanding and Implementing the New Continental Law*, Island Press, 1996, pp. 50–67. The concern is to some extent also valid for the relationship between host state and foreign investments.

766 Direct references to MEA obligations is only found in the award in *S.D. Myers v. Canada* 2000.

UN Convention in the preamble.<sup>767</sup> New Zealand has in the context of its FTAs included a general affirmation to fulfil commitments from UN conferences like Rio 1992 and Johannesburg 2002, and also international environmental agreements.<sup>768</sup> The first IIA to explicitly refer to international environmental treaties was NAFTA, which proclaims that in the event of any inconsistency between NAFTA and trade obligations in a number of listed MEAs the obligations of the latter prevail.<sup>769</sup> Subsequent US FTAs have followed, however, adding new MEAs.<sup>770</sup> Complete recognition of the obligations in those MEAs applies in case of any inconsistency with the IIA:

767 See ECT preamble: 'Recalling the United Nations Framework Convention on Climate Change, the Convention on Long-Range Transboundary Air Pollution and its protocols, and other international environmental agreements with energy-related aspects'; however, also note article 16, which make clear that provisions in other agreements between the parties that are most favourable for the investment prevail, if there is a conflict between the agreements.

768 Malaysia–New Zealand FTA 2009, Environmental Agreement, art. 2.2.

769 NAFTA article 104 states:

Relation to Environmental and Conservation Agreements

1. In the event of any inconsistency between this Agreement and the specific trade obligations set out in:

- a) the Convention on International Trade in Endangered Species of Wild Fauna and Flora [CITES], done at Washington, March 3, 1973, as amended June 22, 1979,
- b) the Montreal Protocol on Substances that Deplete the Ozone Layer, done at Montreal, September 16, 1987, as amended June 29, 1990,
- c) the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, done at Basel, March 22, 1989, on its entry into force for Canada, Mexico and the United States, or
- d) the agreements set out in Annex 104.1,

such obligations shall prevail to the extent of the inconsistency, provided that where a Party has a choice among equally effective and reasonably available means of complying with such obligations, the Party chooses the alternative that is the least inconsistent with the other provisions of this Agreement.

Annex 104.1 also lists the Agreement Between the Government of Canada and the Government of the United States of America Concerning the Transboundary Movement of Hazardous Waste, signed at Ottawa, October 28, 1986; and the Agreement Between the United States of America and the United Mexican States on Cooperation for the Protection and Improvement of the Environment in the Border Area, signed at La Paz, Baja California Sur, August 14, 1983.

770 In the Peru–US FTA 2006, Annex 18.2, the list has expanded to seven MEAs, except

In the event of any inconsistency between a Party's obligations under this Agreement [the IIA] and a covered agreement [the referred MEA], the Party shall seek to balance its obligations under both agreements, but this shall not preclude the Party from taking a particular measure to comply with its obligations under the covered agreement, provided that the primary purpose of the measure is not to impose a disguised restriction on trade.<sup>771</sup>

Hence, the hierarchy, in the event of conflict, between the IIA and the mentioned MEAs is in these IIAs clarified to the advantage of the MEA obligations.

However, the texts of IIAs may also promote the enforcement of MEA obligations. In CAFTA 'the Parties recognize that multilateral environmental agreements to which they are all party play an important role in protecting the environment globally and domestically and that their respective implementation of these agreements is critical to achieving the environmental objectives of these agreements.'<sup>772</sup> In the US–Peru FTA the obligation towards the MEA goes further and obliges the parties to adopt, maintain, and implement laws, regulations, and all other measures to fulfil their obligations under the MEAs.<sup>773</sup>

for CITES and the Montreal Protocol named in NAFTA. This IIA also includes the protocol relating to the International Convention for the Prevention of Pollution from Ships (MARPOL) 1978, the Convention on Wetlands of International Importance Especially as Waterfowl Habitat (Ramsar Convention) 1971, the Convention on the Conservation of Antarctic Marine Living Resources 1980, the International Convention for the Regulation of Whaling 1946, and the Convention for the Strengthening of the Inter-American Tropical Tuna Commission Established by the 1949 Convention between the United States of America and the Republic of Costa Rica (Antigua Convention) 2004.

771 Peru–US FTA 2006 art. 18.13(4), a note to the paragraph adds that it is without prejudice to multilateral environmental agreements other than covered agreements.

772 Art. 17.12(1).

773 Art. 18.2, noteworthy is the explanatory note to the article which emphasises that future commitments under the MEAs are included: "covered agreements" shall encompass those existing or future protocols, amendments, annexes, and adjustments under the relevant agreement to which both Parties are party; and (2) a Party's "obligations" shall be interpreted to reflect, inter alia, existing and future reservations,

Canada has also included language of affirmation of the Convention on biodiversity (CBD) and commitments to work together with the FTA parties to advance the objective of that convention in its FTAs.<sup>774</sup> The EU includes commitments that each state take necessary measures in domestic legislation to ensure that investors do not operate their investments in a manner that circumvents obligations of international environmental agreements which the states have signed.<sup>775</sup>

To summarise, some negotiators of IIAs have felt a need to clarify the relationship to international environmental obligations. This has been done, as in the first example above, with hortatory references or clauses of hierarchy reminding of the negotiators' intent that the IIA should be viewed in connection with the state parties' international environmental commitments, thereby safeguarding measures connected to MEAs from being seen as conflicting with IIA provisions. There are also IIAs with obligations that enhance implementation of common MEA commitments, as the latter example shows. While the first method is the most common, the second method elaborated within more comprehensive economic cooperation agreements creates new instruments to enforce some provisions of environmental agreements. One may note that the specific MEAs which are enhanced, for example, in the USA's FTAs with Peru and Colombia, except for the Montreal Protocol, all include obligations related to trade, and therefore mainly risk conflicting with the FTA trade provisions. If the USA had ratified the CBD or the Kyoto Protocol, whose obligations relate more to investments,<sup>776</sup> it would be logical that those MEAs also be explicitly listed in the FTAs in the same way.

However, it was generally concluded in section 1.5 above that the main complication in the MEA–IIA relationship is found in the 'asymmetric relation', that is, the relation wherein one may not establish symmetry on the sides of parties between the environmental obligations and the investment obligations. The development of IIA clauses

exemptions, and exceptions applicable to it under the relevant agreement.'

774 Canada–Peru FTA 2008, environmental side agreement, art. 2.8.

775 CARIFORUM–EU FTA 2008, art. 72(c).

776 Ebbesson 1998, summary.

seen so far has not dealt with that situation in an explicit way. This does not mean that global environmental norms stemming from MEAs and other sources (see section 3.2.2) cannot impact the interpretation of IIAs; see discussion especially in section 5.7.

#### 8.4.4 Non-lowering of environmental standards

The fear for a 'race to the bottom', meaning that states compete to attract foreign investment by lowering the environmental standards applied to the investment, has motivated the inclusion of so-called non-lowering standards clauses. Two reflections on the motivations for those clauses can be made. First, there is little empirical support for the assumption that investors in general choose a place of investment based on low standards of environmental regulation,<sup>777</sup> and second, the fear of race to the bottom often expressed by industrial countries does not always articulate so much a concern for the environment as a concern of jobs moving from industrial states to the growing economies of the south. It is significant that the debate in the USA over new negotiations mandates for IIAs has included these arguments for protecting domestic companies from being 'discriminated against' because foreign investors come better off than domestic firms with the rights granted by the IIAs.<sup>778</sup> In any case, in the formulation of the clauses the aim is to ensure that environmental regulation is not softened as foreign investments are encouraged to establish. That is in itself a legitimate aim.

777 For most industries the cost of environmental regulation is very small compared with the value on skilled workforce, accessibility to resources and components. However, in some heavy polluting industry sectors these costs may indeed have an impact on location, thus, in developing country context and looking at mining or energy sectors lower environmental standards can make a significant gain in cost for companies, thus, the fear for a race to the bottom may be more relevant in these sectors.

778 See the agreement between the conservatives and the democrats in the US Congress, which implied further constraints for the negotiation of new IIAs by strengthen the perspective that foreign investors should not be treated better than domestic ones in the USA, US Bipartisan agreement on trade policy 2007.

The non-lowering standards clause was introduced by NAFTA,<sup>779</sup> but the clause has been copied in a number of other FTAs and was proposed for inclusion in the MAI. The EU also proposed it as part of the 2006 model for its trade agreements.<sup>780</sup> An example:

The Parties recognise that it is inappropriate to encourage investment activities by relaxing domestic health, safety or environmental measures or lowering labour standards. To this effect, each Party should not waive or otherwise derogate from such measures and standards as an encouragement for establishment, acquisition or expansion of investments in its Area.

(Japan–Switzerland FTA 2009, article 101)

The non-lowering of environmental standards clauses does not try to transform the investment protection provisions, as the two above-mentioned approaches show. Instead it can be seen as some sort of independent obligation by the state parties. It is a rather weak obligation, which is difficult to enforce, not only because assessment of states' intentions when changing environmental regulation is problematic in itself, but also because a rigid compliance might freeze the development of environmental regulations, as it would prohibit the state from softening a regulation that came out too harsh a first.<sup>781</sup>

US and Canadian IIAs often connect this clause to a special right of state–state dispute settlement if one party accuses the other of acts breaching the clause.<sup>782</sup> Yet, it seems no such consultation has ever happened. In more comprehensive environmental cooperation agreements, the approach has been elaborated further; see section 8.4.6 on enforcement of environmental IIA obligations.<sup>783</sup> Thus, one may ask if

779 NAFTA, art. 1114(2), this clause was called the Pollution Havens Clause; see Johnson & Beaulieu 1996, p. 112.

780 Communication from the European Community and its Member States, Working Group on the Relationship between Trade and Investment, April 7, 2003.

781 Johnson & Beaulieu 1996, pp.112–113.

782 US model BIT 2004, art. 12(1), Canada model BIT 2004, art. 11, while most other IIAs refer such disputes to the ordinary state–state dispute settlement of the treaty.

783 See, for example, CAFTA 2004, art. 17.10 and the Canada–Jordan agreement on the

the non-lowering 'obligation' is included for its political value, rather than being meant for judicial interpretation.<sup>784</sup> As a political obligation it could be referred to by governments when facing criticism from environmental NGOs and other actors who express worries about companies moving their production abroad not needing to take full responsibility for their environmental impacts.

### 8.4.5 Increased environmental protection and diligence in enforcing environmental law

If the levels of environmental regulation and enforcement are very different among the IIA parties, the pollution havens hypothesis gives an incentive for states with higher environmental standards to try to upgrade certain environmental standards or practices in the other states when negotiating IIAs. Such efforts seem almost exclusively to have been carried out in the context of wider economic agreements like FTAs (or within wider political cooperation areas such as the EU) and not in the more limited BITs.<sup>785</sup>

For those provisions also NAFTA has been a predecessor, even if the provisions in NAFTA are placed in the environmental side agreement, NAAEC. In US or Canadian FTAs of the 2000s the first articles of the chapter on environment, or in the case of Canadian FTAs the first in the general provision of the environmental side agreement, go beyond the affirmation of regulatory rights and prohibition of lowering standards by stating that 'each Party shall ensure that its laws and policies provide for and encourage high levels of environmental protection, and shall strive to continue to improve those laws and policies,'<sup>786</sup> and 'a Party shall not fail to effectively enforce its environmental laws,

environment in connection to the Canada–Jordan FTA 2009, art. 23.

784 Romson 2008.

785 The USA current model BIT does not include these standards, while US FTAs do.

786 NAAEC 1992, art. 3; Jordan–USA FTA 2000, art. 5; Chile–USA FTA 2003, art. 19.1; US–DR–CAFTA 2004, art. 17.1, Peru–USA 2006, art. 18.1; Canada–Peru FTA 2008, environmental side agreement, art. 2.1. A similar formulation is in the Treaty of European Union, art. 3 (ex art. 2 TEU).



through a sustained or recurring course of action or inaction, in a manner affecting trade between the Parties.<sup>787</sup>

Of these two provisions it is the one on diligence in enforcing environmental laws that has brought most consideration in the agreements, leaving the provision on high levels of environmental protection to merely a clause of affirmation. The specification of diligence in enforcement mentioned in the agreements is rather comprehensive and ranges from access to justice to the capacity and capability of inspectors. However, it is clarified that the provision does not aim to challenge a public measure that ‘reflects a reasonable exercise of [...] discretion, or results from a bona fide decision regarding the allocation of resources’.<sup>788</sup> Considering the complex structure of enforcement of administrative law, it is hard to imagine a situation where a state would fail to explain any weaknesses in enforcing environmental law to fit that description. The desire to strengthen enforcement has, as seen in the next section, perhaps been more empowered in practice through cooperation and support of environmental authorities.

Further, the required enforcement of environmental laws is restricted by excluding natural resource management and regulation directly related to workers’ safety or health from the definition of ‘environmental laws’.<sup>789</sup> Gonzales means that measures on urban or rural plan-

787 NAAEC 1992, art. 5 (more detailed formulation); Jordan–USA FTA 2000, art. 3(a); Chile–USA FTA 2003, art. 19.2(1); US–DR–CAFTA 2004, art. 17.2(1); Peru–USA FTA 2006, art. 18.3(1), Canada–Peru FTA 2008, environmental side agreement, art. 2.2 (slightly different formulation).

788 Chile–USA FTA 2003, art. 19.2(1)(b); Canada–Peru FTA 2008, environmental side agreement, art. 2.3 (slightly different formulation).

789 See, *inter alia*, NAAEC, art. 45(2) and US–DR–CAFTA, art. 17.13:

(a) ‘environmental law’ means any statute or regulation of a Party, or provision thereof, the primary purpose of which is the protection of the environment, or the prevention of a danger to human life or health, through

(i) the prevention, abatement or control of the release, discharge, or emission of pollutants or environmental contaminants,

(ii) the control of environmentally hazardous or toxic chemicals, substances, materials and wastes, and the dissemination of information related thereto, or

(iii) the protection of wild flora or fauna, including endangered species, their habitat, and specially protected natural areas in the Party’s territory, but does

ning, culture heritage, and landscape views, as well as the constitutional right to ecosystems in balance, which all traditionally are referred to in Costa Rica risk as part of the broader environmental law, fall outside this definition in CAFTA.<sup>790</sup>

Thus, the provisions of increased environmental protection and diligence in enforcing environmental law seen in today's IIAs are unlikely to do anything about the uneven levels of environmental law existing between many countries. In a region like Central America where several states have joined the FTA the situation might be even harder for a state like Costa Rica, practising a reasonably good level of environmental law but still needing to compete for foreign investments with neighbouring states with significantly worse environmental performance. In spite of the environmental provisions of CAFTA, such a state might undergo pressure to lower its standards to attract investments and sense a constraint to implementing further higher environmental standards.<sup>791</sup> However, for such states high environmental standards also may attract certain investments, for example, eco-tourism and industry whose production in any case needs high standards of control.

Although the provision of increased environmental protection and diligence in enforcing environmental laws is formulated as a legal obligation, it rather provides the basis for environmental cooperation and expresses a political commitment; see also sections 8.4.6. and 8.4.7.

not include any statute or regulation, or provision thereof, directly related to worker safety or health.

(b) For greater certainty, the term 'environmental law' does not include any statute or regulation, or provision thereof, the primary purpose of which is managing the commercial harvest or exploitation, or subsistence or aboriginal harvesting, of natural resources.

(c) The primary purpose of a particular statutory or regulatory provision for purposes of subparagraphs (a) and (b) shall be determined by reference to its primary purpose, rather than to the primary purpose of the statute or regulation of which it is part.

790 González 2008, p. 18.

791 Estado de la Nación, Resumen del TLC 2007, p. 19; Villata interview, and Interview, Ballar, Rafael González, Dean at the Faculty of Law UCR, San José, Costa Rica, 2008-12-05

## 8.4.6 Enforcement mechanisms of environmental IIA obligations

As provisions on enhancement of environmental regulation, as mentioned in the sections above, are included in IIAs, the issue of how to empower them with some sort of enforcement mechanism has become relevant. Enforcement of international environmental commitments is traditionally referred to soft mechanisms with few sanctions and a focus on cooperation for future fulfilment of the obligations. States have shown little interest in hard legal disputes with partners in environmental cooperation, and the effectiveness of such enforcement is debated.<sup>792</sup> A more attractive way to deal with enforcement in MEAs is therefore different forms of non-compliance mechanisms, meaning, for example, a standing compliance committee which examines reported cases and may recommend a decision-making body of the MEA to decide on non-compliance and give recommendations or help for capacity building. The initiative to register a case at the compliance committee could go beyond the state parties of the MEA and be entrusted to the MEA secretariat. Citizens might also sometimes file complaints.<sup>793</sup>

IIAs, for their part, build their enforcement mechanisms on dispute settlement; the involvement of the investor–state dispute settlement in particular is much profiled, as was discussed in section 2.5. Unless otherwise specified, this dispute settlement mechanism could be used for any obligation in the IIA that an investor would like to have enforced. However, for obligations not to lower environmental standards or enforce public environmental law, the state–state dispute settlement would be more relevant.<sup>794</sup> The recourse to dispute settlement

792 Klabbers, Jan, Compliance Procedures, Bodansky, Brunnée & Hey (Eds.), *The Oxford Handbook of International Environmental Law*, chapter 43, Oxford University Press, 2007.

793 For example, the Aarhus Convention compliance committee, art. 15 of the Aarhus Convention; for information, see <http://www.unece.org/env/pp/cc.html> (visited 2012-01-07).

794 In theory one can imagine a foreign company competing with companies in a state which is lowering the standards so that other companies are kept in business, while

for the parties in environmental matters may, however, be limited and cover only some specific obligations. For example, in the NAAEC the consultation and arbitration system available for environmental issues between the NAFTA parties is limited to the issue of whether there has been a persistent pattern of failure by that other party to effectively enforce its environmental law.<sup>795</sup> The NAAEC also contains special rules on the appointment of panellists in such disputes; a roster of persons especially skilled in disputes on the enforcement of environmental law is formed, from which five panellists are picked.<sup>796</sup> However, the NAAEC dispute mechanism has, after almost 15 years, not been used a single time, and there are reasons to believe it never will be.<sup>797</sup> Still, similar mechanisms are included in several USA FTAs of the 2000s. Thus, the mechanism seems to fill a purpose, if not a traditional legal one, then rather a meaningful 'symbolic exercise [...] giving the impression that something is being done about some problem without actually doing much about it', to use the words of Jan Klabbers.<sup>798</sup>

NAAEC also includes a procedure by which citizens can notify authorities of cases of non-compliance with the environmental obligations. The treaty constitutes the North American Commission on Environmental Cooperation (CEC), which council may empower the secretariat to carry out a 'factual record' in a specific case and ul-

the foreign actor loses and wants to dispute with the host state. But in reality investors will not dispute with a host state over too low environmental standards or quality of law.

795 NAAEC, part five, on consultation and resolution of disputes, only covers the issue of whether there has been a persistent pattern of failure by that other Party to effectively enforce its environmental law, art. 22(1).

796 'Roster members shall: (a) have expertise or experience in environmental law or its enforcement, or in the resolution of disputes arising under international agreements, or other relevant scientific, technical or professional expertise or experience,' NAAEC, art. 25(2).

797 The ten-year review, 2004 (cited in Blair, David, Trade liberalisation, environmental regulation and the limits of reformism: the North American experience, *Environmental Politics*, vol 17 (2008), 5, pp. 693–711, p. 701).

798 Klabbers 2007, p. 1005, discussing the existence of 'political rationality' (as opposed to instrumental rationality, following Martti Koskenniemi) in compliance mechanisms of MEAs.

timately to make such record public.<sup>799</sup> Several, but not all, USA FTAs subsequent to NAFTA/NAAEC include similar citizen's submission procedures.<sup>800</sup> The NAAEC citizen's submission procedure has been criticised as weaker than comparable MEAs' mechanisms,<sup>801</sup> and it has been questioned whether it leads to any changes in state behaviour.<sup>802</sup> However, as some writers remark, the mechanism has given an additional tool to environmental NGOs to reach out and get publicity around a legal or physical environmental problem, especially for NGOs in less powerful states in economic cooperation.<sup>803</sup>

Hence, some IIAs that include non-lowering standards or other environmental provisions also have included some lenient forms of enforcement. The investor–state dispute settlement mechanism, however, is not suited for enforcement of the environmental provisions, since the upholding of these provisions is of little interest to a complaining investor. Accessible compliant mechanisms may, however, empower citizens and NGOs in their efforts to guard environmental work in the host state.

#### 8.4.7 Enhanced environmental cooperation

In addition to the methods discussed above, aiming to safeguard or enhance environmental regulation in the IIA context, some integrated trade and investment agreements take a step further and also form a

799 NAAEC, art. 14 and 15, 'A Guide to articles 14 and 15' at <http://www.cec.org> (visited 2010-06-23).

800 For example, citizen's submission procedures exist in CAFTA 2004 and USA–Peru FTA 2006, but not in USA–Chile 2003.

801 Fitzmaurice, Malgosia, Environmental justice through international complaints procedures? Comparing the Aarhus Convention and the North American Agreement on Environmental Cooperation, Ebbesson & Phoebe (Eds.), *Environmental law and justice in context*, pp. 211–27, Cambridge University Press, 2009, pp. 211–227.

802 Blair 2008.

803 Mexican environmental NGOs have been more interested in using the complaint mechanism of NAFTA than their US counterparts, which have preferred stronger juridical forms available in the US; see *ibid.* For Costa Rican environmental NGOs the mechanism in US–DR–CAFTA could be seen as an interesting complement to domestic judicial activism, according to Jorge Cabrera, Cabrera Interview.

framework for activities of state cooperation in environmental work. The earliest examples are found in the Energy Charter Treaty and NAFTA.

In the Energy Charter Treaty environmental issues related to energy have been incorporated through article 19 of the main treaty on 'Environmental Aspects' and the Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA). There is also an institutional framework in the Working Group on Energy Efficiency and Related Environmental Aspects which acts as institutional body and forum. The work is based on article 19 of the ECT, which confirms several environmental law principles: the polluter pays principle, the principle of prevention, and responsibility for transboundary pollution. The language in the article is, however, soft, and the obligations are to 'strive at', 'take account of', or 'promote' environmentally sound regulation. The environmental commitments in ECT and PEEREA work very similar to those of traditional international environmental agreements, which focus on cooperation, sharing information, building of knowledge, and exchanging best practices.

In the NAFTA context the ambitions to strengthen cooperation in environmental issues were channelled through the environmental side agreement, NAAEC, forming the institution North American Commission on Environmental Cooperation (CEC), which carries out environmental projects on a broad range of regional environmental issues.<sup>804</sup> In the post NAFTA FTAs, as well, the USA seeks to establish consultative mechanisms to strengthen the capacity of the trading partner to develop and implement environmental standards.<sup>805</sup> Within the comprehensive economic cooperation between the USA and the Central American states, including the Republic of Dominica, concluded with CAFTA, environmental cooperation is also integrated. The CAFTA parties have established a secretariat of independent specialists at the Secretariat for Central American Economic Integration

804 Information on the tasks of CEC and a list of projects can be found at <http://www.cec.org> (visited 2010-06-24).

805 USA Trade Act 2002, section 2102(c)(3).

(SIECA), which facilitates those mechanisms,<sup>806</sup> and there is a council of state representatives that meets annually and in general reviews the progress of the environmental provisions of the agreement.<sup>807</sup> There is further a special side agreement to CAFTA on environmental cooperation with the focus to strengthen enforcement of environmental laws.<sup>808</sup> The work programme lists a large number of areas for common activities.<sup>809</sup> However, to work in practice, the programme clearly needs some resources. Therefore, the US Agency for International Development (USAID) supports a number of activities to be carried out by another SIECA body, CCAD (the Central American Commission on Environment and Development):

806 Understanding Regarding the Establishment of a Secretariat for Environmental Matters, 18 February 2005.

807 CAFTA, article 17.5.

808 Agreement on Environmental Cooperation between the states of CAFTA.

809 *Ibid.* art. V(1): (a) strengthening each Party's environmental management systems, including reinforcing institutional and legal frameworks and the capacity to develop, implement, administer and enforce environmental laws, regulations, standards and policies; (b) developing and promoting incentives and other flexible and voluntary mechanisms in order to encourage environmental protection, including the development of market-based initiatives and economic incentives for environmental management; (c) fostering partnerships to address current or emerging conservation and management issues, including personnel training and capacity building; (d) conserving and managing shared, migratory, and endangered species in international commercial trade and management of marine and terrestrial parks and other protected areas; (e) exchanging information on domestic implementation of multilateral environmental agreements that all the Parties have ratified; (f) promoting best practices leading to sustainable management of the environment; (g) facilitating technology development and transfer and training to promote the use, proper operation and maintenance of clean production technologies; (h) developing and promoting environmentally beneficial goods and services; (i) building capacity to promote public participation in the process of environmental decision-making; (j) exchanging information and experiences among Parties wishing to perform environmental reviews, including reviews of trade agreements, at the national level; and (k) any other areas for environmental cooperation on which the Parties may agree.

- Environmental management systems for the CAFTA countries, inter alia, strengthening environmental regulation enforcement capacity;
- Capacity-building for member countries in complying with the environmental obligations of CAFTA, inter alia, harmonising environmental claim systems;
- Compliance with multilateral environmental agreements, by promoting enforcement of CITES and the Montreal Protocol at a regional level;
- Use of clean production technologies, inter alia, promoting the application of voluntary and flexible clean production mechanisms; and
- Inter-ministerial coordination, capacity building, and communication.

The focus of the supported activities is strengthening the capability of environmental authorities in general, but could also be linked to environmental areas facilitating trade and investments, harmonisation of claims, strengthening enforcement, and promoting voluntary instruments. However, according to some sources the environmental authorities and organisations did not participate in the negotiations on the environmental provision and cooperation agreement of CAFTA.<sup>810</sup> If so, it might be more difficult in practice to coordinate the environmental work of CAFTA and the developments of environmental regulation and capacity building in the Central American states.

Since 2008 Canada also includes special agreements on environmental cooperation and frameworks to review the environmental provisions linked to the FTAs.<sup>811</sup> Outside the Canada–US FTAs, the Singapore–Korea FTA 2009 expresses similar desires to strengthen cooperation in environmental issues; however, the cooperation focuses mainly

810 Aguilar & Iza 2005, p. 549; Interview González Ballar.

811 Sections II and III in the Agreement on Environment, side agreements to Canada–Peru FTA 2008, Canada–Colombia FTA 2008, and Canada–Jordan 2008 FTA. The Canada–Costa Rica FTA 2001 also includes a side agreement on environmental cooperation, but has few substantive rules on cooperation activities.



on technology development and renewable energy.<sup>812</sup> New Zealand has concluded various cooperation agreements on environmental issues in the context of its FTAs. Those agreements form a framework for cooperation and may list areas of cooperation like collaborative research on subjects of mutual interest, exchange of environmental experts and management personnel, and exchange of technical information and publications.<sup>813</sup> However, it is hard to predict how successful those agreements will be in encouraging cooperation, since the funding of cooperative activities will be decided by the participants on a case-by-case basis.<sup>814</sup>

Hence, there is a trend to widen the trade and investment agreements not only by including safeguard and enhancing provisions for environmental regulation, but by forming a framework for cooperation in environmental matters directly or indirectly linked to the economic integration of the states. This development does not take place within more limited cooperation such as the BITs. Common environmental institutions are created as parts of the agreements and some ideas of concrete work are indicated as a framework, involving, *inter alia*, capacity building and monitoring. However, another crucial element seems to be less developed: the resources. This raises a flag of warning, considering the perseverance of the environmental efforts. If funding is secured and the efforts to strengthen environmental governance structures are sincere, these trade and investment environmental cooperation agreements can enhance environmental policy space.

812 Singapore–Korea FTA 2009, art.18.9, and the memorandum of understanding concerning this cooperation.

813 See, for example, the Environmental cooperation agreement within the Trans-Pacific Strategic Economic Partnership Agreement (New Zealand, Brunei, Singapore, and Chile), art. 4.

814 Arrangement on environment within the economic partnership between New Zealand and Thailand, art. 2(4).

## 8.5 More radical shifts in the use of IIAs

Above, the miscellaneous toolbox of methods in use to safeguard and enhance environmental regulation through the IIA has been unfolded. Those strategies to various degrees show the beginning of an integration of environmental concern in the IIAs. However, they invoke few clear standards in favour of environmental regulation that would over-trump any narrow interpretations of the core protection provisions. Yet, some of the strategies may also contribute to widening interpretations of the IIA in dispute settlements.

In this section more radical shifts in the use of IIAs are explored to see whether those agreements can be transferred into proactive instruments for sustainable investments and support of technology transfer. Three different kinds of changes to the common IIA will be discussed: cutting out the investor–state dispute settlement mechanism, adding home state responsibility and investor accountability, and reserving the IIA protection for investment clearly leading towards sustainable development. Inspiration for this approach is taken from the work of the International Institute for Sustainable Development (IISD) model IIA also referred to above. The proposal of IISD aims at showing, in contrast to the view of many other NGOs that the complete system of IIAs needs to be abandoned, how IIAs may be turned into tools for sustainable development.<sup>815</sup>

815 The IISD gives, for example, the following reasons for its proposal of a new model IIA: ‘Whatever its merits at the time, the model for IIAs developed 50 years ago no longer meets the needs of the global economy in the 21st century. Many observers, especially from civil society groups around the world, believe that the current international investment regime is so inherently flawed as to be beyond repair or reform. They argue for the complete dissolution of the regime, and for the construction of an alternative regime specifically focussed on the obligations of transnational actors. While IISD shares many of the concerns, we have taken a different tack in response to them. We believe the time is ripe to propose a new model for IIAs, a new direction that is consistent with the goals and requirements of sustainable development and the global economy of the 21st century.’

## 8.5.1 Cut out the investor–state dispute settlement mechanism from IIAs?

The IIA increases the risks for host states to be questioned about environmental regulation, less because IIAs include much stronger substantive rights for investors than because of the investor–state arbitration clause. One of the major criticisms against the investment treaties' current status is that the investor–state arbitration mechanism is inappropriate for solving the public regulatory disputes which IIA disputes are.<sup>816</sup> Some of the critics also point to very weak arguments for the investor–state dispute settlement mechanism. For example, the Australian commission on productivity concluded that such a mechanism implies many risks for host state regulation without fulfilling any clear policy goal.<sup>817</sup> It has been noted that the IIA dispute mechanism does not fit very well for those investors which probably are the ones in most need of an alternative forum for dispute settlement, the small companies and individuals.<sup>818</sup> In this work it has been shown that the administrative reviews are an inherent part of national environmental governance, a structure that is weakened if foreign operators are excused from it; see section 3.6.

One obvious 'solution' to those problems is to cut out the investor–state arbitration mechanism from investment treaties. This was one of the recommendations in a public call from a group of academic jurists who criticised the international investment regime for its far-reaching impacts on communities and public benefits.<sup>819</sup> The investor–state dispute settlement could be taken away as part of other more radical shifts, or without other changes to the IIA. Thus, the substantive provisions might stay the same, but it would be up to the home state to consider how to act to solve conflicts between an investor and the host state, either through diplomatic work or through any state–state dispute settlement mechanism included in the IIA or offered by another

816 Newcombe & Paradell 2009, p. 64.

817 Australian Government Productivity Commission 2010.

818 Nordrum 2008, p. 362.

819 [http://www.osgoode.yorku.ca/public\\_statement](http://www.osgoode.yorku.ca/public_statement) (visited 2012-01-15).

international institution. That is the way disputes concerning the obligations in international treaties are handled within the WTO and in those investment treaties which still do not include an investor–state dispute settlement mechanism.

A less far-reaching change to the investor–state dispute settlement mechanism could also give a good result in widening policy space for host states. That is to limit the mechanism to cases where the domestic legal remedies have been exhausted by the claimant. This kind of limitation of the investor–state dispute settlement mechanism was proposed in the Norwegian draft model IIA; see section 2.5.1. Interestingly, the European parliament expressed sympathy for such restructuring of the dispute settlement mechanism, according to its resolution on the future European international investment policy in March 2011.<sup>820</sup> Besides these proposals, a complementary strategy is to include in the dispute mechanism rules on transparency, allow for participation by third parties, and arrange for an appeal system, as been advocated by many; see section 2.5.3.

## 8.5.2 Add home state responsibility and investor accountability?

A second potential strategy to radically shift the perspective on protection of foreign investments is to add home state responsibility and rules on investor accountability to the IIAs.

An often expressed criticism of IIAs is that they give private actors several rights, but no corresponding duties or responsibilities. Therefore, proposals to reform the role of IIAs include ways to impose duties on the investor, preferably through regulation by the home state. One example is home country extraterritorial regulation, meaning that the company's home state regulates and monitors the environmental behaviour of the company abroad in the same way as behaviour connected to anti-trust laws or non-trading laws is monitored by some states.<sup>821</sup> The practicability of implementing extraterritorial regulation for en-

820 EP resolution on the future European international investment policy 2011.

821 Especially the USA; Sornarajah 2004, pp. 182–184.

environmental purposes is being debated, and developing states are divided in the opinions on whether such control helps them ensure that TNCs contribute to development in the developing country, or is an unacceptable interference in their sovereign power.<sup>822</sup> Other proposals to include home state responsibilities in an IIA show that it is hard to express those provisions in forms other than very soft provisions; the IISD model talks about the home state which should assist with capacity building and technology transfer, and on request shall provide information to the host state about its environmental standards for comparable operations.<sup>823</sup>

A more popular avenue to carry out home state responsibility is to facilitate transnational litigation and force home states to open up their domestic regulation to make it easier for victims in developing countries to access justice in the corporation's home state.<sup>824</sup> Such litigation aims at holding the decision-making centre of TNCs accountable for damage and seeking redress beyond the financial constraints of the subsidiary operating in the host state. However, the field of transnational litigation presents many difficulties: few cases, expensive and difficult processes, strongly opposing business community, few engaged home states, and host states which sometimes reject the intervention of foreign rules.<sup>825</sup> The IISD model includes a commitment by the home state to ensure its legal system may be used for transnational litigation;<sup>826</sup> however, no real IIA includes such a commitment.

Some IIAs, however, include soft references to instruments of corporate responsibility; Canadian IIAs with environmental side agreements include a provision on the encouragement of voluntary best

822 Ibid.; Morgera 2009, pp. 30–31. Sceptical views on the conflict with sovereign powers were also expressed in UNCTAD 2001iii p. 47.

823 IISD model IIA 2005, art. 29 and 30.

824 See, *inter alia*, Morgera 2009, pp. 31–34; Perez 2004, pp. 200–228; Ebbesson, Jonas, Transboundary corporate responsibility in environmental matters: fragments and foundations for future frameworks, Winter (Ed.), *Multilevel governance of global environmental change*, chapter 8, Cambridge, 2006, pp. 222–224.

825 Morgera 2009, pp. 31–34, and Perez 2004, pp.220–228.

826 Art. 31.

practices of corporate social responsibility.<sup>827</sup> Draft IIAs have also referred to the OECD Guidelines and Global Compact. Those provisions are, however, also of a very soft character; the Norwegian draft ‘encourages’ investors to comply with the guidelines<sup>828</sup> and participate in the UN Global Compact, and the MAI draft included the following paragraph on the relation to the OECD Guidelines, which were linked to the treaty:

Annexation of the Guidelines shall not bear on the interpretation or application of the Agreement, including for the purpose of dispute settlement; nor change their non-binding character.<sup>829</sup>

Hence, despite the number of initiatives taken to balance investor rights with duties, little progress is seen among the IIAs in force. The call for international rules on corporate accountability, however, demonstrates this issue should be taken seriously, and including some rules in the IIAs could be one way to go.

### 8.5.3 Limit the IIA protection to investments resulting in sustainable development?

A third potential strategy to radically change the perspectives of investment protection is to let the IIA cover only investments resulting in sustainable development.

Birnie, Boyle and Redgwell note in discussing the *Ogoniland* case, which concerned severe social and ecological damage from extensive oil drilling by multinational oil companies in the Niger Delta, that ‘it seems improbable that a BIT could provide the investor with any protection against changes in local law or policy necessary to give effect to fundamental human rights obligation’.<sup>830</sup> The reasoning indicates that corporate crimes and breaches against human rights are legiti-

827 See, inter alia, Canada–Peru FTA 2008, Agreement on Environment, art. 6.

828 Art. 32.

829 Part X, art. 1(4), p. 95.

830 Birnie, Boyle & Redgwell, 2009, p. 327.

mate grounds to deny an investor the protection of an IIA. The opposite would, of course, be considered most unreasonable. The question is whether even less grave wrongdoings by the private actor could withdraw the protection of the IIA, or if this protection can even be reserved only for investments that qualify above a certain standard in promoting sustainable development.

As was shown in section 2.3, illegal businesses can be barred from IIA protection, and in the IISD model IIA it is suggested that it be made explicit that some of the rights of the investor may depart, due to corruptive behaviour or persistent breaches of environmental standards.<sup>831</sup> In section 2.3 it was also discussed whether the definition of investment might exclude investments from protection if they do not contribute to the host state's economy. It was shown that there was little room for such exclusion based solely on the definition of investment. However, it is not very far-reaching to include an analysis of the objective of the IIA and discuss whether a requirement to contribute to sustainable development can be applied, granting the investment protection from the treaty. As was shown in section 8.1, the preambles of IIAs sometimes embrace the concept of sustainable development as the overarching objective. Following this reasoning, the investor could have the burden to show that the project falls in line with sustainable development, as a criteria to make use of the IIA protection.

However, there are no signs in the current IIA jurisprudence that such a position would be defended. The precise language in most IIAs on the definition of investment, often framed in terms of the form rather than the purpose of the activity of the capital used, may limit the space for interpretations in this direction. Also, the focus in policy debates on quantities of investments, instead of the qualities, as part of the objective and vagueness in the concept of sustainable development, adds to the difficulties of making the interpretation illustrated here regarding most current IIAs.

Clarifications of the IIA objective could in any case open such an interpretation. The objective of the IISD model IIA is, for example: 'to promote foreign investment that supports sustainable development, in

831 IISD model IIA 2005, art. 13–15 and 18.

particular in developing and least-developed countries'.<sup>832</sup> To include such a sustainable development threshold in the IIA objective could radically shift the perspective of IIAs. With such an objective it is clearly possible to require that investment projects must comply with international standards of environmental protection or social rights. The difficult task, however, would be to find a vigorous definition of 'investments promoting sustainable development'. For that task the investment mechanisms and objectives in international environmental treaties could be of some guidance.

## 8.6 Conclusions and some remarks on policy space

This chapter started off by analysing the practice of trade and investment reviews, and it was argued that regulatory assessments, that is, assessments of the impact on the regulatory system, can play an important role in avoiding unwanted constraints to environmental policy space and facilitating policy coherence in the phase of negotiating an IIA. A wider question is whether assessment procedures make the IIA negotiations more focused on environmental issues. If so, the assessment practice may to a certain extent give preference of environmental protective rules in the negotiating process and thus work as a tool for truthful integration of environmental concerns, as was discussed in section 1.4. However, nothing in the current practice of assessments indicates that environmental issues are put in any favourable position *vis-à-vis* quantitative trade or investment objectives. There is also a need for further development of methods to analyse legal implications of the investment treaties. Here an analysis tool like the environmental policies space questionnaire can contribute to present desk studies by officials at the ministries involved with negotiation of new or renewing IIAs.

In the analysis of existing strategies in the context of IIAs to accommodate the investment–environment conflict, it was noted that

832 Art. 1.



various methods to safeguard and enhance environmental regulation have developed mainly in broader FTAs, following on the NAFTA environmental agreement. Safeguarding environmental policy space has become an explicit issue in these IIAs, however, without bringing any clear change of the investment protection power. Rather, the 'greening' power is added to the treaty, creating new areas of international environmental law where the IIA to some extent empowers MEA commitments. It was also noted that some mechanisms to 'green' the IIA could hardly be meant to be used in practice, but rather play a symbolic, or a mere 'cosmetic' role.<sup>833</sup>

In the political debate about economic globalisation there are few proponents of weaker environmental governance. Considerable efforts are made to ensure that new international economic instruments reflect environmental concern. However, it is noteworthy that when international investment law recognises the conflict with environmental regulation, there is a tendency to limit the area of environmental law to the 'core' areas of health and environmental regulation and not regard sustainable management of natural resources (for the distinction, see section 1.4.1). This means that a part of environmental law that capital-exporting countries have much developed in their home states is in focus in the debate on the conflict between environmental regulation and IIA rules, and not an area like management of natural resources, for which capital-importing states normally have greater concern.

Some strategies to enhance environmental governance seemed, however, to make a real difference. It was recognised that IIA mechanisms which invite individuals to report on underperformance of the international environmental commitments of the host state have provided an additional tool for environmental NGOs to reach out and get publicity around environmental problems. This is a possibility that especially NGOs in less powerful states will gain from. The analysis further showed that there are interesting developments of frameworks for cooperation on environmental issues, which, *inter alia*, may strengthen

833 See 8.4.4 on the non-lowering of environmental standards. See also Tienhaara 2009, who describes the environmental provisions in the new generation of IIAs as 'cosmetic', p. 92.

the capacity of environmental governance. This work has potential to lead to significant benefits for environmental governance; however, the resources seem often to be unclear, and it is too early to evaluate the initiatives in any comprehensive way.

In discussing putting more responsibility on the investors, and thus better balancing the treaties, rules on home state standards are sometimes also discussed. In reality we know there are many different standards for corporate conduct. Gallagher and Zarsky argue that foreign investors in practice choose between four sets of standards, following different environmental regulations with different levels of stringency: do as local companies do (meaning count on lax enforcement), comply with national regulation, apply international standards, or apply home state standards.<sup>834</sup> Tienhaara notes that foreign companies sometimes 'overperform' and apply home state standards, which contribute to lower emissions and transfer of technology and know-how to developing countries.<sup>835</sup> It is, however, the perception of this work that the reason for this higher than expected performance seldom is the legal standards prescribed in national regulations of host states, but rather business motives of the company, which benefits from similar production structures in all its units worldwide and from granting consumers a reliable brand.

Remarkably little has happened to develop radically different ways to accommodate the IIA–environment conflict. There are few explorations of a road where the traditional investment protection regime is put to a more focused use for sustainable development, at least, in practice. Thus, in spite of heavy criticism from NGOs on the imbalance of rights and duties for companies in the IIAs, and their strong call for the need of international rules on corporate accountability, little progress is seen by states concluding IIAs. The Latin American states which have expressed a critical view of the IIA regime have chosen to step out from the multilateral institutions rather than propose changes to the current regime.

834 von Moltke 2004, p. 28.

835 Tienhaara 2009, p. 26.

The contribution of these reflections to the policy space questionnaire could be summarised as follows. The whole questionnaire is reproduced in Appendix 2.

#### Specification 4 of policy space questionnaire: Provisions on Environmental Concerns

##### **'Green' provisions**

- Are there provisions in the IIA which reflect that environmental protection shall not be trumped by the investment protection provision?
- Are there provisions which enhance environmental governance, corporate responsibility, and technology transfer?

*Yes to both questions indicates that the IIA may widen environmental policy space for the host state.*



## 9 Conclusions, reflections and some recommendations

This chapter recapitulates some of the findings in previous parts and discusses the issues of the work in order to reach some further conclusions. Recommendations are given regarding how to better safeguard environmental policy space. The recommendations are directed towards host states already committed to investment treaties, states negotiating such treaties, and investors seeking responsible solutions while safeguarding their treaty rights.

### 9.1 Conclusions and reflections

This work has investigated the continuously growing amount of international investment treaties which today number more than 3000 and cover a big part of the direct foreign investment made in the world. The vast majority of the treaties are bilateral treaties between a European or North American state and a state on the southern continents, following the history of capital-exporting states in the north and capital-importing state in the south. Most of the treaties include an investor–state dispute settlement mechanism, and those have generated over 400 known arbitrations. In about 10 per cent of the cases environmental regulation of the host state has been challenged, and in over 50 per cent of the cases the disputed matter related to natural resource management, the energy sector, or sectors of basic services like water

and waste. These figures show the relevance of discussing environmental policy space in relation to international investment treaties.

Three treaty provisions on investment protection were taken as the basis of the analysis: fair and equitable treatment, which calls for respect of investors' legitimate expectations and granting of due process; national treatment, which calls for non-discrimination between foreign investors and similar national ones; and the provision on expropriation, which calls for respect of property rights and requires compensation for interference with such rights. Environmental law was explored in relation to regulatory stability, differentiation between similar actors, and respect of property rights to match the perspectives of these investment law obligations. Further, three important issues in environmental law were examined: the need for preventive action and precaution to deal with uncertainties; public participation and access to justice; and multi-tiered environmental governance structures. Together these six areas created the framework for the analysis of environmental policy space.

The aim of the work has been to explore the extent to which international investment law provides sufficient policy space for the host state to adequately protect health and environment, regulate sustainable use of natural resources, and develop new approaches to manage environmental risks and uncertainties. Investment protection provisions of the IIAs definitely have the potential to constrain environmental policy space for host states. This is also shown by some cases from investor–state arbitration. However, it is possible to interpret IIAs and their provisions in ways that by and large properly respect environmental law and policy. This view is expressed by many writers and is also confirmed by some of arbitration case law.

A core conflict regards the issue of investors' legitimate expectations of being allowed to carry out the activity in the way the investor plans. Both the investment treaty provision on fair and equitable treatment, and the provision on expropriation includes elements protecting the investor from being restricted to act in accordance with its legitimate expectations. Although there are well known principles of national administrative law on how public authorities create legiti-

mate expectations, the reasoning in investment law and arbitration on this issue is weak. It is suggested that, like in national administrative law, only precise, specific, and clear public representations should be allowed to create legitimate expectations also in international investment law. This would clarify the FET provision and safeguard policy space for implementing for example new general environmental regulation, set harder requirements for polluting industries in accordance with rules for changes of environmental permits and perform multi-tiered environmental governance, including public participation.

Also the understanding of what is a legitimate basis for differential treatment in environmental law challenges a narrow interpretation of investment treaties. Concerning the protection against discrimination it is most important to acknowledge that environmental law safeguards operators mainly through procedural rules, granting the private actor transparency, procedures to participate and access to legal reviews. This contrast with investment law, which rely more on substantive rights. An important factor to safeguard environmental policy space is therefore that IIA arbitration acknowledges and respects the environmental procedural safeguards against discrimination.

At a more general level it was observed that investment treaties are imbalanced with respect to the interests of foreign investors and the interests of the host state. James Crawford describes this imbalance as 'the most significant challenge facing international investment law today'.<sup>836</sup> This imbalance contributes to create the risks for IIAs to create constraints to environmental policy space. This is because 'legal obligations in IIAs have been interpreted on several occasions in an expansive, overly broad manner',<sup>837</sup> leading to difficulties for host states in reforming environmental regulation and obligations to compensate foreign investors. The imbalance of interests is performed by the investor–state dispute settlement mechanism, which for the transnational

836 James Crawford, preface, chapter 27, Cordonier Segger, Ghering & Newcombe, *Sustainable development in international investment law*, Kluwer Law International, Amsterdam, 2011.

837 *Ibid.* conclusion, p. 777.

investors provides an international forum for direct dispute settlement with the host state, in which third parties have no say.

This work shown two ways to overcome the imbalance and lower the risk for policy constraint in environmental law: the application of good governance and sustainable development. This means that it is necessary to promote good governance and rule of law in the environmental context, as in the examples above.. As an overarching aim sustainable development can guide both the narrow analysis of the definition of investment and the broader analysis of the interplay between global environmental norms and the standards of investment protection.

Concerning rule of law and good governance in environmental context, it was noted that the challenges to halting environmental degradation have brought about changes in the structure and functions of law resulting in more interventionist legislation, which is open textured in character, building on defining principles and setting goals that authorities are intended to achieve.<sup>838</sup> Ebbesson argues, using Habermas's epochs of states, that the notion of rule of law in a 'security state' (where the focus of governance is to manage collective risks) must be different than in the 'liberal state' (where the focus is on social order).<sup>839</sup> The analysis in this work also shows by a number of examples that rule of law, legal certainty and good governance is ensured by most approaches in environmental law, yet in different manners than in the classic, liberal state manner. First, public participation and access to justice are vital concepts that secure the rights to environmental benefits for third parties and build trust in government. Second, transparent communication of information and assessments will grant that operators' views are heard, as are the views of affected people. Third, administrative or judicial reviews in the national systems play an important role in reviewing the legal requirements put on the operator, and thus, ensure rule of law. Fourth, clear time frames for permitted activities and explicit rules on changes of conditions for ongoing activities give stable regulatory environments for operators. Fifth, rea-

838 Ebbesson 2010; see section 3.2.1.

839 Ibid. pp. 415–417.



sonable transition periods for existing operators are often used when introducing new general regulations, which demand great adjustments of private actors. Thus, the implementation of rule of law and good governance in environmental context is important in each situation where public environmental regulations and measures are involved in international investment conflicts.

Some writers are discussing international investment arbitrations as a body of international administrative law forming new global norms.<sup>840</sup> While there are writers firmly rejecting such conclusions,<sup>841</sup> this work has tried to illuminate some of the problems which arise in host states when investment arbitrations act as judge in international review of local environmental law and policy. For most of the conclusions above it is indifferent whether investment arbitrations rightly are described as an 'international intergovernmental regime' or 'an uncoordinated system'.<sup>842</sup> However, the basis for this work has been that each individual IIA bears its own rights and obligations, hence, it is first of all in the hands of state parties to determine how to develop the international investment law for the future.

Inspiration to develop sound rules, fostering good governance, can be found in the international human rights regime. As was noted in the analysis, the European Convention on Human Rights allows for legal persons as well as corporations to claim rights in the Convention. These rights include the right to have civil rights judged in a fair trial, the right of non-discrimination, and the right to have one's possessions respected and not taken without compensation—rights which appear quite similar to the IIA investment protection rights. It is however striking that very few cases in the ECtHR have touched upon sensitive issues of environmental regulation the way which is seen in IIA

840 Kingsbury, Benedict & Schill, Stephan, *Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law*, New York University School of Law: Public Law & Legal Theory Research Paper Series 46; Hallström, Pär, *Internationell investeringsrätt och dess inverkan på uppkomsten av en internationell förvaltningsrätt*, Madell, *et al.* (Eds.), *Utblick och inblick – vänbok till Claes Sandgren*, pp. 245–259, Lustus, Uppsala, 2012.

841 Muchlinski 2011.

842 *Ibid.*, p. 6.

arbitrations.<sup>843</sup> The few cases there are involve planning regulation or land use and hunting in connection with unclear or disproportional restrictions by the authorities.<sup>844</sup>

There could be two logical reasons for this divergence. Either the similarities of substantive protection offered are misleading, and the rights are substantially different (the ECHR right to property may, for example, allow the state a wider discretion to regulate), or the differences in procedures have a significant impact on the eagerness of the companies to claim these rights. The procedural differences in the ECHR compared to IIA arbitration are mainly three: the ECHR requires the claimant to exhaust local remedies; the ECHR procedures are transparent and the hearings are public; and according to ECHR jurisprudence, an investor can, in principle, only claim rights on behalf of its interest as a shareholder and not directly on behalf of the company, as in IIA arbitration.<sup>845</sup>

Of course both material and procedural reasons may explain the significantly less controversial relation between human rights law and environmental policy space than between investment law and environmental policy space. For the EU, which is in a discussion on future framework of investment treaties, it should anyway be of interest to take a deeper glance at the European human rights regime and, as the

843 Several of the rights of ECHR are applicable to companies and legal entities are not excluded from being victims in the view of the convention, Emberland, Marius, *The Human Rights of Companies – Exploring The Structure of ECHR Protection*, Oxford University Press, Oxford, 2006, p. 63. Darpö concludes ECtHR has been reluctant to interfere in domestic balances of interests between environmental protection and property rights and acting to uphold a minimum standard of review, Darpö 2010, p. 28.

844 Sporong & Lönnroth; Matos e Silva Ltd. v. Portugal, E.H.R.R., 1997, p. 573; Pine Valley v. Ireland; Fredin v. Sweden; Chassagnou and others v. France, 1999.

845 ECtHR has been reluctant to allow shareholders act on behalf of company interest, only if it is impossible for the company to act, due to liquidation or else, such claims may be considered, see i.a. Agrotexim case. However, in both the cases of Pine Valley and Mateos y Silva the majority shareholders jointly with the company were recognized as 'victims'. Emberland notes that when the Strasbourg court lift the corporate veil it is in order to give shareholders rights which they in other case could not receive, Emberland 2006, pp. 80–.

EU parliament did in their resolution in March 2011, question the present IIA-tradition to offer investors international dispute settlement directly with host states even though local remedies are not exhausted. If the investor–state dispute settlement mechanism would function as last resort when domestic justice fail, the number of claims would decrease radically and operators, owned by nationals or foreigners, would be controlled in equal basis by the environmental administrative system.

The analysis in previous chapters further led to the conclusion that one must recognise the complex work of environmental authorities and the need for flexibility in environmental law, to generate appropriate political solutions which are both environmentally effective and socially just; in other words fulfils the criteria of good environmental policy design see section 3.2.4. Environmental law consists of a diversity of policy and legal instruments which interplay in environmental governance. In light of the importance of frontrunners, states, or local actors who introduce new instruments and more ambitious standards to meet new environmental problems, the risk of *regulatory chill* is alarming. Further research on the role of frontrunners in the development of environmental law and policy is needed to better explore this risk.

In what way can sustainable development be a guiding principle for the relationship between international investment law and environmental regulation? Can, for example, globally recognised environmental standards of corporate conduct play a greater role in a situation where environmental regulation on investments are disputed? These questions go back to the investigation on environmental standards of corporate conduct in section 3.2.2. Such standards are prescribed in instruments of almost universal recognition, or are generally complied with by private actors of the sector. There are standards reflecting the principle of ‘no harm’, meaning that negative impacts should be avoided where possible, and if these impacts are unavoidable, they should be reduced, mitigated, or compensated for appropriately. For example, the World Bank IFC standards, typically represent a minimum standard.

Business codes of conduct setting standards on a no-harm approach also often constitute minimum standards within the relevant sector. Could such standards, be considered, in a systemic interpretation of the international treaty,<sup>846</sup> on what corporations can expect regarding environmental regulation?

Clearly, standards that are generated from corporate codes would fall outside any criteria of customary law. However, if one keep a sustainable development perspective and sees the rules of treaty interpretation in the context of IIA investor–state arbitration, which already has invited companies to act in the privileged sphere of international law, it is not unreasonable to give significance by analogy to voluntary codes of conduct. Corporate codes may then reflect a minimum standard on what is fair treatment and global environmental minimum standards on corporate conduct should be taken into consideration when considering investors' legitimate expectations and the host states' right to regulate. Some international praxis supports such a conclusion, for example: The UN Security Council made use of the standards of the OECD guidelines and decided to report to their home governments the companies that were found taking part in the plundering of natural resources in Congo.<sup>847</sup> Further, international corporate standards have been important evidence in the USA in cases of transnational environmental litigation.<sup>848</sup>

There is an increased interest by states in safeguarding or enhancing environmental regulation when concluding IIAs. A sustainable development perspective requires that this interest cover more than host state regulation of environmental and health protection. Also, sustainable use and management of natural resources must be an integrated perspective. The previous analysis shows that regulation of the use and management of natural resources is an area which increasingly conflicts with investment law, but does so in a more direct fashion than pollution control or health standards; see, *inter alia*, section 5.4.I. Policy reforms for sustainable use and management of natural resources of-

846 See section 1.5.1, discussing Vienna Convention, article 31(3)(c).

847 UN Security Council resolution 1457 and following resolutions in 2003.

848 Kiss & Shelton 2007, p. 68, refers to *Sosa v. Alvarez Machain*, 124 S.Ct. 2739 (2004).

ten involves important economic and national interests, for instances-related to land or mineral ownership and public or private organisation of basic infrastructure for water, energy or waste. The inflexibility that investment treaties give to states in these areas may be unhelpful for sound policies. Analysing such difficulties further is an important task in future research, and should also broaden the perspective outside law to incorporate social policy perspectives.

While it was noted there is a development towards rules on environmental protection included in IIAs, some of the strategies used are rather inspired by a fear of business emigration from the capital-exporting state with relatively strong environmental laws. Other environmental language introduced in IIAs makes explicit the rights and scope of public measures which otherwise could be open to interpretation. However, to be more proactive instruments for sustainable development, the investment treaties in general must shift perspective and change their bias of protection of foreign investors. In other words, IIAs should not only offer transnational business legal tools to combat host states, but also include obligations and incentives for companies to raise the level of environmental concern and implement it in their corporate practice. In that way international treaties on investments can strengthen corporate social responsibility globally.<sup>849</sup>

So what could be the drivers of such a shift in investment treaties? A shift may take place as states with relatively strong environmental law become the respondent parties in investor–state arbitrations. Traditionally, these states are capital-exporting and have concluded IIAs with the main interest of ensuring protection for their national companies acting abroad. As state partnerships change, and previously capital-importing states become capital-exporting ones, more claims will be directed towards states with strong environmental laws.<sup>850</sup> The

849 A source of inspiration could be the rules on investments and technology transfer which already exist in international environmental treaties, examples mentioned in the text above is the Clean Development Mechanism in Kyoto Protocol and the fund included in the Montreal Protocol, see section 5.7.2.

850 This has already happened in North America, where the USA, but especially Canada, has rendered quite a few claims on environmental measures. In Europe the first dispute settlement for Germany as respondent was the Vattenfall claim.

experience of defending their public regulations, and right to policy space, can then be brought to the next negotiations on an investment treaty.<sup>851</sup> Another driver for a shift of perspectives is that more states are questioning various aspects of the investor–state dispute settlement mechanism, as, for instance, Australia and EFTA states excluding the investor–state arbitration mechanism and other core IIA provisions in trade agreements, Brazil declining to conclude IIAs at all, and some of the ALBA states withdrawing from various parts of the IIA protection and arbitration system; see section 2.2.3.

## 9.2 Some recommendations

Here follow some recommendations directed towards host states already committed to investment treaties, states negotiating such treaties, and investors seeking responsible solutions while safeguarding their treaty rights.

### Host states should reassure their environmental policy space while honouring signed IIAs

Host states committed to international investment treaties should not rest in enforcing and developing their environmental law. Using the environmental policy space with confidence is important to avoid sending signals either to other states or to investors that the IIA obligations lead to more restrictive policy actions.

A number of actions can be taken by the host state to ensure continuous environmental performance from ministries and authorities:

- Implementation of regulations granting a high degree of public participation and access to justice in environmental matters enhances environmental governance. It may at the same time lead to good governance in environmental decisions that disarm many of the risks for the decision to be challenged by IIA claims.

851 For the USA the experience as respondent in investor–state arbitrations has resulted in a number of changes in the IIAs concluded in the 2000s; see section 7.4.

- Active cooperation in multilateral environmental cooperation keeps the environmental standards updated, while capacity building exchange occurs in the administration.
- If resources can be allocated, building competence in core environmental authorities is a good investment.

## State parties should design IIAs with maximum space for environmental law and policy

When negotiating international investment treaties, states have full freedom to shape the content of the treaty, at least in theory; developing states may feel obliged to accept unfavourable deals in exchange for other gains or support. Clearly defined and articulated objectives from the negotiating parties facilitate talks on appropriate obligations and the expectations that are raised among citizens and foreign investors.

- Sustainable development should be articulated as the overarching objective of the treaty and guiding principle for its implementation. Special efforts should be taken to make the investment treaty supportive of sustainable management of natural resources and technology transfer.
- In preparation for negotiations impact and regulatory assessments should be carried out, as well as a process to assure that the negotiating team is aware of the existing environmental regulation, especially of the state most likely to be the host state for investments, so that potential difficulties can be discussed before conclusion of the treaty.<sup>852</sup>
- The quality of the assessments is enhanced if they are open to public participation, and the negotiating process should also be transparent for interested groups and persons to address.

852 One may, as von Moltke does, question how international agreements are negotiated without any debate about the domestic implications for existing institutions, in his example, the design to ensure non-discrimination with respect to investments within countries, von Moltke 2004, p. 174.

- In defining the investment treaty obligations, one can use good examples to maximise environmental policy space. A number of such examples are discussed in chapters 4, 5, 6 and 8 and aspects to consider are summarised in the questionnaire. For example, by copying the clause on taxation and expropriation stating in the US model BIT 2004, article 21, that tax authorities may agree that the tax measure is not expropriation referred to in section 8.4.2, the risk of constraining environmental policy space would certainly decrease as national environmental protection agencies in a similar way would be trusted to determine whether an environmental measure is expropriatory or not.
- The inclusion and design of any investor–state dispute settlement mechanism should be considered properly with the risks of constraining environmental policy space. If such mechanism is included its relation to domestic environmental review procedures should be clarified. Preferably, investors should be referred to exhaust local remedies before having access to international dispute settlement. IIA arbitration panels in cases covering environmental issues should include experts on environmental law.

### Investors should also commit to sustainable development and enhance environmental governance in host states

The transnational investors are not present around the table when international investment treaties are signed, but some are active as lobbyists before and during negotiations, and some are indeed active in using the arbitration mechanism. The use of the arbitration mechanism occur both when corporations feel their rights accorded in the treaty are breached by the host state or any of its national or local authorities, and when demanding a dispute settlement will serve as lobby action to the host state. The global business community is addressed in Agenda



21 as an important stakeholder in the process of sustainable development.<sup>853</sup> As such, the business community is responsible for working towards sustainable development. There are innumerable initiatives around the world where companies try to live up to these expectations and guidelines, and of codes of conduct prepared by international governmental and non-governmental organisations.

- Transnational investors are generally advised to abstain from ‘any improper involvement in local political activities’, and as part of their responsibility, investors should not use the notification or registration of international investment dispute settlement based on IIAs as a means to reform environmental regulation to suit their business purposes.<sup>854</sup>
- Business may enhance environmental governance in host states by offering transparent information on all environmental impacts of its operations and fulfil payments of any taxes or fees to public administrations in an orderly way.
- International business organisations may help arbitration panels by providing information on environmental standards and praxis in the business sector, thereby preventing investors from spreading false pictures of the abnormal length of permit approvals or surprise over demands for pollution mitigation.

\* \* \*

The context of this work is sustainable development and the integration of environmental concerns into economic decisions. Foreign direct investments can without doubt be important for economic development, which in many economically poor societies is needed to build better social conditions. However, sustainable development in both developed and developing countries requires that scarce resources are used efficiently and that ecosystems which provide essential services to society are not put out of service. The perspectives of economic de-

853 Agenda 21, UN World Summit on Environment and Development, 1992, chap. 30.

854 OECD Guidelines for Multinational Enterprises, 2000, part I, chap II, General Policies, A 15. See section 2.5.4.

velopment and environmental respect must be integrated. This means for international investment law that it must open up and engage with other areas of law. It is not an option that investment law promotes sustainable development, but a necessity.<sup>855</sup> Or as Konrad von Moltke rightly expresses: ‘The imperatives of sustainability [must be] respected in the investment process. Indeed it can be argued that an investment regime which does not actively promote sustainable development represents an important step back from the widely endorsed principle of sustainable development.’<sup>856</sup>

The analysis of environmental policy space was based on the conviction that truthful integration of environmental law in international investment law demands respect for policy space and regulatory public powers. Only by acknowledging the importance of national regulation and enforcement procedures is it possible to safeguard reasonable policy space. A profound understanding of principles, approaches, and instruments of environmental law then become important factors for the analysis of policy space and the potential conflicts with investment protection obligations.

855 Cordonier Segger, Ghering & Newcombe 2011, conclusion, p. 792.

856 von Moltke, Konrad, *International Investment and Sustainability: Options for Regime Formation*, Gallagher & Werksman (Eds.), *International Trade & Sustainable Development*, Earthscan, London, 2002, p. 349.

# Appendix I

## IIA cases challenging environmental regulation

### Award, investor prevailed in the environmental matter

- Cases Saar Papier and Lutz Ingo Schaper v. Poland, 1995 – Import restrictions on waste paper for recycling.
- Metalclad Corporation v. United Mexican States, ICSID ARB(AF)97/1 Award 30 August, 2000 – Rejection of local building permit for waste treatment project due to local resistance and nature protection.
- S.D. Myers Inc. v. Government of Canada, Award 13 November, 2000 – Export restrictions of PCB waste material.
- Tecnicas Medioambientales SA (Tecmed) v. United Mexican States, ICSID ARB(AF)00/2 Award 29 May, 2003 – Non-renewal of permit for landfill for hazardous waste.
- MTD Equity Sdn Bhd. & MTD Chile S.A. v. The Republic of Chile, ICSID ARB/07/7 Award 25 May, 2004 – Denial of building project in Santiago green belt.

## Award, state prevailed in the environmental matter

- Emilio Augustin Maffezini v. Kingdom of Spain, ICSID APR/97/7 Award 13 November, 2000 – Non-approval of chemical project after EIA.
- Methanex Corp. v. United States of America, Award 3 August, 2005 – Prohibition of methanol additive to unleaded gasoline due to water contamination.
- Parkerings Compagniet AS v. Republic of Lithuania, ICSID ARB/05/8 Award 11 September, 2007 – Rejection of tender in parking project partly due to culture heritage in UNESCO town.
- PCL Nova, Plama Consortium Limited v. Republic of Bulgaria, ICSID ARB/03/24 Award 27 August, 2008 – Change of environmental liability laws.
- Glamis Gold Ltd. v. The United States of America, Award 14 May, 2009 – Demand that all excavations after mining are backfilled and graded to original contours of the land if close to American Native sacred site.
- Chemtura Corporation v. Canada, Award 2 August, 2010 – Prohibition on the substance Lindane due to health and environmental effects.

## Award, no jurisdiction

- Empresas Lucchetti, S.A. and Lucchetti Peru, S.A. v. Peru, ICSID ARB/03/4 Award 7 February, 2005 – Revoked construction permits for industry due to near by protected wetland (no jurisdiction due to *ratione temporis*).
- Vieira/CONCAR v. Chile, ICSID ARB/04/7 Award 21 August, 2007 – Denied fishing permit (no jurisdiction due to *ratione temporis*).
- Canadian Cattlemen for Fair Trade v. United States, Award 28 January, 2008 – Import restrictions in animal health protection regulation (no jurisdiction due to no foreign investment).

- Commerce Group Corp. and San Sebastian Gold Mines, Inc. v. Republic of El Salvador, ICSID ARB/09/17 Award 14 March, 2011 – Revoked mining permit (no jurisdiction due to non waiver of local proceedings).
- Vitto G. Gallo v. Canada, Award 16 September 2011 – Non renewing of permit for using old mine as landfill (no jurisdiction due to lack of evidence for being owner at time of regulatory change).

### Award on settlement or cases withdrawn/abandoned after changes of the regulation or measure reacted on

- Philip Morris & Reynolds Tobacco Company v. Canada 1994 – Proposed ban on the use of the words light and mild on cigarette packaging.
- Ethyl Corporation v. Canada, Settled 1998 – Import and trade restrictions on additive to unleaded gasoline.
- Vanessa Ventures & Industrias Infinito S.A. (La Cruzitas) v. Costa Rica, Settled, 2005 – Denied environmental permit for mining.
- Shell Brands Int AG and Shell Nicaragua S.A. v. Republic of Nicaragua ICSID ARB/06/14 Settled, 2007 – Court seizure of brand asset to enforce judgment on injuries caused by chemical use.
- Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG & Co. KG v. The Federal Republic of Germany, ICSID ARB/09/6 Settled 2011 – Water permit denied high amount of cooling water use for new coal power plant.

### Award on settlement or cases withdrawn/abandoned, no indication of changes

- Sun Belt Water, Inc. v. Government of Canada (claimant not been active), 1998 – Denied to export large quantities of water.

- David Bishop v. Government of Canada (not concluded at the time of publishing), 2008 – Changed rules for distribution of fishing licenses.
- Georg Nepolsky v. Czech Republic, Award February 2010 – Denial of permit on water use.
- William Jay Greiner and Malbaie River Outfitters Inc. v. Government of Canada, Withdrawn 2011 – Changed rules for distribution of fishing licenses.
- Dow AgroSciences v. Canada, Settled, 2011 – Prohibition of pesticide for private lawns.

### Cases not concluded at the time of publication of this work

- Kenex Ltd. v. United States of America, 2008 – Prohibition to sell cannabis product due to health impact.
- Cases Marion and Reinhard Hans Unglaube v. Costa Rica, ICSID ARB/08/1 and ARB/09/20, 2008 – expansion of national park causes restrictions on tourism lodges
- Clayton/Bilcon v. Government of Canada, 2009 – Rejection to basalt mining in costal area after EIA.
- Abengoa, S.A. y COFIDES, S.A. v. United Mexican States, ICSID ARB(AF)/09/2, 2009 – Rejection of local construction permit due to resistance against land fill.
- Gold Reserve Inc. (Las Brisas) v. Bolivarian Republic of Venezuela ICSID ARB(AF)/09/1, 2009 – Slow process of environmental permit in extractive industry.
- Oak Investments and BAES v. El Salvador 2009 – Shut down of batteries recycling due to environmental and health problems.
- Pac Rim Cayman LLC (El Dorado) v. Republic of El Salvador ICSID ARB/09/12, 2009 – Denied environmental permit for mining.

- Chevron Corporation & Texaco Petroleum II v. Ecuador, PCA, 2009 – Law suit against the oil company on compensation for health and environmental harm.
- John R. Andre v. Government of Canada, 2010 – Restrictions of hunting in reform to rescue the caribou.
- Philip Morris Brand Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay, ICSID ARB/10/7, 2010 – Phase outs of labelling as light or mild and 80 percentage cover of health information on cigarette packaging.
- Renco Froup, Inc. (La Oroya) v. Republic of Peru, 2010 – Denial of request to extend time for mining to meet environmental remediation obligations.
- RSM Production Company v. Ecuador, 2010 – Termination of a mining license for a tar-sands project.
- Adel A Hamadi Al Tamimi v. Sultanate of Oman, ICSID ARB/11/33, 2011 – Denied environmental permit for limestone quarry.
- Accession Eastern Europe Capital AB and Mezzanine Management Sweden AB v. Republic of Bulgaria ICSID ARB/11/3, 2011 – Cancellation of waste contract in Sophia, *inter alia*, due to performance.
- Copper Mesa v. Ecuador, 2011 – Termination of mining licences, probably because of lack in compliance with environmental regulation.
- Inter-Nexus Consulting Services v. United States of Mexico, 2011 – Rejection of funds for construction of land fill.
- Philip Morris Asia v. Australia, 2011 – Plan to introduce plain-packaging requirements for tobacco products.
- Renée Rose Levy and Gremcitel S.A. v. Republic of Peru ICSID ARB/11/17, 2011 – Prohibition to construct building on property due to historical values.





# Appendix 2

## A policy space analysis questionnaire

Throughout the study findings on policy space constraints have been summarised in the form of a questionnaire. Beginning with an outline of the method and different categories in chapter 1, this tool has been built section by section in the chapters introducing investment law, elaborating on environmental law controlling economic activities, analysing the three core provisions of investment treaties, and finally in the previous chapter, on strategies to widen environmental policy space. Going through the list and reflecting on the questions will reveal the impacts on environmental policy space. It gives some ideas of where the weakest part of the analysed treaties are and where the risks are for constraints to environmental policy space.

### General Aspects

#### Capacity of the host state:

- Is the administrative capacity of the host state environmental authorities weak?

*Yes to this question indicates there is an increased risk of policy space constraints.*

### General scope of the investment treaty:

- Is there a wide definition of ‘investment’?
- Is there unlimited ‘most favoured nation treatment’?
- Is there an ‘umbrella clause’?

*Yes to these questions indicates there is an increased risk of policy space constraints.*

### Investor–state dispute settlement mechanism:

- Does it allow for the domestic judicial system to have a clear role in legal reviews of environmental measures?
- Are there rules on transparency?
- Are there any safeguards against improper use against weaker states?

*An investor–state arbitration mechanism significantly raises the risk for policy space constraints. However, yes to these questions indicates that the policy space constraints are somewhat mitigated.*

## Environmental Law

### Average global conduct or frontrunner?

- Are the regulations and measures at stake following a globally recognised standard of environmental protection, or is it an effect of a policymaker that plays a frontrunner?

*A regulation in line with global conduct should run less risk of being constrained by investment law, while a frontrunner regulation might run a greater risk.*

### Good governance

- Do the regulations and measures at stake provide for accessible, transparent and predictable decisions for the operator?

*Yes indicates there should be less reasons to worry about a conflict with investment law.*

## General need for policy development

- Is the host state in need of development of environmental law and policy?

*Yes indicates that policy constraints must be avoided.*

## Provisions on Investment Protection – Reflecting Environmental Aspects

### Fair and equitable treatment

- Is the provision limited to cover only due process and non-denial of justice?
- Might the interpretation acknowledge that changing general environmental regulation does not *per se* disrespect investors' legitimate expectations?
- Might the interpretation acknowledge the principle of precaution in demands on decision making to be balanced and based on scientific knowledge?
- Might the interpretation respect that representatives of public institutions and politicians are expected to engage actively in the public debate?
- Might the interpretation respect that there are multi-tiered structures in environmental governance?

*Yes means that the constraints to environmental policy space are mitigated in some respect.*

### National treatment

- Is the provision limited to post-establishment measures?
- Might the interpretation respect that procedural measures in environmental law can safeguard actors from discrimination?
- Might the interpretation allow for different praxis towards operators by different local authorities within the discretion given them by law?

*Yes means that the constraints to environmental policy space are mitigated in some respect.*

### **Expropriation and compensation**

- If the provision concerns indirect expropriation, is it limited to a 'right to regulate' doctrine?
- Might interpretation to some extent respect environmental perspectives on collective property rights?
- Might interpretation respect that actions to prevent harm to the environment or protect the health in normal situations do not imply compensation for public infringement?

*Yes means that the constraints to environmental policy space are mitigated in some respect.*

## **Provisions on Environmental Concerns**

### **'Green' provisions**

- Are there provisions in the IIA which reflect that environmental protection shall not be trumped by the investment protection provision?
- Are there provisions which enhance environmental governance, corporate responsibility, and technology transfer?

*Yes to both questions indicates that the IIA may widen environmental policy space for the host state.*

# Annex I

## Om miljöpolitiskt handlingsutrymme och mellanstatliga investeringsavtal i den svenska kontexten

(On environmental policy space and international investment treaties in the Swedish context)

Möjligheterna för stater att reglera utländska investerare och företags verksamhet för att skydda miljön och människors hälsa samt säkra hållbar användning av naturresurser kan begränsas och försvåras av reglerna i mellanstatliga avtal som främjar investeringar, så kallade investeringsavtal. Med andra ord kan det politiska utrymmet för miljömässigt hållbar samhällsstyrning minska på grund av hur reglerna i de mellanstatliga investeringsavtalen är utformade. Den här avhandlingen undersöker hur investeringsavtalens regler påverkar miljörättsliga styrmedel och systemet för miljömässigt hållbar samhällsstyrning. Syftet är att fördjupa den internationellt pågående policy- och forskningsdiskussionen om investeringsavtal avseende det miljörättsliga utrymmet, samt att hitta vägar som minskar investeringsreglernas begränsning på miljörettens område. För källor hänvisas till den engelska huvudtexten.

## Kort bakgrund om investeringsrätt och investeringstvister

Den internationella investeringsrätten har utvecklats från 1960- och 70-talens ställningskrig mellan i- och u-länder, om rätten till självbestämmande över naturresurser och miniregler om kompensation för storskaliga expropriationer och utvecklingen av sedvanerätt, till 1980-talet och framåt som handlat om bilaterala och multilaterala investeringsavtal i vilka utländska investerares verksamhet garanteras fysiskt och rättsligt skydd. Övergången från sedvanerätt till investeringsavtal har också inneburit att rättspraxis nu utvecklas främst i skiljemannaavgöranden utifrån tvistlösningsmodellen i investeringsavtalen (en modell som liknar den kommersiella tvistlösningen i avtalstvister där den utländska investeraren får en direkt tvistlösning med värdstaten).

I slutet av 2011 fanns över 3 000 mellanstatliga investeringsavtal och över 400 avgjorda eller pågående tvistlösningar. Sverige har minst 59 bilaterala och ett multilateralt investeringsavtal. Även om Tyskland har nästan dubbelt så många avtal tillhör Sverige de tiotal länder i EU som har flest investeringsavtal. Avtalen sluts traditionellt mellan ett kapitalexporterande land (vars investerare ska "försäkras") och ett kapitalimporterande land (vars ekonomi behöver investeringar) vilket bland annat det sista avtalet Sverige ingick före reformeringen av investeringsavtal inom EU i och med Lissabonfördraget är ett exempel på. Det slöts med Guatemala 2005. Generellt gäller avtalens regler ömsesidigt för båda ländernas investerare, men få kapitalexporterande länder tvingas till tvistlösning som värdland (till exempel att svenska regeringen tvingas försvara hur myndigheter behandlat ett guatemalanskt företag i Sverige). Flera svenska företag har dock använt sig av avtalens möjligheter och drivit tvister mot länder som Sverige har investeringsavtal med: ett företag i avfallsbranschen har stämt Bulgarien efter att dess kontrakt om avfallshantering i Sofia avslutats efter bland annat klagomål på utförandet,<sup>1</sup> ett företag som fick sitt fartyg beslagttaget och sålt utan kompensation stämde lettiska staten och fick

1 Accession Eastern Europe Capital AB and Mezzanine Management Sweden AB v. Republic of Bulgaria, ICSID ARB/11/3, ej avslutat vid tryckning av denna skrift.

rätt,<sup>2</sup> även ett energibolag stämde och fick rätt mot Lettland för att prissättning för ny elproduktion ändrats,<sup>3</sup> ett företag i mejeribranchen har stämt rumänska staten efter att förmånliga skatteregler i en exportzon tagits bort i och med Rumäniens inträde i EU,<sup>4</sup> och statliga Vattenfall stämde Tyskland efter att miljötillståndet för ett nytt stenkolseldat kolkraftverk i Hamburg ställde krav på större begränsningar av användningen av kylvatten från floden Elbe än vad företaget räknat med.<sup>5</sup> Samtliga tvister som svenska investeringsavtal använts till rör alltså länder som idag är med i EU (Lettland var dock inte medlem vid tiden för deras tvister). Två av tvisterna kan sägas påverka miljö- och hälsoskyddsregler.

Ser man generellt handlar omkring 10 procent av investeringstvisterna internationellt om att företag och enskilda personer klagat på myndigheters ingripanden med miljö- och hälsoskyddsregler, och över 50 procent av tvisterna rör verksamhet inom områdena energi, vatten och avfall.

## De rättsliga konflikterna mellan investeringsskydd och miljöskydd

Genom att mellanstatliga investeringsavtal garanterar utländska företag rättvis och jämlik behandling, likvärdighet med inhemska aktörer samt full kompensation vid indirekt expropriering ställs nya krav på värdlandets miljölagstiftning och miljömyndigheters agerande. Miljölagar och beslut av miljömyndigheter som gör ett företags verksamhet omöjlig eller mindre lönsam kan komma att bli juridiskt granskade genom den tvistlösning med skiljenämnd som inorporerats i investeringsavtalen. Skiljenämnden har att bedöma om någon av de rättigheter som det utländska företaget garanterats i avtalet inskränkts på ett

2 Swembalt AB v. Republic of Latvia, Skiljedom 23 oktober 2000.

3 Nykomb Synergetics Technology Holding AB v. Latvia, Stockholms Handelskammarers Skiljedomsinstitut, skiljedom 16 december 2003.

4 Ioan Micula, Viorel Micula and others v. Romania, ICSID ARB/05/20, ej avslutat vid tryckning av denna skrift.

5 Vattenfall Europe and Vattenfall Germany v. Germany, ICSID ARB/09/6, tvisten förlikades 2010.

sådant sätt att värdlandet ska hållas ansvarigt enligt folkrättens princip om statsansvar.

Omfattningen och även innebörden av rätten till rättvis och lika behandling som ges i de mellanstatliga investeringsavtalen är oklar så tillvida att olika skiljenämnder kommit till delvis olika slutsatser i de fall som prövats. Avgörande för miljöpolitikens utrymme är om rätten till rättvis och lika behandling knyts till en hög och särskild standard eller enbart garanterar grundläggande rättigheter till god myndighets- hantering och rättsäkert bemötande. Bedömningen av utländska investerarens rättmätiga förväntningar på investeringsklimatet har fått stor betydelse. Regler och beslut som gått emot sådana förväntningar, som investerare också haft skäl att agera efter, gör värdlandet ersättnings- skyldigt för förluster hos företagen. För det fall att nya miljölagar och skärpningar av miljöbeslut skulle anses bryta mot investerarens förvänt- ningar gör det att handlingsutrymmet för värdlandet minskar. Hittills har det dock relativt få investeringstvister bedömts att ändrade miljö- villkor för företag är ett brott mot investeringsavtalen, och inte i något fall har ändrade generella miljölagar getts den tolkningen. De fall som berört miljörettsliga verktyg och som värdländer förlorat har handlat om att företag förespeglats att en verksamhet ska få nytt eller fortsatt tillstånd för sin verksamhet, eller att ändrade regler bedömts protektionistiska snarare än miljömässigt motiverade (se Appendix 1).

Investeringsavtalens garanti mot diskriminering gentemot inhem- ska aktörer kan få till följd att individuella miljötillstånd som ges ett utländskt företag ifrågasätts i fall det finns inhemska företag som har tillstånd med lägre miljökrav. Detta förutsätter dock att företagen an- ses jämförbara. Dock bör de miljömässiga skillnaderna mellan olika verksamheters påverkan, liksom behovet av att låta gamla tillstånd löpa innan de ändras, vara grund för att olika företags verksamheter inte så ofta kan likställas i miljömässigt hänseende. Det skydd mot dis- kriminering som nationell miljö rätt ofta ställer upp är en processuell likabehandling oavsett företages ursprung.

Genom investeringsavtal kan utländska företag också garanteras likvärdig tillgång till naturresurser med inhemska aktörer. Det kan begränsa statens möjligheter att reglera ett hållbart nyttjande av re-



surserna kopplat till utveckling riktad till lokalbefolkningen. För att en tydlig begränsning av det slaget ska uppstå krävs dock att avtalet innehåller regler om nationell likabehandling redan i etableringsfasen. Investeringsavtal ingångna av europeiska länder, inklusive Sverige, täcker vanligen inte etableringsfasen, men det gör däremot flertalet investeringsavtal ingångna av USA och Kanada.

Investeringsavtalens krav på kompensation vid expropriering påverkar miljöpolitikens utrymme främst genom att det utvidgar värdlandets internationella förpliktelse om kompensation för exproprieringar till att omfatta även indirekt expropriering, vilket innefattar situationer där myndigheter reglerar själva nyttjandet av egendom (om regleringen gör att nyttjandet starkt begränsas), och att det gäller både fysisk och immateriell egendom. I rättspraxis om investeringskydd dominerar bedömningar som utgår ifrån den amerikanska äganderättsbegreppen och doktrinen kring "regulatory takings". Om detta äganderättsbegrepp, genom investeringstvister, skulle etablera sig som internationell norm, finns risk för att miljörättsliga verktyg oftare skulle bedömmas som expropriation än vad europeiska länder är vana vid från Europadomstolens avgöranden avseende rätten till egendom enligt den europeiska konventionen för mänskliga rättigheter, tilläggsprotokoll 1. Ingen investeringstvist har dock fastslagit att en miljörättsligt motiverad reglering har inneburit en indirekt expropriation och krävt kompensation från värdlandet.

Internationella investeringsavtal anger bara undantagsvis att förpliktelser i internationella miljöavtal har företräde vid en eventuell konflikt mellan regelverken. I praktiken är frågan snarare huruvida internationella miljöregler får betydelse för tolkningen av investeringsavtalen. Vid avsaknad av tydliga nationella standarder för företagens ansvar för att minska miljöpåverkan kan internationella branschstandarder och icke-bindande globala minimiregler om miljöansvar ange en nivå som företagen inte rimligen kan räkna med att länder underskrider. Globala miljönormer och även branschpraxis och branschkodex kan därför användas vid investeringstvister för att visa på att investerare saknar legitima förväntningar på väldigt lågt satta miljökrav.

Genomförande av vissa investeringsåtgärder som regleras i internationella miljökonventioner kan utmanas rättsligt av företag som åberopar rättigheter enligt investeringsavtalen, till exempel stöd till inhemska aktörer för att fasa ut ozonnedbrytande ämnen genom fonden som skapats under Montrealprotokollet, eller utveckling av förnybar energiproduktion med stöd av Kyotoprotokollets flexibla mekanismer. På så vis kan internationella investeringsavtal även försvåra genomförandet av internationella miljökonventioner. Huruvida det är en direkt begränsning av miljöåtgärder beror dock på utformningen av reglerna i värdlandet. Hittills har få internationella investeringstvister uppstått på grund av myndighetsåtgärder kopplade till miljökonventioner. Det får förmodas att allmänna miljörettsliga principer och i miljökonventioner rekommenderade handlingsvägar i normala fall accepteras som fullt legitima åtgärder för värdlandet i investeringsrättsligt hänseende.

## Rekommendationer för att säkra det miljöpolitiska handlingsutrymmet

För att i ett investeringsrättslig sammanhang värna om det miljöpolitiska handlingsutrymmet krävs agerande från flera aktörer. Värdländer för utländska investeringar som redan ingått investeringsavtal kan säkerställa en hög ambitionsnivå i miljöarbetet genom att utveckla myndigheternas administrativa kapacitet att genomföra miljöskyddsåtgärder på ett rättsäkert sätt och säkerställa att den miljömässiga samhällstyrningen genomförs i regelverket på ett koherent sätt. Som framgår av bland annat OECD:s riktlinjer för multinationella företag bör investerare alltid följa de regler som gäller i värdlandet, inklusive betala skatter som kan stärka myndigheterna, men de kan också bidra till att miljöregler genomförs på ett adekvat sätt genom att tydligt ta fram information kring miljöpåverkan av verksamheten och ha god dialog med lokalbefolkningen. Stater som ingår investeringsavtal kan naturligtvis påverka reglerna för dessa och här finns många sätt att säkerställa att det miljöpolitiska handlingsutrymmet inte minskar (i alla fall inte mer än vad staterna explicit avser). Först och främst behövs en ordentlig översyn av hur miljöpolitiska mål, verktyg och myndighe-

ter fungerar i de länder som ingår investeringsavtalet. Är myndighetsstrukturen på miljösidan skral kan de långtgående rättigheterna som utländska företag ges i investeringsavtalen innebära betydande risker för att miljöåtgärder inte kan vidtas utan hot om dyra skiljedomsförfaranden för staten.

Ett exempel på investeringsavtal där bristfällig miljöadministration inte beaktades är Sveriges avtal med Guatemala, ett land med uppenbara miljöproblem med till exempel avskogning. Att svenska skogs- eller gruvföretag ges rätt till att stämma staten Guatemala ifall ett miljö-tillstånd inte ger företaget de ramar de önskar för exploaterande verksamhet (jämför fallet Vattenfall mot Tyskland) riskerar tveklöst att undergräva uppbyggnaden av starka miljöinstitutioner i ett land som fick sin första riktiga lagstiftning om miljökonsekvensbeskrivningar 2003 (året innan investeringsavtalet med Sverige undertecknades).

Sverige har inte i något av sina investeringsavtal inkluderat sådana miljöklausuler som tydliggör att avtalen inte avser begränsa det miljöpolitiska handlingsutrymmet, vilket flera andra länder börjat föra in. Det Sverige har gjort under 2000-talet är att föra in en lös skrivning i avtalens inledningstext (preamble) om att investeringskydd kan uppnås utan att minska kraven på miljö- och hälsoskydd. Det är inte ett tillägg helt utan betydelse, men långt ifrån tillräckligt för att hindra avtalet kan få negativa konsekvenser för det miljöpolitiska handelsutrymmet.

Sverige har inte heller någon löpande dialog med sina avtalpartners om hur avtalen används och om det behöver göras justeringar. När svenska departementsföreträdare under en workshop hos OECD reflekterade över fallet med svenska Vattenfall menade man att det över huvud taget inte hade med svenska staten att göra utan enbart var en fråga för bolaget.<sup>6</sup> Ett sådant ointresse över investeringsavtalens effekter visar att det saknas en bredare medvetenheten om riskerna för miljöpolitiskt handlingsutrymme.

Hur EUs framtida investeringsavtal ska utvecklas diskuteras just nu (2012). Kommissionen vill att fullfjädrade investeringsavtal (som täck-

6 Roundtable on freedom of investment 15, *Summary of Roundtable discussions by the OECD Secretariat*, 5 December, 2011

er skydd mot orättvis behandling, diskriminering och expropriering utan kompensations, samt rätt till tvistlösning direkt med värdlandet) ska ingå i framtida europeiska frihandelsavtal, bland annat det man förhandlar med Kanada, och att åtagandena i de 1 200 bilaterala investeringsavtal som medlemsländerna redan ingått förs över på kommissionen. Om detta genomförs blir en EU mycket inflytelserik aktör på det internationella investeringsrättsliga området. Ett viktigt vägval att göra blir då inte bara utformningen av investeringskyddsklausulerna i relation till miljöskyddet, utan även valet av tvistlösning.

När det gäller miljöskydd finns inom EU utarbetade principer och regleringar för hur medlemsländerna ska bedriva ett aktivt arbete och ha rätt att gå före på miljöområdet. Vill man skapa investeringsavtal som slår vakt om miljömässig samhällsstyrning är dessa regler viktiga att bygga vidare på.

När det gäller tvistlösningmodell är det noterbart att länder som Australien och Norge på senare år antingen har verkat för att helt avskaffa rätten till direkt tvistlösning mellan investerare och värdland, eller för att begränsa den till tvister där inhemska rättsmedel inte räckt till. En stor del av den "kylningseffekt" för miljöåtgärder som investeringsavtalen medför kommer av osäkerheten som skapas av tvistlösningsmekanismen. Om den inte kan avskaffas helt så skulle en begränsning till tvister där inhemska rättsmedel uttömts innebära en stor fördel för den miljörättsliga styrningen. Då skulle nämligen instrument som administrativ omprövning och överprövning, och inhemska domstolar få möjlighet att säkerställa rättvis behandling både av inhemska och utländska aktörer. Dessa instrument är viktiga i den miljörättsliga kedjan för att säkra att miljöpolitiska mål uppfylls på ett riktigt sätt. Det gagnar inte en hållbar utveckling att miljömyndigheter och domstolar i kapitalimporterande länder med dagens svenska och europeiska investeringsavtal inte tillåts utveckla sina institutioner på likande sätt som Sverige och många europeiska länder gjort.

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UNCTAD keeps a useful Investment Instruments Online database with BITs and and dispute settlement cases:

[http://www.unctadxi.org/templates/Startpage\\_\\_\\_\\_718.aspx](http://www.unctadxi.org/templates/Startpage____718.aspx)

Government of Canada keeps an online record with full text documents of all their NAFTA disputes, including cases notified by the claimant:

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Organisation of American states (OAS) keeps an online database of free trade agreements with states on the American continents:

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Ronald B Mitchell, University of Oregon, USA, runs the International Environmental Agreement Database with data and full text of environmental treaties:

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The international organisations IUCN, FAO and UNEP is running the EcoLex website with search functions for a wide spectrum of legal material on environmental law:

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