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# **GREENING INVESTMENT LAW**

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## *Abstract*

This thesis investigates the relationship between investment law and the power of states to produce and implement environmental measures. Through a strictly legal approach, and by situating the issue within the framework of public international law, this project endeavours to find avenues for the incorporation of environmental legal obligations within the investment legal regime. The thesis examines the main substantive protections granted to investors by the system of bilateral and multilateral investment instruments, before considering the ways in which, through express provisions, general conflict rules, and procedural means, tribunals can take environmental law into account. This taxonomy is tested in the third part of this work, through the analysis of the jurisprudence issuing from investment tribunals in disputes containing an environmental element.

## *Acknowledgments*

This thesis is dedicated to the memory of Professor Kevin Boyle.

I declare that, except where explicit reference is made to the contribution of others, that this thesis is the result of my own work and has not been submitted for any other degree at the University of Glasgow or any other institution.

Signature \_\_\_\_\_

Printed name      Alessandra Asteriti

## Part I: The issues

The topic of this thesis is the incorporation of environmental legal obligations within the framework of investment law. The first part of this thesis is divided into three chapters, providing the background to the work. In the first chapter, the topic is introduced, as well as the methodology adopted in the work, summarised as ‘pragmatic normative coherence’. The pragmatism of the methodological approach refers to the avoidance of policy appeals and the focus on the legal terrain, and more specifically, the search for a normative coherence that is grounded in what works in the practice of the law-makers in the international arena, the states, and of the investment tribunals charged with applying that law.

The second chapter presents a complex structure, as it seeks to provide as comprehensive a view of the normative background of the project as possible. There are three main elements, or areas, that the chapter endeavours to cover in its first section in an increasingly detailed way: the general issue of the fragmentation of international law, the specific nature of international investment law, and the legal avenues of redress of the negative environmental externalities of investment activities out-with the framework of investment law. The main argument of this work is that investment law’s insular nature jars with the necessity to account for diverse legal commitments, and specifically, environmental ones.

Finally, the chapter closes with a section on the role of risk management in the decision-making process of the main actors, and more specifically, of states. A lot has been written on the role of the ‘regulatory’ and ‘post-regulatory’ state<sup>1</sup> and some of the conclusions and the hypotheses arising

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<sup>1</sup> See for example Collins, H., ‘Regulating contract law’, in Parker, C. *et al.* (eds.), *Regulating Law*, Oxford, OUP, 2004: 13, at 28: ‘[...] the state diminishes its reliance upon publicly owned assets for the delivery of public services, and rather tries to use privately owned companies to provide equivalent services to the public. To ensure

for those debates are relevant at the policy level, but with spill-over effects at the level of norms production and enforcement<sup>2</sup>.

Chapter 3 closes the first part and constitutes the necessary stepping stone to the second part. The chapter reviews the substantive investment obligations contained in international investment agreements, and specifically those obligations with regards to the standards of treatment and the protection against uncompensated expropriation. The chapter describes the ‘orthodox view’ of investment protection, unencumbered by extraneous obligations and commitments. It is the view reflected in the older bilateral treaties (which do not contain express provisions for non-investment obligations) and frequently adopted by tribunals, especially before the developments of the NAFTA jurisprudence.

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reliability and fair access to public services, the state often creates an elaborate regulatory apparatus...’ Further restrictions come with the post-regulatory state, only tasked with providing a framework for the provision of services, with the insertion of other forms of controls such as soft law instruments, codes of conduct, voluntary business standards, private forms of arbitration and settlement of disputes, etc.

<sup>2</sup> See Black, J., ‘Law and regulation: the case of finance’, in Parker *et al.*, 2004: 33, at 52: ‘...while law might regulate, it is also seen by the regulatory system as risk...[this fact] calls into question all the main formulations of legal theorists as to the relationship of law and society. Law is neither a mirror, nor glue, nor order: it is a technical obstacle devoid of any normative content which is to be managed or overcome.’



## Chapter 1: Introduction

Although titled “bilateral” investment treaties, this case makes clear that which has been clear to negotiating States for some time, namely, that through the definition of “national” or “investor,” such treaties serve in many cases more broadly as portals through which investments are structured, organized, and, most importantly, encouraged through the availability of a neutral forum<sup>3</sup>.

### 1.1 Thesis topic

The statement quoted above, made by the *Aguas del Tunari* tribunal in its Decision on the Objections to Jurisdiction in the course of a very contentious case, in many ways served as an inspiration for the topic of this thesis. Borrowing apparently from the language of informatics<sup>4</sup>, the tribunal lets us know that we are entering a ‘new world’, where words do not mean what they used to mean anymore. Bilateral investment treaties are sites that give access to many ‘clickable options’ (or very large entrance doors indeed), created for the purpose of encouraging investment, not least by the provision of neutral *fora* for the resolution of investment disputes. In this thesis, we aim to find out if, amongst the clickable options, a space as been reserved for environmental options, and if the doors are wide enough to function as entry points for environmental obligations, or if they are moving and adaptable, widening and narrowing in response to whoever knocks at the door<sup>5</sup>.

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<sup>3</sup> *Aguas del Tunari S. A. v. Republic of Bolivia*, (ICSID Case ARB/02/3), Decision on the Respondent’s Objections to Jurisdiction, 21 October 2005, § 332.

<sup>4</sup> Where it means ‘an Internet site providing access or links to other sites’; the original meaning is ‘doorway’ or ‘gate’ (Oxford Dictionary).

<sup>5</sup> In *Sosa v. Alvarez-Machain et al.*, 542 U.S. 692 (2004), the Court had this to say, with reference to the possibility of exercising ‘independent judicial recognition of actionable

There are many ways in which this topic can be developed, and many starting points. It might be easier to start by saying what this thesis will not be. This is not an appeal for ‘caring about the environment’ and how to do so. There are no policy arguments being brought forward, and no analysis of the (infinite) policy discussions. It is not even simply a superficial appeal for a ‘balancing approach’ that takes into account the legitimate regulatory powers of states<sup>6</sup>, to the extent that such appeals are heavily value-leaden and judgmental<sup>7</sup>. This is a thesis about law, based on how the law acts, and says it acts.

The exclusion of policy discussions extends to the choice of topic to the effect that this is not a thesis about ‘law as ought’, legal reform, *lege ferenda* or any of these permutations. This is a project of discovery of the law ‘as is’. We are certainly not claiming that there is no point of view and no bias in this thesis: however, taking sides, declaring, in unison with most of the inhabitants of the investment community, that ‘investment is good’, or, more predictably for this thesis, that ‘investment is bad’, does not serve any purpose other than weakening any argument one wishes to advance. ‘Investment is’ and ‘the environment is’; both exist as realities,

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international norms’: ‘judicial power should be exercised on the understanding that the door is still ajar subject to vigilant doorkeeping’. (At § 729). We wish to adopt this metaphor, *mutatis mutandis*, aware that the problem, in international investment law, is the identity of the doorkeepers.

<sup>6</sup> No negative *political* judgment is necessarily implied of any such appeals; see for example the ‘Public statement on the international investment regime’ of 31 August 2010, signed by 48 academics (at [http://www.osgoode.yorku.ca/public\\_statement/](http://www.osgoode.yorku.ca/public_statement/)).

<sup>7</sup> It is precisely the less-than-satisfactory regulatory environment to constitute one of the characteristics of many host states: it seems perverse to hold them hostage to externally imposed governance standards focussed on the protections guaranteed to investors and investments, as a sort of ‘canaries in the coalmine’ test of what constitute a ‘reasonably well-behaved regulatory state’ (see Montt, S., *State Liability in Investment Treaty Arbitration*, Oxford and Portland, Hart, 2009: 21) and at the same time, dangle above their heads the threat of international arbitration if regulation ‘goes too far’ (in the words of Justice Holmes; this statement will be discussed in detail in Chapter 3).

one exclusively man-made, one arguably on its own terms (but our representation of what environment means just as man-made as the first one). The investment community tends to ‘naturalise’ investment, to present it as an unavoidable reality with which we have to come to terms (like its cognate, the ‘market’). The environmental community tends to ‘humanise’ the environment, to lead us to believe that there is a lot we can do to change it, tame it, ameliorate it. We wish to avoid the pitfalls of such stark distinctions and try to take as pragmatic an approach as possible.

The third exclusion, the third thing this thesis is not, constitutes also a choice of field: this thesis is not about environmental law; after excluding policies, and excluding legal reform, we also wish to exclude non-investment law. This thesis analyses how the investment legal community deals with environmental legal obligations. And here lies our only, modest, policy argument: that whatever position one takes on the *necessity* of incorporating environmental obligations in the investment framework, the *possibility* to do so is already present in the investment law system.

After the exclusions, the inclusions: what is this thesis about then? As we have just said at the closing of the previous paragraph, this is a thesis about how investment law deals with environmental legal obligations. Even so circumscribed, the field of investigation is rich with possibilities. Investment law specificity, both in relation to its substantive content and its procedural characteristics, makes for an ideal laboratory in which to observe how discrete sub-systems of law interact. The specificity of investment law is borne out of its historical development and its political role. Its current structure developed in the last fifty years, as foreign investment became not only a way for companies to profit, but a

substitute for state intervention in development policies<sup>8</sup>. At first, the rules of customary law on the protection of aliens and aliens' property were supplemented and to a degree replaced by bilateral treaty commitments that tie host states to an international standard of treatment of foreign investors, the main elements of which are uncontroversial: protection against uncompensated expropriation, non-discrimination and international standing against states for breaches of protected treaty rights<sup>9</sup>. Then came the shift to 'sustainable development policies'<sup>10</sup> and

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<sup>8</sup> See Sornarajah, M., *The International Law on Foreign Investment*, 2<sup>nd</sup> ed., Cambridge, CUP, 2004: Introduction. As an example of the above-mentioned 'synergy', this is how the *Biwater* Tribunal summed up the facts leading to the dispute it was tasked to arbitrate: 'In 2003, the Republic was awarded World Bank, African Development Bank and European Investment Bank funding in the amount of USD 140,000,000 for the purpose of commissioning a comprehensive program of repairs and upgrades to, and the expansion of, the Dar es Salaam Water and Sewerage Infrastructure: the Dar es Salaam Water Supply and Sanitation Project (the "Project"). *As a condition of the funding*, [italics added] the Republic was obliged to appoint a private operator to manage and operate the water and sewerage system, and carry out some of the works associated with the Project.' *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania* (ICSID Case No. ARB/05/22), Award, 24 July 2008, § 3.

<sup>9</sup> This last element was not present in the older BITs, such as the Germany-Pakistan BIT of 1959, the first of the investment protection treaties. Wälde noted that '[t]he first treaty with a direct investor-State arbitration right has as yet not been identified, but the UK BITs of the late 1970s seem to have included the mechanism already, and it was accepted subsequently in the seminal *AAPL v Sri-Lanka* case'. (in 'Interpreting investment treaties: experiences and examples', Binder *et al.*, 2009: 724 at 729 footnote 15). Of course, like in a successful chemical reaction, it was the combination of international investment agreements (IIAs), ICSID Convention (1965) and New York Convention (on the Recognition and Enforcement of Foreign Arbitral Awards, of 1958) to create the conditions for investment arbitrations as we know them today.

<sup>10</sup> While sustainable development principles are not binding *per se*, criteria on sustainable development are applied by institutions such as the World Bank and its Multilateral Investment Guarantee Agency (MIGA) when funds are released. For example, MIGA requires the environmental assessment of proposed projects if insurance coverage is to be provided (MIGA Environmental Assessment Policy, Annex B of MIGA's Operational Regulation, at [http://www.miga.org/policies/index\\_sv.cfm?stid=1683](http://www.miga.org/policies/index_sv.cfm?stid=1683)).

states' renewed anxieties about the reach of investment treaties in areas traditionally reserved to state regulatory powers. This thesis analyses the ways in which these two opposite forces are brought to bear on investment law and investment arbitration, and how investment law reacts to them.

The substantive content of investment law, which will be considered in more detail in Chapter 3, is in itself a hybrid system of rules, which combines elements of customary international law developed for the protection of aliens and their property, fundamental rights concerning treatment standards which are mirrored in human rights law, public law, connected to the presence of the state as one of the parties, and domestic property law rules.

The procedural framework of investment arbitration has been universally recognised as a *sui generis* system allowing standing to natural or legal persons *vis-à-vis* host states in a commercial law-inspired setting, and guaranteeing compensatory damages for investors successful in their claim, enforceable internationally thanks to the widespread acceptance of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards<sup>11</sup>.

Two tensions are recognisable in the investment law system itself and in its interaction with environmental law: the first one between reciprocity and subordination, the second one between symmetry and fragmentation. In an influential article Mario Liverani uncovered the hidden message of subordination and vassalage contained in an apparently reciprocal treaty drafted in Anatolia in the second millennium B.C.<sup>12</sup>. Investment treaties

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<sup>11</sup> For the text of the convention, which has been ratified by 145 countries, see [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html).

<sup>12</sup> Liverani, M., 'Storiografia politica hittita – I. Šunaššura, ovvero: della reciprocità', 12 *Oriens Antiquus* (1973): 267. [Hittite political historiography – I. Shunashura, or on

are formally reciprocal instruments in which the Parties promise to accord each others' investors a high standard of protection; yet normally, the flow of investors is one-directional. Investment law formally situates itself within general international law; yet it is often said that investment tribunals subordinate any other international commitment to the investment protection commitments of the treaty under which they are established.

The second tension seems counterintuitive: the correct couplings would seem to be symmetry/asymmetry and unity/fragmentation. Human desire for symmetry is as primordial as the desire for unity<sup>13</sup>. Yet no system works without the insertion of the capability to asymmetricise itself and therefore operate choices, and no reality is un-fragmented. We will see in the following chapter the impact the discourse on fragmentation has had on investment law; in this context we wish to point out that a lot of misunderstandings and misconceptions might be born from reading this tension as one between unity and fragmentation. It is instead the way in which a fragmented (or differentiated) legal reality interacts with the innate need of any (legal) system to asymmetricise itself that results in the tensions, or conflicts, that the international legal community seems to be seized by.

The impression could be given that these tensions are distinguished by their nature: the first could be more correctly described as a legal tension, the second as a political one, and this is correct at one level of understanding, which will suffice for the purposes of this thesis. This is being said without prejudicing the choice of using either tension to

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reciprocity]. English translation in Liverani, M., *Myth and Politics in Ancient Near Eastern Historiography*, London, Equinox, 2004.

<sup>13</sup> On the topic the essential reading is Weyl, H., *Symmetry*, Princeton, Princeton University Press, 1952. My thanks to Joseph Tanega for leading me to the discovery of this book.

analyse the problems raised by this thesis, even if we restrict ourselves to legal problems and legal solutions.

## 1.2 Methodology

The choice of topic (and accompanying exclusions) dictates partially the choice of methodology: a pragmatic approach is adopted throughout this work. We are interested in ascertaining how the law of international investment works, and what works within the law of international investment. In practice, this means that the stress will be on the ‘legislative moment’ and the ‘judicial moment’, with investment arbitration chosen as the privileged *locus* in which investment tribunals are asked to interpret investment instruments.

There are political reasons why this is the case, summarised briefly here, in order to better situate the topic in its regulatory environment. The starting assumption in the international community is that ‘investment is good’ and consequently, the adoption of international instruments for the protection of investment is necessarily a good thing as well. This assumption is derived from classical investment law theory, which espouses a view of investment as ‘wholly beneficial for the host economy’<sup>14</sup>, which has been adopted by all the major international organisations, such as the World Bank and the International Monetary Fund (IMF), and finds its expression at the policy level in the ‘Washington Consensus’ requirement for the liberalisation of foreign direct investment<sup>15</sup>, and at the legal level, in the language adopted in

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<sup>14</sup> Sornarajah, 2004: 57. A very recent expression of this position in Schill, S., Schill, S., *The Multilateralization of International Investment Law*, Cambridge, CUP, 2009: Chapter 1.

<sup>15</sup> This term refers to the set of policies adopted by the World Bank and the IMF in concert with the United States government in the 1990s, the high water mark of neo-liberal economic policies. The shifting balance of economic power, from West to East,

investment treaties preambles and substantive clauses<sup>16</sup>. The ‘dependency theory’, on the other hand, has questioned the efficacy of investment in promoting economic development, stressing that<sup>17</sup>: ‘...rather than promote development, foreign investment keeps developing countries in a state of permanent dependence on the central economies of developed states’.

Recent theoretical and practical developments<sup>18</sup>, trying to find a middle ground between the critical approach of the dependency theory and the hegemonic weight of the Washington consensus, are indicative of the tendency to strive for a balance between competing interests, of which the balancing between investment protection and environmental regulation is probably the most conspicuous example. From a methodological perspective, this work will not follow either the dependency theory nor the classical investment theory. One stated reason is that this thesis intends to focus on the legal aspects of inter-systemic conflicts, not on the policy-making and especially not on the policy discussions.

Having overcome the policy choice, this thesis will also avoid taking an exclusionary position on the universalistic/particularistic debate (to borrow the words of Bruno Simma, ‘whether international law is conceived as a unified legal order or as the sum total of loosely interrelated subsystems’<sup>19</sup>). It is submitted here that framing the debate in these terms results from the misconception, at least the proposal of a

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has not changed the content of the policies, as much as the winners and losers of the processes they set into motion.

<sup>16</sup> Some examples of these will be provided in the following chapters.

<sup>17</sup> See for example Sornarajah, 2004: 58.

<sup>18</sup> As this approach is more relevant to the topic of the thesis, references to work conducted in this direction will be present throughout this work.

<sup>19</sup> Simma, B. and Pulkowski, D., ‘Of planets and the universe: self-contained regimes in international law’, 17 *EJIL* (2006): 495.



misconception, on the nature of the tension, which is not between law as a unified (which is another way of saying hierarchical) or fragmented system, but between a state of unresolved fragmentation and a state of accomplished harmonisation: it is not a return to unity as much as an attempt at symmetry (not necessarily a value-driven one<sup>20</sup>). One cannot fail to notice that, in order to bring the argument to its logical conclusion, especially if ‘values’ are eschewed, one would have to argue for the ‘explosion’ of the very idea of investment law. In other words, to the extent that the sort of protections accorded by investment law to investors can be guaranteed by application of human rights law (due process, access to justice and other standards of treatment) and to investments by application of commercial law, company law, business law, contract law, administrative law (as almost all these fields of law have undergone a process of internationalisation and globalisation), the need of ‘investment law’ as such is made redundant. But this would be taking the argument too far for the sake of the argument. We are not so naïve as to believe investment law is mainly about the content of the law in itself. It is (mostly) about the arena of contestation, the protections offered by the dispute settlement provisions, by the setting, not the words (or how the setting determines the words). To the extent that we accept this as the legitimate place of contestation, we have already conceded the argument: we have to talk about the environment as the ‘intruder’, the

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<sup>20</sup> On the political contestations taking place in similarly occurring conflicts, see Lang, A., ‘Reflecting on “linkage”: cognitive and institutional change in the international trade regime’, 70 *MLR* (2007): 523. The ‘trade and...’ has turned out to be a very active forum of debate and criticism; however much this criticism is reconfigured in order to make substantive change of the trade regime more difficult (which is Lang’s argument), it arguably constitutes a step further compared to the current situation of the investment regime, which has hardly being challenged in a similar fashion (where are the ‘investment and...’ linkages?). The argument will rest on the value one attributes to discursive practices, to the extent that rather than as linkages or challenges, the whole project can be seen as one of saturation and colonisation (where trade – or investment – becomes the dominant element of the linkage and colonises the field with which is put in [apparent] conflict).

‘outsider’ in the world of the investment. But we accept this and we take it to task. In short, if the approach of this thesis could be summarised it would be as something resembling ‘pragmatic normative coherence’ within the framework as given.

## Chapter 2: The background

The national members of this new international elite, a *noblesse de robe*, by exercising their talents in the major trans-national entities, humanitarian organizations, or even great legal multinationals, help to bring juridical forms to a higher level of universalization in and by a confrontation of different and at times opposed visions. Always at play in this confrontation, both as a weapon and as stakes, is the law (whether the rights of business, the rights of man, or the rights of businessmen) – that is, piously hypocritical reference to the universal<sup>21</sup>.

### 2.1 Introduction

For an area of law perceived as secretive and self-contained, investment law is not immune from flare-ups of public attention and notoriety. Two such moments occurred in the last fifteen years. The first one was in the mid-1990s, at the time when the Organisation for Economic Co-operation and Development (OECD) launched the negotiations on the Multilateral Agreement on Investment (MAI)<sup>22</sup>; the following angry debates and criticisms, and the outcries from the environmental NGOs, effectively contributed to killing the project<sup>23</sup>. The second episode took place ten years later, when the multinational Bechtel was forced to

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<sup>21</sup> From Pierre Bourdieu's Introduction to Dezalay, Y. and Garth, B. G., *Dealing in Virtue: International Commercial Arbitration and the Construction of a Transnational Legal Order*, Chicago, University of Chicago Press, 1996 (at viii).

<sup>22</sup> OECD, The Multilateral Agreement on Investment – Draft Consolidated Text, 22 April 1998; at <http://www1.oecd.org/daf/mai/pdf/ng/ng987r1e.pdf>.

<sup>23</sup> On the effect of environmental NGOs on the negotiations, see Ward, H. and Brack, D., (eds.), *International Trade and the Environment*, London, Royal Institute of International Affairs, 2000. On the failure of the negotiations, see also Kamminga, M. T. and Zia Zarifi, S. (eds.), *Liability of Multinational Corporations under International Law*, The Hague, Kluwer Law International (2000): 6. In any case, most of the provisions of the MAI have found their way into regional and bilateral treaties.

withdraw from arbitration against Bolivia in the *Aguas del Tunari* case<sup>24</sup>; a negative campaign mounted against Bechtel's chief executive by environmental NGOs was said to have been one of the reasons for the corporate retreat. The presence of the investor in the country had been accompanied by widespread protests from the local population, which provoked the reaction of the police forces and resulted in one death.

Both these episodes concern the relationship of investment law with environmental law and public interests issues in general. The first episode represents more specifically a legal problem (how legal sub-systems interact), the second a political one (how does law accommodate the public interest and political concerns) or a constitutional one (either as a conflict of fundamental rights and interests or of competences and powers, namely the legislative and the (quasi) judicial powers). The interaction of these two distinct phenomena (normative and political-constitutional conflicts) is hidden from view by the more immediately apparent characteristics of investment law which were brought to the fore in the above-mentioned examples, procedural closure and substantive isolationism (or structural bias). To the extent that these are allowed to dictate the outcome of investment arbitrations, the investment regime effectively externalises the conflict between investment and environment, to the obvious detriment, at the policy level, to the efficacy of the host state's environmental policies, and at the legal level, to the normative

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<sup>24</sup> *Aguas del Tunari S.A. v. Republic of Bolivia* (ICSID Case No. ARB/02/3). The dispute regarded the privatisation of water and sewage provision in the city of Cochabamba. The tribunal only delivered a decision on the respondent's objection to jurisdiction; the dispute never reached the merits stage because of an international campaign against the investor, Bechtel Corporation, which decided to withdraw the claim (for a history of the case, see Schneiderman, D., 'Investment rules, the immobilized state, and the difficulties of counter-hegemonic resistance', Paper presented at the annual meeting of The Law and Society Association, TBA, Berlin, Germany, 25 July 2007). Of course it could equally be argued that the company just cut its losses by not pursuing the arbitration, so if it is a victory of the environmental community, it is a shallow one indeed.

coherence of the international legal system. Additionally, by conferring to arbitrators the power to select which rights to uphold (if one conceptualises investment arbitrations as decisional *loci* of a quasi-constitutional nature insofar as they assign a priority of applicability to conflicting fundamental rights), investment law provides a solution to these constitutional dilemmas which risks leaving all parties unsatisfied: the investors unhappy with the normative vagueness of the regime, which militates against clarity and consistency of awards; the state weary of the ‘anti-regulatory creep’ of investment law; and finally, the public, as the default presence/absence of investment law, misrepresented, unrecognised and unheard.

The first problem is a problem of normative dissonance. An analysis focussed on the law centres both on the tools to avoid normative conflicts (inter-state negotiations, careful treaty drafting and alternative dispute settlement) and the tools to manage them in investor-state arbitrations (interpretation and conflict resolution). Inevitably, a considerable delegation of decisional power has to be conferred to the arbitrators in order to deal with these conflicts. Recently, discussions on balancing and proportionality approaches to normative, ‘investment and...’ conflicts have been developing in the investment community<sup>25</sup>. While these discussions constitute a welcome development in contrast to the default isolationism of the investment regime, the consequence of arbitration tribunals interpreting non-investment obligations into investment treaties, or performing a proportionality analysis, is the discretionary power conferred upon them, which is intrinsic to any exercise of proportionality. Regardless of the drawbacks, it has been proposed that ‘...proportionality analysis can constitute a gateway for non-investment law principles to enter into the argumentative framework of investment treaty arbitration and thereby help to overcome the fragmentation of

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<sup>25</sup> Most interestingly, the comparative approach advocated in Schill, S. (ed.), *International Investment Law and Comparative Public Law*, Oxford, OUP, 2010.

international law into functional and special-interest-related sub-systems'<sup>26</sup>. Arguably, the overlap between normative dissonance, to be solved by application of a proportionality analysis, and fragmentation, for which interpretation and systemic integration (by reference to treaty law as codified by the Vienna Convention on the Law of Treaties) are proposed as solutions, is not automatic. Be that as it may, inevitably, when dealing with the issue of normative conflict in international law, the focus turns to the supposed state of 'fragmentation' of the international legal system.

## 2.2 The fragmentation of international law

In recent years an intense debate has developed on the phenomenon of 'fragmentation' of international law. Here is how the International Law Commission introduced the issue in its Report on the subject<sup>27</sup>:

One of the features of late international modernity has been what sociologists have called "functional differentiation", the increasing specialization of parts of society and the related autonomization of those parts... The fragmentation of the international social world has attained legal significance especially as it has been accompanied by the emergence of specialized and (relatively) autonomous rules or rules-complexes, legal institutions and spheres of legal practice....The result is conflicts between rules or rules-systems, deviating institutional practices and, possibly, the loss of an overall perspective on the law.

The very use of the term *fragmentation* implies a previous unity and

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<sup>26</sup> Schill, 2010: 104.

<sup>27</sup> International Law Commission Study Group, *Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law*, Report of the Study Group of the International Law Commission – Finalized by Martti Koskenniemi, 13 April 2006, UN Doc. A/CN.4/L.682: 11; at <http://daccessdds.un.org/doc/UNDOC/LTD/G06/610/77/PDF/G0661077.pdf?OpenElement>.

integrity of the international legal system<sup>28</sup>. Arguably, it was the limited number of actors and the relative uniformity of interests (where similar interests were shared by actors in competition) to guarantee this unity under the overarching principle of sovereignty. The functional differentiation of modern international law, accompanied by its non-hierarchical nature<sup>29</sup>, the emergence of non-state global legal sub-systems<sup>30</sup> and the multiplication of adjudicating bodies and institutional settings have come to be defined as a state of fragmentation and

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<sup>28</sup> Additionally, the language is indicative of an evaluative judgment: in the coupling of unity/fragmentation, it is evident that the attribution of positive/negative is performed. The myth of a previous unity is obviously that, just a myth, useful to argue for a necessity of return to it and against fragmentation (see also Dünkelsbühler, U., 'Rahmen-Gesetze und Parergon-Paradox: Eine Übersetzungsaufgabe', in H.U. Gumbrecht and K.L. Pfeiffer (eds.) *Paradoxien, Dissonanzen, Zusammenbrüche: Situationen offener Epistemologie*. Frankfurt, Suhrkamp, 1991, 212: 'It is only the assumption of a (deficiency) as a loss which makes it possible that an original perfection – as unity – can be presupposed, which can be replaced later on. Thus the (metaphysical logic of the) "original" identity can be perfectly reconstituted.' Commenting (somewhat sarcastically) on differentiation, Niklas Luhmann said: 'It is dubious whether the creation of judicial hierarchies can ever overcome a form of legal fragmentation that derives from structural social contradictions. Reversal or return to a coordinating form of international law, however, and a resurrection of old myths is equally foreclosed: The sin of differentiation can never be undone. Paradise is lost.' (Luhmann, N., *Die Wirtschaft der Gesellschaft*, Frankfurt, 1994 at 344, translated in Fischer-Lescano and Teubner, 2004: 1007).

<sup>29</sup> Fischer-Lescano and Teubner, 2004: 1017. See also Luhmann, N., 'Globalization or world society? How to conceive of modern society', 7 *International Review of Sociology* (1997): 67; but see Koskeniemi, M., and Leino, P., 'Fragmentation of international law? Post-modern anxieties', 15 *Leiden Journal of International Law* (2002): 553, for a non nostalgic view of the lost unity of international law.

<sup>30</sup> For a review of the issue of legal pluralism within regimes, and especially the environmental regime (which in itself is divided, at least at a policy level, in several, often conflicting currents, such as 'deep ecology', 'eco-socialism' etc.), see Perez, O., *Ecological Sensitivities and Legal Pluralism: Rethinking the Trade and Environment Conflict*, Oxford and Portland, Hart Publishing, 2004: 12 ff.; Teubner, G., 'The two faces of Janus: rethinking legal pluralism', 13 *Cardozo Law Review* (1992): 1419, at 1459.

conceptualised as a problem. What interests us is the way fragmentation is perceived as interfering with international law universal applicability and coherence<sup>31</sup>, as concrete examples of how law-making at the international level (the proliferation of treaties) and law-enforcing at the international level (the proliferation of courts and tribunals) can suffer from the perceived dis-unity of international law<sup>32</sup>.

While much of the debate on fragmentation has concentrated on the tension between a general, or universalistic, conception of international law and the functionalist, or subject-specific, regimes that have been proliferating recently<sup>33</sup>, this thesis engages more closely with the tension between functionalist regimes. It is neither a problem of values (the tired debate on universalism *versus* relativism), nor necessarily of actors<sup>34</sup>, but of tools. System-specific tools, such as *ius cogens*, *erga omnes* obligations<sup>35</sup>, Article 103 of the United Nations Charter, seem of little

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<sup>31</sup> See Simma, B., 'Universality of international law from a practitioner's perspective', 20 *EJIL* (2009): 265.

<sup>32</sup> For a positive assessment of institutional fragmentation through the substantive prism of regulatory takings jurisprudence, see Ratner, S., 'Regulatory takings in institutional context: beyond the fear of fragmented international law', 102 *AJIL* (2008): 475.

<sup>33</sup> As in the whole debate on the nature of *lex specialis*, for which see Chapter 5.

<sup>34</sup> In the sense that it does not necessarily follow that, because international law actors are sovereign equal states, a hierarchy of rules is impossible; see on the opposite, Combacau, J., 'Le droit international: bric-à-brac ou système?' 31 *Archives de philosophie du droit* (1986): 88.

<sup>35</sup> Not a hierarchical tool as such, rather a categorization tool to attribute the power to invoke responsibility for a breach, see Article 42 of the ILC Draft Articles on responsibility of States for Internationally Wrongful Acts. For the concept of obligations *erga omnes*, see the dictum of the ICJ in *Case concerning the Barcelona Traction, Light and Power Co Ltd (New Application: 1962) (Belgium v Spain) (Second Phase)* [1970] ICJ Rep 3; see also Tams, C., *Enforcing Obligations Erga Omnes in International Law*, Cambridge, CUP 2005. On the role of *erga omnes* obligations in the resolution of normative conflicts, see Simma, B., and Kill, T., 'Harmonizing investment protection and international human rights: first steps towards a methodology', Binder, C. *et al.*, *International Investment Law for the 21<sup>st</sup> Century*, Oxford, OUP, 2009: 678.



use in the context of international investment law and have been of little use in international law in general. On the other hand, *lex specialis* and systemic integration by way of interpretation have been proposed as possible solutions endogenous to the field of investment law<sup>36</sup>. Regardless of the position one takes on the impact of the fragmentation discourse for international law in general and for investment law specifically, it is beyond doubt that the success of the discourse in itself, and the way it has been used as an explanation and a short-hand for certain recurring phenomena (inconsistency of awards and judgments, proliferation of dispute settlement *fora*, multiplication of instruments), demands that due account is given to the way in which it can be employed as a key to understanding how international law is developing.

### 2.3 The nature of investment law

The fragmentation of the international law system and the distinctiveness of the investment regime are a matter of perspective<sup>37</sup>. However, undoubtedly the investment regime presents peculiarities and unique characteristics. The first one relates to investment law's subject matter: it is undisputed that investment law concerns the protection of foreign investment; however, there is no agreement either on the extent of the protection to be granted, or on what 'foreign', 'investment' or 'investor'

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<sup>36</sup> On the relevance of 'institutional fragmentation' and the role of foreign investors in determining the legal outcome of the disputes, see van Aaken, Anne, *Fragmentation of international law: the case of international investment protection*, University of St. Gallen Law School, Law and Economics Research Paper Series, Working Paper No. 2008-1: 4. On endogenous solutions, or what Schill refers to as 'system-internal adaptation', see Schill, S., 'International investment law and comparative public law – an introduction', in Schill, 2010: 7 ff. On the dangers of interpretation, see our comments at the end of Section 3.4 and in Chapter 8.

<sup>37</sup> Equally, the decision of what comes first (if the differentiation or the fragmentation) is a matter of ultimately political choices.

mean, what do we mean when we say that an investor is ‘foreign’, what kind of economic activity qualifies as an ‘investment’ and so on<sup>38</sup>.

Closely related to the subject matter is the substantive content of investment law and its sources. Article 38 of the Statute of the International Court of Justice lists the sources of law applicable to international disputes and is well known, so there is no need to analyse it further here<sup>39</sup>. However, in international investment disputes the

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<sup>38</sup> Issues of definition are often discussed at the jurisdictional stage in investment arbitrations; see for example *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco* (ICSID Case No. ARB/00/4), Decision on Jurisdiction, 23 July 2001; *Saipem S.p.A. v. People’s Republic of Bangladesh* (ICSID Case No. ARB/05/7), Decision, 21 March 2007; *Inceysa Vallisoletana S.L v. Republic of El Salvador* (ICSID Case No. ARB/03/26), Award, 2 August 2006; *Tokios Tokéles v. Ukraine* (ICSID Case No. ARB/02/18), Decision on Jurisdiction, 29 April 2004; *Bayindir Insaat Turizm Ticaret Ve Sanayi A.Ş. v Islamic Republic of Pakistan* (ICSID Case No. ARB/03/29), Decision on Jurisdiction, 14 November 2005; *FEDAX v. Venezuela* (ICSID Case ARB/96/3(1), Decision on Jurisdiction, 11 July 1997; *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania* (ICSID Case No. ARB/05/22), Award, 24 July 2008; *Malaysian Historical Salvors, SDN, BHD v. Malaysia* (ICSID Case No. ARB/05/10), Award, 17 May, 2007; *Malaysian Historical Salvors, SDN, BHD v. Malaysia* (ICSID Case No. ARB/05/10), Decision on the Application for Annulment, 16 April 2009; *Consortium Groupement L.E.S.I.-DIPENTA v. People’s Democratic Republic of Algeria* (ICSID Case No. ARB/03/08), Award, 10 January 2005; *L.E.S.I. S.p.A. and ASTALDI S.p.A v. People’s Democratic Republic of Algeria* (ICSID Case No. ARB/05/3), Award, 12 July 2006; *Joy Mining Machinery Limited v. Arab Republic of Egypt* (ICSID Case No. ARB/03/11), Decision on Jurisdiction, 6 August 2004; *Jan de Nul N.V. and Dredging International N.V. v. Arab Republic of Egypt* (ICSID Case No. ARB/04/13), Decision on Jurisdiction, 16 June 2006; *Helnan International Hotels A/S v. Arab Republic of Egypt* (ICSID Case No. ARB/05/19), Decision on Jurisdiction, 17 October 2006; *Československa obchodní banka, a.s. v. Slovak Republic* (ICSID Case No. ARB/97/4), Decision on Objections to Jurisdiction, 24 May 1999; *M.C.I. Power Group, L.C. and New Turbine, Inc. v. Republic of Ecuador* (ICSID Case No. ARB/03/6), Award, 31 July 2007; *Pantechniki S.A. Contractors & Engineers v. Republic of Albania* (ICSID Case No. ARB/07/21), Award, 30 July 2009.

<sup>39</sup> Statute of the International Court of Justice, annexed to the Charter of the United Nations, at <http://www.un-documents.net/icj-s.htm>.

traditional sources of public international law, custom, treaty and general principles, representing the ‘public side of investment law’ have to be supplemented by the law of the contract where necessary<sup>40</sup> and the municipal law of the host country where applicable, especially if a claim of expropriation is raised<sup>41</sup>. Some scholars and (to a lesser extent) tribunals have also argued for the applicability of trans-national commercial norms, so called rules of *lex mercatoria*<sup>42</sup>. Additionally, disputes are normally governed by procedural rules of international commercial arbitration<sup>43</sup>. The complexity of the rules regarding the applicable law in investment arbitrations might bring to mind similar problems relating to conflict of laws rules<sup>44</sup>; however, while the task of private international law is to select the law applicable in the characterisation of a dispute, the outcome of a similar exercise in an investment case is more cumulative, to the extent that, for example,

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<sup>40</sup> For example, if an incidental question relating to a breach of treaty is raised by an investor in a contractual dispute in front of an investment tribunal (where this is possible) and the state presents as a defence an environmental regulation, if the tribunal establishes that the defence is not valid, the regulation will be null but the remedies will be decided according to the governing law of contract, even if it is a tribunal established by treaty and the incidental question related to the breach of a treaty-protected right (see Douglas, Z., *The International Law of Investment Claims*, Cambridge, CUP, 2009: 50).

<sup>41</sup> Where the relevant provisions of property law will be applied in order to assess if there was a property capable of being expropriated; see for example Douglas, 2009: 51 ff. See also Section 3.3.1.

<sup>42</sup> On *lex mercatoria*, see Galgano, F., ‘The new *lex mercatoria*’ 2 *Annual Survey of International and Comparative Law* (1995): 102; Stone Sweet, A., ‘The new *lex mercatoria* and transnational governance’, 13 *Journal of European Public Policy* (2006): 627; for a more critical approach, Teubner, G. ‘Global Bukowina: legal pluralism in world society’, in Teubner, G. (ed.), *Global Law without a State*, Brookfield, Dartmouth, 1997: 3; G. Teubner, ‘Breaking frames: economic globalization and the emergence of *lex mercatoria*’, 5 *European Journal of Social Theory* (2002): 199.

<sup>43</sup> For those disputes that do not take place within the institutional setting provided by the International Centre for the Resolution of Investment Disputes (ICSID) for which the rules set up in the ICSID Convention apply.

<sup>44</sup> The parallel is drawn amongst others by Douglas, 2009: 45 ff.

normally customary law remains in the background even if treaty rules apply as *lex specialis*<sup>45</sup>.

Finally, while bilateral investment treaties (the most common source of investment law) constitute a web of interconnected reciprocal inter-state obligations<sup>46</sup>, the investor possesses limited international personality and is therefore endowed with *locus standi* for the purpose of initiating an investment arbitration<sup>47</sup>. The pyramidal structure put in place by international investment law for dispute settlement<sup>48</sup>, including choice of law and of arbitration clauses in contracts, arbitration clauses in national

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<sup>45</sup> On the different ways in which custom and treaty obligations interact, with reference to investment rules, see Gazzini, T., 'The role of customary international law in the field of foreign investment,' 8 *JWI&T* (2007): 712; for the approach of investment tribunals, see for example *ADC and ADC & ADMC v Hungary* (ICSID Case No. /ARB/03/16), Award, 2 October 2006, § 481: 'There is general authority for the view that a BIT can be considered as a *lex specialis* whose provisions will prevail over rules of customary international law (see, e.g., *Phillips Petroleum Co. Iran v. Iran*, 21 *Iran-U.S.C.T.R.* at 121); *CME Czech Republic B.V. (The Netherlands) v. The Czech Republic* (UNCITRAL), Final Award, 14 March 2003, § 497-8 (on the standard of compensation); a controversial decision in this respect is *Sempra Energy International v. Argentine Republic* (ICSID Case No. ARB/02/16), Award, 28 September 2007, where the Tribunal incorrectly, according to the Annulment Committee, allowed the customary law criteria on necessity, as codified in Article 25 of the ILC Draft Articles on Responsibility of States for Internationally Wrongful Acts, to trump the substantive provisions of the applicable BIT; see also Decision on Annulment of 29 June 2010 and A. Gourgourinis, 'Lex Specialis in WTO and investment protection law', Society of International Economic Law Second Biennial Global Conference, Barcelona 2010, Online Proceedings Working Paper No. 2010/37: 30.

<sup>46</sup> And are to a lesser extent accompanied by regional (such as the NAFTA) and sectoral (the Energy Charter Treaty) instruments presenting similar characteristics.

<sup>47</sup> Most BITs contain an open offer to arbitrate which is concluded when the investor initiates a dispute by submitting a notice or intention to arbitrate; similar clauses can be contained in national investment codes or in the contract between the host state and the investor.

<sup>48</sup> See van Harten, G., *Investment Treaty Arbitration and Public Law*, Oxford, OUP, 2007: 24 ff.

investment codes, arbitration agreements within bilateral or multilateral treaties, and finally arbitration rules in the International Centre for the Settlement of Investment Disputes (ICSID) Convention<sup>49</sup> and the United Nations Commission on International Trade Law (UNCITRAL) Convention<sup>50</sup>, allows foreign investors to dispense with the requirement of the exhaustion of domestic remedies<sup>51</sup> and the privity rule<sup>52</sup>. Once consent for arbitration is given, the home state of the investor's right to exert diplomatic protection is normally forgone unless the host state refuses to abide by the award<sup>53</sup>.

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<sup>49</sup> Convention on the Settlement of Investment Disputes between States and Nationals of Other States, available at <http://icsid.worldbank.org/ICSID/ICSID/DocumentsMain.jsp>. See also Schreuer, C., *The ICSID Convention: A Commentary*, Cambridge, CUP, 2001.

<sup>50</sup> United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards; 330 UNTS 3; text available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html).

<sup>51</sup> Article 26 of the ICSID Convention.

<sup>52</sup> See *Asian Agricultural Products Limited v. Democratic Socialist Republic of Sri Lanka* (ICSID Case No. ARB/87/3), Award 27 June 1990, § 2. See Paulsson, J., 'Arbitration without privity', 10(2) *ICSID Review* (1995): 232. The concept is not universally accepted: see for example Sornarajah, M., *The Settlement of Foreign Investment Disputes*, The Hague, Kluwer Law International, 2000: 308, footnote 6, or Orrego Vicuña, F., *International Dispute Settlement in an Evolving Global Society*, Cambridge, CUP, 2004: 66: 'Although this situation has occasionally been considered as an example of arbitration without privity, it is in fact a form of consent given at different points in time.' (The consent of the investor is perfected only at the moment in which he submits a dispute). See also Mann, F.M., 'British treaties for the promotion and protection of investments', in Mann, F.M., *Further Studies in International Law*, Oxford, Clarendon Press, 1990: 244. However, the fact remains that the consent of the host state can be construed from an offer contained in a bilateral treaty or domestic legislation, that is, in absence of privity with the investor who will start a dispute based on that open offer. Privity, which is dispensed with by BITs, allowing for a claim to be brought for treaty violation without a contract breach, re-enters by the window, as most claims start from a contract breach and the first determination is if the contract breach constitutes a violation of the treaty.

<sup>53</sup> Article 27 of the ICSID Convention.

The structural characteristics outlined above and the problems resulting from them have given rise to debates on a ‘legitimacy crisis’ of investment law, which are reflected in the following comment made by Gus van Harten<sup>54</sup>:

[Investment treaty arbitration] is a method of public law adjudication, meaning that it is used to resolve *regulatory* disputes between private parties or between states. [...] the system’s unique use of private arbitration in the regulatory sphere conflicts with cherished principles of judicial accountability and independence in democratic societies; in effect, it taints the integrity of the legal system by contracting out the judicial function in public law.

Investment law is often considered to display a significant structural bias towards one outcome<sup>55</sup>, the protection of the investor to the detriment of any other competing consideration; more correctly, it can be affirmed that many tribunals seem to operate a complete overlap between the interests of investors and the public interest<sup>56</sup>. This is not simplistically to state that investors are more likely to win than lose a dispute; rather, to affirm that the system is weighed in its substantive content and in its interpretative thrust towards the rights and standards of protection

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<sup>54</sup> van Harten, 2007: 4. See also Atik, J., ‘Repenser NAFTA Chapter 11: A catalogue of legitimacy critiques’, 3 *Asper Review International Business & Trade Law* (2003): 215. More recently, see Waibel, M. (ed.), *The Backlash against Investment Arbitration*, The Hague, Kluwer Law International, 2010.

<sup>55</sup> This is a criticism that can be easily moved to any functional regime, and indeed to law in general; see for example Koskeniemi, M., *From Apology to Utopia*, Cambridge, CUP, 2006: 606: ‘.... the main political point ... irrespective of indeterminacy, the system still de facto prefers some outcomes or distributive choices to other outcome or choices... there is a structural bias.’ Simma and Kill refer to: ‘...the tendency towards considering international investment law in a vacuum...’ (Simma, B. and Kill, T., ‘Harmonizing investment protection and international human rights: first steps towards a methodology’, in Binder *et al.*, 2009: 679.)

<sup>56</sup> This approach is sometimes explicitly stated by tribunals; see for example, *Amco v. Indonesia* (ICSID Case ARB/81/1), Decision on Jurisdiction, 25 September 1983, 1 *ICSID Reports* (1993): 400: ‘To protect investment is to protect the general interest of development and of developing countries.’

accorded to investors<sup>57</sup>: in short, the system displays an investor-centred approach<sup>58</sup>.

The issues of the cross-fertilisation, or conversely of isolationism, of sub-systems of international law and of the legitimacy of the system, which is both procedural (who applies the rules) and substantive (which rules are applied) are distinct and require distinct attention and analysis. While the tools of systemic integration and interpretation can address problems of closure of individual legal regimes and consequent isolationism, they fail to account for and address the procedural and substantive legitimacy deficit of the regime; to the contrary, as we have previously remarked, arguably conferring to arbitrators the power to interpret non-investment obligations into the investment regime, and *a fortiori* to apply the principle of proportionality, does nothing to help dispel the perception that the system lacks democratic legitimacy. Luhmann noted that<sup>59</sup>:

Formulas of ‘equalizing’, ‘balancing’ or ‘proportionality’ can be achieved only arbitrarily. If the law has to resort to such formulas than a technically informed arbitrariness is not the worst solution. It is just not a specifically legal one.

The advantages of a ‘technically informed arbitrariness’ are appealing to a proponent of a pragmatic approach to conflict resolution, and allow for

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<sup>57</sup> It is especially the ‘interpretative thrust’ that is our concern, if we want to argue, as we do, that it is through interpretation that non-investment obligations can be incorporated in investment law. The two different approaches, the ‘investor-centred’ and the more ‘holistic’ one, will be discussed in Chapter 3 and Chapter 7 respectively. On the use of a more holistic approach, the statement of the WTO Panel in *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China* is to be noted, where the Panel declared that: ‘...the interpretative process under Article 31 of the Vienna Convention is a holistic one...’ (At § 8.56, Report of 22 October 2010, WT/DS379/R).

<sup>58</sup> This is to a certain extent inevitable, as a guarantee of consistency of the investment law system.

<sup>59</sup> Luhmann, N., *Ecological Communication*, Chicago, University of Chicago Press, 1989: 69.

a focus on the tools available rather than the policy justifications, easily hijacked by competing communities with pretensions of universality and embracing the ‘pious hypocritical reference to the universal’ that Bourdieu so acutely noted<sup>60</sup>.

The distinction between substantive isolationism and procedural closure can be employed to analyse how the substantive obligations and rights provided by investment law are insulated to outside normative influences<sup>61</sup>. Procedural closure (which is still very much evident in investment arbitration) can work to reduce substantive openness and therefore allow arbitrators to disregard public interest issues. It is not argued here that this is the stated reason, or even the underlying rationale, for procedural closure, which is based partially on the adoption of the commercial arbitration model by investment tribunals and partially on reasons of expediency, efficiency and the ‘orderly unfolding of the arbitral process ...[,] conducive to the maintenance of working relations between the Parties’<sup>62</sup>. However, it is also certainly the case that, once the doors are metaphorically as well as literally closed to the outside, there is in principle no need to take into account ‘outside’ and ‘outsiders’ issues<sup>63</sup>.

The second aspect of the debate, the ‘constitutional conflict’ between fundamental rights, is often presented as one between protection (of

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<sup>60</sup> In the quote at the opening of this chapter.

<sup>61</sup> We will see in more detail in Chapter 6 how investment law arbitration has fundamentally changed its nature from complete closure to relative openness, with varying degrees of transparency and publicity allowed by the different institutional settings.

<sup>62</sup> *Metalclad Corporation v. United Mexican States* (ICSID Case ARB(AF)/97/1), Procedural Order One (Confidentiality), 27 October 1997, § 10.

<sup>63</sup> The phenomenon might be impossible to prove, as it might take place precisely in those disputes that are confidential, and for which therefore we don’t have access to the reasoning of the tribunal or the pleadings by the parties, and sometimes even to the award rendered.



investors) and regulatory powers. On the contrary, the inflow of investment is facilitated, not hindered, by the presence of a regulatory framework, which includes international investment treaties, national investment codes, guarantees by international institutions, insurance coverage<sup>64</sup> and so on. The extent to which a tension exists concerns the objective of the regulation, not the existence of a regulatory framework *per se*<sup>65</sup>. In analysing this conflict, the default point of view is the one of investors, who do not perceive the whole regulatory apparatus set up for their protection as over-regulation; a more nuanced and neutral outlook would recognise that both investment protection measures and environmental measures constitute legitimate exercises of governmental policy<sup>66</sup>. The problem then is to recognise to what extent investment tribunals can balance these measures in the context of the dispute, where investment treaties normally do not specifically confer to them this power<sup>67</sup>, and how they can do so.

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<sup>64</sup> Both national insurance programmes, such as the Overseas Private Investment Corporation (OPIC) in the United States (at <http://www.opic.gov/>), or international investment guarantees programmes, such as the Multilateral Investment Guarantee Agency (MIGA), which is a member of the World Bank Group (at <http://www.miga.org/>).

<sup>65</sup> On the role of states in creating the framework for the protection of investment, see Schneidermann, D., 'Globalisation, governance and investment rules' in Clarke, J. N. and Edwards, G. R. (eds.), *Global Governance in the Twenty-First Century*, Basingstoke, Palgrave Macmillan, 2004: 67. For the importance of regulation in establishing a framework for business expansion and globalisation, see Braithwaite, J. and Drahos, P., *Global Business Regulation*, Cambridge, CUP, 2000, especially Chapters 1-7. In general on the role of the state in the development of capitalism and market economy, see Polanyi, K., *The Great Transformation: the Political and Economic Origins of Our Time*, Boston, Beacon Press, 1957.

<sup>66</sup> Vaughan Lowe, A., 'Regulation or expropriation?', 55 *Current Legal Problems* (2002): 459.

<sup>67</sup> But we will see in Chapter 4 which express means are present in investment treaties to incorporate non investment obligations.

## 2.4 Non-investment law approaches

Environmental policies have seemingly become a priority for states. New international instruments are being signed all the time<sup>68</sup>, sometimes with legally binding targets, which require states to implement new and ever more demanding regulation<sup>69</sup>. In the developing world this regulation might impact foreign investors disproportionately, as they are often involved in traditionally highly polluting industries, such as mining and oil extraction. The right of states to adopt and enforce environmental legislation and their duty to guarantee a certain level of protection to foreign investors and their investments are likely to come into conflict, for example if the regulation impacts on the profitability or the legal status of the investment. If from the vantage point of the investment lawyer the problem is the intrusion of environmental obligations in the system of protection for the investor and its investment, from the point of view of the government lawyer or the legislator, the problem lies in dealing with the environmental externalities of investors' activities.

This thesis does not engage with policy discussions, and this exclusion repeats itself once we cross from the investment field to the environmental field<sup>70</sup>. In this section we will consider instead legislative

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<sup>68</sup> The 2005 UNEP Register of International Treaties and Other Agreements in the Field of the Environment lists 272 instruments; register available at [http://www.unep.org/law/PDF/register\\_Int\\_treaties\\_contents.pdf](http://www.unep.org/law/PDF/register_Int_treaties_contents.pdf).

<sup>69</sup> For a good introduction to the topic, see Sands, P., *Principles of International Environmental Law*, 2<sup>nd</sup> edition, Cambridge, CUP, 2003.

<sup>70</sup> Policy is discussed only to the extent that it crosses into the next category, that of 'soft law'. Our exclusion of policy and to a certain extent, of soft law, cuts against the grain of most 'governance talk', equally adamant about the exclusion of mandatory standards (hard law); in its 2004 White Paper on Trade and Investment, *Making Globalisation a Force for Good*, the UK Government proclaimed: 'We do not believe that the WTO should try to impose minimum social standards on investors: trade and labour is not [sic] part of the WTO mandate.' (at 13); text available at <http://webarchive.nationalarchives.gov.uk/+http://www.berr.gov.uk/files/file23441.pdf>.

and judicial means for dealing with environmental problems, both at the national and at the international level<sup>71</sup>. At the domestic level, both criminal and civil actions can be used in order to hold investors to account for environmentally injurious activities, including, in certain countries, civil actions for acts committed abroad or in violation of international law. At the international level, courts or arbitration tribunals can adjudicate on violations of international environmental law by foreign investors.

A lot of quasi-legislative activity takes the form of non-binding, soft law instruments. These might include, at the state level, memoranda of understanding, global compacts, declarations and resolutions, and at the investors' level, industry standards and codes of conduct, including codes on corporate social responsibility (CSR). Given the hybrid nature of soft law, half-way between policy and law, its rise to prominence in the field of business and its enthusiastic acceptance by governments, the literature on the issue is quite vast<sup>72</sup> and, to the extent that it rarely enters the world of investment arbitration in any significant way, quite irrelevant for the purposes of our thesis<sup>73</sup>.

For the purpose of its efficacy in dealing with environmental negative externalities, two main problems are attributable to soft law, lack of enforceability and of consistency. Instruments generated through inter-

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<sup>71</sup> See for example the way in which the 1997 Kyoto Protocol to the 1992 UN Framework Convention on Climate Change (37 *ILM* 1998, 22) seeks to harness foreign investment to its environmental goals (especially Articles 10 and 11).

<sup>72</sup> See Muchlinski, P., *Multinational Enterprises and the Law*, Oxford, Blackwell, 1999; Muchlinski, P., 'Corporate Social Responsibility' in *The Oxford Handbook of International Investment Law*: 637; see also Crane, A., McWilliams, A. and Matten, D., *The Oxford Handbook of Corporate Social Responsibility*, Oxford, OUP, 2008.

<sup>73</sup> For a rare mention, thanks to the involvement of NGOs as non-disputing third parties, see the use of the UN Millennium Development Goals for assessing the investor's behaviour in the provision of water, *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania* (ICSID Case No. ARB/05/22), Award, 24 July 2008, § 379.

state negotiations, such as the Global Compact<sup>74</sup> or memoranda of understanding<sup>75</sup>, and those that issue from the world of industry and business (codes of conduct, industry standards) share low enforceability levels. The level of compliance can vary between low for inter-state instruments and higher for industry instruments; however the higher compliance results mostly from the fact that the industry issues standards at a level it is comfortable with. It is also important to note that the relationship between enforceability and compliance is not unproblematic: to take an example from the area of human rights law, the recent polemic on the memoranda of understanding between the United Kingdom and Algeria and Jordan on the detention of foreign nationals convicted of terrorism charges can only be understood if one considers these instruments to have an effect<sup>76</sup>; in other words, the problem is not that these instruments do not work, but that they do for reasons that have nothing to do with their legal force and everything to do with the economic or political power that underpins them<sup>77</sup>.

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<sup>74</sup> United Nations Global Compact, available at

<http://www.unglobalcompact.org/issues/Environment/index.html>.

<sup>75</sup> These are undertaken for many reasons, including environmental co-operation; see for example the 2009 Indo-Swedish Memorandum of Understanding on the Environment, available at [http://www.swedenabroad.com/Page\\_99265.aspx](http://www.swedenabroad.com/Page_99265.aspx).

<sup>76</sup> In short, human rights NGOs complained that the non-binding instruments that supposedly protected the detainees against torture did not constitute enough protection for them; see for example the comments by Liberty and by Justice, two respected UK-based NGOs, at <http://www.liberty-human-rights.org.uk/issues/1-torture/12-deportation-to-torture/index.shtml>, and [www.justice.org.uk/images/pdfs/uncatsept05.pdf](http://www.justice.org.uk/images/pdfs/uncatsept05.pdf). The problem is precisely the opposite, i.e. that they probably did have an effect, and Algeria and Jordan were not going to torture prisoners X and Y sent by the UK, while they happily tortured all the other ones. Therefore a soft-law instrument created a discriminatory regime of protection against torture. Additionally, by imposing these memoranda the UK acknowledged that the hard law Convention against Torture, ratified by all countries in question, constituted no protection at all.

<sup>77</sup> One could take a 'whatever works' attitude to this and not worry excessively about the fact that a memorandum accomplishes what a multilateral treaty does not, but it is

Industry standards might result in liability problems in contractual disputes where the contract contains a stabilisation clause<sup>78</sup>, especially

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argued here that this sends entirely the wrong message about the binding force of international law, if one worries about this of course.

<sup>78</sup> On stabilisation clauses, see Article 3 Institute de Droit International, ‘The parties may agree that domestic law provisions referred to in the contract shall be considered as being those in force at the time of conclusion of the contract.’ The binding force of stabilisation clauses is not undisputed, and can be challenged on three grounds: principles of international law, such the doctrine of permanent sovereignty over natural resources, which could render the clauses invalid and inapplicable; constitutional obligations, such as the UK constitutional principles prohibiting a sitting parliament from fettering the action of a future parliament, and connected doctrines of ‘executive necessity;’ contract law principles such as *imprévision*, *force-majeure*, changed circumstances, etc. The case law on stabilisation clauses is extensive; some of the awards that dealt with them are: *Texaco Overseas Petroleum Co. and California Asiatic Oil Co. v. Libya* (1977), 53 *I.L.R.* 389; (1978) 17 *I.L.M.* 1; *Kuwait v. American Independent Oil Co.* (1982), 21 *I.L.M.* 976; *Amoco International Finance Corp. v. Government of the Islamic Republic of Iran* (1987), *Iran-USCTR* 189; *Libyan American Oil Company v. Government of the Libyan Arab Republic* (1981), 20 *I.L.M.* 1; *Revere Copper & Brass Inc v. Overseas Private Investment Corp.*, 56 *ILR* 258 (1978); *Waste Management Inc. and the United Mexican States* (ICSID Case No. ARB/00/3), Award, 30 April 2004; *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines* (ICSID Case No. ARB/02/6), Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004; *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan* (ICSID Case No. ARB/01/13), Decision of the Tribunal on Objections to Jurisdiction, 6 August 2003; *Eureko B.V. v. Poland*, Partial Award, 19 August 2005; *Siemens A.G. v. the Argentine Republic* (ICSID Case No. ARB/02/8), Decision on Jurisdiction, 3 August 2003; *LG&E Energy Corp. v. the Argentine Republic* (ICSID Case No. ARB/02/01), Award, 25 July 2007; *Sempra Energy Int’l v. the Argentine Republic* (ICSID Case No. ARB/02/16), Award, 28 September 2007; *El Paso Energy International Company v. the Argentine Republic* (ICSID Case No. ARB/03/15), Decision on Jurisdiction, 27 April 2007; *Enron Corp. v. the Argentine Republic* (ICSID Case No. ARB/01/3), Decision on Jurisdiction, 2 August 2004; *Joy Mining Machinery Ltd. v. Egypt* (ICSID Case No. ARB/03/11), Award, 6 August 2004; *CMS Gas Transmission Co. v. Argentine Republic* (ICSID Case No. ARB/01/8), Award, 12 May 2005; *Noble Ventures, Inc. v. Romania* (ICSID Case No. ARB/01/11), Award, 12 October 2005; *Aguaytia Energy, LLC v. Republic of Peru* (ICSID Case No. ARB/06/13), Award, 11 December 2008; *Duke Energy International Peru Investments*

concession contracts for oil and gas exploration (and other activities of high environmental impact, such as mining). While these standards are applicable to the investor as per contractual agreement, liability can be problematic, as the standards-issuing agencies do not accept any liability for reliance on them by investors<sup>79</sup>. Therefore, using these standards as ‘benchmarks’ for international contracts presents risks for the host state, as well as potentially for the investor.

Domestic environmental legislation and ratification of international environmental instruments are ways in which host states can regulate the activity of investors and reduce negative environmental externalities; while not discounting the efficacy of these actions, investors can avail themselves of the protection of investment law to counteract potentially damaging regulatory intervention by the host state in two ways. The already mentioned stabilisation clauses contained in investment contracts, especially the so-called ‘freezing clauses’<sup>80</sup> can at the very

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*No. 1 Ltd. V. Republic of Peru* (ICSID Case No. ARB/03/28), Award on the Merits, 18 August 2008.

<sup>79</sup> Cameron, P.D. , ‘Stabilisation in investment contracts and changes of rules in host countries: tools for oil & gas investors’, Final report for the Association of International Petroleum Negotiators, 5 July 2006. See also Verhoosel, G., ‘Foreign direct investment and legal constraints on domestic environmental policies: striking a “reasonable” balance between stability and change’, 30 *Law and Policy in International Business* (1998).

<sup>80</sup> The GOVERNMENT hereby undertakes and affirms that at no time shall the rights (and the full and peaceful enjoyment thereof) granted by it under this Agreement be derogated from or otherwise prejudiced by any Law or by the action or inaction of the GOVERNMENT, or any official thereof, or any other Person whose actions or inactions are subject to the control of the GOVERNMENT. In particular, any modifications that could be made in the future to the Law as an effect on the Effective Date shall not apply to the CONCESSIONAIRE and its Associates without their prior written consent, but the CONCESSIONAIRE and its Associates may at any time elect to be governed by the legal and regulatory provisions resulting from changes made at any time in the Law as in effect on the Effective Date. In the event of any conflict between this Agreement or the rights, obligations and duties of a Party under this Agreement, and any other Law,

least effectively prevent the progressive interpretation of the law, and, in the worst cases, completely relieve investors from compliance with environmental legislation above the standard required by the contract<sup>81</sup>. Stabilisation clauses have been proposed as a way to avoid: ‘creeping expropriation [such as] progressive labour legislation, [and] change in the legal or regulatory requirements [including] changes in environmental law...[and political risk including] war, civil unrest, terrorists attack and NGO interference with investment or property rights [which] will obviously affect the smooth running of the contract and its stability’<sup>82</sup>. From the point of view of the host state, the drawback is in the risk

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including administrative rules and procedures and matters relating to procedure, and applicable international law, then this Agreement shall govern the rights, obligations, and duties of the Parties.’ This clause was from an investment contract with a sub-Saharan country; text from the *International Finance Corporation Report on Stabilization Clauses and Human Rights*, published on 11 March 2008; available at [http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p\\_StabilizationClausesandHumanRights/\\$FILE/Stabilization+Paper.pdf](http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p_StabilizationClausesandHumanRights/$FILE/Stabilization+Paper.pdf). On stabilisation clauses and the environment, see Cotula, L., *Regulatory Takings, Stabilization Clauses and Sustainable Development*, 2008, available at <http://www.oecd.org/dataoecd/45/8/40311122.pdf>. See also, Cotula, L., ‘Pushing the boundaries vs. striking a balance: The scope and interpretation of stabilization clauses in light of the *Duke v. Peru* Award, 11 *JWI&T* (2010): 27 (especially at 42-3, where Cotula mentions the 2007 Model Host Government Agreement for Cross-Border Pipelines, drafted by the Energy Charter Secretariat, which includes an economic equilibrium clause with an exception for environmental standards. Cotula reports that the clause was included ‘following proposals from the EU Commission, which was concerned that a broader stabilization clause may make it more difficult for EU member states to comply with social and environmental measures adopted at the EU level’).

<sup>81</sup> This standard can be tied to industry standards and therefore evolve independently from domestic legislation (but with the liability problems outlined in the previous section); if not, it will be a standard of decreasing normative value, the more it is left behind compared to evolving domestic legislation. Finally, standards can be tied to other international standards, for example European Union legislation for concession contracts in CIS countries, with an unpleasant element of ‘environmental hegemonism’.

<sup>82</sup> Nwete, B.O.N., ‘To what extent can stabilization clauses mitigate the investor’s risks in a production sharing contract?’, 3 *Oil, Gas & Energy Law Intelligence* (2005): 12.

incurred in case of an environmental disaster in which local citizens might have their right to a remedy curtailed by the presence of a stabilisation clause of the sort quoted above<sup>83</sup>, with the consequence that the remedies accorded by the legislation applicable at the time of the accident might not apply<sup>84</sup>. The deficiency in remedies is particularly troubling since it has been reported that: ‘...contracts from non-OECD countries are more likely than those from OECD countries to insulate the investor from new social and environmental laws or to provide compensation to the investor for compliance with new social and environmental laws’<sup>85</sup>.

Stabilisation clauses can be ‘operationalised’ by treaty-based umbrella clauses<sup>86</sup>. A widely worded umbrella clause, which commits the host

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<sup>83</sup> On the subject of market allocation of costs, see Oren Perez’s example: ‘The response of the *lex constructionis* to the construction-environmental dilemma is ... based primarily on a strategy of deference, which seeks to externalize the responsibility for regulating the environmental aspects of the construction activity to the ‘extra-contractual’ realm of the law of the host-state...The notion of “efficient risk allocation” further illustrates how this logic of externalization operates. In order to maximise its economic value the contract is expected to provide the parties with an efficient risk allocation scheme. This should be achieved by allocating particular risks to the party best able to manage them.’ Perez, 2004: 178. On risk management strategies, see ‘Concluding remarks’ in this chapter.

<sup>84</sup> This very point was brought up in the context of the Production Sharing Agreement for the Baku – Tbilisi – Ceyhan Pipeline Project; see *Striking a Balance: Intergovernmental and Host Government Agreements in the Context of the Baku – Tbilisi – Ceyhan Pipeline Project*, a publication of the European Bank for Reconstruction and Development, available at <http://www.ebrd.com/pubs/legal/lit042e.pdf>.

<sup>85</sup> *Stabilization Clauses and Human Rights*, A research project conducted for IFC and the United Nations Special Representative to the Secretary General on Business and Human Rights, 2008: xi; at [www.ifc.org/ifcext/enviro.nsf](http://www.ifc.org/ifcext/enviro.nsf).

<sup>86</sup> See for example how Seidl-Hohenveldern, I., *International Economic Law*, Dordrecht, Kluwer Law International, 1999: 154, explains the function of umbrella clauses: ‘Investment protection treaties therefore contain a clause whereby the host State promises to the home State of the investor that it will respect the agreements



state to compliance with any obligation it has entered with respect to the investment, can elevate a contractual breach to an actionable breach of treaty. There are several objections to the wide applicability of umbrella clauses, which need not be reviewed here; but the concern has been expressed that umbrella clauses might function as a ‘closet stabilisation clause’. While we share the criticism on a simplistic equivalence which has been expressed elsewhere<sup>87</sup>, the fact remains that, if there is an express stabilisation in the contract, the umbrella clause can have a freezing effect<sup>88</sup>. In other words, the umbrella clause in the treaty might allow the linkage between contract and treaty, to the effect that a violation of any of the terms of the contract will entail a violation of the umbrella clause in the treaty, with the consequences for the applicable law, responsibility of the state and its liability for damages<sup>89</sup>.

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concluded with the investor. These clauses have led such treaties to be called “umbrella treaties.” After their conclusion there can be no longer any doubt that any unilateral impairment of the economic investment contract concerned will also be an international delinquency, as it violates this umbrella treaty.’

<sup>87</sup> Crawford, J., ‘Treaty and contract in investment arbitration’, *The 22<sup>nd</sup> Freshfields Lecture on International Arbitration*, London, 29 November 2007, at 20.

<sup>88</sup> If it is also accepted that the clause can have the jurisdictional power to elevate the contractual claim, and therefore the contractual stabilisation obligation, to the level of an international breach. Two conflicting awards on the reach of umbrella clauses are *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan* (ICSID Case No. ARB/01/13), Decision of the Tribunal on Objections to Jurisdiction, 6 August 2003, and *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines* (ICSID Case No. ARB/02/6), Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004.

<sup>89</sup> The traditional debate over the strength of stabilisation clauses took place in the 1960s and 1970s in the context of the nationalisation programmes by newly independent countries. The debate has now moved to the strength of umbrella clauses; given the vulnerability of stabilisation clauses to sovereignty-based exceptions, umbrella clauses in BITs have become more popular. Any treaty obligation is legally binding on states, as an attribute of their sovereignty, rather than in tension with it, like the contract-based stabilisation clauses. Nonetheless, they do have the effect of transforming contracts-breaches into treaty-breaches, fulfilling the function of the old stabilisation clauses (see *Wimbledon Case*, PCIJ Series A No.1: ‘The Court declines to

International environmental instruments can create enforceable obligations, but present problems of compliance and attribution of responsibility. Conflicting investment obligations can prevent the host states from enforcing the environmental treaty. Furthermore, as treaties are binding upon states, attributing responsibility for environmental treaty violations on the home state of the investor for the conduct of its nationals abroad is problematic. To what extent the home state is responsible for breaches of international law by its own nationals is a matter of debate: in the first instance, the issue is one of attribution of responsibility to the perpetrator, normally a multinational corporation. In that case, can investors be prosecuted in their own country? The application of the *forum non conveniens* doctrine could restrict prosecution to the host state and might result in a lower *quantum* of damages for the victims<sup>90</sup>.

Recent developments in the direction of domestic criminal responsibility for environmental obligations have been taking place at the European level<sup>91</sup>, with a greater margin of appreciation being granted to states using their domestic criminal codes to pursue violators of environmental

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see in the conclusion of any treaty by which a State undertakes to perform or refrain from performing a particular act an abandonment of its sovereignty ... the right of entering into international engagements is an attribute of state sovereignty.’).

<sup>90</sup> As was the case for the Bhopal disaster; the literature on this case is quite extensive; for a recent, well referenced contribution, see Eckerman, I., *The Bhopal Saga - Causes and Consequences of the World's Largest Industrial Disaster* Hyderabad, Universities Press, 2005. For a case in which the doctrine was not applied, and also liability for duty of care by a parent company for its subsidiaries abroad was accepted in principle by the House of Lords, see *Lubbe and Others and Cape Plc. and Related Appeals* [2000] UKHL 41; [2000] 4 All ER 268; [2000] 1WLR 1545 (20<sup>th</sup> July 2000).

<sup>91</sup> Convention on the Protection of the Environment through Criminal Law (ETS No. 172), which has been signed by twelve European countries since 1998, but only ratified by one, Estonia, and therefore has not entered into force yet (3 ratifications being necessary).

law in compliance with their international obligations<sup>92</sup>. Additionally, some national systems allow civil suits to be brought for violations of some norms of international law (for example the Alien Tort Claims Act [ATS] in the United States<sup>93</sup>). However, this statute only covers

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<sup>92</sup> In *Mangouras v. Spain*, ECtHR, Application No. 12050/04, Judgment, 28 September 2010, (Mangouras' ship was involved in an oil spill which resulted in catastrophic environmental damage), the Court ruled that a bail amount set at 3 million euros was not a violation of Article 5(3) of the Convention; the Court stated that: '...the Court cannot overlook the growing and legitimate concern both in Europe and internationally in relation to environmental offences... It cannot therefore be ruled out that, in a situation such as that in the present case, the professional environment which forms the setting for the activity in question should be taken into consideration in determining the amount of bail, in order to ensure that the measure retains its effectiveness....the Court points out that the facts of the present case – concerning marine pollution on a seldom-seen scale causing huge environmental damage – are of an exceptional nature and have very significant implications in terms of both criminal and civil liability.'

<sup>93</sup> 28 U.S.C. § 1350; see for example *John Doe I et al. vs. Unocal Corp. et al. and John Roe III et al. vs. Unocal Corp. et al.* (Case Nos. BC 237 980 and BC 237 679) Superior Court of California; all legal documentation is available at the website of the NGO Earth Rights, which acted as counsel for the plaintiffs:

<http://www.earthrights.org/files/Legal%20Docs/Unocal/PlaintiffMSARuling.pdf>. The plaintiffs made recourse to the *Alien Tort Claims Act* of 1789 (the case has been settled by the parties, see 403 F.3d 708 (2005)). See also Koebele, M., 'Corporate responsibility under the Aliens Tort Statute', 10 *Human Rights Law Review* (2010): 383; Buxbaum, R. M. and Caron, D. D. , 'The Alien Tort Statute: An overview of the current issues', 28 *Berkeley Journal of International Law* (2010): 513; see also *Beanal v. Freeport-McMoran Inc.*, at the United States District Court, E.D. Louisiana, 969 F.Supp. 362 (1997), where the court stated: 'A corporation found to be a state actor can be held responsible for human rights abuses which violate international customary law.' (However on the facts the case was dismissed, and the judgment was affirmed by the United States Court of Appeal, in *Beanal v. Freeport-McMoran Inc.*, 197 F.3d 161 (5<sup>th</sup> Cir. 1999)). The land-mark case for this Statute is *Filártiga v. Peña-Irala*, 630 F.2d 876 (2<sup>nd</sup> Cir. 1980) in which jurisdiction was accepted on the grounds of torture being covered by universal jurisdiction. On the issues arising from the applicability of the Aliens Tort Statute for international law violations and investors liability in that respect, see Ramsey, M. D., 'International law limits on investor liability in human rights litigation', 50 *Harvard International Law Journal* (2009): 271. The Supreme Court has only heard one Aliens Tort case, *Sosa v. Alvarez-Machain et al.*, 542 U.S. 692 (2004).

customary law violations; furthermore very recent case law in the United States suggests that the courts have become much less willing to find against corporations in civil liability suits under the ATS<sup>94</sup>.

Sornarajah argued that, ‘... in circumstances in which the environmental harm is prohibited both by the host state’s law and by international environmental law, there arises a duty on the part of the home state to ensure that there is compliance by its corporate national making the foreign investment’<sup>95</sup>. The argument rests both on the obligation of the foreign national to respect the laws of the host state and of the duty of the home state to withdraw its protection (including diplomatic protection and espousal of claim<sup>96</sup>) from its national guilty of causing environmental harm. The United States regularly applies extra-territorial jurisdiction in cases of anti-trust or trade law<sup>97</sup> but no general rule of

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<sup>94</sup> See *Kiobel v. Royal Dutch Petroleum*, United States Court of Appeal, 06-4800-cv, 06-4876-cv, (2<sup>nd</sup> Cir.17 September 2010), in which the Court argued that: ‘Because customary international law consists of only those norms that are specific, universal, and obligatory in the relations of States *inter se*, and because no corporation has ever been subject to *any* form of liability (whether civil or criminal) under the customary international law of human rights, we hold that corporate liability is not a discernable—much less universally recognized—norm of customary international law that we may apply pursuant to the ATS. Accordingly, plaintiffs’ ATS claims must be dismissed for lack of subject matter jurisdiction.’

<sup>95</sup> Sornarajah, 2004: 180.

<sup>96</sup> To the extent that it is relevant in investment law, where diplomatic protection is at most considered residual with respect to the system of independent investors’ standing guaranteed by investment treaties.

<sup>97</sup> For example through *The Cuban Liberty and Democratic Solidarity (Libertad)* Act of 1996 (*Helms–Burton Act*, Pub.L. 104-114, 110 Stat. 785, 22 U.S.C. § 6021–6091) and the *Iran and Libya Sanctions Act* of 1996 (D’Amato Act, Pub. L. 104–172, 110 Stat. 1541, 50 U.S.C. § 1701); see also Sornarajah, 2004: 184 ff. The Helms-Burton Act was invoked against Costa Rica in the *Santa Elena Case*, which resulted in the delay of an Inter-American Development Bank loan to the country until it consented to arbitration, see *Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica* (ICSID Case No. ARB/96/1), Award, 17 February 2000: §§ 24-25.

international law has developed in the field of human rights, labour or environmental law to assure respect of home state norms by multinational corporations. In some environmental law instruments, responsibility for the conduct of nationals abroad is accepted. An example is the Basel Convention<sup>98</sup>, which holds the home state of the carrier of hazardous waste responsible for breaches of the treaty. The jurisdictional objection can be resolved for violations of *ius cogens* rules, where universal jurisdiction is applicable, but no norms of international environmental law are considered to have this status.

Finally, the role of home states in ensuring compliance with their own environmental legislation abroad is equally problematic<sup>99</sup>. There is in principle no bar in international law to the home state applying the nationality principle of jurisdiction to hold a corporation accountable for violations of domestic environmental legislation<sup>100</sup>. However, several difficulties arise: for example, corporate nationality cannot always be easily ascertained<sup>101</sup>. Furthermore, jurisdictional conflicts might arise:

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<sup>98</sup> Basel Convention on the Control of Transboundary Movement of Hazardous Wastes and Their Disposal (1989) 28 *ILM* 657.

<sup>99</sup> The issues arising from alleged violations of human rights laws are different: in the case of environmental law violations we are usually dealing with *direct liability* of the investor for *domestic law* violations (and sometimes environmental treaties) and the problem might be in the inadequacy of the domestic standards of remedies on one side and the reach of the stabilisation clause in the concession agreement on the other; for breaches of human rights law usually it is *indirect liability* of the investors for violations of *international law* to be raised, as human rights law violations are governmental in character.

<sup>100</sup> See Sands, 2003: 239.

<sup>101</sup> The first ICSID case in which a jurisdictional objection based on the nationality of the investor was raised is *Holiday Inns v. Morocco* (ICSID Case No. ARB/72/1); the award has not been published, but for a review, see Lalive, P., 'The first World Bank Arbitration (*Holiday Inns v. Morocco*) – Some legal problems', 51 *BYIL* (1980): 123. Some other older awards dealing with nationality are *Amco v. Indonesia* (ICSID Case No. ARB/81/1), Decision on Jurisdiction, 25 September 1983, 23 *ILM* 351 (1984); *Klöchner v. Cameroon* (ICSID Case No. ARB/81/2), Award, 21 October 1983, 19

the host state might also want to assert jurisdiction if the investor's actions are unlawful under domestic law. Issue of anti-competitive practices might be raised, as well as of trade-distorting practices. Finally, as a matter of political expedience, the home state might have no interest in pursuing a claim against a powerful multinational corporation for the violation of an environmental regulation that has no detrimental effect in its own territory.

A potential remedy to the problems of prosecuting foreign investors domestically for violations of international environmental law, applicable in case of trans-boundary environmental damage, is the recourse to

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*Revue de l'arbitrage* (1984) (excerpts); see also Decision of the Ad Hoc Committee, 3 May 1985 (at <http://icsid.worldbank.org/ICSID/>); *Letco v. Liberia* (ICSID Case No. ARB/83/2), Award, 31 March 1986 and Rectification, 17 June 1986, 26 *ILM* 647 (1987); *SOABI v. Senegal* (ICSID Case No. ARB/82/1), Award, 25 February 1988 and its attachments, 117 *Journal du droit international* (1990): 192 (excerpts); see also Sinclair, A. C., 'Nationality of individual investors in ICSID arbitration', 6 *International Arbitration Law Review* (2004): 194: 'Investment promotion and protection treaties are designed to create a mechanism of direct recourse to arbitration against the host state, independent of any need for further intervention by the investor's home state. The bond of nationality appears to have diminished in significance to a mere formality.' A relevant application of this is in *Aguas del Tunari S.A. v. Republic of Bolivia* (ICSID Case No. ARB/02/3), Decision on Respondent's Objection to Jurisdiction, 21 October 2005, 20 *ICSID Rev* (2005): 450. See also *Wagui Elie George Siag and Clorinda Vecchi v. Arab Republic of Egypt* (ICSID Case No. ARB/05/15), Award, 1 June 2009; for the opposite approach, see the Dissenting Opinion of Prosper Weil in *Tokios Tokéles v. Ukraine* (ICSID Case No. ARB/02/18), Decision on Jurisdiction, 29 April 2004; *TSA Spectrum de Argentina, S.A. v. Argentine Republic* (ICSID Case No. ARB/05/5), Award, 19 December 2008 and Concurring Opinion of Judge Abi-Saab; the more restrictive approach proposed by Weil and adopted by the TSA Tribunal was rejected in *The Rompetrol Group N.V. v. Romania* (ICSID Case No. ARB/06/3), Decision on Jurisdiction and Admissibility, 18 April 2008, and *Victor Pey Casado and President Allende Foundation v. Republic of Chile* (ICSID Case No. ARB/98/2), Award, 8 May 2008.

international arbitration<sup>102</sup>. There is an historic precedent to this, the *Trail Smelter Case*<sup>103</sup>, which involved the effect in the State of Washington of the fumes discharged from smelting activities taking place across the border in British Columbia. The Tribunal, constituted by agreement of the parties to the dispute, famously stated that<sup>104</sup>:

[...] under the principles of international law, as well as of the law of the United States, no State has the right to use or permit the use of its territory in such a manner as to cause injury by fumes in or to the territory of another or the properties or persons therein, when the case is of serious consequence and the injury is established by clear and convincing evidence.

While according to Sands<sup>105</sup>, ‘...there is growing evidence to support the view that states view arbitration as an attractive means of resolving international disputes’, they certainly do not run in the numbers we have grown accustomed to for investment arbitration. Since the acknowledged weakness of the international environmental regime is in its enforcement power, there should be space of arbitrations to take place in order to remedy the damage caused by violations of environmental law. There will be differences in the applicable law (the *Trail Smelter* Tribunal applied only general principles of international law, as also reflected in US law) but these need not influence the choice of remedies, provided there is agreement between the parties and the treaty allows for

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<sup>102</sup> See for example Rosenberg, M. and Cheah, M., ‘Arbitrating environmental disputes’, 16 *ICSID Review* (2001): 39.

<sup>103</sup> *Trail Smelter Arbitration* (1938/1941), 3 *R.I.A.A.* 1905.

<sup>104</sup> *Ibidem*: 1965. The Tribunal established the ‘polluter pays principle’ for which see also Principle 16 of the Rio Declaration on Environment and Development of 1992: ‘National authorities should endeavour to promote the internalization of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the cost of pollution, with due regard to the public interest and without distorting international trade and investment.’ Available at <http://www.un.org/documents/ga/conf151/aconf15126-1annex1.htm>.

<sup>105</sup> Sands, 2003: 213.

arbitration<sup>106</sup>. A recent arbitration that included an environmental element resulted in the *Iron Rhine Award*<sup>107</sup>, where the applicable law was international law and European law, and where the Tribunal accepted that international environmental law principles (which it held to be part of general international law) have a role to play in ‘the interpretation of those treaties in which the answers to the Questions may primarily be sought’<sup>108</sup>. However, this arbitration, as well as the *MOX Plant Case*<sup>109</sup>, which was suspended awaiting the decision at the ECJ<sup>110</sup>, initiated pursuant to the United Nations Convention on the Law of the Sea (UNCLOS), contains an environmental element, rather than being based on an alleged breach of an environmental instrument<sup>111</sup>.

Institutional settings, such as international courts, also have their drawbacks. There is not at present an international court with exclusive

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<sup>106</sup> Movements in this direction are the adoption in 2001 of the Permanent Court of Arbitration’s Optional Rules for the Arbitration of Disputes Relating to the Environment and/or Natural Resources (at [http://www.pca-cpa.org/showpage.asp?pag\\_id=1058](http://www.pca-cpa.org/showpage.asp?pag_id=1058)) and the establishment in 2003 of the International Court of Environmental Arbitration and Conciliation (<http://iceac.sarenet.es/>) in Mexico. Numerous environmental treaties contain an arbitration clause (for list, see Sands, 2003: 212).

<sup>107</sup> *Iron Rhine (Ijzeren Rijn) Railway (Belgium v. Netherlands)* 24 May 2005, Permanent Court of Arbitration, Award available at [http://www.pca-cpa.org/showpage.asp?pag\\_id=1155](http://www.pca-cpa.org/showpage.asp?pag_id=1155).

<sup>108</sup> Award, § 60.

<sup>109</sup> *Ireland v. United Kingdom*, Permanent Court of Arbitration, proceedings available at [http://www.pca-cpa.org/showpage.asp?pag\\_id=1148](http://www.pca-cpa.org/showpage.asp?pag_id=1148).

<sup>110</sup> *Commission v. UK and Ireland*, Case C-459/03. Judgment was rendered on 30 May 2006. The proceedings at the PCA were officially terminated, by request of Ireland, on 6 June 2008, see Press Release at [http://www.pca-cpa.org/showpage.asp?pag\\_id=1148](http://www.pca-cpa.org/showpage.asp?pag_id=1148).

<sup>111</sup> However artificial this distinction might be: Sands argued that it is better to talk about disputes having an environmental component rather than environmental disputes, see ‘Litigating environmental disputes: courts, tribunals and the progressive development of international environmental law’, *OECD Global Forum on International Investment*, 27-28 March 2008: 6, at [www.oecd.org/investment/gfi-7](http://www.oecd.org/investment/gfi-7).



jurisdiction for violations of international environmental law<sup>112</sup>; there are arguments pro- and against the existence of such a court and especially the extent of its jurisdiction, given the risk of overlap with other courts, inconsistency of judgments, with resulting fragmentation and lack of coherency, and also more practical problems of ‘forum shopping’<sup>113</sup>. These might of course all be ‘straw men’ or in other words, false problems, based on the premise that fragmentation is in principle bad. Opposite arguments could be made in defence of the proliferation of courts as a guarantee of the dynamism and diversity of the international legal system, with specialised expertise developing and coherence guaranteed by the deference international courts and tribunals normally grant each other (if nothing else based on a shared background)<sup>114</sup>, even if the argument cannot carry on itself the weight of the opposite criticism of structural bias of the individual functional regimes<sup>115</sup>. The International Court of Justice, which is empowered to hear ‘all legal disputes’ concerning international treaties and any question of international law<sup>116</sup>, established a Chamber for Environmental Matters in July 1993<sup>117</sup>; however, this specialised chamber has never had a case

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<sup>112</sup> See Hinde, S. M., ‘The international environmental court: its broad jurisdiction as a possible fatal flaw’, 32 *Hofstra Law Review* (2004): 727.

<sup>113</sup> *Fragmentation Report*: 247; see also Simma, B., ‘Universality of international law from the perspective of a practitioner’, 20 *EJIL* (2009): 278 ff.

<sup>114</sup> For a sociological analysis of the commercial arbitration community and how legal institutions can work to internationalise law (or a certain version of it), see Dezalay and Garth, 1996.

<sup>115</sup> A positive appraisal of the ‘specialisation’ of international law also in Wälde, T., ‘Interpreting Investment Treaties, Experiences and Examples’, in: Binder *et al.*, 2009: 724, at 769 ff. See also Gaffney, J.P., ‘Going to Pieces without Falling Apart: Wälde’s Defence of “Specialisation” in the Interpretation of Investment Treaties’, in Werner, J., Ali, A.H., (eds.), *A Liber Amicorum: Thomas Wälde*, London, CMP Publishing, 2009: 55, at 56.

<sup>116</sup> Statute of the Court of International Justice, Article 36, available at <http://www.icj-cij.org/documents/index.php?p1=4&p2=2&p3=0>.

<sup>117</sup> Pursuant to Article 26(1).

brought before it<sup>118</sup> and seems now not to have a role anymore. The ICJ has yet to issue a judgment for a breach of an environmental treaty obligation<sup>119</sup>, but there have been cases in which the Court has been asked to consider environmental issues relevant to the dispute. We will analyse one recent case in Chapter 5; in here we would like to point out a more general issue that arose from the latest ICJ Judgment in the *Pulp Mills Case*<sup>120</sup>: this case raised very complex issues of fact around the scientific evidence presented by the Parties in connection with the construction of the pulp mills by Uruguay and the supposed environmental damage claimed by Argentina. In their Joint Dissenting Opinion, Judges Al-Khasawneh and Simma argued that the Court should have availed itself of the help of experts, as allowed by Article 50 of the Statute of the Court<sup>121</sup>, in order to assess the reliability and soundness of the scientific evidence. The Opinion correctly pointed out three problems resulting from the approach of the Court: the tension between scientific

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<sup>118</sup> On the role of the ICJ in the development of international environmental law, see Viñuales, J. E. , ‘The contribution of the International Court of Justice to the development of international environmental law: a contemporary assessment’, 32 *Fordham International Law Journal* (2008-2009): 232; Sands, P., ‘Litigating environmental disputes: courts, tribunals and the progressive development of international environmental law’, *OECD Global Forum on International Investment*, 27-28 March 2008, available at [www.oecd.org/investment/gfi-7](http://www.oecd.org/investment/gfi-7).

<sup>119</sup> But this will change with two new cases to be decided by the Court: in *Aerial Herbicide Spraying (Ecuador v. Colombia)*, Ecuador instituted proceedings on 1 April 2008 against Colombia for ‘aerial spraying of toxic herbicides at locations near, at and across its border with Ecuador’ which ‘has already caused serious damage to people, to crops, to animals, and to the natural environment on the Ecuadorian side of the frontier’ (*Aerial Herbicide Spraying (Ecuador v. Colombia)*, Order of 30 May 2008, I.C.J. Reports 2008, p. 174); in *Whaling in Antarctic (Australia v. Japan)*, Australia instituted proceedings on 1 June 2010 against Japan for an alleged breach of the International Convention for the Regulation of Whaling and other international conventions for the preservation of the marine environment (at <http://www.icj-cij.org/docket/index.php?p1=3&p2=3&k=64&case=148&code=aj&p3=6>).

<sup>120</sup> *Pulp Mills on the River Uruguay* (Uruguay v. Argentina), Judgment, 20 April 2010.

<sup>121</sup> See § 8 of the Opinion.

facts and the standard of legal evidence in environmental cases; the role of the Court in tackling this tension in a transparent way; and the relationship between procedural and substantive obligations. The tension between legal facts and scientific facts is real and ought to be taken into account, even if not too much faith should be uncritically given to ‘experts’ or to the ‘objective’ nature of scientific facts<sup>122</sup>; even then, it certainly cannot be summarily dismissed as the Court seems to have done<sup>123</sup>. On the second point, the judges argued that the court did not engage in good practice and that ‘[t]ransparency and procedural fairness are important because they require the Court to assume its overall duty for facilitating the production of evidence and to reach the best representation of the essential facts in a case, in order best to resolve a dispute’<sup>124</sup>. Finally, on the third point, the dissenting judges noted<sup>125</sup>:

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<sup>122</sup> The political use of scientific facts is never more evident than in the application of the ‘precautionary principle’ (Principle 15 of the Rio Declaration on Environment and Development); for an interesting account of how these issues are dealt with in practice, see Castleman, B., ‘WTO confidential: the case of asbestos’ at <http://hesa.etui-rehs.org/uk/default.asp>.

<sup>123</sup> As seems to transpire from § 168 of the Judgment: ‘As for the independence of such experts, the Court does not find it necessary in order to adjudicate the present case to enter into a general discussion on the relative merits, reliability and authority of the documents and studies prepared by the experts and consultants of the Parties. It needs only to be mindful of the fact that, despite the volume and complexity of the factual information submitted to it, it is the responsibility of the Court, after having given careful consideration to all the evidence placed before it by the Parties, to determine which facts must be considered relevant, to assess their probative value, and to draw conclusions from them as appropriate. Thus, in keeping with its practice, the Court will make its own determination of the facts, on the basis of the evidence presented to it, and then it will apply the relevant rules of international law to those facts which it has found to have existed.’

<sup>124</sup> At § 14.

<sup>125</sup> At § 26. See also the illuminating comments by Simma and Pulkowski, 2006: 503 at footnote 96: ‘In an attempt to maximise its own rationality, the legal system attempts to resolve conflicts within its own operation, at the expense of, say, the political system....the *crux* of the fragmentation of international law lies precisely in this inner tension.’

... in matters related to the use of shared natural resources and the possibility of transboundary harm, the most notable feature [...] is the extreme elasticity and generality of the substantive principles involved. Permanent sovereignty over natural resources, equitable and rational utilization of these resources, the duty not to cause significant or appreciable harm, the principle of sustainable development, etc., all reflect this generality. The problem is further compounded by the fact that these principles are frequently, where there is a dispute, in a state of tension with each other. Clearly in such situations, respect for procedural obligations assumes considerable importance and comes to the forefront as being an essential indicator of whether, in a concrete case, substantive obligations were or were not breached.

Similarly, the generality and vagueness of the substantive provisions relative to investment protection is sometimes decried as introducing an unwelcome element of uncertainty in the law, especially because, contrary to the statute applied by the court in this case, investment treaties normally accompany the vagueness of the substantive provisions with an absence of specific procedural obligations<sup>126</sup>. The vagueness and indeterminacy of the substantive obligations must be taken as intentional (which does not mean that it cannot have unintended consequences) and is made to work to the advantage of the investor more often than not; however, the same indeterminacy brings with it the possibility to incorporate, by means of interpretation and systemic integration, non-investment obligations<sup>127</sup>.

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<sup>126</sup> With some exceptions, for example the establishment of ‘contact points’ as a way to implement the transparency obligations with respect to investors, see Article 11(1) of the US Model BIT 2004, at [www.state.gov/documents/organization/117601.pdf](http://www.state.gov/documents/organization/117601.pdf).

<sup>127</sup> The openness of the system has to allow for rules that are not necessarily to the advantage of the investor to be taken into account; for the argument that either all is in, or nothing is (except of course expressed exclusions in the treaty), see van Aaken, art. cit., 5. Also Klabbers, J., ‘Reluctant grundnormen: Articles 31(3)(c) and 42 of the Vienna Convention on the Law of Treaties and the fragmentation of international law, in Craven, M., Fitzmaurice, M. and Vogiatzi, M. (eds.), *Time, History and International Law*, Leiden, Brill, 2007: 141, at 161: ‘...the interpreter can literally include anything – or, as the case may be, exclude things’. Of course this is the risk of openness, that is, that it is a two-way street. When substantive exclusion is accompanied by procedural opaqueness, the risks are even higher.

## 2.5 Regulation as risk

What do we mean when we talk about ‘greening investment law’? It really depends on who does the greening.... States can do this, by implementing environmental legislation or concluding investment treaties that incorporate their environmental commitments; investors could do this, by taking the environment into account in their practices<sup>128</sup>; tribunals should do this, if they are serious about their obligation to apply investment law ‘in context’, that is, within the framework of general international law, including environmental instruments and principles.

There are risks involved in regulating investment and environment, and to the extent that host states are free to take political decisions (if one disregards political and economic constraints to act one way or the other, that is, the pressure to enter into bilateral investment agreements, on one side, or conversely, to sign up to international environmental agreements or respect environmental standards tied to the release of investment funds by the World Bank), they also need to adopt risk management strategies<sup>129</sup>. Both sets of decisions, by definition, involve an element of risk taking (if risk, as opposed to danger, is defined as what happens when ‘losses that may occur in the future are attributed to decisions made’<sup>130</sup>).

When states decide whether to conclude a BIT, they have to weigh the

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<sup>128</sup> As we have previously noted that investors are rules producers as well as rules followers. For a policy centred approach, see Neumayer, E., *Greening Trade and Investment: Environmental Protection without Protectionism*, London, Earthscan Publications, 2001.

<sup>129</sup> For risk management as the underlying rationale of regulatory expropriation cases, see also Newcombe, A., ‘The boundaries of regulatory expropriation in international law’, 20 *ICSID Review* (2005): 1.

<sup>130</sup> Luhmann, N., *Risk – A Sociological Theory*, 4<sup>th</sup> edition, London, Aldine Transaction, 2008: 101.

risk of international arbitration (with associated costs) against the risk of a reduction of investment flows<sup>131</sup>; this second risk is more difficult to assess, as even in the absence of a BIT there can be an increase of investment flows, provided other elements are in place, such a wealth of natural resources<sup>132</sup>. In deciding to implement environmental regulation,

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<sup>131</sup> Investors also have to balance the risk of investing in a particular country against those same regulatory elements (presence/absence of a good regulatory framework for investment protection, presence/absence of an effective environmental regulatory framework with connected costs). At least some tribunals have included the element of 'commercial risk' in the definition of investment for jurisdictional purposes (see for example *Bayindir Insaat Turizm Ticaret Ve Sanayi A.Ş. v Islamic Republic of Pakistan* (ICSID Case No. ARB/03/29), Decision on Jurisdiction, 14 November 2005, § 134. There is a considerable literature on the supposed effect of BITs on investment flows; for a positive appraisal, see Banga, R., *Impact of Government Policies and Investment Agreements on FDI Inflows*, Indian Council for Research and International Economic Relations, New Delhi, 2003; Neumayer, E. and Spess, L., 'Do bilateral investment treaties increase foreign direct investment to developing countries? 3 *World Development* (2005): 31; for a more sceptical approach see Tobin, J. and Rose-Ackerman, S., 'Foreign direct investment and the business environment in developing countries: the impact of bilateral investment treaties', *Yale Law and Economics Research Paper No. 293* (2005); Gallagher, K. P. and Birch, M.B.L., 'Do investment agreements attract investment? evidence from Latin America', 7 *JWI&T* (2006): 961; Guzmán, A. T., 'Explaining the popularity of BITs', *Jean Monnet Programme Papers*, 1997/12; Yackee, J. W., 'Are BITs such a bright idea: exploring the ideational basis of investment treaty enthusiasm' 12 *University of California Davis Journal of International Law & Policy* (2005-06): 195; Salacuse, J.W. and Sullivan, N.P., 'Do BITs really work? An evaluation of bilateral investment treaties and their grand bargain', 46 *Harvard International Law Journal* (2005): 67; Montt, S., 2009: Chapter 2.

<sup>132</sup> According to UNCTAD, *International Investment Rule-setting: Trends, Emerging Issues and Implications*, 2007: 6 (at [http://www.unctad.org/en/docs/c2d73\\_en.pdf](http://www.unctad.org/en/docs/c2d73_en.pdf)), 39% of BITs concluded as of June 2006 involved a developed and a developing country pairing; 26%, two developing countries; 13% developed countries and countries of South-Eastern Europe (SEE) and of the Commonwealth of Independent States (CIS, former Soviet Union); 10% developing countries and SEE-CIS countries; 4% SEE-CIS countries; only 8% developed countries signed treaties amongst themselves. Recent data on inflows of foreign investment (UNCTAD Investment Brief, No. 1 2007, *Foreign Direct Investment surged again in 2006*, at

host states have to assess the risk of lack of regulation, namely the risk of environmental damage mitigation<sup>133</sup> against the risk of regulation, specifically, the possible conflict with investment protection obligations; furthermore, environmental regulation might incur in the ‘regulatory trilemma’: regulation being ineffective, or destroying the regulated system (for example, by making economic development impossible) or destroying the regulatory system (for example, by creating a system of rules so complicated as to be impossible to implement, and therefore causing the regulatory system to seize up<sup>134</sup>). Therefore, the tension between the economic and the social is reflected in the incapacity of the regulatory system to translate legitimate social needs into enforceable norms against a hostile economic system, which reads everything in terms of profit (similarly, the commercial logic underlying investment arbitration fails to appreciate the difference between *economic damage* and *ecologic damage*<sup>135</sup>). Consequently, the structural coupling between law and investment reads any intervention in the social field as an

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[http://www.unctad.org/en/docs/iteiia misc20072\\_en.pdf](http://www.unctad.org/en/docs/iteiia misc20072_en.pdf)) show that the largest single recipient for foreign investment in 2006 was the United States, with the developed world experiencing a 48% increase; the European Union accounted for 46% of total investment inflows. While investment to the developed world was \$800 billion, for African countries was \$38 billion, mostly to oil-rich countries. The trend is for more investment in a developed-to-developed pairing than in a developed-to-developing one; in the first case, BITs make no difference, as there are few if any treaties signed between developed countries; in the second case, the flow of investment seems to follow resources and not BITs (as in the case of sub-Saharan countries).

<sup>133</sup> Deriving from the unintended consequences that flow from unregulated economic development.

<sup>134</sup> See Teubner, G., ‘Juridification: Concepts, Aspects, Limits, Solutions’, in Baldwin, R., Scott, C. and Hood, C. (eds.) *Socio-Legal Reader on Regulation*, Oxford, OUP, 1987.

<sup>135</sup> In a similar fashion, in the Dissenting Opinion issued with the Judgment in the *Pulp Mills Case*, Judges Simma and Al-Khasawneh noted: ‘the Court must remain aware, when confronted with challenges of risk of environmental pollution and endangerment of ecosystems, of the inherent weaknesses and flaws of the traditional retrospective judicial process and its compensatory logic.’ (At § 24).

economically disadvantageous proposition, which is then translated into a request for compensation, to re-establish the *economic equilibrium* of the investment<sup>136</sup>. Regulatory failure<sup>137</sup> here goes beyond inefficacy: it is not simply the case that environmental regulatory costs are passed on to the consumer without an improvement of the environment<sup>138</sup>; instead, the foreign investors externalise the cost of regulation by requiring to be compensated<sup>139</sup>. The tension is then interpreted as a cost allocation

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<sup>136</sup> This term is not used casually: the new-style stabilisation clauses in investment contracts are used to re-establish the economic equilibrium that might have been disrupted or negatively affected by regulatory action: what this means in practice is that a decrease in profit because of stricter regulation has to be compensated monetarily by the state. See for example the HGA (Host Government Agreement) for the Baku-Tbilisi-Ceyhan Pipeline Project: ‘The State Authorities [i.e. the host government, local authorities and state controlled or owned entities] shall take all actions available to them to restore the Economic Equilibrium established under the Project Agreements if and to the extent the Economic Equilibrium is disrupted or negatively affected, directly or indirectly, as a result of any change (whether the change is specific to the Project or of general application) in Azerbaijan Law (including any Azerbaijan Laws regarding taxes, health, safety and the environment) occurring after [date of the HGA or its ratification]...’ in *Striking a Balance: Intergovernmental and Host Government Agreements in the Context of the Baku-Tbilisi-Ceyhan Pipeline Project*, a publication of the European Bank for Reconstruction and Development, available at <http://www.ebrd.com/pubs/legal/lit042e.pdf>.

<sup>137</sup> As discussed in this section.

<sup>138</sup> Because foreign investors continue environmentally unsafe practices and pay a fine; this can be charged to the consumers through an increase in the price of the final product.

<sup>139</sup> Why regulatory risk should be compensated can be justified by appealing to fairness, risk allocation, cost internalisation and investment promotion (where cost internalisation refers to the internalisation of the regulatory costs by the state, not of environmental costs by the investor; risk allocation, or insurance rationale, allowing the investor to invest in a risky enterprise knowing that some of the risk is amortised through compensation; fairness, connected to the cost internalisation rationale, in the sense that the investor does not bear the exclusive burden of the developing regulatory framework). A good review of the issue is in Been, V. L. and Beauvais, J. C., ‘The global Fifth Amendment? Nafta’s investment protections and the misguided quest for an international ‘regulatory takings’ doctrine’, 78 *New York University Law Review*



exercise, instead of a goal allocation one.

The risks undertaken in regulating investment are manageable to the extent that they are by and large predictable. On the other hand, environmental risk is unmanageable to the extent that environmental damage can result from a functioning as well as a failing regulatory framework and, more importantly, independently from economic decision-making (in other words, economic development can cause environmental damage when it fails, as well as when it succeeds), and that it can have consequences that are not predictable. Therefore, it is, politically, a difficult risk to manage, as inaction and action can both have negative consequences<sup>140</sup>.

Seen from the angle of risk-avoidance strategies, the tension between protecting the investment and protecting the environment takes on a different meaning. Risk management strategies also account for the opposite phenomena of ‘regulatory chill,’ where states refrain to implement non-investment regulation (either in the hope to attract further investment or to avoid costly arbitrations) and of ‘investment chill’, that is, a reduction of the investment flows to countries perceived to impose

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(2003): 30. On the application of these principles in cases of regulatory expropriation, see Section 3.3.2.

<sup>140</sup> For this, see also Luhmann, N., *Ecological Communication*, Chicago, University of Chicago Press, 1989, at 73: ‘Ecological problems are simply too complex, interdependent, circumstantial, unpredictable, determined by the ‘dissipative structures’ of thermodynamic systems, the abrupt disturbances of stability (catastrophes) and similar structural changes...; and at 74-5: ‘...the legal system reacts to the desideratum of an environmental law with a considerable increase and complication of the regulation apparatus. ...The political system finds itself in the need of having to profess and to cope with the desire to decrease and increase the scope of laws at the same time. ...One can observe therefore that ecological communication deforms classical structures of the legal system, and how it does this, on more than just the level of the content of norms.’

an excessive regulatory burden<sup>141</sup>. The consequence of the ‘regulatory chill’ effect are the phenomena of the so-called ‘pollution havens’, where ‘countries with lax pollution standards attract industry and jobs away from countries with high standards’<sup>142</sup> or ‘stuck at the bottom’ countries<sup>143</sup>; however it is probably more correct to assume that what actually takes place is not necessarily that industries with high environmental impact migrate to less regulated countries, but that they will use more polluting and cheaper technologies, processes and products in the countries that allow them to and where they already have a presence. Therefore, products and processes that are banned in one country will be used in another if the ban is not (yet) in place, with the option of initiating an investment dispute if the host state tries to impose a similar ban, even if the ban is in place in the home state of the investor<sup>144</sup>. In addition, industries with a higher environmental impact are more likely to be established in countries with lower environmental

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<sup>141</sup> For a sceptical view, see Schill, S., ‘Do investment treaties chill unilateral state regulation to mitigate climate change?’ 24 *Journal of International Arbitration* (2007): 469; more accepting, Mann, H. and von Moltke, K., ‘NAFTA’s Chapter 11 and the environment: addressing the impacts of investor-state process on the environment’ (IISD Working Paper 1999), <http://www.iisd.org/pdf/nafta.pdf>.

<sup>142</sup> Matsushita, M., Schoenbaum, T. J. and Mavroidis, P. C., *The World Trade Organization: Law, Practice and Policy*, Oxford, OUP, 2006: 468, state that there is no empirical evidence for this phenomenon. See also Tienhaara, K., ‘Mineral investment and the regulation of the environment in developing countries: lessons from Ghana’, 6 *International Environmental Agreements* (2006): 371; and Zarsky, L., ‘From regulatory chill to deepfreeze?’ *ibidem*, 395.

<sup>143</sup> Where environmental standards do not evolve in response to changed circumstances or are not enforced; see Mann, H. and van Moltke, K., ‘Protecting investor rights and the public good: assessing NAFTA’s Chapter 11: 8, at <http://www.iisd.org/trade/ILSDWorkshop>; Porter, G., ‘Trade competition and pollution standards: “race to the bottom” or “stuck at the bottom”?’ 8 *Journal of Environment and Development*, (1999): 133.

<sup>144</sup> See *S.D. Meyers Inc. v. the Government of Canada*, Damages Award, 21 October 2002; see also *Chemtura Corporation v. Canada* (UNCITRAL) PCA, Award, 2 August 2010.

compliance. It is the cost of clean up and liability for damage that is high in developed countries, not necessarily the preventive costs of regulatory compliance<sup>145</sup>.

If risk management strategies are a reason for states to avoid regulation or not is probably a question too difficult to answer; we have sketched above what the possible repercussions for states are: regulatory chill and pollution havens in cases in which states choose high levels of investment protections and low levels of environmental protection, investment chill if the opposite is the case.

## 2.6 Concluding remarks

This chapter has been about choices. We have stated at the beginning that this thesis does not intend to engage with policy discussions, and that the focus will be pragmatically on the ways in which investment tribunal can take environmental obligations into account. However, there is the matter of choices: the choices the state makes in balancing its commitments to

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<sup>145</sup> In the *Trafigura Case* the Amsterdam District Court fined the Trafigura company £ 840,000 for illegally transporting and dumping hazardous waste to the Ivory Coast, which resulted not only in environmental damage but also in several thousands citizens of the Ivory Coast needing medical treatment and in sixteen deaths (see <http://www.business-humanrights.org/Categories/Lawlawsuits/Lawsuitsregulatoryaction/LawsuitsSelectedcases/TrafiguralawsuitsreCtedIvoire>). Apparently, the company decided to transport and dump the waste in the Ivory Coast to avoid the higher costs of disposal in the Netherlands (€750 per tonne, as opposed to the €27 per tonne the company paid to a local African operator; see <http://www.independent.co.uk/news/world/europe/trafigura-found-guilty-of-toxic-waste-offence-2034313.html>) The judgment was appealed by the Dutch Public Prosecutor on the grounds of the insufficient amount of the fine; the company keeps a page on its version of the events on its website: [http://www.trafigura.com/our\\_news/probo\\_koala\\_updates.aspx#k77L1kkLS2UF](http://www.trafigura.com/our_news/probo_koala_updates.aspx#k77L1kkLS2UF). In the end the case proves that even marginally lower clean up costs will be decisive for multinationals in selecting their course of action.

the investors and its obligations to the defence of public goods; the choices the investors make, and how they are informed by risk assessment of the quality of the investment environment in the host country; the choices of remedies, when high environmental impact activities go wrong; and we will explore in the next chapters how investment tribunals deal with choices. So, while we can avoid the policy discussions, we cannot pretend that there aren't *political* choices being made all the time, at all levels. It is commonly believed that political considerations can be avoided by recourse to arbitration between the host state and the investor, where the dispute settlement process is 'depoliticised'<sup>146</sup>. But political issues do not disappear so easily. It is a fact that by signing an investment treaty which allows for independent dispute settlement, the home state renounces the political discretion that is part of its sovereign powers; the dispute is not depoliticised as such, but the terrain of politics is shifted and privatised<sup>147</sup>. The decision to initiate a dispute is left to the political discretion of the investor. As

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<sup>146</sup> See Schreuer, C., *The ICSID Convention: A Commentary*, Cambridge, CUP, 2001: 398: 'The individual or corporation has no right to diplomatic protection under international law but depends on the political discretion of his government...As soon as the national State has taken up the claim, it becomes part of the foreign policy process, with all the attendant political risks.'; Shihata, I.F.I., 'Towards a greater depoliticization of investment disputes: the role of ICSID and MIGA', 1 *ICSID Review* (1986): 1. See also the Tribunal in *Enron Corporation and Ponderosa Assets LP v The Argentine Republic* (ICSID Case No. ARB/01/3), Decision on Jurisdiction (Ancillary Claim) of 2 August 2004, § 37: '...[the] greatest innovation of ICSID and other systems directed at the protection of foreign investments is precisely that the rights of the investors are not any longer subject to the political and other considerations by their governments, as was the case under the old system of diplomatic protection, often resulting in an interference with those rights. Investors may today claim independently from the view of their governments.'

<sup>147</sup> International legal firms are well aware of the importance of political power in investment arbitration; here is how the firm Crowell & Moring describes its international arbitration team: 'Our lawyers are well-schooled in the art of leveraging political power to resolve complex cross-border commercial and investment disputes.' At <http://www.crowell.com/PracticeAreas/PracticeArea.aspx?id=126>

remarked by Dezalay and Garth in their sociological study on commercial arbitration<sup>148</sup>:

A coincidence of interests...between the holders of economic power and the lawyer-representatives has accounted for an evolution that has allowed the seemingly irreconcilable to be reconciled. A conflict determined in critical respects by political and economic conditions can be re-enacted on the legal stage as independent of political and economic power.

In many ways, the legalisation of the relationship between host states and private investors is a consequence of the shifting balance of power away from states and represents a return to the past, when companies exercised political power on behalf of their home country. Now, however, it is more likely that companies exercise political power independently (it is common place to note that companies do not require the approval of their home country to initiate a dispute<sup>149</sup>, and, in the case of multinationals, the very issue of what constitutes the home country, in other words, the

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<sup>148</sup> Dezalay and Garth, 1996: 70.

<sup>149</sup> Up to the point of the home state actively opposing the investors' claim, as was the case in *GAMI Investments Inc. v. United Mexican States*, UNCITRAL, Final Award of 15 November 2004 (see USA – Article 1128 submission on jurisdiction of 30 June 2003, available at <http://naftaclaims.com/Disputes/Mexico/GAMI/GAMius1128Jurisdiction.pdf>); see also *Mondev International Ltd v. United States of America* (ICSID Case No. ARB(AF)/99/2), Award of October 11, 2002, 42 *ILM* 85 (2003); The English Court of Appeal in *Occidental v. Republic of Ecuador* noted: 'Where a dispute arises out of or relates to a commercial agreement made with the investor, it would seem to us both artificial and wrong in principle to suggest that the investor is in reality pursuing a claim vested in his or its home State, and that the only improvement by comparison with the traditional State protection for investors is procedural. It would potentially undermine the efficacy of the protection held out to individual investors, if such protection was subject to the continuing benevolence and support of their national State. *Douglas*, at p.170 in the article already cited [citation omitted], draws attention to arbitrations where the national State by intervention or in submissions opposed its investor's claims or the tribunal's jurisdiction to hear them; but, if the claims were the State's, such opposition should have been of itself fatal.' ([2005] *EWCA Civ* 1116 Case No: A3/2005/1121: § 17).

issue of nationality, is controversial): in this sense we can talk about a 'privatisation of politics,' accomplished through law (increasingly, private law, or better, a hybridisation of private and public law). If before there was an 'order without law'<sup>150</sup>, now law has acquired a more relevant role, to the detriment however of states' control over the way private actors use the law. If political roles are restricted to certain actors, and if international relations and foreign policy are the domain of states, it is correct to refer to the investment arbitrations as depoliticised, insofar as the host state does not have a counterpart with which to interact.

In the following chapters we will assess how investment law can address the normative dissonance, which is both internal (inconsistency of awards, vagueness of substantive content) and external (conflicts between investment and non-investment obligations). This thesis argues for 'system-internal' approaches for the resolution of these conflicts, especially of the second kind<sup>151</sup>. Having accepted this approach as theoretically more feasible, as well as politically more likely<sup>152</sup>, we will next consider the main substantive facets of the investment law system.

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<sup>150</sup> Ellickson, R., *Order without Law*, Cambridge, Harvard University Press, 1991.

<sup>151</sup> Not least because of the adoption of Luhmann's systems theory as the theoretical grounding for this project; see especially Luhmann, N., *Social Systems*, Stanford, Stanford University Press, 1995, and Luhmann, N., *Law as a Social System*, Oxford, OUP, 2004. See also Teubner, G., 'Substantive and Reflexive Elements in Modern Law' 17 *Law & Sociology Review* (1983): 239, in which Teubner proposes the reflexivity of the law (or its proceduralisation) as a solution for problems of structural coupling; in other words, law acting as a trigger for self-regulation within the sub-systems, according to their own internal logic.

<sup>152</sup> Withholding judgment on its political intrinsic value.

## Chapter 3: Substantive investment obligations

It is not easy to define the exact dividing line, just as it is not easy in twilight to see the divide between night and day. Nonetheless, whilst the exact line may remain undrawn, it should still be possible to determine on which side of the divide a particular claim must lie.<sup>153</sup>

### 3.1 Introduction

Investment law is in a state of flux: the ever increasing case law of investment tribunals, the proliferation of BITs and FTAs, the debates on the standards of protection available to investors, the relationship with other areas of law, all contribute to give the impression of a field of law in constant development. This activity concerns both the procedural<sup>154</sup> and the substantive aspects of the law. In this chapter we have chosen to concentrate on two areas of substantive law, standards of treatment and expropriation. This choice is dictated not only by the fact that it is here

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<sup>153</sup> *Methanex v. United States of America*, (UNCITRAL), Preliminary Award on Jurisdiction and Admissibility, 7 August 2002, § 139. The tribunal was here referring to competing interpretations as to the connection between the investor and the impugned measure for the purpose of the admissibility of a claim, but this statement can easily be extended to the general task of tribunals (and of law) in drawing lines. More often than not, it seems that this task is performed in the twilight.

<sup>154</sup> The procedural aspects that impact significantly on the relationship with non-investment obligations will be tackled in Chapter 6. Other procedural developments have taken place recently, which have a closer relationship with general concerns about the role of states in arbitration. For example, Rule 41(5) adopted by ICSID in 2006 allows for the summary dismissal of claims patently without merits; this Rule has been invoked by respondent states already three times since its adoption; see *Trans-Global Petroleum, Inc., v. Jordan* (ICSID Case No. ARB/07/25), Decision, 12 May 2008; *Brandes Investment Partners LLP v. Venezuela* (ICSID Case No. ARB/08/3), Decision, 2 February 2009; *RSM Production Corporation and others v. Grenada* (ICSID Case No. ARB/10/6), Award, 10 December 2010.

that the intersection between investment protection and environmental regulation can create the most friction and where the boundaries are undefined and fluctuating<sup>155</sup>. It is also because these two areas define and demonstrate what is peculiar about the way investment law exists as a discrete area of law in its substantive aspects. We opened the chapter by remarking on the investment regime's state of flux. It is equally important not to underestimate a certain rigidity of the system, which works in unison with assumptions made by investors and tribunals alike as to the goal of the whole system of investment arbitration. This chapter considers the 'orthodox' approach to investment protection, that is, the maximisation of the protections accorded to the foreign investors by a generous application of the provisions contained in the treaties.

There are issues of internal coherence in the investment regime, resulting from the vagueness of the provisions, the possibility of inconsistency of the awards and the limited grounds of appeal and review of the decisions. And then there are the issues of external coherence, or inter-regime consistency, which form the focus of this project. The interaction between these levels (internal and external) brings its own difficulties and consequences: for example, the vagueness in the language of the treaties can work both to increase the level of protection for investors as well as well as to incorporate non-investment commitments.

This review of substantive obligations has to be put into the context of a wider analysis on the feasibility of introducing non-investment obligations as interpretative aids for determining the extent of the protection accorded to investors. Several elements have to be kept in

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<sup>155</sup> Performance requirements provisions are also intrinsically subject to this sort of balancing exercise and therefore could have been included in the analysis; however they do not seem to be invoked in arbitrations as often as the other two (this in itself might be an issue worth investigating) even if their potential effect on environmental measures is significant. Additionally, they do not share the same level of normative convergence as standards of treatment and expropriation provisions in the investment agreements.



mind: firstly, few of these provisions *at present* explicitly impose environmental obligations upon the state or the investors<sup>156</sup>. Secondly, these provisions do not normally spell out in detail the extent of the protection to be accorded, preferring to refer to vague ‘fair and equitable’ treatment, ‘measures ‘tantamount to expropriation’ and similarly worded obligations. Thirdly, because of their open-textured nature, these provisions are subject to interpretation by tribunals to a greater extent than precisely worded provisions. Fourthly, the applicable rule for treaty interpretation being Article 31 of the VCLT, its clause 31(3)(c) ‘any relevant rules of international law applicable in the relations between the parties’ has to be taken into consideration by tribunals when interpreting the substantive protections. Fifthly and lastly, evolving social, political and legal standards have a bearing both on the substantive content of these outside ‘relevant rules’ and on the way interpretation itself is brought to bear on them.

Investment law is set up as a means of international protection and enforcement of property rights and the right to equality and non-discrimination, developed in their modern form in the Enlightenment era<sup>157</sup>, which became part of the newly drafted constitutions, following the French and the American revolutions, as rights of citizens. The development of human rights law following the Second World War resulted in the transposition on the international plane of these rights as rights of men rather than of citizen, as expressed for example in the Universal Declaration of Human Rights<sup>158</sup>, the International Covenants on Civil and Political Rights<sup>159</sup> and Economic, Social and Cultural Rights<sup>160</sup>, the European Convention on Human Rights<sup>161</sup> and so on.

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<sup>156</sup> With a few exceptions that will be considered in Chapter 4.

<sup>157</sup> Locke, J., 1690, *Two Treaties of Government*, Cambridge, CUP, 1963.

<sup>158</sup> <http://www.un.org/en/documents/udhr>.

<sup>159</sup> <http://www2.ohchr.org/english/law/ccpr.htm>.

<sup>160</sup> <http://www2.ohchr.org/english/law/cescr.htm>.

<sup>161</sup> <http://www.hri.org/docs/ECHR50.html>.

However, while equality rights found expression in international human rights law, the protection of property rights remained by and large the domain of domestic legal systems, not least because of different approaches to property in different economic systems, and consequent disagreements at the international level as to the extent to which there should be an international standard of protection for property<sup>162</sup>.

The customary rules on the protection of aliens and their property had developed independently<sup>163</sup> at a time in which a system of international protection of fundamental rights was non-existent and national standards varied considerably. And this brings us back to the observation that investment law is not only procedurally different from other areas of law, but also that it developed independently a set of standards of protection for foreign investors the content of which, while sharing a parallel development with human rights standards<sup>164</sup>, has limited convergence in substantive content, procedural rights or choice of remedies<sup>165</sup>.

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<sup>162</sup> The right to property is recognised at the European level (Article 1 of Protocol 1 of the ECHR) at the American level (Article 21 of the ACHR) and at the African level (Article 14 of the Banjul Charter), but not at the international level generally in legally binding instruments (it is contained in Article 17 of the Universal Declaration of Human Rights, at <http://www.un.org/en/documents/udhr/>). .

<sup>163</sup> For a general review of the history, see Sornarajah, 2004, especially 18 ff. and 37 ff.

<sup>164</sup> DiMascio and Pauwelyn argued that the rise in importance of national treatment provisions in investment law is a sign of the ‘substantive convergence between trade and investment law’; see DiMascio, N. and Pauwelyn, J., ‘Non-discrimination in trade and investment treaties: worlds apart or two sides of the same coin?’, 102 *AJIL* (2008): 48, at 59. On the relevance of human rights remedies for investment protection, see Tomuschat, C., ‘The European Court of Human Rights and investment protection’, Binder, C., *et al.*, *International Investment Law for the 21<sup>st</sup> Century*, Oxford, OUP, 2009: 636.

<sup>165</sup> Douglas argued that: ‘The investment treaty obligations of states are not coterminous with their human rights obligations. Human rights deserve a special status; they are inalienable because their protection is fundamental to the dignity of every human being.’ Douglas, Z., ‘Nothing if not critical for investment treaty arbitration: Occidental, Eureko and Methanex’, 22 *Arbitration International* (2006): 27, at 37. The cross-

### 3.2 Standards of treatment

It is an accepted rule of customary international law that aliens are subjected to the host country's laws<sup>166</sup>. Host states can establish entry requirements, limit admission and expel foreigners, unless prohibited to do so by a specific commitment in a treaty<sup>167</sup>. The standards of treatment to which aliens are subject vary from country to country, as do the remedies available to those aggrieved by the treatment received. There has been a 'paradigm shift' in the way international law deals with the consequences of this diversity of treatment and the resulting possible claims of mistreatment or injury<sup>168</sup>. Exhaustion of local remedies,

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fertilization of criteria on regulatory expropriation between American takings jurisprudence and the European Courts of Human Rights case law on expropriation will be analysed in Section 3.3.2 and in Chapter 7.

<sup>166</sup> Higgins, R: 'The taking of property by the state: recent developments in international law', *Recueil des Cours*, Hague Academy of international Law, Vol. 176, 1982-III, 285: 'It is generally accepted that an individual submits himself to the local jurisdiction of a foreign state when he chooses to reside or conduct his business there'; Mann, F. A., 'The doctrine of jurisdiction in international law', 11 *Recueil des cours* Vol. III (1964); Brownlie, I., *Principles of Public International Law*, 5<sup>th</sup> Edition, Oxford, OUP, 1998: Chapter 24; Amerasinghe, C. F., *State Responsibility for Injuries to Aliens*, Oxford, Clarendon Press, 1967; Borchard, E.M., *Diplomatic Protection of Citizens Abroad*, New York, Kraus Reprint, 1970; Dunn, F. S., *The Protection of Nationals: A Study in the Application of International Law*, Baltimore, Johns Hopkins Press, 1932; Eagleton, C., *The Responsibility of States in International Law*, New York, New York University Press, 1928; Freeman, A. V., *The International Responsibility of States for Denials of Justice*, London and New York, Longmans, Green & Co., 1938; Jessup, P. C., *A Modern Law of Nations: An Introduction*, New York, Macmillan, 1949; Lillich, R. B. (ed.) *The International Law of State Responsibility for Injuries to Aliens*, Charlottesville, VA, University Press of Virginia, 1983.

<sup>167</sup> Article I:2(c) of the GATS (provider's commercial presence in the user's country) 'essentially amounts to an international agreement to liberalize investment.' (Matsushita, Schoenbaum and Mavroidis, 2003: 237).

<sup>168</sup> As also noted by Schreuer; see Schreuer, C., 'Paradigmenwechsel im Internationalen Investitionsrecht', in Hummer, W. (ed.) *Paradigmenwechsel im Völkerrecht zur Jahrtausendwende*, Vienna, Manz, 2002: 237. One wishes not to overstate this shift,

diplomatic protection<sup>169</sup> and denial of justice<sup>170</sup> claims constituted the bulk of cases until well into the post-war era<sup>171</sup> while now they have receded into the background and diplomatic protection is considered to fulfil merely a residual role amongst the remedies provided by international investment law<sup>172</sup>. Innovations in international law in the

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which concerns the issues of standing and remedies. The substance of investment law, the treaties, is still a product of inter-state negotiations and as such, a purely public international law matter.

<sup>169</sup> For the right of diplomatic protection, see *The Case of the Mavrommatis Palestine Concessions* (1924) PCIJ Rep Series A, No. 2: 'It is an elementary principle of international law that a State is entitled to protect its subjects, when injured by acts contrary to international law committed by another State, from whom they have been unable to obtain satisfaction through the ordinary channels. By taking up the case of one of its subjects and by resorting to diplomatic action or international judicial proceedings on his behalf, a State is in reality asserting its own rights – its right to ensure, in the person of its subjects, respect for the rules of international law.' A recent review of the topic in the context of investment law in Muchlinski, P., 'The diplomatic protection of foreign investors: a tale of judicial caution', Binder, C., *et al.*, 2009: 341.

<sup>170</sup> One wonders what significance the denial of justice doctrine has in the context of a system of secondary rules that has for the most part dispensed with the exhaustion of local remedies rule. See also *Loewen Group Inc. & Raymond L. Loewen v. United States of America* (ICSID Case No. ARB(AF)/98/3), Final Award, 26 June 2003. For a recent treatment of the issue, see Francioni, F, 'Access to justice, denial of justice and international investment law', 20 *EJIL* (2009): 729.

<sup>171</sup> All these issues generated a vast case law and literature, which would be impossible to quote comprehensively; see for example Sohn, L. B. and Baxter, R. R., 'Responsibility of states for injury to the economic interests of aliens', 55 *AJIL* (1961): 545; see also Vattel, E. *Le droit des gens ou principes de la loi naturelle appliqué à la conduit et aux affaires des nations et des souverains*, Washington DC, Carnegie Institution of Washington 1916; for diplomatic protection, see also the International Law Commission's Draft Articles on Diplomatic Protection, [http://untreaty.un.org/ilc/texts/instruments/english/draft%20articles/9\\_8\\_2006.pdf](http://untreaty.un.org/ilc/texts/instruments/english/draft%20articles/9_8_2006.pdf):

<sup>172</sup> On the residual character of diplomatic protection, see *Case Concerning Ahmadou Sadio Diallo (Republic of Guinea v. Democratic Republic of the Congo)*, ICJ, Preliminary Objections, 24 May 2007, 88: 'The Court is bound to note that, in contemporary international law, the protection of the rights of companies and the rights of their shareholders, and the settlement of the associated disputes, are essentially

area of human rights have revolutionised concepts such as the international minimum standard of treatment and injury to aliens. The standards contained in international investment agreements have arisen to prominence in recent years, when claims arising from these treaties are increasingly structured around an alleged violation of a standard of treatment obligation rather than (or in addition to) alleging expropriation of the protected investment.

Standards of treatment can be comparative or absolute<sup>173</sup> and have their source in customary law or exist independently as treaty standards. The national and most-favoured-nation (MFN) standards are considered comparative (or contingent), while the international minimum standard (IMS) and the fair and equitable treatment (FET) standard do not *per se* contain a comparative element and are therefore absolute (non-contingent) standards. The national and the international minimum standard were developed in customary law, and have been received in treaty law (where the national standard is accompanied by the MFN standard and has been transformed from a provision against positive discrimination in favour of aliens into a provision against negative discrimination); the FET standard is a creature of treaty law and, as we shall see, its relationship with the international minimum standard has given rise to a heated debate in the investment community.

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governed by bilateral or multilateral agreements for the protection of foreign investments... In that context, the role of diplomatic protection somewhat faded, as in practice recourse is only made to it in rare cases where treaty régimes do not exist or have proved inoperative.’ The Court has delivered its Judgment on the case on 30 November 2010, founding in favour of Guinea and granting reparation in the form of compensation, to be settled by the Court failing agreement by the parties.

<sup>173</sup> See for example Grierson-Weiler, T. and Laird, I. A., ‘Standards of treatment’, Muchlinski, P., Ortino, F., and Schreuer, C., *The Oxford Handbook of International Investment Law*, Oxford, OUP, 2008: 261 ff.; Newcombe, A. and Paradell, L., *Law and Practice of Investment Treaties: Standards of Treatment*, Alphen Aan den Rijn, Kluwer Law International, 2009.

### 3.2.1 Comparative standards

#### 3.2.1.1 Most-favoured-nation standard

The cardinal non-discrimination principle of international trade law<sup>174</sup>, the MFN standard is incorporated into most investment treaties<sup>175</sup>. Its formulation in the NAFTA, as contained in Article 1103, is as following<sup>176</sup>:

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments<sup>177</sup>.

2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

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<sup>174</sup> See the ILC Draft Articles on Most-Favoured-Nation Clauses, with Commentary, *Yearbook of the International Law Commission*, 1978, vol. II, Part Two; Report of the Working Group on Most-Favoured-Nation Clauses, A/CN.4/L.719 20 July 2007; Matsushita, Schoenbaum and Mavroidis, 2003: 143.

<sup>175</sup> See United Nations Conference on Trade and Development, *Most-Favoured-Nation Treatment*, UNCTAD Series on Issues in International Investment Agreements, United Nations Publications, New York 1999, UNCTAD/ITE/IIT/10(Vol. III). As the MFN has been incorporated into BITs from their inception, it has a longer pedigree in investment treaty law than, for example, the national treatment standard (see UNCTAD, 1999: 12); it is therefore appropriate to open the chapter with its analysis. For a recent brief review of the standard, see also Acconci, P. 'Most-favoured-nation treatment', in *The Oxford Handbook of International Investment Law*: 363.

<sup>176</sup> Available at <http://www.naftaclaims.com/commission.htm>. The International Law Commission's definition is as following: '...a treaty provision whereby a State undertakes an obligation towards another State to accord most-favoured-nation treatment in an agreed sphere of relations.' See 'Final draft articles on most favoured nation clauses', 2 *Yearbook of International Law Commission* (1978): 16.

<sup>177</sup> Similarly to the other standard of treatment clauses contained in the NAFTA, the MFN clause includes pre-entry treatment, forbidding any discrimination with regards to 'market access' for investors and investments.

Not all MFN clauses are the same, firstly as, even within a general non-discrimination goal, exceptions are common<sup>178</sup>; secondly because the wording varies markedly and has evolved over time<sup>179</sup>. Nonetheless, in general terms the function of this clause is to equalise treatment, creating a ‘level playing field’<sup>180</sup> by guaranteeing that new commitments made by states in successive investment treaties will be extended to investors covered by previous treaties<sup>181</sup>. In this way the MFN clause multilateralises investment commitments<sup>182</sup> and harmonises treatment upwards (by ‘ratcheting up’ towards higher standards of protection)<sup>183</sup>. The *RosInvest* Tribunal boldly stated that: ‘the very character and

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<sup>178</sup> See Newcombe and Paradell, 2009: 231 ff.

<sup>179</sup> With more specific clauses being introduced in treaties, also in response to the inconsistent jurisprudence of the tribunals as to the reach of the clause into procedural rights (see Article 3(3) of the United Kingdom Model BIT).

<sup>180</sup> See Schill 2009: 123. However, it could be argued that MFN clauses act as a constraint to a greater diversity of provisions to reflect the diversity of economic and social conditions (with the slippage between reciprocity and subordination outlined in Chapter 1). It seems reasonable to presume, for example, that developing countries would be weary of signing BITs amongst themselves that offer better treatment than what is available on the ‘investment treaty market’, because investors from third, developed countries, could use the MFN clause to take advantage of those benefits. As a consequence, there will be very similar BITs across the board, giving the false impression that there is a consensus on the content of these treaties, with the MFN clause acting as an effective stoppage for any real diversity.

<sup>181</sup> See *Berschader v. Russia*, SCC Case No. 080/2004, Award of 21 April 2006, § 179: ‘It is universally agreed that the very essence of an MFN provision in a BIT is to afford to investors all material protection provided by subsequent treaties.’ For the MFN clause as a tool for evolutionary interpretation, see also *RosInvest v. Russian Federation*, SCC Case No V079/2005, Award on Jurisdiction, 5 October 2007, at § 40: ‘...so far as the treaty parties foresaw and wished to admit an evolutionary development at all, the MFN clause in Article 3 was their chosen vehicle for doing so.’

<sup>182</sup> Schill, 2009; Schill, S., ‘Multilateralizing investment treaties through most-favoured-nation clauses’, 27 *Berkeley Journal of International Law* (2009): 496.

<sup>183</sup> The first investment treaty arbitration in which this principle was affirmed was *Asian Agricultural Products Limited (AAPL) v. Democratic Socialist Republic of Sri Lanka* (ICSID Case No. ARB/87/3), Award, 27 June 1990, § 54.

intention [of MFN clauses] is that protection not accepted in one treaty is widened by transferring the protection accorded in another treaty',<sup>184</sup>.

As a form of comparative standard, MFN clauses do not contain any substantive element: their function is purely as 'containers' of whatever treatment the investor claims to be more favourable than the one accorded to him in the circumstances. Consequently, the task of the arbitral tribunal is to assess if the facts of the case, and the application of the limiting provisions when applicable, warrant the acknowledgment that the investor was unfairly discriminated under the basic treaty<sup>185</sup> by failure to grant the more favourable treatment accorded to third party nationals (either *de jure* or *de facto*). Jurisprudence under the NAFTA has proven that the incorporation of more favourable treaty provisions is undertaken with caution, at least within the NAFTA regime. While the *Pope & Talbot* tribunal accepted in principle that the MFN Article 1103 in the NAFTA could be used to import more favourable provisions with respect to the 'fair and equitable' treatment from other BITs signed by Canada, in the end it did not examine the behaviour of Canada under Article 1103<sup>186</sup>. On the other hand, in *MTD v. Chile*<sup>187</sup> the tribunal

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<sup>184</sup> At § 131, for the argument that the tribunal '[upheld] jurisdiction ... by allowing a British investor to invoke a dispute settlement clause with a wider substantive scope. This seems to be so far the only existing decision where the tribunal accepted the import of a procedural aspect of a dispute settlement provision other than the waiting period', see Herrmann, C. and Terhechte, J. P., *2010 European Yearbook of International Economic Law*, Berlin, Springer, 2010: 98.

<sup>185</sup> The treaty containing the MFN clause is designated as the basic treaty; the more favourable treatment might not necessarily be treaty-based, therefore there might or might not be another treaty for tribunals to consider. The repercussions on the burden of proof for the investor in relation to the existence of the more favourable treatment are beyond the scope of this project.

<sup>186</sup> Its argument being dependent on the scope of the fair and equitable treatment under Article 1105 following the Interpretative Note of the FTC. See *Pope & Talbot v. Canada*, Award in Respect of Damages, 31 May 2002, § 12. Normative overlap between the standards has attracted the attention of the NAFTA parties; the United States made a submission to the *Chemtura* Tribunal, to the effect that: 'the most-



applied the MFN clause of the basic treaty; as this one explicitly pegged the MFN to the fair and equitable treatment standard<sup>188</sup> all the tribunal said it had to consider, in dealing with the MFN breach claim, was ‘...whether the provisions of the Croatia BIT and the Denmark BIT [third party treaties invoked under the MFN] which deal with the obligation to award permits subsequent to approval of an investment and to fulfilment of contractual obligations, respectively, can be considered to be part of fair and equitable treatment.’ Equally, the *Rumeli* tribunal held that a breach of the fair and equitable treatment standard could be found by application of the MFN clause which imported that obligation from third treaties into the basic treaty<sup>189</sup>. The linkage between MFN and FET was equally sought by the claimant and examined by the tribunal in the *Parkerings Case*<sup>190</sup>, a case in which ultimately the tribunal found against the claimant also by application of the limiting clause (‘in like circumstances’ provision).

There are two ways in which this clause can be used to maximise the protections accorded to the investor: by express inclusion of the pre-establishment phase within the reach of the clause<sup>191</sup> and by a wide

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favoured-nation (“MFN”) obligation under Article 1103 does not alter the substance of the fair and equitable treatment obligation under Article 1105(1).’ (Submission of 31 July 2009, at <http://www.state.gov/s/l/c29737.htm>). This is a restatement of what already submitted by the parties to the *Pope & Talbot* tribunal.

<sup>187</sup> *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile* (ICSID Case No. ARB/01/7), Award, 25 May 2004, §§ 100 ff.

<sup>188</sup> The article read as follows: ‘Investments made by investors of either Contracting Party in the territory of the other Contracting Party shall receive treatment which is fair and equitable, and not less favourable than that accorded to investments made by investors of any third State.’

<sup>189</sup> *Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Kazakhstan*, (ICSID Case No. ARB/05/16), Award, 29 July 2008, § 575.

<sup>190</sup> Analysed in Section 7.4.2.

<sup>191</sup> As in the NAFTA clause and in most recent Free Trade Agreements (see Report of the MFN Working Group, at 9).

interpretation of the ‘treatment’ and ‘in like circumstances’ terms (for example to include procedural rights in the treatment, or by application of the WTO definition of likeness<sup>192</sup>). In short, the clause can work on three levels, extending substantive protections, procedural avenues to redress (by-passing admissibility criteria) and the arbitral ‘reach’ (the state’s consent to arbitration). Recent jurisprudence of arbitration tribunals has generated a considerable debate on the procedural aspects of the clause<sup>193</sup>; however, it is the extension (or restriction) of

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<sup>192</sup> For the ‘like products’ clause (GATT I:I), see Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*; *Canada/Japan – Tariff on Imports of Spruce, Pine, Fir (SPF) Dimension Lumber*, 19 July 1989, GATT B.I.S.D.(36<sup>th</sup> Supp.): 167 (1990). This approach was rejected by the *Occidental* Tribunal, with regard to the interpretation of the national treatment: ‘...it [the national treatment] is to avoid exporters being placed at a disadvantage in foreign markets because of the indirect taxes paid in the country of origin, while in GATT/WTO the purpose is to avoid imported products being affected by a distortion of competition with similar domestic products because of taxes and other regulations in the country of destination’. (*Occidental Exploration and Production Company v. Ecuador*, LCIA (UNCITRAL), Award, 1 July 2004: § 176). Divergent interpretation is also advocated by the *Methanex* Tribunal, *Methanex v. United States*, Award, 3 August 2005: Part IV, Ch. B, §§ 30-35.

<sup>193</sup> Cases in which the jurisdictional extension argument was rejected include the *Anglo-Iranian Oil Company Case (United Kingdom v. Iran)* 1952 *I.C.J. Rep* 93; *Plama Consortium Ltd. v. Republic of Bulgaria* (ICSID Case No. ARB/03/24) Decision on Jurisdiction, 8 February 2005, § 214 (the Tribunal also argued on the back of the ‘generally accepted principle of the separability... of the arbitration clause’, at § 212); see also *Telenor Mobile Communications AS v. Republic of Hungary* (ICSID Case No. ARB/04/15), Award, 13 September 2006, § 95. Cases in which the clause was intended to extend to such matters include *Ambatielos Case (Greece v. United Kingdom)*, 1953 *I.C.J. Rep.* 10; *Emilio Agustín Maffezini v. Kingdom of Spain* (ICSID Case No. ARB/97/7), Decision on Objections to Jurisdiction, 25 January 2000, § 50; *Siemens AG v. Argentine Republic* (ICSID Case ARB/02/8), Decision on Jurisdiction, 3 August 2004, § 109. For a taste of the ensuing debate, see Chukwumerije, O., ‘Interpreting most-favoured-nation clauses in investment treaty arbitrations’, 8 *JWI&T* (2007): 35-36; Freyer, D., and Herlihy, D., ‘Most-favored-nation treatment and dispute settlement in investment arbitration’, 20 *ICSID Review* (2005): 67; Gaillard, E., ‘Establishing jurisdiction through a most-favored-nation clause’, 233 *New York Law Journal* (June 2, 2005): 7; Hsu, L., ‘MFN and dispute settlement – when the twain meet’, 7 *JWI&T*

substantive protection by application of the clause that has a more immediate relationship with conflicting obligations undertaken by the state.

While the extension of the treaty protections to investors in the pre-establishment phase constitutes in absolute terms the most significant change, we are more interested in the interpretative work of tribunals applying the MFN clause by reference to the ‘treatment’ and ‘in like circumstances’ provisions<sup>194</sup>. As it is uncontroversial that the function of the MFN clause is to optimise the treatment of investors, a lot rests on how the term ‘treatment’ is interpreted; in other words, beyond the application of the *ejusdem generis* principle<sup>195</sup>, what kind of treatment is covered by the clause. Is treatment accorded to an individual investor the same as treatment accorded to investors as a group (national v. foreigner, or country A investor(s) v. country B investor(s)?) The answer lies in part in the wording of the clause itself<sup>196</sup> and in part in the approach

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(2006): 29; Radi, Y., ‘The application of the most-favoured-nation clause to the dispute settlement provisions of bilateral investment treaties’, 18 *EJIL* (2007): 771-73. See also *Plama Consortium Ltd. v. Bulgaria*, (ICSID Case No. ARB/03/24), Decision on Jurisdiction, 8 February, 2005, § 221.

<sup>194</sup> Taking into consideration that, for example, there are no NAFTA cases in which a successful claim for violation of the MFN clause was made; see for example *ADF v. United States of America* (2002) and *Pope & Talbot Inc. v. Canada* (2001, 2002).

<sup>195</sup> ‘The *ejusdem generis* principle is the rule according to which a MFN clause can only attract matters belonging to the same subject matter or the same category of subject to which the clause relates.’ OECD, *International Investment Perspectives*, Paris, OECD Publications, 2004: 151. See Articles 9 and 10 of the ILC’s Draft Articles on Most-Favoured-Nation Clauses with Commentaries, *Yearbook of the International Law Commission*, 1978, Vol.II, Part Two.

<sup>196</sup> There is quite a difference between a wording such as ‘Neither Contracting State shall subject investments in its territory owned or controlled by investors of the other Contracting State to treatment less favourable than it accords to investments of its own investors or to investments of investors of any third State’ (Germany 1998 Model BIT) or clauses that contain the ‘in like circumstances’ restriction.

taken by the tribunal<sup>197</sup>. The interpretation of what constitutes treatment for the purpose of the clause is essential to determine its applicability, keeping into consideration that certain ‘treatments’ might not be easy to ascertain: for example, favourable concessions contained in a contract might be covered by commercial confidentiality.

Conversely, there are two ways in which the reach of the clause can be limited: express restrictions and exceptions<sup>198</sup>, or restrictions by the language of the treaty, mainly by inclusion of the ‘in like circumstances’ limiting clause, as is the case in the NAFTA<sup>199</sup>. The similarly worded principle in GATT rests on a competitive, market-based test to establish likeness<sup>200</sup> and it’s circumscribed by the accompanying exceptions; in

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<sup>197</sup> The general approach is to consider the clause applicable to *de jure* and *de facto* treatment; see the Commentary to Article 8 in the ILC Draft Articles on the MFN clause: ‘The rule is important and its validity is not dependent on whether the treatment extended by the granting State to a third State, or to persons or things in a determined relationship with the latter, is based upon a treaty, another agreement or a unilateral, legislative, or other act, or mere practice.’ For its application in trade law, see also Appellate Body Report, *Canada–Certain Measures Affecting the Automotive Industry*, § 78, T/DS139/AB/R, WT/DS142/AB/R (WTO) (May 31, 2000).

<sup>198</sup> For example, for taxation measures or customs unions or other similar regional arrangements; see OECD report: 5 ff. On the conflict between the MFN clause and European Union law, see Schill, 27 *Berkeley Journal of International Law* (2009): 496, at 525 ff.

<sup>199</sup> As in US and Canadian BITs. The ‘in like circumstances’ provision is not common in European BITs; see OECD study, at 6 and footnote above for one example.

<sup>200</sup> See for example Bronckers, M., *A Cross Section of WTO Law*, Cameron May, London, 2000, at 18: ‘What the *Liquor Taxes* cases have done is emphasise that what counts in defining ‘like’ or ‘directly competitive or substitutable products’ is competition in the market place, which is determined from the consumer’s perspective.’ Again, at page 50: ‘It is not sufficient for a WTO member to make a political statement that consumers want, or should want, to make a distinction between different products out of environmental or other concerns. ‘Like’ products are not determined by legislative command; they are created by market perceptions.’ It is part of the ‘political choices’ theme that we introduced in the previous chapter to note that, according to Bronckers’ interpretation, supported by Appellate Body case law (see *Japanese Liquor*

investment law, the clause's application is in principle absolute in scope (there are normally no exceptions) so it is only through reference to the 'circumstances' in which investors find themselves (this extent comparable to a 'regulatory context test'<sup>201</sup>) that the clause is amenable to be interpreted as to allow for lawful discrimination based on the regulatory element of the treatment (where high environmental impact industries, subjected to a different regulatory regime compared to low impact ones, cannot claim a breach of a non-discrimination standard with respect of the low impact industries because the 'in like circumstances' clause is not applicable)<sup>202</sup>.

### 3.2.1.2 National treatment standard

The national treatment standard, developed as part of the customary rules on the treatment of aliens<sup>203</sup>, is included in most investment treaties<sup>204</sup>.

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*Taxes II*, Appellate Body Report, § 20), market based evidence trumps democratic votes in establishing the will of the 'consumers' (who are also voters). See however *European Communities – Measures Affecting Asbestos and Asbestos Containing Products*, Report of the Appellate Body, WTO, AB-2000-11, March 2001, where the AB accepted that environmental factors can be taken into account in determining 'likeness' between products. (But see 'WTO Confidential', at footnote 121, for an insider's, more nuanced view of this apparent victory for environmentalists).

<sup>201</sup> See DiMascio, N. and Pauwelyn, J., 'Non-discrimination in trade and investment treaties: worlds apart or two sides of the same coin?' 102 *AJIL* (2008): 81.

<sup>202</sup> See Baetens, F., 'Discrimination on the basis of nationality: determining likeness in human rights and investment law', in Schill, 2010: 279 at 310, quoting the statement of the US representative at the MAI negotiations to the effect that the 'in like circumstances' clause serves the purpose of allowing for all the circumstances to be taken into consideration (including limiting ones) in order to establish likeness.

<sup>203</sup> For the content of the standard in trade law and its relationship with the investment law version, see DiMascio and Pauwelyn, 2008: 48.

<sup>204</sup> A review of the standard in United Nations Conference on Trade and Development, *National Treatment*, UNCTAD Series on Issues in International Investment

As intended by those countries that championed it, this standard prohibited preferential or privileged treatment of foreigners: in the words of Carlos Calvo, the Argentine publicist who contributed to the development of the doctrine<sup>205</sup>: ‘Aliens who established themselves in a country are certainly entitled to the same rights of protection as nationals, but they cannot claim any greater measure of protection.’ In the translation from customary to treaty law, the national standard of treatment has been re-conceptualised as a classic non-discrimination provision<sup>206</sup>. Similarly to the MFN standard, the national standard acts as a comparing standard, where the treatment granted to the foreigner is compared to that of nationals, usually to the effect that the treatment should be ‘same as’ or ‘no less favourable than’ that granted to nationals. As an example of a far-reaching national treatment clause<sup>207</sup>, we refer to the NAFTA provision, at Article 1102 of Chapter Eleven<sup>208</sup>:

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Agreements, United Nations Publications, New York 1999, UNCTAD/ITE/IIT/11 (Vol. IV).

<sup>205</sup> See Dolzer, R., *National Treatment: New Developments*, OECD Symposium, 12 July 2005, at <http://www.oecd.org/dataoecd/5/53/36055356.pdf>;

<sup>206</sup> To this extent, a comparison between the classic customary notion of the standard and its modern treaty version could be considered inappropriate; see Weiler, T., ‘Saving Oscar Chin [*sic*]: non-discrimination in international investment law’, in Horn, N. (ed.), *Arbitrating Foreign Investment Disputes*, The Hague, Kluwer Law International, 2004: 159. To note that the ‘in like circumstances’ clause is applied by the PCIJ, which established, at 23, that: ‘The special advantages and conditions resulting from the measures of June 20th, 1931, were bound up with the position of Unatra as a Company under State supervision and not with its character as a Belgian Company. These measures, as decreed, would have been inapplicable to concerns not under government supervision, whether of Belgian or foreign nationality. The inequality of treatment could only have amounted to a discrimination forbidden by the Convention if it had applied to concerns *in the same position* [italics added] as Unatra, and this was not the case.’ On this case see also Lauterpacht, H., *The Development of International Law by the International Court*, Cambridge, CUP (Reprint) 1996: 262.

<sup>207</sup> As we have seen already for the MFN standard, clauses that include so-called ‘pre-entry’ rights are considered particularly favourable, as they extend the reach of the clause to admission of investors, prohibiting discrimination at this level as well, contrary to customary law but in line with the principles as used in trade law (where it

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

2. Each Party shall accord to investments of investors of another Party treatment no less favorable 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.

An example of a national treatment clause that does not include pre-entry rights is Article 10(7) of the Energy Charter Treaty<sup>209</sup>:

Each Contracting Party shall accord to Investments in its Area of Investors of other Contracting Parties, and their related activities including management, maintenance, use, enjoyment or disposal, treatment no less favourable than that which it accords to Investments of its own Investors or of the Investors of any other Contracting Party or any third state and their related activities including management, maintenance, use, enjoyment or disposal, whichever is the most favourable.

As the MFN standard with which it is usually coupled, the standard rests on a two-steps test for applicability<sup>210</sup>: if the foreign investor and the

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is border restrictions that need to be eliminated). On the right of establishment, see Sacerdoti, *Recueil des Cours*, 1997.

<sup>208</sup> Available at <http://www.naftaclaims.com/commission.htm>.

<sup>209</sup> Available at <http://www.encharter.org/index.php?id=178>. The clause also includes the MFN element.

<sup>210</sup> The standard case for the ‘in like circumstances’ provision in the NAFTA is *Pope & Talbot, Inc. v. Canada*, NAFTA/UNCITRAL, Damages Award, 31 May 2002; see also *Marvin Feldman v. United Mexican States*, (ICSID Case No. ARB(AF)/99/1), Final Award, 16 December 2002; *ADF Group Inc. v United States of America* (ICSID Case No. ARB(AF)/00/1) Final Award, 9 January 2003; for a different, contrary, approach, see *Raymond Loewen and the Loewen Group v. United States of America*, (ICSID Case No. ARB(AF)/98/3) Final Award, 26 June 2003. A violation of Article 1102 was claimed also in *Ethyl Corporation v. Canada* (UNCITRAL), Award on Jurisdiction, 24 June 1998; *S.D. Meyers v. Canada* (UNCITRAL), Partial Award on the Merits, 13 November 2000; *Mondev International Limited v. United States of America* (ICSID Case No. ARB(AF)/99/2), Award, 11 October 2002; *GAMI Investments v United*

domestic investor are ‘in like circumstances’ (as this restriction normally applies) and if the treatment to which the domestic investor is subject is more favourable than the treatment accorded to the foreign investor<sup>211</sup>. In other words, tribunals are required to perform a test of ‘likeness’ (to ascertain that the circumstances of the two groups of investors are the same) and a test of ‘difference’ (to ascertain if their treatment differs, and if so, if the treatment is less favourable, as per treaty standard). For the purpose of protection, it could therefore be the extension, or conversely, the restriction of the comparing circumstances, to determine the extent to which the foreign investor will benefit from the coverage of the clause<sup>212</sup>.

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*Mexican States (UNCITRAL)*, Final Award, 15 November 2004; *Methanex Corporation v. United States of America (UNCITRAL)*, Final Award on Jurisdiction and Merits, 9 August 2005; *Softwood Lumber Cases (Canfor, Tembec and Terminal v. United States of America)*, (UNCITRAL), Decision on Jurisdiction, 6 June 2006; *United Parcel Service of America v. Canada*, Final Award on the Merits, 24 May 2007; *Corn Products International v. United Mexican States (ICSID Case No. ARB(AF)/04/01)* Decision on Responsibility, 15 January 2008.

<sup>211</sup> A separate issue is the applicability of the clause to sub-national entities. If the foreign investor is given the ‘best national treatment’, this can be either a) if the same conditions apply (in like circumstances provision applied in the strictest sense); b) regardless (for example, even if they are not investing in a deprived area, in which the best conditions apply, but they invest in the same industry: lax application of the ‘in like circumstances’); if the foreign investor is given the ‘minimum national treatment,’ this can also be 2 ways, a) if the conditions do not apply (opposite of 1a), b) even if conditions apply (opposite of 1b); in case 2a, can foreign investors claim for anticompetitive policy by the State? In case 2b, can foreign investors claim against the treatment given to national investors for discrimination?

<sup>212</sup> Incidentally, the value of the national treatment clause is directly proportional to the standard of treatment granted to national investors: consequently, the NAFTA national treatment clause will be more valuable than the national treatment clause contained in a BIT which pairs up a developed and a ‘least developed’ country, structurally and economically ill-equipped to provide what would be considered a high standard of treatment. Equally, better business conditions might be accompanied by a stricter regulatory regime: since ‘national treatment’ is an all-encompassing term’, in principle



The circumstances can be restricted to the economic or business circumstances (i.e. investors operating in the same economic sector, in a strict application of the clause<sup>213</sup>, or without sectoral limitations, in a lax application) or include the regulatory circumstances, which ultimately requires the tribunal to examine the intent of the state in differentiating treatment on the basis of a legitimate exercise of the public interest rationale<sup>214</sup>. Even when tribunals are willing to take ‘regulatory likeness’ into consideration, not necessarily this will work to exonerate the state from a finding of violation of the national treatment clause: in this case, both intent and the burden of proof then become relevant to the analysis of the tribunal: as intent can also include other, non legitimate grounds for action (such as protectionist intent), the tribunal might still find against the state, even if there were other, legitimate grounds for treating the foreign investor ‘unlike’ the national one (as was the case in *S.D. Myers*); additionally, the measures might still be subjected to a WTO-style proportionality test, with only the least restrictive measures being allowed. As for the burden of proof, it will matter at which stage of the process (as we have seen that there are at least two steps in establishing likeness) which party has the burden to prove discrimination: a *prima facie* claim of discrimination might be met by a defence of legitimate regulation. It will then be up to tribunals to consider if, even with a successful defence of legitimate exercise of the public interest, the claimant can counter-claim that: either the legitimate exercise masks a hidden protectionist intent; or, least restrictive measures were available to achieve the same goal.

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all elements of the treatment can be used as comparators, even if the investor only claim a violation of the clause with reference to one of the elements.

<sup>213</sup> As done for example by the tribunals in *Martin Feldman v. United Mexican States* (ICSID Case No. ARB(AF)/99/1), Final award, 16 December 2002, § 171; and *Methanex Corp. v. United States*, UNCITRAL/NAFTA, Final award, 9 August 2005, Part IV, Chapter B, §§ 17 ff.

<sup>214</sup> As done for example by the *S.D. Myers* and *Parkerings* Tribunals; analysis and full references for both cases in Chapter 7.

Overall, tribunals, most of them established under the NAFTA<sup>215</sup>, have been cautious in assessing claims of violation of national treatment standard; proportionality analysis is not the norm in investment law in general and all the more in claims arising from comparative standards violations. The complexity of the WTO texts and jurisprudence on comparative standards, either MFN or national, is not matched by the minimalist, some could say deficient, language of the investment treaties and the underdeveloped case law and reasoning of investment arbitration tribunals, not helped, it is submitted, by the structural differences between the trade and the investment legal regimes. Additionally, for historical, economic and political reasons, investors in general prefer the ‘absolute standard’ route, as we shall see in the following section<sup>216</sup>.

### ***3.2.2 Absolute standards***

#### ***3.2.2.1 International minimum standard***

This standard of treatment was developed in customary law as a way of guaranteeing a minimum standard of treatment for aliens, regardless of

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<sup>215</sup> As noted by Grierson-Weiler and Laird: ‘Thus far [2008], we have only a clutch of NAFTA awards addressing the meaning of a “proper” national treatment or MFN provision ...Virtually no other awards are publicly available addressing what “treatment no less favourable” means outside the GATT/WTO and NAFTA context.’ (in *Oxford Handbook of International Investment Law*: 259, at 290-1). It is submitted that, the greater the economic and governance divide between the parties, the less likely that a claim for violation of the comparative standards will be raised, therefore it is no surprise that most of the claims arise from the NAFTA, where two of the three parties share a very similar level of economic development.

<sup>216</sup> As also noted by Kurtz, J., ‘The merits and limits of comparativism: national treatment in international investment law and the WTO’, in Schill, 2010: 243, at 250.

the level of the national standard<sup>217</sup>. Capital exporting states championed the international minimum standard (IMS) as capable of guaranteeing an acceptable standard of protection for aliens across the board<sup>218</sup>. The criteria for its application were established by the *Neer Claim* Commission and have been used ever since<sup>219</sup>. They establish quite a high threshold for an investor to meet in his claim (or conversely, subject the states to quite low obligations with respect to foreigners) and it has been argued that investment law has developed an independent, higher standard of treatment decoupled from the minimalist approach of the

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<sup>217</sup> Rousseau, C., *Droit International Public*, Paris, Siray, 1970: 46; OECD, *Fair and Equitable Treatment Standard in International Investment Law*, OECD Working Papers on International Investment, No. 2004/3, Paris, OECD, 2004: 8-9.

<sup>218</sup> As noted by the *S.D. Myers* tribunal: ‘The minimum standard of treatment provision of the NAFTA is similar to clauses contained in [bilateral investment treaties]. The inclusion of a “minimum standard” provision is necessary to avoid what might otherwise be a gap. A government might treat an investor in a harsh, injurious and unjust manner, but do so in a way that is no different than the treatment inflicted on its own nationals. The “minimum standard” is a *floor below which treatment of foreign investors must not fall* [italics added], even if a government were not acting in a discriminatory manner.’ *S.D. Myers, Inc. v. Government of Canada*, Award, 13 November 2000, § 259.

<sup>219</sup> *L.F.H. Neer and Pauline Neer (USA) v. United Mexican States*, U.S.-Mexican General Claims Commission, 4 *RIAA* 60. The Commission required that, in order for there to be ‘an international delinquency’, ‘the treatment of an alien ... should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.’ (At :1). The Commission found the facts of the case did not support such a claim, which was therefore disallowed. It might also be opined that the criteria have been given more weight than they are able to carry. The standard is already mentioned in the *Sicilian Sulphur Monopoly Case* in 1838 (see British and Foreign State Papers, Vol. 28: 1166 ff., especially 1202, 1215 and 1218), as quoted by Herz, J.H. , ‘Expropriation of foreign property’, 35 *AJIL* (1941): 243, at 257: ‘there [in the *Sicilian Sulphur Case*] for the first time, the principle of equal treatment of aliens as the maximum of what foreigners could claim in this respect was opposed to that of an international standard of justice which, under certain circumstances, would give foreigners more than equality with nationals’.

*Neer* standard. In its 2001 Interim Award,<sup>220</sup> the *Pope & Talbot* Tribunal read an additional requirement of fairness in the international minimum standard of treatment (contained in Article 1105 of the NAFTA) thanks to the developments of treaty law, and more specifically, the 1987 US Model Bilateral Investment Treaty. The tribunal's interpretation provoked the response of the Free Trade Commission, which issued a binding interpretative note to the effect that the Article 1105 standard '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>221</sup> The *Mondev* tribunal went even further, rejecting the *Neer* standard as outdated and inadequate to cover the rights of individuals against state action<sup>222</sup> and arguing for the status of the IMS as *lex specialis*.

With respect to the relationship between the treaty standard and customary international law two currents can be identified: tribunals arbitrating disputes on a violation of NAFTA Article 1105 will pay greater attention to the content of the customary standard, with more or less deference paid to the Interpretative Note of the FTC<sup>223</sup>; tribunals

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<sup>220</sup> *Pope & Talbot v. Government of Canada*, Interim Award on Merits, Phase 2, 10 April 2001, § 111.

<sup>221</sup> In its subsequent Interim Award on Damages, the *Pope & Talbot* Tribunal, while accepting the note, defended its Award as consistent with it; see *Pope & Talbot*, Interim Award on Damages, 31 May 2002, §§ 49 ff. The Tribunal rejected a 'static interpretation' of customary international law, 'frozen in amber' at the time of the *Neer Claim*, stressing again the influence of treaty law's developments on customary obligations. However it went on to remark that the behaviour of the defendant state in any case rose to the level of the *Neer* standard.

<sup>222</sup> See *Mondev International Ltd v. United States of America* (ICSID Case No. ARB(AF)/99/2), Award, 11 October 2002, §§ 116-118.

<sup>223</sup> See *ADF Group Inc. v. United States of America* (ICSID Case No. ARB(AF)/00/1), Award, 9 January 2003, § 183: 'We are not convinced that the Investor has shown the existence, in current customary international law, of a general and autonomous requirement (autonomous, that is, from specific rules addressing particular, limited, contexts) to accord fair and equitable treatment and full protection and security to

arbitrating disputes arising under other investment agreements will refer to general rules of treaty interpretation in order to give content to the standard in the context of the treaty<sup>224</sup>, to the extent that they recognise, first, that CIL and treaty standard differ, and, second, that the treaty standard requires treatment in addition to what is provided in CIL<sup>225</sup>.

### 3.2.2.2 Fair and equitable treatment standard

The FET standard has been transformed from ‘sleeping beauty’<sup>226</sup> to ‘workhorse’ of investment law<sup>227</sup>. The case law on it is increasing<sup>228</sup>, as

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foreign investments. The Investor, for instance, has not shown that such a requirement has been brought into the corpus of present day customary international law by the many hundreds of bilateral investment treaties now extant.’

<sup>224</sup> See *Técnicas Medioambientales (Tecmed) S. A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, § 155. The *Tecmed* Tribunal gave a comprehensive account of what it considered the content of the FET standard in the previous paragraph.

<sup>225</sup> See also Kläger, R., ‘Fair and equitable treatment: a look at the theoretical underpinnings of legitimacy and fairness’, 11 *JWI&T* (2010): 436, referring to the *plain meaning approach* (FET as a free-standing standard) and the *equating approach* (FET equivalent to the IMS). Kläger, however, argues that contemporary tribunal practice is overcoming the controversy around this distinction, at 439.

<sup>226</sup> Schreuer, C., ‘The FET standard as “sleeping beauty”’, in Ortino *et al.*, 2007: 92.

<sup>227</sup> OECD, *Fair and Equitable Treatment Standard in International Investment Law*, OECD Working Papers on International Investment, No. 2004/3, Paris, OECD, 2004; Ortino, F. *et al.*, *Investment Treaty Law – Current Issues II*, British Institute of International and Comparative Law, London, 2007 (Part II); Tudor, I., *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment*, Oxford, OUP, 2008; Yannaca-Small, ‘Fair and equitable treatment standard: recent developments’, in Reinisch, 2008: 111; McLachlan, C., Shore, L. and Weiniger, M., *International Investment Arbitration – Substantive Principles*, Oxford, OUP, 2009 (Part III.7).

<sup>228</sup> Schreuer cites 13 claims of violation of the FET standard between 2006 and 2008; see Schreuer, C., ‘Introduction: interrelationship of standards’, Reinisch, A. (ed.), *Standards of Investment Protection*, Oxford, OUP, 2008: 2. For a comprehensive list of awards, see footnote 256, *infra*.

is the literature on its wording and its content<sup>229</sup>. Its relationship with the IMS<sup>230</sup> has provoked disagreements between states and investors and resulted in conflicting awards by tribunals, with some arguing for its self-standing, autonomous nature as a treaty-based standard, and some insisting on its linkage with the customary law international minimum standard. As Zachary Douglas remarked: ‘The complex issue is the technique by which, and the extent to which, general international law can be relied upon to give more specific content to the legal standard created by the investment treaty obligation’<sup>231</sup>.

These disagreements notwithstanding, tribunals and commentators have found agreement on a series of elements included in the terms ‘fair and equitable’ as an independent treaty standard, taking into consideration the context in which the terms appear. The elements have been summarised in the OECD study<sup>232</sup> as follows: a) obligation of vigilance and protection<sup>233</sup>; b) due process (to include protection against denial of justice and arbitrariness); c) transparency; d) good faith; and e) autonomous fairness elements. A definition that has been quoted and

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<sup>229</sup> The terms ‘fair’ and ‘equitable’ are normally considered separately; see however the suggestion that they might be interpreted as a sort of hendiadys, Wälde, in Ortino *et al.*, 2007: 140, or, as also suggested, as a reference to ‘law and equity’ familiar to common law practitioners.

<sup>230</sup> Already established in the OECD Draft Convention on the Protection of Foreign Property of 1967, 13-15, and confirmed in Article 1105 of the NAFTA.

<sup>231</sup> Douglas, 2009: 81. In other words, here, as often, the proposed approach is not of a binary choice, but of a balancing exercise. The conflict between the need to reconcile conflicting interests, or interpretations, and the binary structure of law results in the inevitable tensions and contestations.

<sup>232</sup> *Fair and Equitable Treatment Standard in International Investment Law*, OECD Working Papers No 2004/3: 26 ff., at <http://www.oecd.org/dataoecd/22/53/33776498.pdf>.

<sup>233</sup> Also part of the usual accompanying standard of ‘full protection and security’.

relied upon by several tribunals<sup>234</sup> was provided by the *Tecmed* tribunal<sup>235</sup>:

... [the FET standard], in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. 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. [...] The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities.

It is particularly within the context of NAFTA arbitrations that the content of the standard has resulted in disagreements and contestation<sup>236</sup>, as a result of some awards, which the NAFTA member states felt went too far in extending the standard to cover wide ranging protections, such as the transparency requirement advocated by the *Metalclad* tribunal<sup>237</sup>, or the requirement of fairness proposed by the *Pope & Talbot* tribunal. The FTC Interpretative Note can be seen as symptomatic of the attempt

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<sup>234</sup> *Eureko BV v. Republic of Poland*, UNCITRAL (PCA Case No. 2008-13), Partial Award, 19 August 2005, § 235; *Occidental Exploration and Production Co. v. Republic of Ecuador* (ICSID Case No. ARB/06/11) Final Award, 1 July 2004, § 185; *MTD Equity Sdn Bhd and MTD Chile SA v. Republic of Chile* (ICSID Case No. ARB/01/7), Award, 25 May 2004, § 114.

<sup>235</sup> *Tecnicas Medioambientales Tecmed, SA v. United Mexican States* (ICSID Case No. ARB(AF)/00/2) Award, 29 May 2003, § 154.

<sup>236</sup> See especially *Pope & Talbot*, Interim Award on Damages, 31 May 2002, §§ 49 ff; Free Trade Commission Notes of Interpretation of Certain Chapter 11 Provisions (*NAFTA Free Trade Commission, July 31, 2001*) (On Article 1105).

<sup>237</sup> *Metalclad Corporation v. United Mexican States* (ICSID Case No. ARB(AF)/97/1), Final Award, 30 August 2000, §§ 76 ff. This criterion was rejected in the judicial review of the award by the Supreme Court of British Columbia, *The United Mexican States v. Metalclad Corporation 2001 BCSC 664*, §§ 69 ff.

made by the NAFTA states parties to anchor the IMS/FET standard to the supposedly stricter customary law provision<sup>238</sup>. Similar steps have been taken by the NAFTA parties in the re-drafting of their model investment treaties. For example, the US 2004 Model BIT provides that, ‘The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights’<sup>239</sup>. The recent debates on the relationship between the IMS and

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<sup>238</sup> From the Interpretative Note of the FTC: ‘The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.’ (At [http://www.naftaclaims.com/files/NAFTA\\_Comm\\_1105\\_Transparency.pdf](http://www.naftaclaims.com/files/NAFTA_Comm_1105_Transparency.pdf)). It is submitted that the Note was meant to remind the tribunals ‘who is the boss’ in the NAFTA system, that is, the states. Especially in the context of the *Pope & Talbot* arbitration, the dual role of the involved state party (Canada) provoked criticism, as the Note was issued before the final award was delivered by the Tribunal. Equally, the tension between the rights of NAFTA investors v. rights of US investors underpinned the debate at the time when former President Bush requested Trade Promotion Authority, when Senators Kerry, Baucus and Grassley presented amendments trying to restrict the President’s power to approve trade and investment agreements which guaranteed rights to investor beyond what is available to US investors; see D. Schneiderman, 2008: 241 note 2.

<sup>239</sup> Article 5 [Minimum Standard of Treatment]. This amendment has been criticised for restricting unduly the scope of the standard; see for example Schwebel, S., ‘The United States 2004 model bilateral investment treaty: an exercise in the regressive development of international law’, *Global Reflections on International Law, Commerce and Dispute Resolution, Liber Amicorum for Dr. Robert Briner*, Paris, ICC Books, 2005: 815; Schwebel, S., ‘The United States 2004 model bilateral investment treaty and denial of justice in international law’, in Binder *et al.*, 2009: 519. The restrictive interpretation was accepted by the *Glamis* tribunal, See *Glamis Gold Ltd. v. United States of America*, Counter-memorial of the Respondent, September 19 2006, §§ 218 ff. In short, this would imply the adoption of the US Supreme Court ‘minimum rationality’ standard of review for economic legislation, as articulated by the Court in *United States v. Carolene Products*, 304 U.S. 144, 152 (1938). This standard is comparable to the international standard expressed in the *Neer Claim*. The position of the United States was accepted by the Tribunal, see *Glamis Gold Ltd. v. United States of America*, Award, June 8 2009,



the FET, between custom and treaty based standards, fail to address satisfactorily both the disagreements on the content and the function of the FET standard, and on its relationship with applicable criteria for expropriation<sup>240</sup>. In any case, outside the independently-developing case law of the NAFTA<sup>241</sup>, investment jurisprudence seem to be moving

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§ 22. A critical review of this case by Schill, S., in 104(2) *AJIL* (2010): 253. In the opposite direction, the awards in *Waste Management, Inc. v. United Mexican States* (No. 2) (ICSID Case No. ARB(AF)/00/3), Award, 30 April 2004, § 93. The *Waste Management* Tribunal also provided its own detailed interpretation of the standard, at § 98: ‘....the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency or candour in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.’ A much wider reach for the obligation is given by the *Tecmed* Tribunal, by extension of the standard to include a stable framework for the investment, see footnote 224; this is accepted also in *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan* (ICSID Case No. ARB/03/29) Decision on Jurisdiction, 14 November 2005, § 240: ‘....a State can breach the ‘stability limb’ of its obligation through acts which do not concern the regulatory framework but more generally the State’s policy towards investments.’

<sup>240</sup> Due process and non discrimination, which are elements of the FET standard, are also criteria for lawful expropriation. This could have repercussions for the assessment of a claim for compensation, as noted by Grierson-Weiler T. and Laird, I. A., ‘Standards of treatment,’ *The Oxford Handbook of International Investment Law*, 2008, Grierson-Weiler and Laird, at 266: ‘...many of the expropriation provisions found in investment protection treaties indicate that state responsibility is incurred when due process is denied during the taking of a property. Surely this cannot mean that denials of due process do not constitute a breach of the minimum standard unless a taking is involved. And if it is accepted...that the obligation to provide full, fair, and effective compensation for expropriation is a matter of customary international law, is it really necessary to include the...rather ubiquitous expropriation provision in treaties that already contain a minimum standard provision?’

<sup>241</sup> Exemplified by the *Glamis* Award, see *infra*.

beyond the controversy, as observed by the *Saluka* Tribunal: [...] it appears that the difference between the Treaty standard and the customary minimum standard, when applied to the specific facts of a case, may well be more apparent than real.’<sup>242</sup>

Functionally, the FET standard is developing as the counterpart of the expropriation clause to cover all those cases short of an expropriation, in which the investor claims to have suffered a harm. This is now accepted by many investment scholars<sup>243</sup> and informs the reasoning of tribunals.

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<sup>242</sup> *Saluka Investments BV v. Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, § 291. However, the Tribunal makes it clear in the following paragraphs that, in order for a violation of the treaty standard to be found, a ‘lower level of inappropriateness’ of the state’s behaviour might be sufficient, as compared to the customary standard, because of the purpose of BITs, which is the promotion of foreign investment, which requires a more pro-active and positive attitude from states.

<sup>243</sup> As noted by Grierson-Weiler and Laird, 1999, 268: ‘... a “fair and equitable treatment” provision can be construed broadly enough to cover all of the obligations in most conceivable investment disputes.’ See also See Schneiderman, 2008, 96; Dolzer, R., ‘Fair and equitable treatment: A key standard in investment treaties,’ 39 *International Law* (2005): 87; On the relevance of the ‘legitimate expectations’ element of the FET standard and its relationship with expropriation claims, see *International Thunderbird Gaming Corporation v. United Mexican States* (UNCITRAL), Separate opinion of Thomas Wälde, 26 January 2006, § 37: ‘One can observe over the last years a significant growth in the role and scope of the legitimate expectation principle, from an earlier function as a subsidiary interpretative principle to reinforce a particular interpretative approach chosen, to its current role as a self-standing subcategory and independent basis for a claim under the “fair and equitable standard” as under Art. 1105 of the NAFTA. This is possibly related to the fact that it provides a *more supple way of providing a remedy* [italics added] appropriate to the particular situation as compared to the more drastic determination and remedy inherent in concept of regulatory expropriation. It is probably partly for these reasons that “legitimate expectation” has become for tribunals a preferred way of providing protection to claimants in situations where the tests for a “regulatory taking” appear too difficult, complex and too easily assailable for reliance on a measure of subjective judgment.’

For example, the *PSEG* tribunal, in a case regarding a privatisation project in the energy sector, stated<sup>244</sup>:

The standard of fair and equitable treatment has acquired prominence in investment arbitration as a consequence of the fact that other standards traditionally provided by international law might not in the circumstances of each case be entirely appropriate. This is particularly the case when the facts of the dispute do not clearly support the claim of direct expropriation, but when there are notwithstanding events that need to be assessed under a different standard to provide redress in the event that the rights of the investor have been breached.

A claim for breach of the FET standard, based on the violation of the principles of good faith and protection of legitimate expectations<sup>245</sup> can

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<sup>244</sup> *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi v. Republic of Turkey* (ICSID Case No. ARB/02/5), Award, 19 January 2007, § 238.

<sup>245</sup> See Grierson-Weiler and Laird, 2008, at 272: ‘As an elemental principle in the ordering of relations between states, good faith provides the glue that holds the international order together.’ See also Schreuer, C., ‘Fair and equitable treatment in arbitral practice’, 6 *Journal of World Investment & Trade* (2005): 357 at 384; for the principle in awards, see *AMCO Asia v. Indonesia*, (ICSID Case No. ARB/81/1), Award, 5 June 1990, 1 *ICSID Reports* 377, at 490 and 493; *Tecnicas Medioambientales Tecmed, SA v. United Mexican States* (ICSID Case No. ARB(AF)/00/2) Award, 29 May 2003, §§ 153-4; *Waste Management, Inc. v. United Mexican States* (No. 2) (ICSID Case No. ARB(AF)/00/3), Award, 30 April 2004, § 138; *MTD Equity Sdn Bhd & MTD Chile SA v. Republic of Chile* (ICSID Case No. ARB/01/7) Award, 25 May 2004, § 109; *Saluka BV v. Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, § 303; *Sempra Energy v. The Argentine Republic* (ICSID Case No ARB/02/16) Award, 28 September 2007, §§ 300-01; *EDF (Services) Limited v. Romania* (ICSID Case No. ARB/05/13), Award, 8 October 2009, § 216: ‘The Tribunal shares the view expressed by other tribunals that one of the major components of the FET standard is the parties’ legitimate and reasonable expectations with respect to the investment they have made’; *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal v. Argentine Republic* (ICSID Case No. ARB/03/19), Decision on Liability, 30 July 2010 (this case is interesting as Argentina, on top of using the necessity defence for its actions, also appealed to its human rights obligations in guaranteeing its citizens’ ‘right to water’; this argument was rejected by the Tribunal, which stated that Argentina had a duty to respect both its investment and human rights obligations equally, at § 262. For this case, see also the Separate Opinion of arbitrator Pedro Nikken, based on a

be successful with a lower standard of proof<sup>246</sup> than a claim for indirect expropriation<sup>247</sup>. As noted by Dolzer, ‘...the principle [FET standard] has the potential to reach further into the traditional “domain réservé” of the host state than any one of the other rules’<sup>248</sup>. It is evidently for this reason that virtually all treaty claims include an alleged violation of the standard, as the casuistic approach advocated for its application allows for the elasticity of the system which makes a claim more likely to be successful.

Recent scholarly developments have advocated a comparative approach that takes into account public law principles and standards for administrative conduct derived from liberal legal systems as an expression of the ‘rule of law’. Schill summarises the elements

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disagreement with the Tribunal on the inclusion of the ‘legitimate expectations’ of the investor in the substantive protections guaranteed by the FET standard.)

<sup>246</sup> The statement that: ‘the *Chorzów Factory* principle of full recovery of losses would equally apply to breach of fair and equitable treatment and expropriation’ might be a bit too optimistic (see Paradell, L., ‘The BIT experience of the fair and equitable treatment standard’, in Ortino *et al.*, 2007: 118). The *Chorzów Factory* standard, which is much repeated in investment law, was linked in that particular case to express treaty commitments *forbidding* expropriation. A helpful survey on the topic in Wälde, T. and Sabahi, B., ‘Compensation, damages, and valuation’, in *The Oxford Handbook of International Investment Law*, 2008: 1049. For tribunals accepting the *Chorzów* standard for non-expropriation treaty breaches (including FET standard) see *S. D. Myers, Inc. v. Canada*, Award, 13 November 2004, § 304; *Metalclad Corp. v. United Mexican States*, Award, 30 August 2000, § 122. But for cases in which tribunals reduced the *quantum* in consideration of the legality of the states’ measures, see *MTD Equity Sdn Bhd and MTD Chile SA v Republic of Chile*, Award, 25 May 2004, §§ 242-6; *Iurii Bogdanov, Agurdino-Invest Ltd and Agurdino-Chimia JSC v. Republic of Moldova*, Award 22 September 2005, § 5.2.

<sup>247</sup> See UNCTAD, *Latest Developments in Investor-State Dispute Settlement*, United Nations, New York and Geneva, 2009 (UNCTAD/WEB/DIAE/IA/2009/6/Rev1) at 8: ‘[...] FET remains the most relied upon and successful basis for a treaty claim.’

<sup>248</sup> Dolzer, R., ‘The impact of international investment treaties on domestic administrative law’, 37 *NYU Journal of International Law and Policy* (2005): 953 at 964.

comprising the standard as follows: '[...] stability, predictability and consistency of the legal framework; the principle of legality; the protection of legitimate expectations; procedural due process and denial of justice; substantive due process and protection against discrimination and arbitrariness; transparency; and the principle of reasonableness and proportionality'<sup>249</sup>. The principles, comprising substantive and procedural protection, absolute and balanced provisions, and pitched at a high level of abstraction, can work both to confer an unreasonably high level of protection against legitimate public interest intervention (for example, by a myopic reading of the stability requirement<sup>250</sup>) or allow for the appropriate balancing of conflicting, legitimate regulatory commitments (*via* the judicious application of the principle of proportionality). Recent arbitral awards reflect the developing consensus around this cluster of inter-related principles, which reveals more the common political and jurisprudential culture of the arbitrators<sup>251</sup> than provides a faithful interpretation of the vague and almost content-free language of the treaties<sup>252</sup>. This is said without prejudice to the effective

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<sup>249</sup> Schill, S., 'Fair and equitable treatment, the rule of law, and comparative public law', in Schill, 2010: 151, at 159-60.

<sup>250</sup> Such as the inflexible standard adopted by the *Metalclad* Tribunal; see *Metalclad Corporation v. United Mexican States* (ICSID Case No. ARB(AF)/97/1), Award, 30 August 2000, § 76. It seems almost ironic that it is the FET standard, whose vagueness and uncertainty of application are common knowledge, to be dictating clarity, predictability, transparency etc.

<sup>251</sup> And of the investment community in general, including practitioners, public international lawyers, commercial lawyers and academics.

<sup>252</sup> A part from the awards already quoted in this section, see also the following: *Ronald Lauder v. Czech Republic*, UNCITRAL, Final award, 2 September 2001; *Occidental Exploration and Production Co. v. Republic of Ecuador*, UNCITRAL, Final Award, 1 July 2004; *GAMI Investments Inc. v. United Mexican States*, UNCITRAL/NAFTA, Final award, 15 November 2004; *CMS Gas Transmission Co. v. Argentine Republic* (ICSID Case No. ARB/01/8), Award, 12 May 2005; *Noble Ventures, Inc. v. Romania* (ICSID Case No. ARB/01/11), Award, 2 October 2005; *International Thunderbird Gaming Corp. v. United Mexican States*, UNCITRAL/NAFTA, Award, 26 January 2006; *Azurix Corp. v. Argentine Republic* (ICSID Case No. ARB/03/30), Award, 14

relationship between rule of law, economic policy, political risk management, development programmes and so on, on which there is an immense literature, which we purposefully avoided in this work.

### 3.3 Expropriation

Moving from standards of treatment to expropriation results in a considerable shift of perspective. From claims based on alleged unlawful governmental action (standards of treatment which might, however peculiarly expressed in investment law, find their basis on general human rights obligations and customary law principles) we move to claims that are borne out of legitimate measures, accepted as lawful in customary international law, treaty law and domestic codes the world over, which can be distilled in a general principle of lawfulness of expropriation against the payment of compensation. Secondly, from standards of

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July 2006; *LG&E Energy Corp. LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic* (ICSID Case No. ARB/02/1), Decision on Liability, 3 October 2006; *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi v. Republic of Turkey* (ICSID Case No. ARB/02/5), Award, 19 January 2007; *Enron Corp. and Ponderosa Assets LP v. Argentine Republic* (ICSID Case No. RB/01/3), Award, 22 May 2007; *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic* (ICSID Case No. ARB/97/3), Award, 20 August 2007; *Parkerings-Compagniet AS v. Republic of Lithuania* (ICSID Case No. ARB/05/8), Award, 11 September 2007; *Metalpar S.A. and Buen Aire S.A. v. Argentine Republic* (ICSID Case No. ARB/03/5), Award on the merits, 6 June 2008; *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania* (ICSID Case No. ARB/05/22), Award, 24 July 2008; *Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Republic of Kazakhstan* (ICSID Case No. ARB/05/16), Award, 29 July 2008; *Duke Energy Electroquil Partners and Electroquil S.A. v. Republic of Ecuador* (ICSID Case No. ARB/04/19), Award, 18 August 2008; *Continental Casualty Company v. Argentine Republic* (ICSID Case No. ARB/03/9), Award, 5 September 2008; *Jan de Nul N.V. and Dredging International N.V. v. Arab Republic of Egypt* (ICSID Case No. ARB/04/13), Award, 6 November 2008; *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan* (ICSID Case No. ARB/03/29), Award, 27 August 2009.

protection grounded directly in international law, we move to property law principles and concepts, rooted in domestic law<sup>253</sup>. While in principle standards of treatment can be enforced by reference to treaty based obligations exclusively (with claims based on a treaty protected right such as the FET standard), expropriation claims will necessarily find their basis on domestic law-protected rights. It will be the *conduct* of the host state with respect to the protected property right to constitute the breach<sup>254</sup>, but the *legal basis* of the claim will be a property right

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<sup>253</sup> On the global constitutional nature of property rights protection, and in general on investment law as ‘global constitutional law’ (GCL), see Montt, S. *State Liability in Investment Treaty Arbitration*, Oxford, Hart Publishing, 2009: 12 ff., at 17: ‘...the principle of no expropriation without compensation, and its corresponding focus on the scope of property rights and investments, is defined here as the ‘centre of gravity’ of GCL...’. Montt notes though, at 173, that property rights do not tend to have a constitutional basis and quotes Fishel (at footnote 30) to the effect that the Takings Clause in the US Constitution has to be assessed with reference to other sources, such as statutes and common law. To this extent, American takings jurisprudence mirrors the way in which expropriation clauses are established with reference to domestic norms of property law; for this, see for example the Separate Opinion of Judge Morelli in *Barcelona Traction, Light and Power Co. Ltd. (Belgium v. Spain)* Second Phase, [1970] ICJ Rep.4, 234: ‘As will be observed, the fact that the rules of international law in question envisage solely such interests of foreigners as already constitute rights in the municipal order is but the necessary consequence of the very content of the obligations imposed by those rules; obligations which, precisely, presuppose rights conferred on foreigners by the legal order of the State in question.’ This might be taken as a further indication of the ‘constitutional status’ of the expropriation standards in international investment law (just as the takings clause has constitutional status with respect to domestically guaranteed property rights), especially in view of the ‘normative creep’ of the standards to cover rights which might not be recognised property rights domestically (‘investment access’ to a foreign market, for example [exercising ‘conceptual severance’], see *Pope & Talbot, Inc. v. The Government of Canada* (UNCITRAL), Interim Award – Phase One, 26 June 2000, § 96).

<sup>254</sup> Regardless of its legality in the municipal law of the host state: see Article 27 of the Vienna Convention on the Law of Treaties. See also Crawford, J. (ed.), *The International Law Commission’s Articles on State Responsibility: Introduction, Text and Commentaries*, Cambridge, CUP, 2002 at 61: ‘The characterization of an act of a

established in the municipal property law or contract law (for expropriation of contract rights) of the host state<sup>255</sup>. As noted by Douglas<sup>256</sup>, ‘general international law contains no substantive rules of property law’; what it does contain, however, is substantive rules on the taking of property, and, more specifically, a set of criteria on lawful expropriation. It is a well-established principle of customary international law<sup>257</sup> that the state has the power to take private property<sup>258</sup> in certain

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State as internationally wrongful is governed by international law. Such characterization is not affected by the characterization of the same act as lawful by internal law.’

<sup>255</sup> See Douglas, 2009: 52. His ‘Rule 4’ is as follows: ‘The law applicable to an issue relating to the existence or scope of property rights comprising the investment is the municipal law of the host state, including its rules of private international law.’ For a more ‘aggressive’ approach in defining what constitutes a ‘possession’ for the purposes of protection, see the Grand Chamber Judgment in *Broniowski v. Poland*, Appl. No. 31443/92, 22 June 2004, § 129: ‘The concept of “possessions” in the first part of Article 1 of Protocol No. 1 has an autonomous meaning which is not limited to the ownership of material goods and is independent from the formal classification in domestic law.’

<sup>256</sup> *Ibidem*.

<sup>257</sup> The literature on the subject is understandably wide; see by way of introduction Herz, J. H., ‘Expropriation of foreign property’, 35 *AJIL* (1941):243; Christie, G. C., ‘What constitutes a taking under international law’, 33 *BYIL* (1962): 307; Fatouros, A. A., *Government Guarantees to Foreign Investors*, New York, Columbia University Press, 1962; Lillich, R., *The Protection of Foreign Investment*, Syracuse, Syracuse University Press, 1965; Schachter, O., ‘Compensation for expropriation’, 78 *AJIL* (1984): 121; see also Garcia Amador, F. V., *Special Rapporteur’s Fourth Report on International Responsibility*, A/CN.4/119, 26 February 1959, § 41: ‘The right of “expropriation” ... is recognized in international law, irrespective of the “patrimonial rights involved or of the nationality of the person in whom they are vested.” ... Traditionally, this right has been regarded as a discretionary power inherent in the sovereignty and jurisdiction which the State exercises over all persons and things in its territory, or in the so-called right to “self-preservation,” which allows it, inter alia to further the welfare and economic progress of its population.’

<sup>258</sup> Property is here intended as a set of legal rights and obligations that connect a person, natural or legal, to a certain good, tangible or intangible. The tension between property rights as fundamental rights beyond the reach of state’s interference and property rights as creatures of the state (which is a classic constitutional dilemma) is noted by many; see for example Higgins, 1982, 274: ‘...the innate tension between



circumstances<sup>259</sup>. Customary law recognises that property taken by a state in the exercise of its “police powers” constitutes a non-compensable act<sup>260</sup>, but in all other cases, compensation needs to be paid in order for the expropriation to be considered lawful. Expropriation is therefore a lawful action *sub modo*, conditioned by the requirements that it is carried out for a public purpose, in a non discriminatory manner, according to

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private property (given its attributes) and the State seems undeniable. It is a function of the law to reconcile these: and it is a function of international law to reconcile these elements when they occur across State boundaries. ... While virtually all nations ... recognize the right to hold property, these same constitutions also envisage that this established right may be limited by community interests.’ See also Schneiderman, D., ‘Property rights and regulatory innovation: comparing constitutional cultures’, 4 *International Journal of Constitutional Law* (2006): 371.

<sup>259</sup> The consequences of expropriation in customary law have been discussed at the Permanent Court of International Justice, the International Court of Justice and at Mixed Claim Commissions, including the decisions of the Iran-US Claims Tribunal; for the jurisprudence of the last one, see amongst others, Khan, R., *The Iran-United States Claims Tribunal: Controversies, Cases, and Contribution*, The Hague, Martinus Nijhoff, 1990; Mapp, W., *The Iran-United States Claims Tribunal: The First Ten Years, 1981-1991: An Assessment of the Tribunal’s Jurisprudence and its Contribution to International Arbitration*, Manchester, Manchester University Press, 1993; Brower, C. N., ‘The Iran-United States Claims Tribunal’ *Recueil des Cours*, The Hague, Martinus Nijhoff Publishers, 1993: 123-396; Aldrich, G. H., *The Jurisprudence of the Iran-United States Claims Tribunal*, Oxford, Clarendon Press, 1996; Lillich, R. and McGraw, D. B. (eds.), *The Iran-United States Claims Tribunal: Its Contribution to the Law of State Responsibility*, Irvington on Hudson, Transnational Publishers, 1998; Mohebi, M., *The international Law Character of the Iran-United States Claims Tribunal*, The Hague, Kluwer Law International, 1999; Caron, D. D. and Crook, J. R. (eds.) *The Iran-United States Claims Tribunal and the Process of International Claims Resolution: A Study by the Panel on State Responsibility of the American Society of International Law*, Irvington on Hudson, Transnational Publishers, 2000.

<sup>260</sup> See also *Reinstatement of the Law of Foreign Relations (Third)*, n 195, 200-2001, § 712. The difficulties of keeping this distinction have been outlined by many; see mainly Michelmans, F., ‘Property, utility and fairness: comments on the ethical foundations of “just compensation” law’, 80 *Harvard Law Review* (1967): 1165. For the principle in international law, see also Brownie, I., *Public International Law*, 6<sup>th</sup> Ed., Oxford, OUP, 2003: 509.

due process, and against payment of compensation<sup>261</sup>. The most important protection traditionally granted to aliens (in customary law) and investors (in treaty law) and their property and investments was against uncompensated direct expropriations and nationalisations. These forms of state interference with property rights reached their peak in the 1970s, as a result of the de-colonisation process and the accompanying elaboration of alternative models of economic development at the United Nations level, including the debates around the New Economic Order, culminating in a series of resolutions passed by the General Assembly<sup>262</sup>. At the time, the basis upon which a state based its claim on property did

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<sup>261</sup> The public purpose criterion is normally treated with a high level of deference by tribunals, being a prerogative of states to establish the content and extent of the public interest (for a recent review, see Reinisch, A., 'Legality of expropriations', in Reinisch, 2008: 178 ff.). On the burden of proof to be placed on the investor to show that there is no public purpose, see *American International Group Case* (1983) 4 *Iran-USCTR* 96, at 105. A recent discussion in the controversial *Kelo v. City of New London*, 545 U.S. 469 (2005). See also *ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary* (ICSID Case No. ARB/03/16), Award, 2 October 2006, § 476, where the tribunal found that: 'the expropriation of the Claimants' interest constituted a depriving measure under Article 4 of the BIT and was unlawful as: (a) the taking was not in the public interest; (b) it did not comply with due process, in particular, the Claimants were denied of "fair and equitable treatment" specified in Article 3(1) of the BIT and the Respondent failed to provide "full security and protection" to the Claimants' investment under Article 3(2) of the BIT; (c) the taking was discriminatory and (d) the taking was not accompanied by the payment of just compensation to the expropriated parties.' The discriminatory character of the host state action needs to be examined in conjunction with the standard of treatment accorded to the investor. The chronological element (how timely does the compensation has to be paid, and when does the state cross the line and finds itself in violation of this obligation?) has been considered by the Tribunal in *Antoin Goetz and Others v. Republic of Burundi*, (ICSID Case No. ARB/01/2) Award, 10 February 1999, 15 *ICSID Review* (2000) 457, § 131.

<sup>262</sup> Permanent Sovereignty Over Natural Resources, 14 December 1962; Permanent Sovereignty over Natural Resources, 17 December 1973; Declaration on the Establishment of a New International Economic Order, 1 May 1974; Charter of Economic Rights and Duties of States, 16 September 1975. All UNGA Resolutions are available on the United Nations website at <http://www.un.org/documents/resga.htm>.

not attract as much as attention as the issue of compensation for the taking of that property<sup>263</sup>. The standard of compensation became a matter of debate: the disagreements between capital-importing and capital-exporting states focussed on the appropriate *quantum*, especially for large-scale nationalisation programmes implemented as part of a decolonisation process<sup>264</sup>. The classic rules on compensation for expropriation had been developed in the nineteenth century, both as a result of diplomatic exchanges, especially between the United States and the Latin American states, and later in a series of arbitrations and cases at the Permanent Court of International Justice. It was US Secretary of State Cordell Hull, in response to a note by the Mexican Foreign Secretary on the existence in international law of the requirement of compensation for “expropriations of a general and impersonal character”, to reply: ‘Under every rule of law and equity, no government is entitled to expropriate private property, for whatever purposes, without provision for prompt, adequate and effective compensation’<sup>265</sup>. The United States, together with several other capital exporting countries, have always maintained the customary character of this formula<sup>266</sup>, but since the beginning there

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<sup>263</sup> See Seidl-Hohenveldern, 1992, at 137: ‘The debate on the legitimacy of taking measures almost exclusively concerns this problem of compensation. Of course, any taking, in order to be justifiable under international law, must also be for a public purpose. Yet this condition has not been the object of much judicial scrutiny.’

<sup>264</sup> On the standard of compensation for unlawful expropriation (damages), see *The Factory at Chorzów (Indemnity) (Germany/Poland)* PCIJ 1928; *Lighthouses Arbitration* (1956) 23 ILR 299; *Sapphire Int. Petroleum v. NIOC* (1967) 35 ILR 136; *BP Exploration Co. (Libya) Ltd. v. Government of the Libyan Arab Republic* (1973) 53 ILR 297; *Texaco Overseas Petroleum Co. and California Asiatic Oil Co. v. Libya* (1977) 53 ILR 389; (1978) 17 ILM 1; *AGIP Company v. Popular Republic of Congo* (1982) 21 ILM 726; (ICSID Case No. ARB/77/1); *SEDCO Inc. v. Iran* (1986) 10 Iran-USCTR 180; *Amoco International Finance Corp. v. Iran* (1987) 15 Iran-USCTR 189; *Sociedad Minera el Teniente SA v. Aktiengesellschaft Norddeutsche Attinerie (Chilean Copper Case)* (1973) 12 ILM 251; *LETSCO v. Liberia* (1986) 26 ILM 647.

<sup>265</sup> Whiteman, 8 Digest 1020, quoted in Sornarajah, 2004: 438 n. 2.

<sup>266</sup> The formula is repeated in the US DoS, *Statement on Foreign Investment and Nationalization*, 15 ILM (1976): 186.

has been resistance to this position<sup>267</sup>. However, its inclusion in bilateral investment treaties signals the acceptance of the standard as the standard applicable in the relationship between the contracting parties<sup>268</sup>.

The protection against uncompensated expropriation is the cornerstone of the substantive content of international investment treaties; however, a claim of expropriation has to be based on the existence of a property right in the domestic law of the country<sup>269</sup>. Only the extent to which property rights are protected against expropriation is determined with reference to international law: by way of example, investment tribunals normally acknowledge that contractual rights can be expropriated and therefore states are liable to pay compensation<sup>270</sup>. Where public law

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<sup>267</sup> See for example Schachter, O., 'Compensation for expropriation', 78 *AJIL* (1984): 121; Dolzer, R., 'New Foundations of the Law of Expropriation of Alien Property', 75 *AJIL* (1981): 553; Friedman, S., *Expropriation in International Law*, London, Stevens & Sons, 1953: 206.

<sup>268</sup> Two conflicting interpretations are given for this: either that treaties are signed because the status of customary law does not guarantee an adequate level of protection for foreign investors (Sornarajah, 2004: 206; Kishoyian, B., 'The utility of bilateral investment treaties in the formulation of customary international law' 14 *Northwestern Journal of International Law & Business* (1994): 327; Baxter, R. R., 'Treaties and customs', 129 *Recueil des Cours* (1970-1): 27, at 83-4. More recently, see also Doak Bishop, R., Crawford, J. and Reisman, M., *Foreign Investment Disputes*, Leiden, Kluwer Law International, 2005: 1007; or, that treaties reinforce the traditional standards of customary law; see Denza, E. and Brooks, S., 'Investment protection treaties: the United Kingdom experience', 36 *ICLQ* (1987): 908, at 913; Mann, F. A., 'British Treaties for the promotion and protection of investment', 52 *BYIL* (1981): 241; Brownlie, 1998: 520; Schachter, O., 'International law in theory and practice: general course in public international law', 178 *Recueil des cours* (1982): 299.

<sup>269</sup> See for example *Alasdair Ross Anderson and others v. Republic of Costa Rica* (ICSID Case No. ARB(AF)/07/3), Award, 19 May 2010, where property obtained illegally according to the municipal law of Costa Rica was not covered by the BIT protection (lack of due diligence on the part of the claimants).

<sup>270</sup> See *Libyan American Oil Co. (LIAMCO) v. Government of the Libyan Arab Republic*, 62 *ILR* 140 (1980); *Starrett Housing Corp. et al. v. Islamic Republic of Iran* (Interlocutory Award) (1983), 4 *Iran-USCTR*, 122, 156-7; *Phillips Petroleum Co. Iran*

obligations and issues of contractual performance intersect, it is difficult to establish to what standard the state should be held to *vis-à-vis* the investors. Investors can bring an international claim only if the substantive obligations on expropriation have been violated. A simple breach of contract will not suffice to trigger the arbitration clause in the treaty, as a contractual claim is subject to the privity rule and might have to be litigated domestically, depending on the arbitration clause contained in the contract, which cannot be bypassed by the equivalent treaty clause. For contractual breaches resulting in economic loss, the determining factor is if the state is acting *iure imperii*<sup>271</sup>. As Reinisch put it: ‘The guiding principle in locating an expropriation appears to be whether a state has acted in its sovereign capacity, exercising its governmental or public power or authority’<sup>272</sup>. Expropriations, of whatever kind, are ‘inherently governmental acts’<sup>273</sup>, therefore, the

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*v. Islamic Republic of Iran, The National Iranian Oil Co.* (1989), 21 *Iran-USCTR* 79, 106. See also *Consortium RFCC v. Kingdom of Morocco* (ICSID Case No. ARB/00/6), Award, 22 December 2003: § 60.

<sup>271</sup> See Schreuer, C., ‘The concept of expropriation under the ECT and other investment protection treaties’, at [http://www.univie.ac.at/intlaw/pdf/csunpublpaper\\_3.pdf](http://www.univie.ac.at/intlaw/pdf/csunpublpaper_3.pdf); see also Brownlie, 1998: 550: ‘A breach of contract is an expropriation if it is confiscatory...if the State exercises its executive or legislative authority to destroy the contractual rights as an asset.’ As recognised by Higgins, 1982, 298: ‘The more that a concession contract had been assimilated to the civil law concept of “administrative contract”, the more opportunity will there be for government to claim to reserve to itself powers to rectify and amend the arrangements entered into.’ See also Campbell, E., ‘Legal problems in government participation in resource projects’, 126 *Australian Mineral and Petroleum Association Yearbook* (1984): 144, as quoted by Sornarajah, M., *The Settlement of Foreign Investment Disputes*, The Hague, Kluwer Law International, 2000, at 87: ‘Those who enter into agreements with governments and government agencies are always at risk that the performance of the agreement may be rendered wholly or partially impossible by either supervening legislation or by ... statutory power.’

<sup>272</sup> Reinisch, A., ‘Expropriation’, in *The Oxford Handbook of International Law*: 418.

<sup>273</sup> *Waste Management, Inc. v. United Mexican States* (ICSID Case No. ARB(AF)/00/3), Award, 30 April 2004, § 174.

simple non-performance of a contractual obligation, however detrimental to the protected property rights, will not qualify as an expropriation<sup>274</sup>.

While the international law rules pertaining to direct expropriations are relatively clear, indirect interference with the property rights of the investor, where no title to property is taken and there is not necessarily a transfer of value between the investor and the state, has been met with a considerable degree of normative uncertainty. These days, states rarely carry out extensive nationalisation programmes or directly expropriate property. Therefore, tribunals are confronted normally with claims of indirect expropriations.

### *3.3.1 Regulatory expropriation*

The ways in which property rights and governmental policy intersect are numerous and constantly evolving: environmental and zoning regulation, health and safety measures, labour standards, taxation can all have an effect on the property rights and the profit expectations of investors. Legislators can hardly keep up with them and account for all the possible harms that can result from regulatory interference with property rights. Equally, when signing investment protection treaties, states do not usually give substantive content to the provisions against unlawful expropriation, preferring to restrict themselves to the criteria of a lawful expropriation. Therefore, what constitutes a measure ‘tantamount to expropriation’<sup>275</sup> is left to the tribunals to decide<sup>276</sup>.

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<sup>274</sup> See also Schwebel, S. M., *International Arbitration: Three Salient Problems*, Cambridge, CUP, 1987, 111: ‘...it is generally accepted that, so long as it affords remedies in its Courts, a State is only directly responsible, on the international plane, for acts involving breaches of contract, where the breach is not a simple breach...but involves an obviously arbitrary or tortious element...’

<sup>275</sup> This term is taken from Article 1110 of the NAFTA. While NAFTA tribunals have clarified that ‘tantamount’ has to be interpreted as ‘equivalent’, and therefore should not

Policy reasons for measures that can cause individual harm in the pursuit of a common good are many and have given rise to a considerable amount of theoretical reflection. Basic principles of distributive justice dictate that the benefits of the majority cannot be bought at the expense

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be used to extend the definition of expropriation (*Pope & Talbot v. Canada*, Interim Award, 26 June 2000: §104; *S.D. Myers Inc. v. Canada* (1st Partial Award, 13 November 2000), 40 *I.L.M.* 1408: § 286), it has been argued that: '[t]he major achievement of the "tantamount" clause, found in substance in almost all BITs, ... consists in extending the scope of indirect expropriation to an egregious failure to create or maintain the normative "favourable" conditions in the host state.' (Reisman, W. M and Sloane, R. D., 'Indirect expropriation and its valuation in the BIT generation', 74 *BYIL* (2003): 115, at 117). We will see in Chapter 6 how NAFTA states have dealt with the issue by way of clarification.

<sup>276</sup> The literature on the subject is vast: see for example Westberg, J. A., 'Applicable law, expropriatory takings and compensation in cases of expropriation; ICSID and Iran-United States claims tribunal case law compared', 8 *ICSID Review* (1993): 1; Vaughan Lowe, A., 'Regulation or expropriation?' 55 *Current Legal Problems* (2002): 447; Dolzer, R., 'Indirect expropriations: new developments?', 11 *New York University Environmental Law Journal* (2002): 64; Been, V., 'Does an international "regulatory takings" doctrine make sense?' 11 *New York University Environmental Law Journal* (2002): 49; Brunetti, M., 'Indirect expropriation in international law', 5 *International Law FORUM du Droit International* (2003): 150; Dolzer, R. and Bloch, F., 'Indirect expropriation: conceptual realignments?', 5 *International Law FORUM du Droit International* (2003): 155; Been, V. and Beauvais, J. C., 'The global fifth amendment: NAFTA's investment protections and the misguided quest for an international "regulatory takings" doctrine', 78 *New York University Law Review* (2003): 30; Fortier, L. Y. and Drymer, S. L., 'Indirect expropriation in the law of international investment: I know it when I see it or caveat investor', 19 *ICSID Review* (2004): 29; Paulsson, J. and Douglas, Z., 'Indirect expropriation in investment treaty arbitration', in Horn, N. and Kröll, S., eds. *Arbitrating Foreign Investment Disputes: Procedural and Substantive Legal Aspects*, The Hague, Kluwer Law International, 2004: 145; Heiskanen, V., 'The doctrine of indirect expropriation in light of the practice of the Iran-United States claims tribunal', 7 *JWI&T* (2007): 215; Kriebaum, U., 'Partial expropriation', 8 *JWI&T* (2007): 69; Kriebaum, U., 'Regulatory takings: balancing the interests of the investor and the state', 8 *JWI&T* (2007): 717; Ratner, S., 'Regulatory takings in institutional context: beyond the fear of fragmented international law', 102 *AJIL* (2008): 475; Hoffmann, A. K., 'Indirect expropriation', in Reinisch, 2008: 151.

of the minority<sup>277</sup>. The ‘socialization of the losses’ consequent to a taking implies that a loss by a private has to be socialised by the imposition of compensation, which is borne ultimately by the community<sup>278</sup>. There are problems inherent with this approach: for example, how to keep the distinction between individual and community interests, if the individual is also a member of the community, and how to quantify the loss accordingly<sup>279</sup>. Can efficiency tempered by fairness act as guiding principles?<sup>280</sup> And is it up to courts or tribunals to establish how these principles should find application in individual cases? These are crucial questions, which go to the core of the interaction between individual rights and social goods. To focus on the matter of ‘just compensation’<sup>281</sup> is immensely reductive and yet still highly

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<sup>277</sup> If one is accounting for the distribution of the burdens rather than of the benefits. Shifting the focus on the distribution of burdens reveals the deficiency of distinguishing between the state as purchaser and as regulator in order to determine if compensation is due or not.

<sup>278</sup> See *Armstrong v. US* (1960) 364 US 40, 49: ‘The Fifth Amendment’s guarantee that private property shall not be taken for a public use without just compensation was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.’

<sup>279</sup> See for example Justice Brandeis dissenting opinion in the landmark case *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922): ‘*Reciprocity of advantage* [italics added] is an important consideration, and may even be an essential, where the state’s power is exercised for the purpose of conferring benefits upon the property of a neighborhood... [citations omitted].’

<sup>280</sup> On the difficulties of applying the efficiency, or cost internalisation, rationale to the international context, see Been, V., ‘Does an international “regulatory takings” doctrine make sense?’, 11 *NYU Environmental Law Journal* (2003): 49 at 53 ff. On a positive account on how the principle of efficiency can help in drawing the line between uncompensated regulation and indirect expropriation, see Gazzini, T., ‘Drawing the line between non-compensable regulatory powers and indirect expropriation of foreign investment – an economic analysis of law perspective’, 7 *Manchester Journal of International Economic Law* (2010): 36.

<sup>281</sup> This is taken from the language of the Fifth Amendment of the US Constitution, which states: ‘No person ... shall be deprived of ...property, without due process of law; nor shall private property be taken for public use, without just compensation.’



complex and frustratingly imprecise. But that is also where our analysis concentrates, as that is where investment tribunals have focused their attention<sup>282</sup>. Two questions are relevant to our enquiry: what measures give rise *in law* to a claim for compensation? And which ones can be implemented with no compensation, without thereby losing their legitimacy<sup>283</sup>? Frank Michelman, in his seminal 1967 article<sup>284</sup>, articulated very clearly the nature of the problems arising from trying to answer these questions:

....legislators and administrators are likely to regard prevention of capricious redistribution not as a “policy” element to be weighed in arriving at decisions, but rather as a technical adjustment to be made by courts after policy decisions have been made. Let it be determined what measures “in the public interest” requires; and, if, in the course of carrying out those measures, it appears that someone is sustaining unacceptable harm, the court can always award just compensation. It is in

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<sup>282</sup> Undoubtedly, the commercial bias of investment tribunals and the scarce attention traditionally paid to public law issues have played a part in this concentration on the compensatory aspect.

<sup>283</sup> Or, ‘whether a given measure would be in order assuming it were accompanied by compensation payments; and...whether the same measure, conceding that it would be proper under conditions of full compensation, ought to be enforced without payment of any compensation.’ (Michelman, 1194).

<sup>284</sup> Michelman, 1248.

the failure of judicial capability to jibe with this implicit legislative and administrative referral that the special danger lies<sup>285</sup>.

As a consequence, to divine what is meant by indirect expropriation, it is necessary to refer to the pronouncement of the courts or the tribunals<sup>286</sup>.

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<sup>285</sup> The downsides of this approach (judicial activism, democratic deficit, inconsistency of judgments) are magnified in the international context. Courts themselves have pointed at a political solution as the only one possible in certain circumstances: this ‘subsidiarity’ which is nothing more than deference of the judiciary to the legislative, and executive, power, has been suggested in the context of the WTO to deal with similar problems of ‘legitimacy deficit’ (Howse, R., and Nicolaidis, K., ‘Legitimacy through “higher law”? Why constitutionalizing the WTO is a step too far’, Cottier, T., and Mavroidis, P.C. (eds.) *The Role of the Judge in International Trade Regulation. Experiences and Lessons for the WTO*, Ann Arbor, University of Michigan Press, 2003: 307). For the problems of judicial encroachment over the legislature, see Justice Stevens’ dissent in *Dolan v. City of Tigard*, 512 U.S. 374, 406-07 (1994): ‘The so-called “regulatory takings” doctrine ... has an obvious kinship with the line of substantive due process cases that *Lochner* exemplified. Besides having similar ancestry, both doctrines are potentially open-ended sources of judicial power to invalidate state economic regulations that Members of this Court view as unwise or unfair.’ See also *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 377 (1991): ‘[the] determination of “the public interest” in the manifold areas of government regulation entails not merely economic or mathematical analysis but value judgment, and it was not meant to shift that judgment from elected officials to judges and juries.’

<sup>286</sup> Case law on indirect expropriation goes back at least to the *Norwegian Shipowners’ Claim (Norway v. United States of America)*, PCIA, Award, 13 October 1922, 1 *RIAA* 307 (which recognised that property rights could be expropriated); see also the *Chorzów Factory Case (Case concerning certain German interests in Polish Upper Silesia) (Germany v. Poland)*, Judgment, 25 May 1926, PCIJ Ser A, No. 7 (1926); *Oscar Chinn Case (United Kingdom v. Belgium)*, Judgment, 12 December 1934, PCIJ Ser A/B, No. 63 (1934); several cases of the Iran Claims Commission are also relevant: see especially *Starrett Housing Corporation v. Government of the Islamic Republic of Iran*, 4 *Iran-US CTR* 122, 156 (1983); *Sea-Land Service Inf. V Iran*, 6 *Iran-USCTR* 149 (1984); *Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA*, 6 *Iran-USCTR* 219 (1984) *Amoco International Finance Corp v. Iran*, 15 *Iran-USCTR* 189 (1987) (this award has been much cited in support of the ‘sole effects’ doctrine of regulatory expropriation; however what the Tribunal said was: ‘The intent of government is *less important* [italics added] than the effects of the measures on the owner, and the form of the measures of control

There is a considerable lack of agreement on the boundaries of any proposed definition of regulatory expropriation<sup>287</sup>. It is useful in this context to quote the definition adopted in Article 11(a)(ii) [Covered Risks] of the Convention Establishing the Multilateral Investment Guarantee Agency<sup>288</sup>:

... [regulatory expropriation could be defined as] 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...

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or interference is less important than the reality of their impact' [at 225-226]); *Phillips Petroleum Co v. Iran*, 21 Iran-US CTR 79 (1989) (however the standards applicable by that tribunal are different, as 'all measures affecting property rights' come within the jurisdiction of the tribunal, see Article II, 'Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran', 1 Iran-USCTR 9. Also relevant is the case law of the European Court of Human Rights under Article 1 of Protocol 1 of the European Convention on Human Rights; see *Handyside v. United Kingdom*, 7 December 1976, 24 ECtHR, Series A; *Sporrong and Lönnroth v. Sweden*, 23 September 1982, Series A No. 52 p. 24; *James v. United Kingdom*, 21 February 1986, 98 ECtHR, Series A, p. 9; *Lithgow v. United Kingdom*, 8 July 1986, 102 ECtHR, Series A, p.1; *Fredin v. Sweden*, 18 February 1991, 192 ECtHR, Series A; *Pine Valley Development Ltd. and Others v. Ireland*, 29 November 1991, 222 ECtHR, Series A, p.1; *Matos e Silva, Lda. and others v. Portugal*, 16 September 1996, 24 EHRR 573. For the European Court of Justice, see *Liselotte Hauer v Land Rheinland-Pfalz*, Judgment of 13 December 1979, Case 44/79, in *Reports of Cases before the Court*, 1979, S. 3727.

<sup>287</sup> R. Dolzer identified this as 'the single most important development in state practice [indirect expropriation]' ('Indirect Expropriation: New Developments?', 11 *New York University Environmental Law Journal* (2002): 65.). It is worth noting in passing that it is not necessarily state practice to have changed (trends of more or less interventionist state policies having developed in the course of the last century), as much as the response of the law: regulatory expropriation is a legal category, a legal concept, not state practice. It is the way an investment tribunal or a court categorizes state's intervention by application of a standard of treatment devised by law.

<sup>288</sup> At [http://www.miga.org/news/index\\_sv.cfm?stid=1506&aid=1347#3](http://www.miga.org/news/index_sv.cfm?stid=1506&aid=1347#3).

There are two elements in the MIGA definition, the legal ('ownership or control') and the economic ('substantial benefit'), presented as discrete (non cumulative) elements for a regulatory expropriation claim<sup>289</sup>. Traditionally, courts and tribunals have considered as the indispensable element the interference with property *rights*, economic damage alone not being sufficient to sustain a claim of regulatory expropriation<sup>290</sup>. This is consistent with the perception that certain economic advantages, such as goodwill and a customer base, do not constitute 'stand-alone vested

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<sup>289</sup> See also *AES Summit Generation Limited AES-Tisza Erőmű KFT v. The Republic of Hungary* (ICSID Case No. ARB/07/22), Award, 23 September 2010, § 14.3.1: 'For an expropriation to occur, it is necessary for the investor to be deprived, in whole or in significant part, of the property in or effective control of its investment, or for its investment to be deprived, in whole or in significant part, of its value.'

<sup>290</sup> This approach is taken also in recent instruments, see for example Annex B (Expropriation) of the 2004 US Model BIT, 4(a)(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, standing alone, does not establish that an indirect expropriation has occurred.' For the case law, see *AWG Group Ltd. v The Argentine Republic* (UNCITRAL), Decision on Liability, 30 July 2010; *Metalpar S. A. and Buen Aire S. A. v. Argentine Republic* (ICSID Case No. ARB/03/5) Award, 6 June 2008; *Société Generale v. The Dominican Republic* (LCIA Case 7927 UN), Award on Preliminary Objections to Jurisdiction, 19 September 2008; *LG&E v. Argentina* (ICSID Case No. ARB/02/1), Award, 25 July 2007; *M.C.I. Power Group L.C. and New Turbine, Inc. v. Ecuador* (ICSID Case No. ARB/03/6), Award, 31 July 2007; *Sempra Energy International v. Argentine Republic* (ICSID Case No. ARB/02/16), Award, 28 September 2007; *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. United Mexican States* (ICSID Case No. ARB(AF)/04/5), Award, 21 November 2007; *BG Group plc v. The Republic of Argentina* (UNCITRAL), Final Award, 24 December 2007; *Waste Management, Inc. v. United Mexican States* (Number 2) (ICSID Case No. ARB(AF)/00/3), Award, 30 April 2004; *Nycomb Synergetics Technology Holding AB v. Latvia*, (SCC Case No. 118/2001), Award, 16 December 2003; *CME Czech Republic B.V. v. Czech Republic* (UNCITRAL), Partial Award, 13 September 2001; *Wena Hotels Ltd. v. Arab Republic of Egypt* (ICSID Case No. ARB/98/4), Award on Merits, 8 December 2000.

rights’<sup>291</sup>. Already the Permanent Court of International Justice, in the *Oscar Chinn Case*, affirmed that<sup>292</sup>:

Favourable business conditions and goodwill are transient circumstances, subject to inevitable changes... No enterprise ... can escape from the chances and hazards resulting from general economic conditions. Some industries may be able to make large profits during a period of general prosperity, or else by taking advantage of a treaty of commerce or of an alteration in customs duties; but they are also exposed to the danger of ruin or extinction if circumstances change. Where this is the case, *no vested rights are violated by the State*. [Italics added]

And this is how the *Biwater* tribunal recently framed the issue in its award<sup>293</sup>:

... whilst accepting that effects of a certain severity must be shown to qualify an act as expropriatory, there is nothing to require that such effects be economic in nature. *A distinction must be drawn between (a) interference with rights and (b) economic loss*. [Italics added] A substantial interference with rights may well occur without actually causing any economic damage which can be quantified in terms of due compensation....In the Arbitral Tribunal’s view, the absence of economic loss or damage is primarily a matter of causation and quantum – rather than a necessary ingredient in the cause of action of expropriation itself.

In practice, tribunals, in assessing whether an investment has been indirectly expropriated, apply the ‘substantial deprivation test’<sup>294</sup>, which,

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<sup>291</sup> *Merrill & Ring Forestry L.P. v. Canada* (UNCITRAL), Award, 31 March 2010, § 141 (citing *Oscar Chinn*).

<sup>292</sup> *The Oscar Chinn Case*, PCIJ, Ser. A./B., No. 63, 1934, 26. A similar sentiment was expressed by the Tribunal in *Emilio Maffezzini v. The Kingdom of Spain* (ICSID Case No ARB/00/3), Award, 13 November 2000, § 64: ‘IIAs [international investment agreements] are not insurance policies against bad business judgments.’

<sup>293</sup> *Biwater Gauff (Tanzania) Ltd v. Tanzania* (ICSID Case No. ARB/05/22), Award, 24 July 2008, § 464-5.

<sup>294</sup> *Merrill & Ring Forestry L.P. v. Canada* (UNCITRAL), Award, 31 March 2010; *Chemtura Corporation v. Government of Canada* (UNCITRAL), Award, 2 August 2010; *AWG Group Ltd. v The Argentine Republic* (UNCITRAL), Decision on Liability, 30 July 2010; *CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/08), Award, 12 May, 2005; *Occidental Exploration and Production Co. v.*

while taking into consideration economic deprivation, gives prevalence to the interference with property rights, with few exceptions<sup>295</sup>. The *Metalclad* Tribunal, for example, pushed the boundaries of the definition of a regulatory expropriation precisely by extending the import of the economic deprivation test<sup>296</sup>:

...expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property,.... but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State<sup>297</sup>.

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*Ecuador* (LCIA Case No. UN 3467), Award, 1 July 2004; *Pope & Talbot Inc. v. The Government of Canada* (UNCITRAL), Interim Award, 26 June 2000.

<sup>295</sup> See for example *Técnicas Medioambientales (Tecmed) S. A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003; *Telenor Mobile Communications AS v. Republic of Hungary* (ICSID Case No. ARB/04/15), Award, 13 September 2006; *Parkerings-Compagniet AS v. Republic of Lithuania* (ICSID Case No. ARB/05/8), Award, 11 September, 2007. But see *Biwater Gauff* for non compensatory damages for expropriation not resulting in economic loss.

<sup>296</sup> *Metalclad Corp. v. United Mexican States* (ICSID Case No. ARB(AF)/97/1) Award, 30 August 2000, § 103. This award has been much criticised; Justice Tysoe, of the Supreme Court of British Columbia, which judicially reviewed some aspects of the award, but not its finding on expropriation, nonetheless noted that: ‘The Tribunal gave an extremely broad definition of expropriation for the purposes of Article 1110. ....This definition is sufficiently broad to include a legitimate rezoning of property by a municipality or other zoning authority.’ (*The United Mexican States v. Metalclad Corporation*, 2001 BCSC 664, § 100). For a positive appraisal of the award’s definition, see Paulsson, J. and Douglas, Z., ‘Indirect expropriation in investment treaty arbitration’, Horn and Kröll, 2004: 149.

<sup>297</sup> Equally, the Tribunal in *S. D. Myers v. The Government of Canada*, Partial Award, 13 November 2000, at § 283, stated that: ‘An expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights although it may be that, in some contexts and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial or temporary.’

The *Chemtura* Tribunal reiterated the interpretation of the kind of work it is tasked with, when it affirmed that<sup>298</sup>:

The determination of whether there has been a ‘substantial deprivation’ is a fact-sensitive exercise to be conducted in the light of the circumstances of each case.... One important feature of fact-sensitive assessments is that they cannot be conducted on the basis of rigid binary rules.

From the traditional position that only an interference with property rights qualified as an expropriation, courts and tribunals have moved to the understanding that a regulation that eliminates *completely* any economic use and value for the property owner is to be classified as a taking<sup>299</sup>, as well as regulation that effectively results in ‘physical invasion of the property’<sup>300</sup>. However simple the application of these ‘categorical’ criteria might seem to be, it is not devoid of difficulties; namely, how to calculate what constitutes a ‘total’ (the so-called ‘denominator’ problem<sup>301</sup>), that is, against which total should the

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<sup>298</sup> *Chemtura Corporation v. Government of Canada* (UNCITRAL), Award, 2 August 2010, § 249. This case will be reviewed in Chapter 7.

<sup>299</sup> In American jurisprudence, the landmark case is *Lucas (David H) v. South Carolina Coastal Council*, 505 U.S. 1003, 1015, 1029 (1992). Importantly, the following exception was applied by the Court: ‘[w]here the State seeks to sustain regulation that deprives land of all economically beneficial use, we think it may resist compensation only if the logically antecedent inquiry into the nature of the owner’s estate shows that the proscribed use interests were not part of his title to begin with.’ For NAFTA, see *Pope & Talbot Inc. v. The Government of Canada* (UNCITRAL), Interim Award, 26 June 2000, § 96.

<sup>300</sup> For the US Supreme Court, see *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982); see also *Biloune and Marine Drive Complex Ltd. v. Ghana Investments Centre and the Government of Ghana* (UNCITRAL), Award on Jurisdiction and Liability, 27 October 1989, 95 *ILR* 184, 211 (1990).

<sup>301</sup> See Epstein, R. A., *Takings: Private Property and the Power of Eminent Domain*, Harvard, Cambridge, CUP, 1985 and Epstein, R. A., *Supreme Neglect. How to Revive Constitutional Protection for Private Property*, New York, OUP, 2008: 124. For American case law, see again *Lucas v. South Carolina Coastal Council*, 505 US 1003, 1016 (1992).

substantial or total deprivation be calculated<sup>302</sup>; if there is no total taking, or there is no agreement as to the totality, what level of interference qualifies as a taking<sup>303</sup> (this is also referred to as ‘conceptual severance’, which allows, through the ‘fragmentation’ of the property rights into discrete strands, to classify as an expropriation the taking of each of these strands<sup>304</sup>).

A test for categorization of state measures as regulatory takings involves several steps: in the first instance, it is an issue of nomenclature: an ‘expropriation’ is bound to attract the duty to pay compensation (unless

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<sup>302</sup> See *Chemtura Corporation v. Canada* (UNCITRAL-NAFTA), Award, 2 August 2010, § 263; *EnCana Corporation v. Ecuador* (UNCITRAL), Award, 3 February 2006, §§ 172-8; *Occidental Exploration and Production Co. v. Ecuador* (LCIA Case No. UN 3467), Award, 1 July 2004, §§ 86-9; *GAMI Investments Inc. v. United Mexican States* (UNCITRAL), Award, 15 November 2004, § 126; *Waste Management Inc. v. United Mexican States II* (ICSID Case No. ARB(AF)/00/3), Award, 30 April 2004, § 141; *Feldman v. United Mexican States* (ICSID Case No. ARB(AF)/99/1), Award, 16 December 2002, § 152.

<sup>303</sup> The ‘partial regulatory taking’ test as devised in the *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978), see *infra*.

<sup>304</sup> In American takings jurisprudence, ‘conceptual severance’ has been rejected by the Supreme Court; see *Andrus v. Allard*, 444 U.S. 51, 65-66 (1979), and more recently *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 535 U.S. 302, 327 (2002). The Court in *Andrus* had this to say: ‘... government regulation – by definition – involves the adjustment of rights for the public good. Often this adjustment curtails some potential for the use or economic exploitation of private property. To require compensation in all such circumstances would effectively compel the government to regulate by purchase. Government hardly could go on if, to some extent, values incident to property could not be diminished without paying for every such change in the general law... The Takings Clause, therefore, preserves governmental power to regulate, subject only to the dictates of “justice and fairness”. ... the denial of one traditional property right does not always amount to a taking. At least where an owner possesses a full “bundle” of property rights, the destruction of one “strand” of the bundle is not a taking, because the aggregate must be viewed in its entirety... When we review regulation, a reduction in the value of property is not necessarily equated with a taking...’ Additionally, in *New York Central R.R. v. White*, 243 US 188 (1917), the Court affirmed that: ‘[n]o person has a vested interest in any rule of law, entitling him to insist that it shall remain unchanged for his benefit.’



covered by the usual exceptions such as confiscation, forfeiture, or seizure for recovery of taxation or other fiscal duties), a ‘government measure’ raises a presumption of non-compensation, with the duty shifted to the property owner/investor to prove that expropriation of the protected property right is involved<sup>305</sup>.

Regulatory measures claimed to effect an indirect expropriation can include *ad hoc* measures affecting the property rights of the investor, such as the withdrawal of a licence, the change of the terms of the concession agreement<sup>306</sup>, or an *ad hoc* adjudicatory determination<sup>307</sup>; general measures directly affecting the economic value of the investment, such as taxation measures targeted to a class of investors, or zoning

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<sup>305</sup> It has been proposed that for a regulatory taking to require compensation, the state has to derive a benefit from the ‘taking’ (as a form of unjust enrichment); see for example *Olguín v. Paraguay* (ICSID Case No. ARB/98/5), Final Award, 26 July 2001, at § 84: ‘For an expropriation to occur, there must be actions that can be considered reasonably appropriate for producing the effect of depriving the affected party of the property it owns, in such a way that whoever performs those actions will acquire, directly or indirectly, control, or at least the fruits of the expropriated property. Expropriation therefore requires a teleologically driven action for it to occur; omissions, however egregious they may be, are not sufficient for it to take place.’; *Nykomb Synergetics Technology Holding AB v. Latvia*, (SCC) Award, 16 December 2003: § 4.3.1. However, this approach has been generally rejected by tribunals. See though Newcombe, A., ‘The boundaries of regulatory expropriation in international law’, 20 *ICSID Review* (2005): 1 at 33; Rose Ackerman, S. and Rossi, J., ‘Disentangling deregulatory takings’, 86 *Virginia Law Review* (2000): 1435; Sax, J. L., ‘Takings and the police power’, 74 *Yale Law Journal* (1964-65): 36.

<sup>306</sup> Permits and licenses are not considered properties for the purposes of the takings clause in US jurisprudence; see *Mobile Relay Assocs .v.FCC*, 457 F.3d 1 (D.C. Cir. 2006); *Conti v .United States*, 291 F.3d 1334, 1340 (Fed. Cir. 2002); *Bronco Wine Co. v. Jolly*, 29 Cal. Rptr. 3d 462, 494 (Cal. App. 2005); *contra*, *State Bd. of Education v. Drury*, 437 S.E.2d 290 (Ga. 1993); *Pre-Need Family Services v. Bureau*, 904 A.2d 996, 1003 (Pa. Commonwealth. 2006).

<sup>307</sup> Judicial decisions are ‘measures’ for the purposes of the NAFTA, see Been, V. L., and Beauvais, J. C., The global Fifth Amendment: NAFTA’s investment protections and the misguided quest for an international ‘regulatory takings’ doctrine, 78 *NYU Law Review* (2003): 30.

restrictions; general measures indirectly affecting the economic value of the investment, such as environmental or labour legislation raising the running costs of the investment.

The character of the measures as outlined above can also take into consideration the intent of the state. In international law, tribunals have oscillated between the ‘sole effect’ and the ‘effect and purpose’ approaches in considering claims of indirect expropriation<sup>308</sup>. The most clear example in investment case law of the sole effect doctrine is the oft-quoted statement of the *Metalclad* tribunal, namely its reference to ‘covert or *incidental* interference [italics added].... which has the effect of depriving the owner, in whole or in significant part, of the use or....economic benefit of property...<sup>309</sup>. In an older, *ad hoc* UNCITRAL arbitration, *Biloune v. Ghana*<sup>310</sup>, similarly the tribunal established that, in assessing the facts having the ‘effect’ of a ‘constructive expropriation’, the tribunal needn’t concern itself with the ‘motivations for the actions and omissions of the Ghanaian governmental authorities’<sup>311</sup>. On the opposite side, the clearest early articulation in investment jurisprudence of the ‘effect and purpose’ doctrine came from the *SD Myers* tribunal<sup>312</sup>, specifically its assertion that ‘...a tribunal [should] look at the substance

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<sup>308</sup> It was Rudolf Dolzer to introduce the term ‘sole effects’ to describe this interpretation of indirect takings (see also *Starrett Housing Corporation v. Islamic Republic of Iran* (1983) Iran-USCTR 122, 154); Dolzer, R., ‘Indirect expropriation: new developments’, 11 *NYU Environmental Law Journal* (2002): 64 at 79. For the principle in US jurisprudence, see *Lingle v. Chevron USA Inc.*, 544 U.S. 528 (2005); this decision went explicitly against *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980), where the Court had held that; ‘The application of a general zoning law to particular property effects a taking if the ordinance does not *substantially advance legitimate state interests* [italics added] or denies an owner economically viable use of the land...’

<sup>309</sup> *Metalclad* Award, § 103.

<sup>310</sup> *Antoine Biloune and Marine Drive Complex Ltd. v. Ghana Investment Centre*, UNCITRAL, Award on Jurisdiction and Liability, 29 October 1989, 95 *ILR* 183 (1993).

<sup>311</sup> 95 *ILR*, at 209.

<sup>312</sup> This case will be analysed in detail in Section 7.5.1.

of what has occurred and not only at form. A tribunal should not be deterred by technical or facial considerations from reaching a conclusion that an expropriation or conduct tantamount to an expropriation has occurred. It must look at the real interests involved and the *purpose and effect of the government measure*’ [italics added]<sup>313</sup>. More recent case law arising mostly from the NAFTA, and from some BITs, and the ‘legislative’ work of states ratifying investment treaties and/or drafting new investment instruments and FTAs, confirms the trend towards tempering the strict ‘sole effect’ approach by way of introduction of balancing or proportionality analysis which inevitably has to consider the purpose and the context of the governmental measures<sup>314</sup>. For example, even measures that result in total deprivation can be exempted from the payment of compensation if certain conditions apply: measures that prevent an illegal or noxious use of the property are exempt from the obligation to pay compensation<sup>315</sup>. Police powers, to the extent that they are exercised in order to prevent such use, are a legitimate excuse from the obligation to compensate for the harm caused to property rights<sup>316</sup>.

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<sup>313</sup> *SD Myers Inc. v. Government of Canada*, UNCITRAL/NAFTA, Partial Award on the Merits, 13 November 2000, § 285.

<sup>314</sup> See for example *Saluka Investments BV v. The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, § 255: ‘It is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner *bona fide* regulations that are aimed at the general welfare.’

<sup>315</sup> This is not the same as a seizure of illegally acquired property, which also does not attract the duty to compensate.

<sup>316</sup> See *Saluka Investments BV v. the Czech Republic* (UNCITRAL), Partial Award, 17 March 2006, § 262: ‘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 law today.’ (Relying on the *Methanex* Award). *Contra*, *Azurix Corp. v. Argentine Republic* (ICSID Case No. ARB/01/12), Award, 14 July 2006, § 310: ‘...the issue was not so much whether the measure concerned is legitimate and serves a public purpose, but whether it is a measure that, being legitimate and serving a public purpose, should give rise to a compensation claim.’

However, police powers can also be exercised to prevent a legal use, depending on the circumstances, or, more importantly for our purposes, a use that conflicts with an equally legally conferred right or with public interest measures<sup>317</sup>; in that case, it becomes a matter of categorical distinction: if the measure is classified as a taking, then compensation is due; if it is classified as a regulatory measure, then compensation in principle is not due<sup>318</sup>.

The problem of how to draw the line between expropriation and regulation<sup>319</sup> can benefit from a comparative analysis of domestic and other international law approaches<sup>320</sup>. A comparative approach of the criteria to ascertain the liability of states for regulatory measures *partially* affecting property rights finds support in the jurisprudence of the Supreme Court following *Penn Central* and the proportionality test

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<sup>317</sup> The categorical exclusion does not completely negate the possibility of balancing between individual harm and public gain: the higher the magnitude of harm, the smaller the scope of the police powers.

<sup>318</sup> As noted by Higgins, 1982, 278: ‘A tribunal can decide to let the loss fall where it lies by one of two ways: either it can decide that, notwithstanding the taking of property, no compensation is due. Or, alternatively, it can find that no ‘taking’ as actually taken place.’ And added, *ibidem*: ‘...in many cases not involving outright nationalization or expropriation, the central question is whether the alteration to the bundle of rights that the corporation or individuals owns is in fact a “taking” of his rights.’

<sup>319</sup> See most recently, the *Continental* Tribunal, which noted: ‘[...]the distinction is not always easy’ and ‘[...] in different historical and social contexts the line has been drawn differently and that different international tribunals, including arbitration tribunals under various BITs, have relied on different criteria and have given different weight to them, such as those recognizing the public interest on the one side and those protecting the integrity of property rights on the other’; *Continental Casualty Company v. Argentine Republic* (ICSID Case No. ARB/03/9), Award, 5 September 2008, § 277.

<sup>320</sup> Specifically, on the influence of American takings jurisprudence on the NAFTA and on the other NAFTA parties, see Kinvin Wroth, L., ‘*Lingle and Kelo*: the accidental tourist in Canada and NAFTA-land’, *Vermont Journal of Environmental Law*, Books and Reports, April 2006: 62. See also Sampliner, G., ‘Arbitration of expropriation cases under U.S. investment treaties – a threat to democracy or the dog that didn’t bark?’, 18 *ICSID Review* (2003): 1.

adopted by the European Court of Human Rights<sup>321</sup>. The Supreme Court in *Penn Central v. New York*<sup>322</sup> rejected the application of eminent domain compensation requirement to regulatory actions that affect only some property interests. The Court's judgment did not set a rule for what constitutes a regulatory taking, simply stating that:

In engaging in these essentially *ad hoc*, factual inquiries, the Court's decisions have identified several factors that have particular significance. *The economic impact* of the regulation on the claimant and, particularly, *the extent to which the regulation has interfered with distinct investment-backed expectations* are, of course, relevant considerations. So, too, is *the character of the governmental action*. [Italics added]

The Court did not elaborate on the criteria, which since then have been adopted and adapted in successive judgments<sup>323</sup>. The criteria have also

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<sup>321</sup> See Ruiz Fabri, H., 'The approach taken by the European Court of Human Rights to the assessment of compensation for "regulatory expropriations" of the property of foreign investors', 11 *NYU Environmental Law Journal* (2002): 148; Mountfield, H., 'Regulatory expropriations in Europe: the approach of the European Court of Human Rights', 11 *NYU Environmental Law Journal* (2002): 136.

<sup>322</sup> *Penn Central Transportation Co. v. New York*, 438 U.S. 104 (1978).

<sup>323</sup> *United States v. Riverside Bayview Homes Inc.*, 474 U.S. 121 (1985); *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987); *First English Evangelical Lutheran Church v. Los Angeles County*, 482 U.S. (1987); *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992); *Dolan v. City of Tigard*, 512 U.S. 374 (1994); *Palazzolo v. Rhode Island*, 533 U.S. 606 (2001). In *Lingle v. Chevron*, U.S. 544 at 539, The US Supreme Court has recently introduced the 'functional equivalence test' to its armoury of interpretative tools used in adjudicating regulatory takings claims, at the same time rejecting the so-called 'substantially advances test', which had introduced intent and rationality as elements for assessing governmental measures. In doing so, the Court firmly entrenched the sole effects doctrine in its jurisprudence, stating that: '[a compensable taking is] functionally equivalent to the classic taking in which government directly appropriates private property or ousts the owner from its domain'. See also Kent, M. B., 'Constructing the canon: an exegesis of regulatory takings jurisprudence after *Lingle v. Chevron*', 16 *NYU Environmental Law Journal* (2008): 63.

been included in several international investment agreements<sup>324</sup>; through this inclusion, the criteria, and with them the influence of American jurisprudence on takings, are spreading to BITs concluded by India, the US, Canada, etc<sup>325</sup>. Their application, in an international as well as in a domestic setting, is problematic to the extent that it comes into conflict with other principles or legitimate reasons. Let's consider them in order<sup>326</sup>:

*The economic impact.* Analyzing the economic impact of state measures brings us right back to the denominator and conceptual severance problems<sup>327</sup>. Investments lend themselves particularly well to exercises of conceptual severance, isolating the discrete elements of the bundle of property rights for the purpose of claiming the totality of the taking of the

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<sup>324</sup> Annex B of the 2004 US Model BIT; Annex B.13(1) of the 2004 Canada Model BIT; Annex B of the India-Singapore Comprehensive Economic Cooperation Agreement; Annex 10-C of the CAFTA-DR; Article 5(b) of the Indian Model BIPA; Annex 10-D of the Chile-US FTA; Annex 11-B of the Australia-US FTA.

<sup>325</sup> On the influence of takings jurisprudence and its constitutionalisation on even wider criteria, see Schneiderman, 2008, especially Ch.2.

<sup>326</sup> Arguably the first and second test are to be considered jointly, as evident by the language used by the Court ('particularly').

<sup>327</sup> For conceptual severance, see Radin, M. J., 'The liberal conception of property: crosscurrents in the jurisprudence of takings', in Radin, M. J., *Reinterpreting Property*, Chicago, Chicago University Press, 1993. The Supreme Court, in its *Tahoe-Sierra Preservation Council v. Tahoe Regional Planning Agency*, 535 U.S. 302 (2002) seems to have put to rest the conceptual severance, or 'parcel of the whole' doctrine, to the effect that assessing the impact of the regulation has to concern the whole of the affected property, and not simply the parcel interested by the regulation (this is obviously a test that applies eminently to real estate), against the more open approach of the *Lucas* Court. However, the recognition of property rights more commonly associated with forms of investment rather than with core rights (such as interest accrued on trust funds, see *Philips v. Washington Legal Foundation*, 524 US 156 (1998)) has been interpreted as 'an egregious form of conceptual severance', Merrill, T., 'The Landscape of Constitutional Property', 86 *Virginia Law Review* (2000): 885 at 900 (see Schneiderman, 2008: 53).

relevant element. In the *Chemtura Award*, the tribunal dealt with the issue in the following way:

The Tribunal gathers from this evidence that the sales from lindane products were a relatively small part of the overall sales of Chemtura Canada at all relevant times. Under these circumstances, the interference of the Respondent with the Claimant's investment cannot be deemed 'substantial'.

If the tribunal had accepted that the sales of lindane constituted the total of the investment for the purposes of calculating the denominator, the deprivation could have been deemed to be substantial.

*The investment-backed expectations.* The Supreme Court introduced the concept of distinct investment-backed expectations, with reference to the *Pennsylvania Coal v. Mahon Case*, but once again, did not elaborate. In investment arbitrations, the issue of legitimate expectations has arisen most often in the context of claims of violation of the FET standard<sup>328</sup>. The application of the same criterion for claims of regulatory expropriation brings into focus the circularity and conceptual overlap of investment protection provisions<sup>329</sup>. Investment-backed reliance (associated with the contractual concepts of detrimental reliance and promissory estoppel<sup>330</sup>) can arise in three sets of situations. The first kind is *contract-based reliance*: an investor relying on a contractual agreement (including its stabilisation clause) which is later rescinded unilaterally by the state, might successfully bring a claim for

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<sup>328</sup> The latest, comprehensive treatment in *Glamis Gold Ltd. v. United States of America* (UNCITRAL), Award, 16 May 2009: §§ 619 ff.

<sup>329</sup> On legitimate expectations in connection to regulatory expropriation and standards of treatment (with an eye to domestic law approaches), see also Orrego Vicuña, F., 'Regulatory authority and legitimate expectations: balancing the rights of the state and the individual under international law in a global society', 5.3 *International Law Forum* (2003): 188, at 193 ff.

<sup>330</sup> See for example *International Thunderbird Gaming Corp. v. United Mexican States* (UNCITRAL), Award, 26 January 2006, §§ 145 ff.

expropriatory breach of contract. The second kind, *treaty based reliance*, is based on the expectation of compliance with a treaty obligation with respect to certain criteria for regulatory expropriation (rarely), or (more often) an umbrella clause giving ‘bite’ to the contractual stabilisation clause. Also in this case, a claim for violation of the treaty obligation might be successful in establishing that an indirect expropriation has taken place. Finally, for the third kind, *regulatory stability reliance*, it is submitted that a claim for compensation should be unsuccessful if based on regulatory expropriation<sup>331</sup>. There is no scope in international law for contesting general *bona fide* measures implemented in the public interest on the basis of ‘distinct investment-backed expectations’ of regulatory stability, unless reliance was placed on reassurances by government officials, but even then, it would probably be more correct to present the claim as a violation of the FET standard. In summary, the strictest approach would consider only an expectation based on a contractual obligation to sustain an actionable claim for regulatory expropriation; at a higher level, the claim could be sustained for reliance by the investor on a treaty based promise (but states would hardly be committing themselves by way of treaty to the kind of regulatory stability that investors would want to raise in an arbitration, so, residually this would apply to umbrella clauses, which are still dependent on reliance to a contractual obligation, which falls again under the first kind); at the highest level of generalisation, which we argue is unsustainable, reliance would be placed on a general expectation of regulatory stability. It is here that the expropriation obligations ‘seep into’ the FET standard

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<sup>331</sup> This proposed distinction seems to have informed the reasoning of the *Glamis* Tribunal, which rejected the claim of violation of Article 1105 of the NAFTA (and the accompanying claim of indirect expropriation), on the basis that, in order for legitimate expectations to have been upset, ‘[there has to be] as a threshold circumstance, at least a quasi-contractual relationship between the State and the investor, whereby the State has purposely and specifically induced the investment.’ *Glamis Gold Ltd. v. United States*, Award, 8 June 2009, § 766. See also *Continental Casualty Company v. Argentine Republic* (ICSID Case No. ARB/03/9), Award, 5 September 2008, § 261.



obligations, which place great emphasis, as we have seen, on the legitimate expectations of the investor.

*The character of the governmental action.* It is presumed that government measures will be implemented for a public purpose and in the public interest. Indeed, this is one of the criteria allowing us to discriminate between lawful and unlawful expropriation. Consequently, the character of the action does not include such things as intent and purpose<sup>332</sup>. But if, *arguendo*, it does, how deep must a tribunal probe into the so-defined character of the action? Since motives for action can be several, does an illegitimate purpose vitiate a legitimate environmental concern? In the *SD Myers Case*<sup>333</sup>, the disguised protectionist intent of the Canadian environment minister was determinative in the success of the claim<sup>334</sup>. Governments are made of people, who might advance different aims and defend different interests, some of them legitimate (the protection of the environment), some of them less so (protectionist motives, personal enrichment). While a case like *S.D. Myers* is relatively simple, in that the disguised protectionist motive and the overt environmental rationale were advanced by the same individual in different settings, cases in which there are different messages coming from different people might more easily be analysed with reference to the legitimate expectations of the investor and reliance on public officials representations<sup>335</sup>. Measures can also be characterised by their generality: a measure of universal application will raise a higher presumption of non-compensation than a more limited measure, and this

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<sup>332</sup> What in American jurisprudence would be the purview of the due process clause rather than the takings clause.

<sup>333</sup> *S. D. Myers Inc. v. The Government of Canada* (UNCITRAL), Partial Award, 13 November 2000.

<sup>334</sup> But not for indirect expropriation, which was unsuccessful. For an in-depth analysis of this case, see Section 7.5.1.

<sup>335</sup> As we shall see when discussing the third criterion, expectations.

one in turn a higher presumption than an *ad hoc* measure<sup>336</sup>. Finally, the way in which the measure is applied is also determinative of its character and therefore can aid the tribunal in its assessment of the state's action. The transfer of this criterion from the jurisprudence of the US Supreme Court to the language of international treaties, which guarantee, together with protection from expropriation without compensation, access to international arbitration without the need to exhaust domestic remedies, is particularly troubling. As noted by the Supreme Court<sup>337</sup>, '... [a] court cannot determine whether a regulation goes "too far" unless it knows how far the regulation goes.' The Court mentioned this famous *dictum* in the context of application of the *Penn Central* test, which includes the character of a governmental action, arguing that the way in which a measure is implemented is part of the assessment of the character of the measure and it's essential in determining the ripeness of the claim. Even discounting the problem of conferring to investment tribunals the power of judicial review that, according to the *Penn Central* Court, was intended for domestic courts<sup>338</sup>, tribunals are not capable of applying fully and correctly the provisions of the treaty with respect of the 'character' of the measure. When it comes to assessing the character of the measure, claims of regulatory expropriation would by definition never be ripe, unless the claimant has exhausted the domestic

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<sup>336</sup> This is not as unproblematic as it seems: a law might apply to such a restricted number of people as to put into question its generality. See for example *Glamis Gold Ltd. v. The United States of America*, UNCITRAL, Award, 16 May 2009, § 793, where the Claimant had argued that California Bill SB22 would in effect only outlaw the operations of the Glamis mining company, even if it purported to be of general application. The Tribunal made the distinction between the 'on its face' and 'in reality' application, and it argued that, even if in the present the bill only in reality targeted Glamis, this could not be affirmed with certainty for the future, and that the company had not proven that the bill exclusively targeted Glamis' activities.

<sup>337</sup> *Palazzolo v. Rhode Island*, 533 U.S. (2001).

<sup>338</sup> And the possible confusion between compensation for takings and remedy for due process violations which is extant in US jurisprudence and is reflected in the overlap between expropriation and FET standard clauses in investment law.

administrative and judicial remedies, which he is not required to do anymore<sup>339</sup>.

It has been argued that the *Penn Central* criteria found their place in U.S. investment instruments in order to minimise the risk that foreign investors would have access to higher protection than that available to U.S. citizens<sup>340</sup>. Be that as it may, it certainly constitutes an attempt by the U.S. legislature to ‘imprint’ constitutional jurisprudence into international protections against regulatory expropriations, where these might affect the rights of American citizens against the rights granted to foreigners. But we have already noted how these provisions, and the accompanying criteria, are also seeping into non-U.S. investment instruments directly through adoption of the same language.

The second strand of jurisprudence influencing conceptions of regulatory takings at the international level, including investment tribunals, originates from the European Court of Human Rights (ECtHR) decisions on claims arising from Article 1, Protocol 1 of the European Convention on Human Rights (ECHR)<sup>341</sup>. It is sufficient to point out the most

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<sup>339</sup> On the tension between the ‘ripeness requirement’ in US takings law and the procedural requirements of NAFTA, see Been and Beauvais, 51 ff. See also what the Tribunal had to say in *Glamis Gold Ltd. v. The United States of America*, UNCITRAL, Award, 16 May 2009, § 330 ff.

<sup>340</sup> In compliance of the Trade Promotion Authority Act of 2002, according to which: ‘...Recognizing that United States law on the whole provides a high level of protection for investment, consistent with or greater than the level required by international law, the principal negotiating objectives of the United States regarding foreign investment are to reduce or eliminate artificial or trade-distorting barriers to foreign investment, while ensuring that foreign investors in the United States are not accorded greater substantive rights with respect to investment protections than United States investors in the United States, and to secure for investors important rights comparable to those that would be available under United States legal principles and practice...’ (19 USC 3801, § 2012(b)(3)).

<sup>341</sup> ‘Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest

relevant elements arising from the jurisprudence of the Court, that is, the principle of ‘proportionality’, accompanied by the customary margin of appreciation usually granted to national governments by the Court<sup>342</sup>, and the concept of ‘control of use’ to cover *de facto* expropriations. The first element (proportionality) is interpreted by the Court as requiring that there ought to be ‘[a] reasonable relationship of proportionality between the means employed and the aim sought to be realised by any measure depriving a person of his possessions’<sup>343</sup>.

The Court established a 3-steps test for the application of Article 1<sup>344</sup>:

... Article 1 of Protocol No. 1 comprises three distinct rules: “the first rule, set out in the first sentence of the first paragraph, is of a general nature and enunciates the principle of the peaceful enjoyment of

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and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a state 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.’

<sup>342</sup> Restated by the Court in *Jahn v. Germany* (see footnote 350, *infra*) in the following terms: ‘...because of their direct knowledge of their society and its needs, the national authorities are in principle better placed than the international judge to appreciate what is “in the public interest”. Under the system of protection established by the Convention, it is thus for the national authorities to make the initial assessment as to the existence of a problem of public concern warranting measures of deprivation of property. Here, as in other fields to which the safeguards of the Convention extend, the national authorities, accordingly, enjoy a certain margin of appreciation.’

<sup>343</sup> *Jahn and Others v. Germany*, (Grand Chamber), Judgment, 30 June 2005, § 93. This case is ‘exceptional’ in that the Grand Chamber accepted that ‘exceptional circumstances’ justified the taking of the land without compensation, against the previous judgment by the Chamber of 22 January 2004.

<sup>344</sup> Most recently in *Jahn and Others v. Germany*, (Grand Chamber), Judgment, 30 June 2005, § 78; see also *James and Others v. the United Kingdom*, Judgment, 21 February 1986, Series A no. 98, § 37; *Sporrong and Lönnroth v. Sweden*, Judgment, 23 September 1982, Series A no. 52, § 61; *The Holy Monasteries v. Greece*, Judgment, 9 December 1994, Series A no. 301-A, § 56; *Iatridis v. Greece* [GC], no. 31107/96, § 55, ECHR 1999-II; and *Beyeler v. Italy* [GC], no. 33202/96, § 106, ECHR 2000-I.

property; the second rule, contained in the second sentence of the first paragraph, covers deprivation of possessions and subjects it to certain conditions; the third rule, stated in the second paragraph, recognises that the Contracting States are entitled, among other things, to control the use of property in accordance with the general interest ...

The ‘control of use’ clause covers cases not involving direct deprivation, that can therefore be equated to ‘*de facto*’ or regulatory expropriation. The application of the proportionality principle will typically result in granting compensation for a deprivation of possession but not, with exceptions, for a control of use<sup>345</sup>.

We are interested here in the extent to which investment tribunals have availed themselves of the jurisprudence of the ECtHR in order to give substantive content to investment treaty protections in regulatory expropriation claims<sup>346</sup>. The Court itself considered how the protection granted by Article 1 might extend to foreign investors<sup>347</sup>:

Especially as regards a taking of property effected in the context of a social reform, there may well be good grounds for drawing a distinction between nationals and non-nationals as far as compensation is concerned. To begin with, non-nationals are more vulnerable to domestic legislation: unlike nationals, they will generally have played no part in the election or designation of its authors nor have been consulted on its adoption. Secondly, although a taking of property must always be effected in the public interest, different considerations may apply to nationals and non-nationals and there may well be legitimate reason for requiring nationals to bear a greater burden in the public interest than non-nationals.

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<sup>345</sup> See Baughen, S., ‘Expropriation and environmental regulation: the lessons of NAFTA Chapter Eleven’, 18 *Journal of Environmental Law* (2006): 207, at 213 ff. It is worth noticing that the test established by the Court does not in itself leave a carve out from the application of Article 1 Protocol 1: every governmental measure is in principle subject to the proportionality test, with the margin of appreciation acting as a counter-balance.

<sup>346</sup> A recent review of the jurisprudence of the ECtHR in expropriation cases in Wildhaber, L. and Wildhaber, I., ‘Recent Case Law on the Protection of Property in the European Convention on Human Rights’, in Binder *et al*, 2009: 657.

<sup>347</sup> *James v. United Kingdom* (1986) 8 EHRR 123, § 63.

The Court also added that<sup>348</sup>:

The inclusion of the reference [to general principles of international law] ...enables non-nationals to resort directly to the machinery of the Convention to enforce their rights on the basis of the relevant principles of international law, whereas otherwise they would have to seek recourse to diplomatic channels or to other available means of dispute settlement to do so.

This is important as it establishes an alternative forum for investment disputes within the jurisdiction of the ECtHR, but with general principles of international law as the governing law of the dispute.

As for the cross-fertilisation between investment and European human rights regimes of protection, the relevant question is if investment tribunals extend or restrict the scope of substantive protections against indirect expropriation by reference to the jurisprudence of the Court. Two parallel cases involving the Czech Republic generated conflicting awards and consequent widespread criticism: one of the tribunals found on the facts that the claim of indirect expropriation could be sustained<sup>349</sup>, while the other one rejected it<sup>350</sup>. James Fry noted that the second tribunal relied, in its analysis and classification of formal and *de facto* expropriation, on the jurisprudence of the ECtHR<sup>351</sup> and suggested that this reliance might have influenced the judgment, effectively implying that the application of the 'human rights test' might have restricted in this case the scope of protection against regulatory expropriation<sup>352</sup>. The complexities of the dispute invite caution in attributing the diverging

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<sup>348</sup> At § 62. The Court also concludes that: 'general principles of international law are not applicable to a taking by a State of the property of its own nationals.' (At § 66).

<sup>349</sup> *CME Czech Republic B.V. v. Czech Republic* (UNCITRAL), Partial Award, 13 September 2001, §§ 591 ff; Final Award, 14 March 2003.

<sup>350</sup> *Lauder v. Czech Republic* (UNCITRAL), Final Award, 3 September 2001, § 200.

<sup>351</sup> Specifically in *Mellacher v. Austria*, 169 ECtHR (Ser. A) (1989).

<sup>352</sup> See Fry, J. D., 'International human rights law in investment arbitration: evidence of international law's unity', 18 *Duke Journal of Comparative & International Law* (2007): 77, at 84.

decisions on a ‘background’ factor such as the influence of human rights jurisprudence on the reasoning of the two arbitral tribunals, also in consideration of the fact that the disputes arose under different BITs, and therefore the tribunals were tasked with interpreting and applying different, and differently worded, provisions<sup>353</sup>. What emerges clearly though is that the second tribunal relied more explicitly on an ‘interference with property rights’ approach, while the first one considered the effect on value as the determining factor<sup>354</sup>. We have seen already that both approaches have been taken by courts (specifically, the US Supreme Court) and tribunals. To the extent that the ECtHR case relied on by the *Lauder* Tribunal adopted the first approach to define an indirect expropriation, it restricted the scope of indirect expropriation.

Probably the most relevant case in which the jurisprudence of the ECtHR was explicitly relied upon is *Tecmed*, in which the tribunal expressly made use of the proportionality test in order to assess if the Mexican government’s measures amounted to a compensable expropriation<sup>355</sup>. Specifically, the tribunal referred to the *James Case*’s articulation of the proportionality principle and its corollary, that the principle has to be

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<sup>353</sup> The *CME* Tribunal noted that: ‘The Treaty [US – Czech Republic BIT] avoids any narrow definition of expropriation in part by avoiding the use of that word altogether. The Treaty focuses on the interference in the investor’s ownership, rather than any transfer of the investment to the State, by prohibiting “deprivations” rather than “takings”.’ (At § 151). On the other hand, the *Lauder* Tribunal was constituted under the Netherlands – Czech Republic BIT, which explicitly refers, at Article III(1) to ‘measures tantamount to expropriation and nationalization’. While one can disagree on too sharp a distinction to be made between deprivation and taking, undoubtedly the two tribunals were faced with distinctively different provisions.

<sup>354</sup> ‘De facto expropriations or indirect expropriations, i.e. measures that do not involve an overt taking but that *effectively neutralize the benefit of the property of the foreign owner* [italics added], are subject to expropriation claims.’

<sup>355</sup> As this case concerns environmental measures, it will be discussed in more detail in Chapter 7.

applied more restrictively to non-nationals<sup>356</sup>; effectively, by doing so the Tribunal rejected the proportionality test *on the terms devised by the Court* for cases decided under the Convention<sup>357</sup>.

Finally, in his dissenting opinion in the *Thunderbird Award*<sup>358</sup>, Thomas Wälde more forcefully argued not simply for using human rights jurisprudence as an interpretative aid in order to give substantive content to the vague provisions of bilateral investment treaties, but that investment arbitration must be seen in the following fashion<sup>359</sup>:

... more appropriate for investor-state arbitration are analogies with judicial review relating to governmental conduct – be it international judicial review (as carried out by the WTO dispute panels and Appellate Body, by the European- or Inter-American Human Rights Courts or the European Court of Justice) or national administrative courts judging the disputes of individual citizens’ over alleged abuse by public bodies of their governmental powers.

We have already argued elsewhere against too easy an analogy between judicial review and investment arbitration<sup>360</sup> and we don’t need to rehearse the argument here, but only to note additionally that it cannot be the perceived weakness of one of the contracting parties to dictate the selective injection of criteria devised for a different setting altogether

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<sup>356</sup> *James v. United Kingdom*, 98 ECtHR (ser. A) §§ 50, 63 (1986).

<sup>357</sup> Tellingly, the Tribunal in *Fireman’s Fund Insurance Company v. United Mexican States* (ICSID Case No. ARB(AF)/02/01), Award, 17 July 2006, in footnote 161 to § 176, noted that: ‘The factor [proportionality] is used by the European Court of Human Rights, [citation omitted], and it may be questioned whether it is a viable source of interpreting Article 1110 of the NAFTA.’ The *Siemens* Tribunal also rejected Argentina’s argument based on the ECHR, on the basis that the margin of appreciation doctrine used by the European Court is not recognised in customary law or in the treaty applicable to the dispute: *Siemens A.G. v. The Argentine Republic* (ICSID Case No. ARB/02/8), Award, 6 February 2007, § 354.

<sup>358</sup> *International Thunderbird Gaming Corp. v. United Mexican States* (UNCITRAL), Dissenting Opinion attached to Final Award, 26 January 2006.

<sup>359</sup> At § 13.

<sup>360</sup> Considering that the only straight analogy is the presence of the state.



(judicial review as opposed to commercial arbitration), while the general setting is not questioned with reference to other, more pressing, weaknesses (lack of democratic control chief amongst them).

As for the scope of enlarging the protections offered by investment treaty by reference to the jurisprudence of the ECtHR, its reliance on the margin of appreciation doctrine makes it an unsuitable source of inspiration in the context of investment law, where tribunals tend not to want to defer to systems of national law towards which they have neither allegiance nor connection to the extent done by the European Court. The layering of competencies in the European polity might create circumstances in which states implement regulation deemed to have an expropriatory effect in pursuance to European directives: it is to be expected that the Court would exercise a high level of deference for this sort of regulations. This is another argument against a simple analogy on the supposed role of the Court as a tool to obtain judicial review. In other words: the analogy holds only for the usual administrative law remedies against irrationality, arbitrariness, illegality, but not for general *bona fide* exercises of governmental authority in pursuance of the common good, were even the Court stops short of adjudicating, having resorted to the construction of the margin of appreciation doctrine precisely to avoid what some investment lawyers are advocating<sup>361</sup>.

In summary, in the matter of regulatory expropriations, it is the tension between the effect (expropriation) and the intent (regulatory) to be the crux of the problem. As we will see again in Chapter 4 and then in Chapter 7, it is either an issue of exceptions/carve outs or of balancing: in other words, either the intent supersedes the effect (if it is regulation, it is not expropriation, and compensation is not due) or the effect supersedes the intent (if it results in a substantial deprivation, it is expropriation and

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<sup>361</sup> See for example Wälde's dissenting opinion in the *Thunderbird Award*, *infra*.

compensation is due), or, finally, intent and effect interact with each other by way of a proportionality analysis.

### 3.4 Concluding remarks

This chapter brought into focus the normative background in which non-investment obligations constitute an ‘interference’. Several issues have arisen already in this review, which will be important in our assessment of the extent of the conflicts and their possible resolution: the redundancy of the investment protection provisions; the shift to the Respondent to justify the legitimacy of the regulation against a claim, if not of regulatory expropriation, of standard of treatment violation (through the emergence of the ‘legitimate expectations’ of the investor as the controlling standard<sup>362</sup>) and the resulting effective coincidence between the criteria for ascertaining a regulatory expropriation and a breach of the FET standard<sup>363</sup>; on the opposite end of the scale, a more frank

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<sup>362</sup> See Wälde’s already mentioned dissenting opinion in *Thunderbird*, with extensive comparative analysis of human rights law and varied domestic administrative law systems, see especially, at §30, the assertion that: ‘under developed systems of administrative law, a citizen – even more so an investor - should be protected against unexpected and detrimental changes of policy if the investor has carried out significant investment with a reasonable, public-authority initiated assurance in the stability of such policy. *Assurance on a particular interpretation of often open-ended statute against an unexpected detrimental change of such interpretation is in this context particularly relevant...*’ [italics added]. He then immediately adds that: ‘Such protection is, however, not un-conditional and ever-lasting. It leads to a balancing process between the needs for flexible public policy and the legitimate reliance on in particular investment-backed expectations.’ We have already argued against this balancing between policy and law, where policy inevitably loses out.

<sup>363</sup> In *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic* (ICSID Case No. ARB/02/1), Decision on Liability, 3 October 2006, § 139, the Tribunal stated: ‘The Tribunal nevertheless recognizes the economic hardships that occurred during this period, and certain political and social realities that at the time may have influenced the Government’s response to the growing economic

recognition of the existence of the conflicts and of the role played by investors' behaviour<sup>364</sup>.

In the second part of this project we will consider the tools available to the actors in investment law and arbitration, but more specifically to states and tribunals, that allow them to incorporate non-investment obligations in the development and application of the law. This review of the substantive obligations contained in investment treaties has to be read as the necessary background to that analysis. Inevitably, it is the obstacles to a holistic approach by states and tribunals in creating and applying investment law that come to the fore. If the ambiguity and vagueness of the investment treaties is a drawback, it is to be imputed to the states responsible for drafting the relevant provisions (and only secondarily to the tribunals that interpret them). The clearer and more precise the language of a treaty, the smaller the scope for interpretation and 'judicial activism' by arbitration tribunals<sup>365</sup>. Conversely, the more open and ambiguous the language, inevitably the greater the scope for tribunals to give substantive content to the provisions on a more *ad hoc* basis, with the risk of them getting perilously close to delivering decisions *ex aequo et bono*. Given the wide powers of interpretation granted to arbitrators, much of the responsibility rests with them for the approach they take to non-investment obligations and their relevance within investment law. The traditional, orthodox approach of investment tribunals, which can be distinguished procedurally by a strict adherence

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difficulties. Certainly, LG&E was aware of the risks inherent in investing in a foreign State. But here, the Tribunal is of the opinion that Argentina went too far by completely dismantling the very legal framework constructed to attract investors.' This reasoning mirrors Justice Holmes famous *dictum* in *Pennsylvania Coal Co. v. Mahon*, 260 U.S. at § 415: '...while property might be regulated to a certain extent, if regulation goes too far it will be recognized as a taking.'

<sup>364</sup> See for example Muchlinski, P., 'Caveat investor?: The relevance of the conduct of the investor under the fair and equitable treatment standard', in Ortino *et al.*, 2007: 205.

<sup>365</sup> See Section 5.4.1 for a review of treaty interpretation by international courts, in connection with the issue of intertemporal law.

to the commercial arbitration model and substantially by faithfulness to an insular view of investment law, has been the object of this chapter. In many cases, one can speak of a sort of ‘tunnel vision’ adopted by investment arbitration tribunals. It is a tunnel vision that works on two levels: firstly, a commercial law bias to the exclusion of public law traditions and practices; second, and connected to the first, an investor-centred approach that underestimates, misconstrues and disapplies public interest concerns and demands. To the extent that tribunals do not concern themselves with these matters, they exclude or diminish their value as defences that can be raised by the state. In other words, in this way tribunals effectively close the doors of investment arbitrations to non-investment general measures. This refusal to let non-investment measures to be taken into due account can be contrasted with tribunals’ eagerness to interpret investment treaties *in favorem* investor on the basis of vague policy statements evinced from the preambles of BITs<sup>366</sup>.

We do not aim to argue that environmental *policy* considerations should work as ‘trumps’ in the interpretation of the treaty. Just as Douglas argued that ‘where there is no specific rule of decision to apply... the

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<sup>366</sup> As done by the tribunal in *SGS v. Philippines* (ICSID Case No. ARB/02/6) Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004, § 116: ‘The BIT is a treaty for the promotion and reciprocal protection of investments. According to the preamble it is intended ‘to create and maintain favourable conditions for investments by investors of one Contracting Party in the territory of the other. *It is legitimate to resolve uncertainties in its interpretation so as to favour the protection of covered investments*’ [italics added]. For a more balanced approach, see also *Saluka Investments B. V. v. Czech Republic*, UNCITRAL, PCA, Partial Award, 16 March 2006, § 300 (while still accepting that BITs, being designed to promote foreign investment, should provide ‘a positive incentive’, including a lower standard of ‘inappropriateness’ of behaviour in order to trigger a violation of the FET standard [at § 293]). For a previous example of the investor-centred approach, see *Kuwait v. AMINOIL*, Final Award, 24 March, 1982, 21 *ILM*, 976, 1033. It should be stressed that, in the context of mixed arbitrations, adopting the traditional international law approach of interpreting treaties *in favorem* state sovereignty (as argued by the United States in *Methanex Corp. v. United States of America*, UNCITRAL, 1<sup>st</sup> Partial Award, 7 August 2002, § 103) would not accomplish a balanced result either.

tribunal should search for principles of law'<sup>367</sup>, equally it is submitted that tribunals ought to consider conflicting *legal* obligations of states<sup>368</sup> in accordance with existing rules of treaty interpretation and conflict resolution.

In the next three chapters we will turn our attention to the ways in which investment law expressly deals with non-investment obligations (Chapter 4), what tools are available in general international law when express means of incorporation are not available (Chapter 5) and, finally, what procedural means of incorporation are at the disposal of investment tribunals (Chapter 6), before finally zooming into investment arbitrations to see how all these tools play out in actual investment cases (Chapter 7).

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<sup>367</sup> Douglas, 2009, 84.

<sup>368</sup> All the ways in which this can be done are discussed in the following chapters. The distinction between rules and principles, which we take from Dworkin (Dworkin, R., 'The Model of Rules?', 35 *University of Chicago Law Review* (1967-68): 14, reprised as chapter 2 in *Taking Rights Seriously*, London, Duckworth, 1978) might not be as useful as it has been argued. Even if rules are applied in an all-or-nothing fashion, while for principles it is a matter of degree or balancing, principles alone will not allow proportionality to 'work its magic', because in the end it is still the matter of deciding which rule will be dis-applied in the particular case. While it is true that principles can help tip the balance in the decision, their unfortunate tendency to be 'regime-specific' (or too vague to be of any help) might result in the regime-bias to dictate the choice between competing principles.

## Part II: The tools

This is the central section of this work, and appropriately, it examines the practicalities of dealing with non-investment obligations in the context of investment law. There are three main means of accomplishing this, each analysed in a separate chapter: express provisions in investment instruments (chapter 4); conflict rules derived from general international law (chapter 5) and procedural means (chapter 6). The part is essentially descriptive in its structure and normative in its approach. Chapter 4 especially aims to provide a taxonomy of all the possible ways in which non-investment commitments are included in investment treaties. To a certain extent, it is a picture of '*il buon governo*', i.e., the ideal way of dealing with conflicting obligations by way of careful drafting and attentive choice of language. As is often the case, reality is quite far from this ideal and most treaties do not measure up to this standard of careful calibration of regulatory commitments, either because the express provisions are not included at all, or because of the vagueness of the language or the 'soft law' nature of the clauses. It is important to stress that chapter 4 does not aim to 'test' these provisions. This will be done in chapter 7, to the extent that the reality of the investment disputes will reflect the drafting of the treaties. The aim of chapter 4 is simply to provide a comprehensive review of the available tools.

Chapter 5 deals with a very complex issue, that has attracted the attention of publicist (less so of treaty drafters and state officials), namely, the resolution of normative conflicts in international law. The argument is that, even when express provisions have not been included in the applicable treaty, investment tribunals can still resort to the conflict rules available in general international law (as codified in the Vienna Convention on the Law of Treaties) in order to avoid the conflict, if possible, or solve it in accordance with generally accepted rules. The chapter includes examples taken from the jurisprudence of the International Court of Justice and the panels and Appellate Body of the

WTO. Also this was a conscious choice, as the application of the conflict rules in investment disputes will be examined in Part 3 of this work.

Finally, chapter 6 reviews the procedural means of incorporation. These should not be considered as a ‘weapon of last resort’; instead, it is advisable for investment tribunals to adopt as their default position openness of proceedings, publicity of materials and awards, and participation of non-disputing parties, regardless of what other means are available to them as outlined in the two preceding chapters.

## Chapter 4: Non-investment obligations in investment instruments

### 4.1 Introduction

In Chapter 3, we reviewed the main obligations to which the host state is subject with respect to the investor. In the next three chapters we will examine how tribunals can take into account the host state's non-investment obligations. There are principally four ways in which non-investment obligations can be taken into consideration: policy initiatives, such as inter-state consultations<sup>369</sup>; procedural means, such as publicity of materials, openness of proceedings and *amicus curiae* briefs; conflict resolution techniques derived from general international law principles and rules; and finally the recourse to express provisions in investment instruments. In this chapter we will concentrate on the last one of these means, keeping in mind that both policy and procedural means can find their way into the express provisions of the investment treaty<sup>370</sup>. Only the conventional sources of investment law, that is bilateral and multilateral treaties, will be considered, both for ease of analysis and for statistical reasons, as most of the investment disputes now take place under the umbrella of an investment treaty. There are five ways in which substantial non-investment obligations are incorporated into the treaties:

1. The preamble of the treaty itself. Preambles do not contain binding obligations, but they can be used by tribunals in aiding the interpretation of the treaty's substantive norms, and as a source for the scope and purpose of the treaty;

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<sup>369</sup> These will not be examined in this chapter or elsewhere, because of the exclusion of policy analysis from this work.

<sup>370</sup> Respectively through the incorporation of clauses on the duty of inter-state consultation or the acceptance of third parties submissions.



2. Specific exception clauses. These clauses explicitly incorporate extraneous obligations in the treaty, and relieve the state from the performance of investment protection obligations to the extent of their applicability. Exception clauses can be of a general or a specific nature (there are no examples of environmental exception clauses in treaties ratified so far, with the possible exception of the exception clauses modelled on Article XX of the GATT).

3. ‘Balancing clauses’, such as articles of the BITs titled ‘Environment’ or even more specifically ‘Investment and Environment’. While these clauses do not provide an exception to the investment obligations of the treaty, and cannot therefore be raised as a defence for non performance, they can be used, through interpretation, to balance the obligations of the treaty against other obligations;

4. Carve-out clauses and more general clarifications, by way of annexes, circumscribing either the extent of regulatory takings or the applicable standard of treatment, in order to take into consideration non investment obligations. Clarifications on the extent of the regulatory powers of states more correctly belong to this category, as we consider them neither exception clauses (where the state is relieved from an obligation that would normally be applicable because of the exception), nor balancing clauses (where two conflicting obligations are balanced by the tribunal, both remaining applicable), but a carve-out clause (where the obligation is not applicable to the situation, therefore there is no need for an exception)<sup>371</sup>.

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<sup>371</sup> See also Mann, H., ‘Investment agreements and the regulatory state: can exception clauses create safe havens for governments?’, 2007, at [http://www.iisd.org/pdf/2007/inv\\_agreements\\_reg\\_state.pdf](http://www.iisd.org/pdf/2007/inv_agreements_reg_state.pdf), at 6: ‘For clarity, it is important to note that the reason such measures are not compensable is that they do not fall within the definition or scope of expropriation. It is not about an expropriation that is non-compensable. Rather, it addresses a measure that is not compensable because it is not an expropriation. The distinction is not just esoteric, but impacts significantly on the burden of proof and other factors in arbitrations around this issue.’

5. Conflict clauses, either specifically establishing a conflict rule for particular environmental instruments, or general conflict clauses.

Not all investment treaties are the same, as the protagonists of the debate on their role in the development of customary law know well, and different treaties accord different weight to non-investment obligations. There has been a diachronic change, with a more frank recognition of the role to be attributed to these obligations (paradigmatic in this sense is the change in the US Model BIT); there is an economic divide, with least developed countries more willing to relinquish their non-investment regulatory rights. This divide tends to be made invisible though, as more often than not, this ‘regulatory deficit’ is implemented at the level of the concession contracts, through stabilisation clauses which exclude the investor from changes in the regulatory environment of the host state.

Each treaty can contain one, more, all or none of these express provisions, with the presence of two or more pointing to a higher level of awareness of the potential environmental fall-outs of investment activities, especially in certain sectors, such as energy and mining. The taxonomy presented here has to be contextualised in the reality of treaty drafting, where the distinctions might not be clear, the categories might overlap, especially where complex clauses might be structured as containing exception, conflict and carve-out provisions (or where the language of the treaty is vague enough as to allow tribunals to interpret these clauses differently), and different express tools are supposed to operate differently, as will be shown in chapter 7.

## 4.2 Preambles to investment treaties

Preambles can be of varying length and level of detail. They can refer to the object and scope of the treaty as instruments for the protection and promotion of investments or can include other considerations in their

text, from a reference to economic development, to a reference to other obligations. The point has been made that it is inappropriate to use the policy declarations contained in preambles to treaty to construe legal obligations<sup>372</sup>. However much one accepts this criticism, it is important to point out that it is an accepted rule of treaty interpretation to refer back to the language of the preamble in order to ascertain the scope and purpose of the treaty<sup>373</sup>. To this extent, any reference to non-investment obligations in the preamble does not of course create a free standing legal obligation nor it gives the tribunal jurisdiction over a dispute on the compliance with these obligations (except to the extent that they are referred to in specific exception clauses in the body of the treaty), but only aides in the interpretation of the legal obligations contained in the treaty proper. As we said, some treaties contain a very short preamble, which only refers to the strict scope of the treaty. An example of this is the United Kingdom-Argentina BIT:

The Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Argentina;  
Desiring to create favourable conditions for greater investments by investors of one State in the territory of the other State;  
Recognising that the encouragement and reciprocal protection under international agreement of such investments will be conducive to the stimulation of individual business initiatives and will increase prosperity in both States;  
Have agreed as follows....

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<sup>372</sup> Z. Douglas, 2009, §§ 147-8. See also, interestingly, the Tribunal in *Bayindir Insaat Turizm Ticaret ve Sanayi AS v. Islamic Republic of Pakistan* (ICSID Case No. ARB/03/29), Decision on Jurisdiction, 14 November 2005, quoting the text of the preamble of the Pakistan – Turkey BIT, at §§ 229-230: ‘ “The Islamic Republic of Pakistan and the Republic of Turkey...agree that fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment....” ...Despite the use of the verb “agree”, it is doubtful that, in the absence of a specific provision in the BIT itself, the sole text of the preamble constitutes a sufficient basis for a self-standing fair and equitable treatment obligation under the BIT.’

<sup>373</sup> See Article 31(2) of the Vienna Convention on the Law of Treaties.

Other treaties, while maintaining the basic structure adopted above, include a reference to international law, therefore situating more explicitly the treaty within the framework of general international law. The BIT between Sweden and Argentina includes the following preamble:

The Government of the Kingdom of Sweden and the Government of the Republic of Argentina,  
desiring to intensify, in conformity with the principles of international law, economic cooperation to the mutual benefit of both countries and to maintain fair and equitable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party,  
recognizing that the promotion and protection of such investments favour the expansion of the economic relations between the two Contracting Parties and stimulate investment initiatives,  
have agreed as follows...

Equally, the preamble can contain a reference to the respective domestic laws of the Parties to the treaty, and in general deference to sovereignty.<sup>374</sup> These preambles can be contrasted with the long text of the Norway Draft Model BIT (2007), which includes the following language:

The Kingdom of Norway and the....., hereinafter referred to as the “Parties”;  
*Desiring* to develop the economic cooperation between the Parties;  
*Desiring* to achieve these objectives in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labour rights;  
.....  
*Emphasising* the importance of corporate social responsibility;  
*Recognising* that the development of economic and business ties can promote respect for internationally recognised labour rights;  
*Reaffirming* their commitment to democracy, the rule of law, human rights and fundamental freedoms in accordance with their obligations under international law, including the principles set out in the United Nations Charter and the Universal Declaration of Human Rights;  
*Recognising* that the promotion of sustainable investments is critical for the further development of national and global economies as well as for

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<sup>374</sup> An example of this in the Preamble of the Egypt-Nigeria BIT  
[http://www.unctad.org/sections/dite/ia/docs/bits/Egypt\\_Nigeria.pdf](http://www.unctad.org/sections/dite/ia/docs/bits/Egypt_Nigeria.pdf).

the pursuit of national and global objectives for sustainable development, and understanding that the promotion of such investments requires cooperative efforts of investors, host governments and home governments;

*Recognising* that the provisions of this agreement and provisions of international agreements relating to the environment shall be interpreted in a mutually supportive manner;

.....

In the end the Norway Model BIT was not adopted, because of opposition to it from different quarters, as reported at the time<sup>375</sup>:

... despite efforts to achieve a model BIT that balanced investor protections with consideration of public goods, a number of nongovernmental organizations and businesses charged that the proposed model agreement was imbalanced. Indeed, public feedback fell broadly in two categories, said a Norwegian government official: groups that felt the model did not provide investors with enough protection, and those that felt the model would restrain governments' ability to regulate in the public interest. The feedback was so polarized that Norway "decided that achieving a proper balance was too difficult," said this person.'

The US 2004 Model BIT also refers to environmental and other obligations in its preamble:<sup>376</sup>

The Government of the United States of America and the Government of [Country] (hereinafter the "Parties");

*Desiring* to promote greater economic cooperation between them with respect to investment by nationals and enterprises of one Party in the territory of the other Party;

*Recognizing* that agreement on the treatment to be accorded such investment will stimulate the flow of private capital and the economic development of the Parties;

*Agreeing* that a stable framework for investment will maximize effective utilization of economic resources and improve living standards;

*Recognizing* the importance of providing effective means of asserting claims and enforcing rights with respect to investment under national law as well as through international arbitration;

*Desiring* to achieve these objectives in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labor rights;

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<sup>375</sup> ITN, 8 June 2009 (<http://www.investmenttreatynews.org/>).

<sup>376</sup> As well as the Preamble of the Central America Free Trade Agreement (CAFTA) includes the United States and is also modelled on the NAFTA with some differences.

*Having* resolved to conclude a Treaty concerning the encouragement and reciprocal protection of investment;  
Have agreed as follows...

Certain sectors of investors' activities are more prone to environmental negative externalities, and it is no surprise that the only sectoral multilateral treaty containing an investment chapter, the Energy Charter Treaty, contains all of the expressed provisions listed in the introduction, starting with the last two paragraph of its preamble, which state:

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; and  
Recognizing the increasingly urgent need for measures to protect the environment, including the decommissioning of energy installations and waste disposal, and for internationally-agreed objectives and criteria for these purposes,  
have agreed as follows....

Here the reference is not generically to international law or domestic law, or even environmental considerations in general, but specifically to two environmental agreements, and to the measures necessary to mitigate the damages created by energy extraction and production activities. In this case it could be argued that the preamble does not simply constitute a source for the object and purpose of the treaty, or an aid for the interpretation of its substantive provisions, but it refers directly to the environmental obligations of the state parties. This preamble should also be read in conjunction to Article 18 of the Treaty (Sovereignty over Energy Resources), which also contains programmatic and objective elements, including its paragraph (3), which states:

Each state continues to hold in particular the rights to decide the geographical areas within its Area to be made available for exploration and development of its energy resources, the optimalization of their recovery and the rate at which they may be depleted or otherwise exploited, to specify and enjoy any taxes, royalties or other financial payments payable by virtue of such exploration and exploitation, and to regulate the environmental and safety aspects of such exploration, development and reclamation within its Area, and to participate in such

exploration and exploitation, inter alia, through direct participation by the government or through state enterprises.

To summarise, preambles can vary in their wording from restricting the focus of the treaty to the protection and promotion of investment, to the inclusion of either international law or municipal law as backgrounds upon which the investment obligations contained in the treaty are to be implemented, to the acknowledgment that investment protection has to be balanced against other public policy obligations of the contracting parties. The language of the preamble can aid tribunals in ascertaining the scope of the treaty and in interpreting its substantive provisions. The interpretation 'in light of' other non-investment obligations of the state can allow the tribunal to apply the substantive clauses of the treaty taking into consideration the obligations that the state has in the defence of the public interest.

#### 4.3 Exception clauses

Investment treaties can contain specific exception clauses. Normally these refer to taxation or national security or cultural preservation; NAFTA Article 1108 allows the State Parties to provide a negative list of exemption and non-conforming measures. There are no investment instruments in force at the moment, either bilateral or multilateral, that allow exceptions based on environmental regulations. The only example are clauses partially allowing health, safety and environmental (HSE) exceptions, based on Article XX of the GATT. The relevant section of the GATT Article, targeted at general exceptions, states:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

- (a) necessary to protect public morals;

- (b) necessary to protect human, animal or plant life or health;
- (c) relating to the importations or exportations of gold or silver;
- (d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement....

Similarly, the US Model BIT of 2004 contains the following exception clause as part of Article 8 on Performance Requirements – Article 8(3)(c):

Provided that such measures are not applied in an arbitrary or unjustifiable manner, and provided that such measures do not constitute a disguised restriction on international trade or investment, paragraphs 1(b), (c), and (f), and 2(a) and (b), shall not be construed to prevent a Party from adopting or maintaining measures, including environmental measures:

- (i) necessary to secure compliance with laws and regulations that are not inconsistent with this Treaty;
- (ii) necessary to protect human, animal, or plant life or health; or
- (iii) related to the conservation of living or non-living exhaustible natural resources.

This clause appears also in the NAFTA, Article 1106 on Performance Requirements, as well as in the Canadian Model BIT, Article 10. The NAFTA contains two exceptions that might allow for non investment obligations to be used as defences against a claim; the first one is contained in Article 1106(2), which is worded more specifically as a conflict clause:

A measure that requires an investment to use a technology to meet generally applicable health, safety or environmental requirements shall not be construed to be inconsistent with paragraph 1(f). For greater certainty, Articles 1102 [National Treatment] and 1103 [Most-favored-Nation Treatment] apply to the measure.

The second, the GATT-style exception clause, is in Article 1106(6):

Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in paragraph 1(b) or (c) or 3(a) or (b) shall be construed to prevent any Party from adopting or maintaining measures, including environmental measures:



- (a) necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;
- (b) necessary to protect human, animal or plant life or health; or
- (c) necessary for the conservation of living or non-living exhaustible natural resources.

The concern has been expressed that the presence of this clause within the article on Performance Requirements can be construed as restricting its applicability to that article and not to the totality of the treaty, therefore not influencing, for example, the standards of treatment or expropriation clauses<sup>377</sup>. The article differentiates between measures adopted or maintained in compliance with legislation, in which case the measures have to be consistent with the obligations contained within the treaty (this provision would cover measures which would be subject to compensation if non-compliant) and measures taken to protect human, animal or plant life and health, or related to the conservation of natural resources; in this second instance, there is no obligation of compliance with the investment obligations, so this is a true exception clause, preventing wrongfulness.

Article 14 of the US Model BIT – Non-conforming Measures, carves out the fields excluded from the application of the treaty, with the negative list approach typical of bilateral investment treaties (as opposed to the WTO less demanding system of positive lists). The Canadian 2004 Model BIT contains a similar GATT-style provision, as does the draft Norwegian Model BIT of 2007, which explicitly mentions the environment, at Article 24 of Section 5:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction on international [trade or] investment, nothing in this

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<sup>377</sup> See Report of the Subcommittee on Investment of the Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty, Collective Statement from Sarah Anderson, Institute for Policy Studies and others, Part IV, available at <http://www.state.gov/e/eeb/rls/othr/2009/131118>.

Agreement shall be construed to prevent a Party from adopting or enforcing measures necessary<sup>378</sup>:

- i. to protect public morals or to maintain public order;<sup>379</sup>
- ii. to protect human, animal or plant life or health;
- iii. to secure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;
- iv. for the protection of national treasures of artistic, historic or archaeological value; or
- v. for the protection of the environment

The Energy Charter Treaty has a general non-derogation clause from the GATT (Part I – Article 4), but the General Exceptions provision, which is very detailed, is contained in Article 24, the first part of which covers environmental exceptions with reference to Part III of the Treaty (the investment chapter)<sup>380</sup>:

(1) This Article shall not apply to Articles 12 [Compensation for Losses], 13 [Expropriation] and 29 [Interim Provisions on Trade-Related Matters].

(2) The provisions of this Treaty other than (a) those referred to in paragraph (1); and

(b) with respect to subparagraph (i), Part III of the Treaty shall not preclude any Contracting Party from adopting or enforcing any measure

(i) necessary to protect human, animal or plant life or health;

(ii) essential to the acquisition or distribution of Energy Materials and Products in conditions of short supply arising from causes outside the control of that Contracting Party, provided that any such measure shall be consistent with the principles that

(A) all other Contracting Parties are entitled to an equitable share of the international supply of such Energy Materials and Products;

and

(B) any such measure that is inconsistent with this Treaty shall be discontinued as soon as the conditions giving rise to it have ceased to exist...

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<sup>378</sup> For greater certainty, the concept of “necessity” in this Article shall include measures taken by a Party as provided for by the precautionary principle, including the principle of precautionary action.

<sup>379</sup> The public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.

<sup>380</sup> For the relationship between the Article 4 and Article 24, see the Final Act of the European Energy Charter Conference, Understanding no. 15 with respect to Article 24.

It is worth noting that the exceptions do not apply to Article 13 on expropriation, with the effect of preventing the application of the listed exceptions if the measures as for subparagraph (i) have ‘effect equivalent to nationalization or expropriation’ (Article 13(1)).

The presence of GATT-style general exception clauses in investment agreements can be problematic. In the context of WTO law, an inter-state system based on positive lists, trade-offs, and interstate disputes, a clause worded such as Article XX of the GATT is coherent with the system. Where the consequence of a breach of the GATT consists in repealing the offending legislation, it is reasonable to state that nothing in the agreement shall be construed as preventing a Party from adopting or enforcing a certain measure. In the WTO system, measures can be unlawful if they are in breach of a trade obligation<sup>381</sup>. Investment law on the other hand possesses its own system of secondary rules which constitute a *lex specialis* regime dealing with consequences of breaches<sup>382</sup>. In an investment agreement, a lawful measure does not become unlawful and therefore subject to the obligation of repeal if it is expropriatory (even if the expropriation is unlawful); it only carries with it the obligation to compensate for the loss if so established by the tribunal. In other words, when cessation or restitution are not the expected remedies, it is unhelpful to grant the state a power that the investment agreement *per se* is not supposed to touch. The risk is also that, given the very similar wording, the investment tribunal might be tempted to interpret the exception clauses similarly to how this has been interpreted by the Dispute Settlement Panels and Appellate Body of the WTO, without taking in due consideration the differences between the two systems, including the differences in remedies<sup>383</sup>.

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<sup>381</sup> See DiMascio, N., and Pauwelyn, J., ‘Nondiscrimination in trade and investment treaties: worlds apart or two sides of the same coin?’, 102 *AJIL* (2008): 48.

<sup>382</sup> See Rule 12 and related discussion in Douglas, 2009: 94 ff.

<sup>383</sup> See Muchlinski, P., ‘Corporate social responsibility’, in *The Oxford Handbook of International Investment Law*: 637 at 670.

Nonetheless, this clause explicitly reaffirms the regulatory space necessary to implement public interest measures. There are three levels of restrictions applicable to the clause: firstly, and most generally, the measures have to be applied in a non-discriminatory manner and not constitute a disguised restriction of investment; secondly, if the measures are adopted or enforced in compliance with legislation, the article establishes a conflict rule to the effect that the measures cannot be inconsistent with the investment treaty (which will therefore prevail to the extent of the inconsistency); and thirdly, only if certain conditions are met (public order preservation etc) the article has the effect of a proper exception clause, precluding wrongfulness. It is to be presumed that only emergency measures will be covered by this exception, as ordinary measures enforced in compliance with legislation (for example, the requirement to conduct an environmental impact assessment) will be covered by the conflict rule as expressed for example in Article 1106(6)(a) of the NAFTA.

#### 4.4 'Balancing' or regulatory measures clauses

When treaties do not create express exceptions from the obligations contained therein, they might nonetheless expressly mention the non-investment obligations of the contracting parties, in 'balancing' clauses. The new generation of BITs has seen the multiplication of this kind of clauses, which can take different forms and express different levels of commitment to non-investment obligations. We refer to them as balancing clauses for two reasons: the first one is that they are not exception clauses, relieving the state from its investment obligations to the extent of the exception; the second one is that they contain the 'otherwise consistent with this agreement' proviso. It has been argued that this proviso renders the clauses meaningless<sup>384</sup>; after a review of a

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<sup>384</sup> See Mann, H., 2007, at [http://www.iisd.org/pdf/2007/inv\\_agreements\\_reg\\_state.pdf](http://www.iisd.org/pdf/2007/inv_agreements_reg_state.pdf).

few of these clauses, we will see that their presence, albeit of limited scope, is not futile. Probably the first of this kind of clauses is Article 1114 of the NAFTA – Environmental Measures, which provides as follows:

1. 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.

2. The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If a Party considers that another Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.

The first paragraph, similarly to Article 1106(6)(a), establishes a conflict rule: while the sovereign power of the state to regulate in response to environmental concerns is reaffirmed, the power is limited by the requirement to act consistently with the investment protection obligations of the agreement. The second paragraph of the Article is worded in hortatory terms, which contrast unfavourably with the mandatory language of the rest of Chapter Eleven, and seems on the face of it to be unenforceable<sup>385</sup>. By way of illustration, let's assume that a Canadian investor is offered a waiver of environmental measures by Mexico if he is willing to invest in Mexico: according to the Article, the investor should then notify his government (Canada; otherwise, how else would Canada 'consider' that such an offer has been made?) so that Canada

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<sup>385</sup> On the enforceability of the environmental provisions of the NAFTA in general, see Banks, K., 'NAFTA's Article 1110 – Can regulation be expropriation?' 5 *Law & Business Review* (1999): 499; Charnovitz, S., 'NAFTA: green law or green spin?' 26 *Law & Policy International Business* (1994): 1; Wickham, J., 'Toward a green multilateral investment framework: NAFTA and the search for models', 12 *Geographic International Law Review* (2000): 617.

could request consultations with Mexico, with a view of withdrawing this offer. Does this put the investor under an obligation to report such an offer? Arguably, it only means that the investor is estopped from using this promise as an ‘investment backed expectation’ in a claim against the host state, were the offer to be withdrawn. Alternatively, can we say that this Article establishes a duty for Canada to ascertain if this is going on? Of course not. The only (soft) obligation is on Parties to refrain from lowering their environmental standards. However, since this course of action is economically beneficial to both the investor and the host state (which is why it is undertaken by the host state) and since there is no duty on the home state of the investor to ascertain that this is taking place, the possibility that these consultations could ever be requested is very low indeed, and in fact this has never happened<sup>386</sup>. Its logical limitations notwithstanding, this provision is repeated in the US Model BIT, Article 11, the Canadian Model BIT, Article 11, the Rwanda-United States BIT, Article 12. More recently adopted instruments have expanded the scope of the environmental exception, both by clarifying the language and by ever so slightly increasing the ‘bite’ of the clause, even if staying within the confines of the hortatory language adopted in previous treaties. We will present three clauses from treaties concluded by Libya,

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<sup>386</sup> See also the comments of the Australian Network of Environmental Defender’s Offices in occasion of the consultations on the Australia-US Free Trade Agreement (AUSFTA) which contained in its draft stage a similar provision. In their letter to the US FTA Task Force they stated: ‘First, a provision such as Article 1114 is patently unenforceable. While the aspiration contained within it is laudable, it should be strengthened considerably to ensure that (present and prospective) environmental and public health and safety laws are not compromised in the name of investment. Second, it is unlikely that one party would complain if the other party sought to encourage investment. For example, if Australia was to induce US investors through lowering its standards (environmental or otherwise), it seems a fanciful scenario that the US would seek to invoke the consultation provisions’ (available at <http://www.edo.org.au/policy/ausftasub.htm>). In final draft, the second part of article 1114 was dropped. The treaty came into force on 1 January 2005, see <http://www.fta.gov.au/default.aspx?FolderID=160>.

respectively with Spain and with Belgium, and the treaty between Nicaragua and El Salvador. Article 8(4) of the 2009 Spain-Libya BIT states<sup>387</sup>:

Recognising the right of each Contracting Party to establish its own level of domestic environmental protection and environmental development policies and priorities, nothing in this present Agreement shall be interpreted as to prevent the Contracting Parties from modifying or adopting measures, otherwise compatible with the present Agreement, for guaranteeing that investment activities are carried out with consideration for environmental concerns, provided that these measures are not applied in an arbitrary or unjustified manner and do not undermine the substance of the rights provided for in the present Agreement. Consequently, each Contracting Party shall strive to ensure that its laws provide for high levels of environmental protection and shall strive to continue to improve these laws<sup>388</sup>.

In the Libya-Belgium BIT, Article 1 (Definitions), includes, at paragraph 5, the following:

The terms “environmental laws” shall mean the laws and regulations, or provisions thereof, in force in the Contracting Parties, the primary purpose of which is the protection of the environment, or the prevention of a danger to human, animal, or plant life or health, through:

- a) the prevention, abatement or control of the release, discharge, or emission of pollutants or environmental contaminants;
- b) the control of environmentally hazardous toxic chemicals, substances, materials and wastes, and the dissemination of information related thereto;
- c) the protection or conservation of wild flora or fauna, including endangered species, their habitat, and specially protected natural areas in the Contracting Party’s territory.

Article 5 (Environment) is as following:

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<sup>387</sup> The BIT is only available in Spanish (and Arabic), from which it has been translated by the author.

<sup>388</sup> A similar provision is contained in Article 17.1 [Levels of Protection] of the CAFTA and in Article 3 of the North American Agreement on Environmental Cooperation: ‘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 and encourage high levels of environmental protection, and shall strive to continue to improve those laws and policies.’

For the purpose of this Agreement, the Contracting Parties shall strive to apply the following principles:

1. Recognising the right of each Contracting 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, each Contracting Party shall strive to ensure that its laws provide for high levels of environmental protection and shall strive to continue to improve those laws.
2. The Contracting Parties recognise that it is inappropriate to encourage investment by relaxing domestic environmental law. Accordingly, each Contracting Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such laws as an encouragement for the establishment, maintenance or expansion in its territory of an investment;
3. The Contracting Parties reaffirm their commitments under international environmental agreements, which they have accepted. They shall strive to ensure that such commitments are fully recognised and implemented by their domestic laws.
4. The Contracting Parties recognise that co-operation between them provides enhanced opportunities to improve environmental protection standards. Upon request by either Contracting Party, the other Contracting Party shall accept to hold expert consultations on any investment matters involving investors of the Contracting Parties and falling under the purpose of this Article.

The scope of these articles is still somewhat limited, the language mostly hortatory and aspirational, but there are some innovations:

- 1) The reference to the continuous improvement of environmental legislation favours a stricter interpretation of the requirement for stability of the regulatory framework: confronted with a claim for regulatory taking, the state can rely on the environmental clause of these BITs to argue against the expectation of stability of its environmental legislation in the absence of specific commitments to the contrary;
- 2) The inclusion in the definitions section of the treaty (in the Libya-Belgium BIT), while it can be considered a limitation of the scope of the environmental article (*expressio unius* principle) nonetheless clarifies the applicability of the measures;
- 3) The inclusion of a clause on compliance with environmental legislation in the Libya-Belgium BIT, albeit in hortatory language, is a perfect example of a balancing clause. It also includes a commitment to recognising and implementing international environmental commitments



in domestic legislation. This can also be interpreted as a conflict clause, to the extent that domestic law is the standard fall-back governing law of any investment agreement;

4) The increased role of the home state of the investor, through the device of the ‘expert consultations...on investment matters...falling under the scope of the [Environment] article’. Again, this is an example of a balancing measure, using inter-state co-operation to minimise the occurrence of normative conflicts.

Finally, it is no surprise that the Energy Charter Treaty contains a detailed provision on the environment, Article 19, and that it is accompanied by the Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA). Article 19 states:

(1) In pursuit of sustainable development and taking into account its obligations under those international agreements concerning the environment to which it is party, each Contracting Party shall strive to minimize in an economically efficient manner harmful Environmental Impacts occurring either within or outside its Area from all operations within the Energy Cycle in its Area, taking proper account of safety. In doing so each Contracting Party shall act in a Cost-Effective manner. In its policies and actions each Contracting Party shall strive to take precautionary measures to prevent or minimize environmental degradation. The Contracting Parties agree that the polluter in the Areas of Contracting Parties, should, in principle, bear the cost of pollution, including transboundary pollution, with due regard to the public interest and without distorting Investment in the Energy Cycle or international trade. Contracting Parties shall accordingly:

- (a) take account of environmental considerations throughout the formulation and implementation of their energy policies;
- (b) promote market-oriented price formation and a fuller reflection of environmental costs and benefits throughout the Energy Cycle;
- (c) having regard to Article 34(4), encourage co-operation in the attainment of the environmental objectives of the Charter and co-operation in the field of international environmental standards for the Energy Cycle, taking into account differences in adverse effects and abatement costs between Contracting Parties;
- (d) have particular regard to Improving Energy Efficiency, to developing and using renewable energy sources, to promoting the use of cleaner fuels and to employing technologies and technological means that reduce pollution;

- (e) promote the collection and sharing among Contracting Parties of information on environmentally sound and economically efficient energy policies and Cost-Effective practices and technologies;
  - (f) promote public awareness of the Environmental Impacts of energy systems, of the scope for the prevention or abatement of their adverse Environmental Impacts, and of the costs associated with various prevention or abatement measures;
  - (g) promote and co-operate in the research, development and application of energy efficient and environmentally sound technologies, practices and processes which will minimize harmful Environmental Impacts of all aspects of the Energy Cycle in an economically efficient manner;
  - (h) encourage favourable conditions for the transfer and dissemination of such technologies consistent with the adequate and effective protection of Intellectual Property rights;
  - (i) promote the transparent assessment at an early stage and prior to decision, and subsequent monitoring, of Environmental Impacts of environmentally significant energy investment projects;
  - (j) promote international awareness and information exchange on Contracting Parties' relevant environmental programmes and standards and on the implementation of those programmes and standards;
  - (k) participate, upon request, and within their available resources, in the development and implementation of appropriate environmental programmes in the Contracting Parties.
- (2) At the request of one or more Contracting Parties, disputes concerning the application or interpretation of provisions of this Article shall, to the extent that arrangements for the consideration of such disputes do not exist in other appropriate international fora, be reviewed by the Charter Conference aiming at a solution.
- (3) For the purposes of this Article:
- (a) "Energy Cycle" means the entire energy chain, including activities related to prospecting for, exploration, production, conversion, storage, transport, distribution and consumption of the various forms of energy, and the treatment and disposal of wastes, as well as the decommissioning, cessation or closure of these activities, minimizing harmful Environmental Impacts;
  - (b) "Environmental Impact" means any effect caused by a given activity on the environment, including human health and safety, flora, fauna, soil, air, water, climate, landscape and historical monuments or other physical structures or the interactions among these factors; it also includes effects on cultural heritage or socio-economic conditions resulting from alterations to those factors;
  - (c) "Improving Energy Efficiency" means acting to maintain the same unit of output (of a good or service) without reducing the quality or performance of the output, while reducing the amount of energy required to produce that output;
  - (d) "Cost-Effective" means to achieve a defined objective at the lowest cost or to achieve the greatest benefit at a given cost.

The very structure of the Article illustrates its complexity, with a preambular section, stating object and purpose, appealing to environmental law-inspired principles, such as sustainable development, precautionary and ‘polluter pays’ principles<sup>389</sup>, and to principles derived from economic and investment law, such as economic efficiency, cost-effectiveness and the importance of the application of the least distorting measures in the field of trade and investment<sup>390</sup>; the middle section contains the substantive provisions, and the last section the definitions applicable to the body of the Article. While the structure is impressive, the content is disappointing<sup>391</sup>, with most provisions having little force, with a ‘best-effort’ soft law approach to environmental commitments, mostly being directed to the promotion of environmental concerns, co-operation, dissemination of information etc; the only provision which refers to actual legal obligations, paragraph (1)(i) on environmental impact assessments, is qualified by Understanding no. 13 of the Final Conference, as follows:

It is for each Contracting Party to decide the extent to which the assessment and monitoring of environmental impacts should be subject to legal requirements, the authorities competent to take decisions in relation to such requirements, and the appropriate procedures to be followed<sup>392</sup>.

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<sup>389</sup> For an expression of the precautionary principle, see for example Principle 15 of the 1992 of the Rio Declaration on the Environment and Development, at <http://www.un.org/documents/ga/conf151/aconf15126-1annex1.htm>; for the ‘Polluter Pays’ principle, see Principle 16 of the Declaration (Internalization of Environmental Costs).

<sup>390</sup> On the nature of principles as ‘regime-specific’, see the discussion of the *Beef Hormones Case* at Section 5.4.2.1.1.

<sup>391</sup> On the relationship between the ECT and sustainable development, see Chalker, J., ‘Making the investment provisions of the Energy Charter Treaty sustainable development friendly’, 6 *International Environmental Agreements* (2006): 435; Wälde, T., ‘Investment arbitration and sustainable development: good intentions – or effective results?’, 6 *International Environmental Agreements* (2006): 459.

<sup>392</sup> There could be other obligations with respect to the production of environmental assessments: for example, in order for MIGA to provide investment protection

Additionally, at Article 19(2), a separate dispute settlement regime is set up for disputes on the interpretation or application of the Article, with a ‘softer’ approach compared to the binding arbitration procedures available to investors<sup>393</sup>. The Final Conference of the Energy Charter approved at the same time as the Charter also the Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA); this protocol contains mostly policy provisions on international co-operation, promotion of energy efficiency and best practice; its Article 13(1) provides: ‘In the event of inconsistency between the provisions of this Protocol and the provisions of the Energy Charter Treaty, the provisions of the Energy Charter Treaty shall, to the extent of the inconsistency, prevail.’ Separate environmental chapters or protocols are also contained in the NAFTA and the CAFTA. The last one contains a very detailed provision, Article 17.2 [Enforcement of Environmental Law], which puts together provisions that are presented separately in similar agreements<sup>394</sup>:

1. (a) A Party shall not fail to effectively enforce its environmental laws, through a sustained or recurring course of action or inaction, in a manner affecting trade between the Parties, after the date of entry into force of this Agreement.

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insurance for certain investments, an environmental assessment has to be carried out, with only environmentally sound and sustainable project receiving coverage; see MIGA Environmental Assessment Policy, Annex B of MIGA’s Operational Regulations, at [http://www.miga.org/policies/index\\_sv.cfm?stid=1681](http://www.miga.org/policies/index_sv.cfm?stid=1681).

<sup>393</sup> See Konoplyanik, A. and Wälde, T., ‘Energy Charter Treaty and its role in international energy’, 24 *Journal of Energy & Natural Resources Law* (2006): 523, at 547. On the ‘synergy’ between the ECT and climate change remediation, see Sussman, E., ‘The Energy Charter Treaty’s investor protection provisions: potential to foster solutions to global warming and promote sustainable development’, 14 *ILSA Journal of International & Comparative Law* (2008): 391.

<sup>394</sup> On the political background of the adoption of the CAFTA, with particular reference to the apprehensions raised about the ability of governments to enact environmental regulations, see Byrnes, S., ‘Balancing investor rights and environmental protection in investor-state dispute settlement under CAFTA: lessons from the NAFTA legitimacy crisis’, 8 *U.C. Davis Business Law Journal* (2007): 103.

(b) The Parties recognize that each Party retains the right to exercise discretion with respect to investigatory, prosecutorial, regulatory, and compliance matters and to make decisions regarding the allocation of resources to enforcement with respect to other environmental matters determined to have higher priorities. Accordingly, the Parties understand that a Party is in compliance with subparagraph (a) where a course of action or inaction reflects a reasonable exercise of such discretion, or results from a *bona fide* decision regarding the allocation of resources.

2. The Parties recognize that it is inappropriate to encourage trade or investment by weakening or reducing the protections afforded in domestic environmental laws. Accordingly, each Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such laws in a manner that weakens or reduces the protections afforded in those laws as an encouragement for trade with another Party, or as an encouragement for the establishment, acquisition, expansion, or retention of an investment in its territory.

3. Nothing in this Chapter shall be construed to empower a Party's authorities to undertake environmental law enforcement activities in the territory of another Party.

As for the value of these balancing clauses, we have already anticipated that they have been criticised for being 'toothless', flawed or meaningless. Partially this can be explained by the mistaken assumption that these are exception clauses, which they are not, or carve-outs, which they are not either<sup>395</sup>. While in practice they could have the same effect, if the tribunal decided that, as a consequence of its environmental obligations, the state was either not in breach of the particular provision invoked by the claimant or excused from the breach, the particular system of investment disputes could allow for a third solution, a balancing of the damages reflected in the amount of compensation granted to the investor. The incorporation of non-investment obligations in the calculation of the quantum of damages is a contentious issue and presents several legal obstacles. A tribunal is mostly bound not to deliver an award *ex aequo et bono*, unless authorised to do so<sup>396</sup>. Most

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<sup>395</sup> In fact most of them are worded as to invite the Parties not to use investment norms as excuses for non compliance of non-investment obligations. If carve-outs and exception norms constitute different ways of creating discrete fields of application, these norms are balancing norms.

<sup>396</sup> See Article 42(2) of the ICSID Convention.

investment treaties do not allow for this, and it is not envisioned that states would be willing to insert a clause to this effect. Lacking this power, tribunals are bound to grant compensation based on the assessment of the damages, striking a balance between the assessment provided by the claimant and by the defendant<sup>397</sup>, but without having the power to go below the lower limit provided and respecting the ‘just compensation’ or Hull standard of prompt, adequate and effective compensation common in investment treaty law. However, while the rules on compensating for direct expropriation are comparatively clear, damages for violations of lesser obligations, such as standard of treatment, but possibly also including regulatory expropriation, could allow the tribunal the leeway necessary to account for the role of non investment obligations in the quantification of the damages, as a mitigating circumstance.

#### 4.5 Carve-out clauses and clarifications

This section deals with clauses that, by their application, create a carve out from a rule, typically allowing the host state the regulatory space necessary to exercise its functions in the public interest. The distinction between carve-out and exception, where for the first wrongfulness is precluded, while for the second it is excluded, can be more easily conceptualised (if not resolved) in cases involving claims of ‘regulatory expropriation’. American jurisprudence involving the takings clause constitutes a good example of the difficulties of keeping these distinctions in practice. As we have already seen in Chapter 3, it was Justice Holmes to state that: ‘...while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking’<sup>398</sup>, introducing the concept of regulatory taking in US

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<sup>397</sup> For example between the going concern value and the net book value.

<sup>398</sup> *Pennsylvania Coal Co. v. Mahon*, 260 US 393 (1922).

jurisprudence. Since then, American courts, and especially the Supreme Court, have been grappling with how to define when regulation ‘goes too far’. While it was generally accepted that regulation which resulted in physical invasion of property was to be equated to a taking<sup>399</sup>, as well as regulation that eliminated all economically beneficial or productive use of land<sup>400</sup>, the problem arose with measures where not all beneficial use and value is taken (in which case it is accepted that a categorical inclusion in the purview of takings is warranted). We have already analysed the jurisprudence of the Court in great detail in Section 3.3.2. For the purpose of considering the extent to which regulatory expropriation clauses can be interpreted by tribunals, three approaches emerge:

1. Measures partially affecting use or value are not takings at all, therefore no compensation is required. In this way regulatory measures partially affecting property rights are equated to a carve-out from expropriation, with a ‘categorical’ exclusion from the reach of the takings clause.
2. Those same measures are ‘categorically’ included within the scope of takings and they are assessed with regards to their effect only; in the Supreme Court, Justice Holmes in *Pennsylvania Coal v Mahon*<sup>401</sup>, and Justice Scalia more recently<sup>402</sup>, have been proponents of this doctrine; in international investment law, the ‘sole effect’ doctrine is based on this

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<sup>399</sup> *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982). Confusingly, this is also what the Court in *Penn Central* meant when it referred to the ‘character of the government’s action’ in determining if a partial regulatory taking required compensation; the Court stated that: ‘[takings] may more readily be found when the interference with property can be characterized as a physical invasion by government ... than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good.’ 438 U.S. at 124.

<sup>400</sup> *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980); *Lucas v. South Carolina Coastal Council*, 505 US 1003, 1015, 1029 (1992).

<sup>401</sup> *Pennsylvania Coal Co. v. Mahon*, 260 US 393 (1922).

<sup>402</sup> In *Lingle v. Chevron*, 544 US 528 (2005) at 539.

principle. If applied, regulatory takings become ‘functionally equivalent’ to direct takings, with only a factual analysis separating compensable and non compensable governmental action, with all the difficulties in “drawing the line”<sup>403</sup>.

3. Balancing or proportionality approach. This mixed approach can be seen as the middle ground between the two doctrinal approaches outlined above. In practice, rejecting either categorical inclusion or exclusion can result in the default acceptance of the categorical inclusion, balanced by the weight tribunals are willing to grant either to the investment-backed expectations on one side, or the public interest on the other. The risk is then that this approach collapses onto the second one.

#### *4.5.1 Expropriation*

We start from the 2004 US and Canadian Model BITs, because both of them introduced, by way of Annexes, clarifications on the extent of regulatory expropriation, in response to anxieties resulting from the first ten years of application of the NAFTA and its investment chapter<sup>404</sup>. Annex B of the US Model BIT is as following:

The Parties confirm their shared understanding that:

1. Article 6 [Expropriation and Compensation](1) is intended to reflect customary international law concerning the obligation of States with respect to expropriation.

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<sup>403</sup> See the difference in approach in *Lucas v. South Carolina Coastal Council*, 505 US 1003 (1992), where the Court required that: ‘when the owner of real property has been called upon to sacrifice all economically beneficial uses in the name of the common good,..., to leave his property economically idle, he has suffered a taking’. (at § 1019); and in *Loretto v. Teleprompter Manhattan CATV Corp*, 458 US 419 (1982), where the Court held that: ‘When the “character of the governmental action” is a permanent physical occupation of real property, there is a taking to the extent of the occupation without regard to whether the action achieves an important public benefit or has only minimal economic impact on the owner.’

<sup>404</sup> As already discussed in Chapter 3.



2. An action or series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in an investment.

3. Article 6 [Expropriation and Compensation](1) addresses two situations. The first is direct expropriation, where an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure.

4. The second situation addressed by Article 6 [Expropriation and Compensation](1) is indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.

(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, standing 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 welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriation.<sup>405</sup>

The model treaty, as amended, provides the government the ‘regulatory space’ necessary to protect legitimate public welfare objectives, limited by some rare circumstances, meant to include measures that *prima facie* respect the standards set by the treaty. However, rather than explicitly setting out a carve-out to the compensation requirement, its purpose is declaratory, restating the principle of non-discrimination when the government goes about its business of regulating in the public interest<sup>406</sup> (in short, a restatement of the good-faith requirement). The re-wording also has to be read in the context of the political situation at the time it was devised, and, more specifically, the unease with which the US

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<sup>405</sup> A similarly worded Annex is appended to the CAFTA’s Investment Chapter, Annex 10-C. The model treaty was used for the US-Uruguay Treaty, entered into force in 2006, and the US-Rwanda Treaty, signed in 2008.

<sup>406</sup> To paraphrase the *SD Myers* Tribunal (at § 282).

Congress considered the treatment of foreign investors *vis-à-vis* US investors<sup>407</sup>. There had also been pressure to include in the expropriation provision a restriction to measures affecting property rights, in line with the jurisprudence of the US Supreme Court<sup>408</sup>. More specifically, some of the participants of the Subcommittee on Investment at the US Department of State<sup>409</sup>, have recommended that:

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<sup>407</sup> Especially as concerns the takings clause in NAFTA and its application (for example, in the *Methanex* Case) See the statements by Senators Max Baucus and Chuck Grassley, quoted by Schneiderman, 2008, at 73-74, and the conclusions of the Bipartisan Trade Promotion Authority Act of 2002, that: '[foreign investors should] not [be] accorded greater substantive rights with respect to investment protections than United States investors in the United States.' Schneiderman remarks, *ibidem*, 74, that 'All of this, ironically, is reminiscent of the discredited Calvo doctrine.' This episode is also discussed in Chapter 3.

<sup>408</sup> For example, taxation measures have consistently been rejected by the Court under the Fifth Amendment (see *County of Mobile v. Kimball*, 102 U.S. 691, 703 (1880); recently, *Empress Casino Joliet Corp. v. Giannoulis*, 896 N.E. 2d 277, 293 (Ill. 2008), cert. denied, 129 S. Ct. 2764 (2009)) while under NAFTA a claim for expropriation arising from taxation measures can be brought, subject to the conditions detailed in Article 2103(6): 'Article 1110 (Expropriation and Compensation) shall apply to taxation measures except that no investor may invoke that Article as the basis for a claim under Article 1116 (Claim by an Investor of a Party on its Own Behalf) or 1117 (Claim by an Investor of a Party on Behalf of an Enterprise), where it has been determined pursuant to this paragraph that the measure is not an expropriation. The investor shall refer the issue of whether the measure is not an expropriation for a determination to the appropriate competent authorities set out in Annex 2103.6 at the time that it gives notice under Article 1119 (Notice of Intent to Submit a Claim to Arbitration). If the competent authorities do not agree to consider the issue or, having agreed to consider it, fail to agree that the measure is not an expropriation within a period of six months of such referral, the investor may submit its claim to arbitration under Article 1120 (Submission of a Claim to Arbitration)'. The Tribunal in *Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN3467 (US/Ecuador BIT), Final Award, 1 July 2004, at § 85, stated that 'Taxes can result in expropriation..'.

<sup>409</sup> Report of the Subcommittee on Investment of the Advisory Committee on International Economic Policy regarding the model bilateral investment treaty, of 30 September 2009, at <http://www.state.gov/e/eeb/rls/othr/2009/131098.htm>.

....the administration [US] [should] consider clarifying in the Model BIT that an “indirect expropriation” occurs only when a host state seizes or appropriates an investment for its own use or the use of a third party, and that regulatory measures that adversely affect the value of an investment but do not transfer ownership of the investment do not constitute acts of indirect expropriation.

This recommendation is in response not only to the risk that *bona fide* environmental regulation is caught in the provision, but also to American anxieties about the possibility that the ‘no greater rights’ principle is not respected and foreign investors under the NAFTA are granted more rights than US investors under the US Constitution. The American approach to limitations to regulatory expropriation finds support in the Restatement (Third) of the Foreign Relations Law of the United States, which excludes from its reach ‘*bona fide* general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police powers of states’<sup>410</sup>. The Canadian Model BIT, while adopting similar language to the US Model, is even more specific on the nature of the carve-out, with the subparagraph (c) of its Annex B.13(1), corresponding to Annex B.4(b) of the US BIT:

Except in rare circumstances, such as when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good-faith, non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation.

As we can see, the Canadian BIT clearly establishes that the ‘rare circumstances’ exception has to be assessed against the good faith requirement<sup>411</sup>. Recent US FTA agreements spell out in further detail the

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<sup>410</sup> Restatement (Third) of the Foreign Relations Law of the United States, § 712.

<sup>411</sup> The first treaty signed by Canada using the new model treaty was the Canada-Peru treaty, signed in 2006 and entered into force in 2007; Canada has also signed new treaties with the Czech Republic, Romania, Latvia and Jordan, but these have entered into force yet. Negotiations for BITs with China and India are ongoing, at a more advanced stage for the treaty with India, see

<http://news.in.msn.com/international/article.aspx?cp-documentid=4383002>.

criteria applicable to indirect or regulatory expropriation. For example, the US-Chile of FTA, also of 2004, contains, in addition to the clarification as per Annex of the Model BIT, the following provision<sup>412</sup>:

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.

But again, this clause, a part from containing the usual ‘otherwise consistent with’ proviso, does not on its own relieve the state from its obligation to pay compensation for expropriatory regulation, even if, read together with the Annex provision, creates a presumption against it which has to be rebutted by the claimant against the high standard of bad faith<sup>413</sup>.

We now consider two instruments that, while not adopted, move in the direction of a greater opening to non-investment obligations. The first one is the draft Norway BIT of 2007; in its Article 6 [Expropriation] the treaty provides as follows:

1. 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.
2. 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.

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<sup>412</sup> Article 10.12 of the US-Chile FTA 2004.

<sup>413</sup> The same argument is made with regards of similar provisions contained in the CAFTA; see for example Byrnes, art. cit., 8 *U.C. Davis Business Law Journal* (2007): 103, where he argued that: ‘A shifting burden-of-proof would be the most appropriate procedural mechanism....[and] achieves the desired balance between investor protection and insulation of legitimate environmental regulation from improper challenges...by providing compulsory criteria, e.g. mandatory consideration of a government’s “regulatory intent” to distinguish between legitimate regulation and disguised trade protectionism’.

In the first paragraph, the criteria for a lawful expropriation are not spelled out, and this is particularly significant in relation to the standard for compensation, which is ‘pegged’ to general principles of international law. In light of the controversy on this standard<sup>414</sup>, the Article leaves the choice open to interpretation. The second paragraph is identical to the European Convention of Human Rights Article 1 of Protocol 1 on the right to property<sup>415</sup> rather than on American-style expropriation provisions considered above. These represent two different ways in which carve-outs from expropriation can be conceptualised: the European model, based both on the language of the European Convention and on the jurisprudence of its Court, which gives a wide margin to states to act in the public interest and subjects the measures to a proportionality test; and an American model, already considered above, which looks at the jurisprudence on regulatory takings of the US Supreme Court for inspiration<sup>416</sup> and conceptualises proportionality in the assessment of which measures are ‘least restrictive’ to trade and/or investment.

The second non adopted instrument is the IISD model investment agreement, which holds, at Article 8(I):

Consistent with the right of states to regulate and the customary international law principles on police powers, *bona fide*, non-discriminatory regulatory measures taken by a Party that are designed and applied to protect or enhance legitimate public welfare objectives, such as public health, safety and the environment, do not constitute an indirect expropriation under this Article.

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<sup>414</sup> For which see Section 3.3.

<sup>415</sup> See for example Demerieux, M., ‘Deriving environmental rights from the European Convention for the Protection of Human Rights and Fundamental Freedoms’, 21 *Oxford Journal of Legal Studies* (2001): 521, especially Section 5.

<sup>416</sup> With the attendant risks of conflict (or worse, cross-contamination) between the constitutionally protected right of compensation against takings guaranteed by the Fifth Amendment and the NAFTA expropriation clause.

This formulation takes into account most of the criteria already present in the previous adopted instruments, including:

1. The recognition of the police powers application to *prima facie* expropriations;
2. The good faith principle, accompanied by the non-discrimination provision;
3. The straight carve-out clause ('do not constitute an indirect expropriation') as opposed to the simple exception.

In summary, indirect or regulatory expropriations being theoretically difficult to differentiate, the exercise of 'drawing the line' between legitimate regulatory action and expropriation is better analysed in the context of the jurisprudence of international courts and investment tribunals.

#### ***4.5.2 Standards of treatment***

All investment agreements contain standards of treatment clauses, typically comparative non discrimination standards, such as the national and most-favoured- comparative standards, and absolute standards such as the international minimum standard, or fair and equitable treatment standard. In Chapter 3 we have examined the substantive investment obligations contained in these clauses; here our concern is to discover if investment agreements contain express provisions conditioning the application of these standards to other, non-investment, obligations. The obvious entry point is the legitimate expectation of investors as to the kind of treatment he is entitled to receive. However, since the standards as articulated in the agreements do not list their constitutive elements, only through an examination of the jurisprudence of the tribunals it is possible to ascertain to what extent tribunals are taking environmental obligations into account when applying the standards. In short, the reality of investment agreements at present does not include the recognition of

non investment obligations directly linked to the content of the standards, leaving it to the tribunal to conduct the analysis necessary to establish, first the substantive content of the standards, and second to what extent this content includes balancing elements derived from general regulatory functions of the state<sup>417</sup>. There are however two non-adopted instruments which took into consideration these functions directly in drafting the standards of treatment clauses. The first one is the Norway 2007 Draft BIT, whose Articles 3 [National Treatment] and 4 [Most-Favoured-Nation] qualify the ‘in like circumstances’ clause with the following footnote:

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.

The second instrument is the IISD Model Investment Agreement for Sustainable Development, which contains, in its Article 5 on National Treatment<sup>418</sup>, the following subparagraph:

(E) For greater certainty, the concept of “in like circumstances” requires an overall examination, on a case by-case basis, of all the circumstances of an investment, including, *inter alia*:  
a) its effects on third persons and the local community;

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<sup>417</sup> See for example the already mentioned function attributed to the ‘equitable’ element of the standard (footnote 227 in Chapter 3), McLachlan and others, 2009, at 206: ‘The inclusion of the reference to equitable treatment also provides a means by which an appropriate balance may be struck between the protection of the investor and the public interest which the host State may properly seek to protect in the light of the particular circumstances then prevailing.’

<sup>418</sup> Applicable also, *mutatis mutandis* as per text, to Article 6 [Most-Favoured-Nation].

- b) its effects upon the local, regional or national environment, or the global commons<sup>419</sup>;
- c) the sector the investor is in;
- d) the aim of a measure of concern;
- e) the regulatory process generally applied in relation to a measure of concern; and
- f) other factors directly relating to the investment or investor in relation to the measure of concern.

The examination shall not be limited to or biased toward any one factor.

These measures are not exactly carve-out measures, as they only establish that regulatory measures, provided certain criteria are met, will not constitute a breach of the standards of treatment provisions and to this extent they can be categorized as exceptions. More precisely, they constitute a ‘non inconsistent with’ provision. In the Norway Model BIT the burden of proof is clearly on the state adopting the measures (...when justified by showing that it bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign owned investment) to prove that the measures are not inconsistent with the standards guaranteed by the relevant articles, on the basis of establishing that they are not a form of disguised discrimination and that they are connected with the goal to be obtained. In the IISD Model Agreement, the onus is generally on the tribunal to conduct a case-by-case examination of the measures of concern to ascertain if they run afoul of the protections guaranteed by the articles, taking in consideration several factors, amongst which disguised discrimination (the bad faith element) is not mentioned.

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<sup>419</sup> This is accompanied by the following footnote (7 in the text): ‘The Parties understand that such considerations can include the cumulative impacts of all investments within a jurisdiction, for example in the natural resources harvesting sectors or in relation to setting of ambient or specific pollution loads. Many jurisdictions do not allow new investments that will cause applicable environmental or human health tolerances to be exceeded.’



## 4.6 Conflict clauses

Some of the clauses classified as exception or regulatory clauses contain a conflict clause as well. There can be several ways of classifying conflicts, and therefore the clauses designed to deal with them. Express conflict clauses can relate to pre-existing treaties, to future treaties or regulate conflict of norms within the same treaty. Additionally, they can directly refer to conflicting environmental (or other, especially trade) obligations, or generally establish a hierarchy between treaties (by reference to technical conflict rules such as *lex specialis* or *lex posterior*). This section will be structured by presenting first a review of the conflict rules present in the main investment instruments, both multilateral and bilateral, then an analysis of their language and their function.

### 4.6.1 Express conflict clauses in multilateral instruments

Article 103 [Relation to Other Agreements] of the NAFTA establishes a general rule of precedence with respect to the GATT and other agreements:

1. The Parties affirm their existing rights and obligations with respect to each other under the *General Agreement on Tariffs and Trade* and other agreements to which such Parties are party.
2. In the event of any inconsistency between this Agreement and such other agreements, this Agreement shall prevail to the extent of the inconsistency, except as otherwise provided in this Agreement.

Article 104 [Relation to Environmental and Conservation Agreements] sets up specific conflict rules for environmental instruments:

1. In the event of any inconsistency between this Agreement and the specific trade obligations set out in:
  - (a) Convention on the International Trade in Endangered Species of Wild Fauna and Flora, done at Washington, March 3, 1973;
  - (b) the Montreal Protocol on Substances that Deplete the Ozone Layer, done at Montreal, September 16, 1987, as amended June 29, 1990;

(c) Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, done at Basel, March 22, 1989, upon its entry into force for Canada, Mexico and the United States; or

(d) the agreements set out in Annex 104.1,<sup>420</sup> 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.

2. The Parties may agree in writing to modify Annex 104.1 to include any amendment to the agreements listed in paragraph 1, and any other environmental or conservation agreement.

In Chapter Eleven, Article 1112 [Relationship to Other Chapters] regulates possible conflicts within the NAFTA: 'In the event of any inconsistency between a provision of this Chapter and a provision of another Chapter, the provision of the other Chapter shall prevail to the extent of the inconsistency.'

Finally, Article 40 [Relation to Other Environmental Agreements] of the North American Agreement on Environmental Cooperation regulates the interrelationship between this ancillary agreement to the NAFTA and other environmental agreements to which the NAFTA states might be parties: 'Nothing in this Agreement shall be construed to affect the existing rights and obligations of the Parties under other international environmental agreements, including conservation agreements, to which such Parties are party.'

The CAFTA contains a provision similar to Article 103 of the NAFTA in its Article 1.3 [Relation to Other Agreements]:

The Parties affirm their existing rights and obligations with respect to each other under the WTO Agreement and other agreements to which such Parties are party.

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<sup>420</sup> Which include 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. This agreement was relevant to the defence by respondent Canada in *S.D. Myers*, discussed in Chapter 7.

2. For greater certainty, nothing in this Agreement shall prevent the Central American Parties from maintaining their existing legal instruments of Central American integration, adopting new legal instruments of integration, or adopting measures to strengthen and deepen these instruments, provided that such instruments and measures are not inconsistent with this Agreement.

Article 10.2 [Relation to Other Chapters] regulates the relationship between the Investment Chapter and the other chapters of the CAFTA:

1. In the event of any inconsistency between this Chapter and another Chapter, the other Chapter shall prevail to the extent of the inconsistency.

2. A requirement by a Party that a service supplier of another Party post a bond or other form of financial security as a condition of the cross-border supply of a service does not of itself make this Chapter applicable to measures adopted or maintained by the Party relating to such cross-border supply of the service. This Chapter applies to measures adopted or maintained by the Party relating to the posted bond or financial security, to the extent that such bond or financial security is a covered investment.

3. This Chapter does not apply to measures adopted or maintained by a Party to the extent that they are covered by Chapter Twelve (Financial Services).

Finally, Article 17.12 [Relationship to Environmental Agreements] contained in the Environment Chapter is similar to Article 104 of the NAFTA, in that it deals with specific conflicts with environmental agreements; however the article is not as explicit on the relationship between potentially conflicting obligations and does not set up a hierarchy of rules, using instead the soft law language of cooperation and consultation. The article states:

1. 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. The Parties further recognize that this Chapter and the ECA can contribute to realizing the goals of those agreements. Accordingly, the Parties shall continue to seek means to enhance the mutual supportiveness of multilateral environmental agreements to which they are all party and trade agreements to which they are all party.

2. The Parties may consult, as appropriate, with respect to ongoing negotiations in the WTO regarding multilateral environmental agreements.

The Energy Charter Treaty contains a complex system of conflict rules relating both to existing instruments and regulating intra-treaty conflicts. The first of these rules is contained in Article 4 [Non-derogation from GATT and related instruments]: ‘Nothing in this Treaty shall derogate, as between particular Contracting Parties which are parties to the GATT, from the provisions of the GATT and Related Instruments as they are applied between those Contracting Parties.’

Article 5 deals with trade related investment measures and their consistency with GATT obligations:

(1) A Contracting Party shall not apply any trade-related investment measure that is inconsistent with the provisions of article III or XI of the GATT; this shall be without prejudice to the Contracting Party’s rights and obligations under the GATT and Related Instruments and Article 29.

(2) Such measures include any investment measure which is mandatory or enforceable under domestic law or under any administrative ruling, or compliance with which is necessary to obtain an advantage, and which requires...

Both articles subject the ECT’s obligations to the parties’ obligations under the GATT, contrary to the equivalent NAFTA provisions considered above. Article 16 [Relation to Other Agreements] is contained in Part III [Investments] and states:

Where two or more Contracting Parties have entered into a prior international agreement, or enter into a subsequent international agreement, whose terms in either case concern the subject matter of Part III or V of this Treaty,

(1) nothing in Part III or V of this Treaty shall be construed to derogate from any provision of such terms of the other agreement or from any right to dispute resolution with respect thereto under that agreement; and

(2) nothing in such terms of the other agreement shall be construed to derogate from any provision of Part III or V of this Treaty or from any right to dispute resolution with respect thereto under this Treaty, where any such provision is more favourable to the Investor or Investment.

Finally, as already noted in the previous section, Article 13(1) of the PEEREA [Relation to the Energy Charter Treaty] establishes a hierarchy between the two instruments: ‘In the event of inconsistency between the provisions of this Protocol and the provisions of the Energy Charter Treaty, the provisions of the Energy Charter Treaty shall, to the extent of the inconsistency, prevail.’

#### *4.6.2 Express conflict clauses in BITs and FTAs*

Neither the US nor the Canadian Model BIT contains a conflict clause modelled on the NAFTA; however, Article 16 [Non-Derogation] of the US BIT contains a prohibition to derogate from ‘international obligations of a Party’ to the extent that they grant a better treatment than that guaranteed by the Treaty<sup>421</sup>:

This Treaty shall not derogate from any of the following that entitle an investor of a Party or a covered investment to treatment more favorable than that accorded by this Treaty:

1. laws or regulations, administrative practices or procedures, or administrative or adjudicatory decisions of a Party;
2. international legal obligations of a Party; or
3. obligations assumed by a Party, including those contained in an investment authorization or an investment agreement.

Article 10(7) of the Canada Model BIT provides as following:

Any measure adopted by a Party in conformity with a decision adopted by the World Trade Organization pursuant to Article IX:3 of the

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<sup>421</sup> A similar provision is contained in Article 7(1) of the 2008 German Model BIT: ‘If the legislation of either Contracting State or international obligations existing at present or established hereafter between the Contracting States in addition to this Treaty contain any provisions, whether general or specific, entitling investments by investors of the other Contracting State to a treatment more favourable than is provided for by this Treaty, such provisions shall prevail over this Treaty to the extent that they are more favourable.’

WTO Agreement<sup>422</sup> shall be deemed to be also in conformity with this Agreement. An investor purporting to act pursuant to Section C of this Agreement [Settlement of Disputes] may not claim that such a conforming measure is in breach of this Agreement.

By and large, all instruments considered above seem to give greater weight to the resolution of potential conflicts with other trade agreements, and to intra-treaty conflicts, than to conflicts with treaties with a different subject matter. As usual, to find a more open recognition of the necessity to tackle conflicts between disparate areas of law we have to look at the two non-adopted instruments. The Norway 2007 Draft Model BIT contains the following provision in Article 29 [Relation to Other International Agreements]: ‘The provisions of this Agreement shall be without prejudice to the rights and obligations of the Parties under other international agreements.’ The IISD Model Agreement, given its sustainable development goal, contains very detailed provisions on the relationship between agreements. The general ones are contained in Article 33 and 34:

Article 33: Relation to other investment agreements and obligations

(A) Upon the home and host states becoming Parties to this Agreement, all pre-existing international investment agreements to which they are a Party shall, as between such states, be deemed to be terminated by mutual consent and all the rights and obligations due shall be pursuant to this Agreement.

Except as specified in Article 3(F), such termination shall be immediate notwithstanding any expiration period for the rights of investors or investments under such pre-existing agreements.

(B) Where states Party to this agreement have an international investment agreement with a non-Party, they shall strive to renegotiate those agreements to make them consistent with the present Agreement or to ensure that all Parties to the other Agreement become a Party to this Agreement.

(C) States Party to this agreement shall ensure that all future investment agreements to which they may become Party are fully consistent with the

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<sup>422</sup> Article IX.3 of the WTO Agreement states: ‘The WTO shall administer the Understanding on Rules and Procedures Governing the Settlement of Disputes (hereinafter referred to as the “Dispute Settlement Understanding” or “DSU”) in Annex 2 to this Agreement.

present Agreement, particularly with the balance of rights and obligations it establishes, and the principal features of the dispute settlement system. The Conference of the Parties may be called upon to assess compliance with this obligation on the request of a Party.

(D) Notwithstanding any of the above, any disputes that have been formally initiated under prior international investment agreements shall be decided in accordance with the rights and obligations of that agreement.

#### Article 34: Relation to other international agreements

(A) The Parties agree that the provisions of other international trade agreements to which they are a Party are consistent with the provisions of this Agreement. The Parties shall seek to interpret such agreements in a mutually supportive manner.

(B) In the event of any dispute arising on this issue, the Parties shall seek to resolve such dispute within the mechanisms of this agreement as a first step.

(C) The Parties hereby re-affirm their obligations under international environmental and human rights agreements to which they are a Party.

In addition, this instrument contains a separate section on the duties of investors, including the duty to comply with the host state's laws (Article 11(A)), to comply with environmental impact assessment criteria (Article 12(A)), and not to circumvent environmental obligations in the post-establishment phase (Article 14(D)). In Part 4, Host State Obligations, Article 21 sets minimum standards for environmental, labour and human rights protection, which include the obligation to comply with the human rights treaties to which they are parties and to the standards of the ILO Declaration on Fundamental Principles and Rights of Work; however no similar duty of compliance is established for international environmental agreements. To the contrary, Article 21(A) states as follows:

Recognizing the right of each Party to establish its own level of domestic environmental protection and its own sustainable development policies and priorities, and to adopt or modify its environmental laws and regulations, each Party shall ensure that its laws and regulations provide for high levels of environmental protection and shall strive to continue to improve those laws and regulations.

Finally, Part 5 on Host States' Rights, contains the following provision as Article 25(B) [Inherent rights of States]:

In accordance with customary international law and other general principles of international law, host states have the right to take regulatory or other measures to ensure that development in their territory is consistent with the goals and principles of sustainable development, and with other social and economic policy objectives.

The policy paper to accompany the model agreement<sup>423</sup> stresses the presumption against conflict and the necessity for international instruments to be interpreted as mutually reinforcing<sup>424</sup>. To this extent, the inclusion of express conflict clauses in an investment instrument is seen as an admission of failure of international law to work as an integrated system of rules. An alternative view is that conflicts are sometimes inevitable and that express conflict clauses provide the best way to deal with them within the framework of the applicable treaty, reducing the power of arbitration tribunals to determine the extent of the regulatory powers of the host state. While the presumption against conflict is a legitimate principle when applied by international courts that necessarily take a generalist approach to the enforcement of international law, it can become a dangerous tool in the hands of investment tribunals which both by design (being restricted in their jurisdiction by the instruments under which they are being set up) and by choice (being made up typically by experts in investment and commercial law) might be inclined to interpret the principle as allowing for investment rules to trump non investment obligations and *a fortiori* non investment rights<sup>425</sup>. This problem is recognised in the ILC's report on fragmentation as 'structural bias'<sup>426</sup>; the ILC added that:

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<sup>423</sup> von Moltke, K., A model international investment agreement for the promotion of sustainable development, 1994: 26.

<sup>424</sup> As discussed in detail in Chapter 7.

<sup>425</sup> The classification of the treaties as dealing with the same subject matter, as per the VCLT, can be similarly viewed as 'argumentative success' in framing the dispute in an arbitrary manner under the instrument one wishes to be applied (see ILC's *Report on fragmentation*, § 22).

<sup>426</sup> At § 280.



The weakness of the strategy of seeking a “mutually supportive” interpretation lies in its open-endedness. By concluding this type of conflict clause, States parties transfer their competence to decide on what should be done in case of conflicts to the law-applier. This may work well in case the two treaties are part of the same regime. But if the conflict is between treaties across two regimes, then the solution works only if the law-applier is an impartial third party that approaches the conflicting instruments from beyond the regimes of which the treaties are a part. It might happen, however, that the law-applier will be a body or an administrator closely linked to one or another of the (conflicting) regimes. In such case, an open-ended conflict clause will come to support the primacy of the treaty that is part of the law-applier’s regime.

#### 4.6.3 Analysis

The previous section provided some illustrative examples taken from investment instruments, listing clauses dealing with conflicts with pre-existing treaties (such as Article 103 of the NAFTA), future treaties<sup>427</sup>, intra-treaty, especially when the investment obligations are contained in the investment chapter of an FTA (such as Article 1112 of the NAFTA). Considering the first two of these categories (namely excluding for now intra-treaty conflicts) and assuming that these clauses create a hierarchy between norms contained within the investment treaty (treaty A) and the other non-investment treaty (treaty B), they can either: 1) give precedence to norms of treaty A with respect to the norms of treaty B, or; 2) give precedence to the norms of treaty B with respect to treaty A; or, 3) allow for compliance with the non-investment treaty only by application of the ‘least inconsistent’ test to the measures adopted (Article 104(1) of the NAFTA). Indeed the possibility for non investment

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<sup>427</sup> Clauses regulating a conflict with future treaties are subject to the contractual freedom of States as expressed in the *lex posterior* criterion and are therefore to that extent potentially ‘futile’, as remarked by Karl, W., ‘Conflicts between treaties’, in Bernhardt, R. (ed.), *Encyclopaedia of Public International Law*, Amsterdam, North-Holland, 1984, VII, 468 at 471. Clauses of this kind are rare; the only exception is Article 103 of the UN Charter, which establishes the priority of the obligations of the Charter over any other obligation under an international agreement.

norms to prevail over investment obligations is contemplated in Article 104 of NAFTA, but two observations need to be made: firstly, only ‘specific trade obligations’ contained in a selected number of environmental instruments (albeit not a closed list, subject to agreement by the parties) can prevail over the obligations of NAFTA; secondly, the Party applying the inconsistent measure has to do so by choosing the least inconsistent alternative for complying with the measure, if a choice is available. One interpretation of this provision would result in general environmental measures not being given precedence over trade and investment obligations; equally however, the reference to ‘specific trade obligations’ might be interpreted as making a distinction between obligations of a reciprocal nature, such as those relative to trade relations, and the other obligations contained in the environmental treaty, which might be classified as integral obligations and for which compliance is required from all parties to the treaty and from which the NAFTA parties are not allowed to derogate, as we shall see in more detail in Chapter 5<sup>428</sup>. In other words, Article 104 constitutes an exception to the general conflict rule set out in Article 103. While it is acknowledged in general that the insertion of express conflict clauses is the most efficient way to avoid normative conflicts, the wording of the clauses is of course paramount in determining their efficacy. To the extent that a specific hierarchy of norms is not established, and recourse to ‘mutual supportiveness’ and cooperation is mentioned (paradigmatic in this sense is Article 17.12 of the CAFTA), the conflict is not solved but only postponed and misplaced to the political level of interstate negotiation. Furthermore, as express conflict clauses are contained within the instrument being applied, they are subject to the rules of treaty interpretation, including whatever definition of conflict the tribunal chooses to apply. As we shall see in Chapter 5, the choice is between a

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<sup>428</sup> To the extent that the second interpretation is correct, the NAFTA establishes a conflict clause in which the trade obligations contained in environmental treaty prevail even if the NAFTA, as a successive treaty of the reciprocal kind, could have allowed for the opposite without running afoul of the criteria of Article 41 of the VCLT.

strict definition, which considers conflicts to occur only between obligations, and a wider definition, which includes obligations and rights. If the text of the instruments expressly refers to either option (as exemplified respectively in Articles 104 and 103 of the NAFTA), the tribunal is bound to apply the appropriate definition, in compliance with Article 31(1) of the VCLT. If the clause simply refers to ‘provisions’, such as Article 1112 of the NAFTA, it is up to the tribunal to decide if a provision establishing a right can trump a provision establishing an obligation.

#### 4.7 Concluding remarks

This brief overview intended to cover all the ways in which investment treaties can expressly refer to non-investment obligations in their text. The review shows that there is a wealth of provisions, expressed in different forms and with different ‘strength’. The clauses tend to recur more often in multilateral instruments, or in more recent BITs, often derived from the model treaties which in themselves have been influenced by the multilateral instruments (especially the NAFTA and its jurisprudence). The application of these provisions will be examined in Chapter 7; however we have already anticipated that many of them have been criticised for being ‘toothless’ and ineffectual. We have also already noted in Chapter 3 that the scope for interpretation by tribunals is directly proportional to the level of detail of substantive provisions of the treaty. In other words, the higher the level of abstraction and vagueness in the wording of the treaties, the higher the scope for tribunals to interpret them. We made this comment with reference to the investment provisions: in that case, we argued that the open-textured nature of the treaties, and the absence of specific procedural obligations, allowed for a generous, investment-centred approach to interpretation, which made extensive use of policy arguments in order to increase the level of protection granted to the investor.

The express provisions reviewed in this chapter act as a counterbalance to the openness of the investment protections guaranteed by the treaty. Each one in its way introduces, by means of policy commitments in the preamble, balancing clauses, expressed exceptions, carve-outs, and conflict clauses, a limitation and a closure. At the same time, to reprise the metaphor that opened this thesis, we argue that investment treaties already contain openings to non-investment obligations: the tools that we have examined in this chapter therefore act both to limit and to expand, as closures and as openings, in (once again) a relationship of inverse proportionality between competing interests. We have commented on their efficacy *in abstracto*, but only a review of the case law of investment tribunals will allow ascertaining to what extent these clauses can work to open up investment treaties to environmental legal commitments undertaken by host states.

## Chapter 5: Conflict resolution in international law

### 5.1 Introduction

In this chapter we will examine how conflicting obligations can be taken into consideration by courts and tribunals in the absence of express provisions in the relevant instruments. The underlying assumption made in choosing to examine how this can be done is that, even in the absence of express provisions, tribunals still possess the power to balance the obligations of the host state so not as to exclude any legally binding obligations that have been undertaken in the environmental field and that are influenced either by the investors' behaviour or by the state's legal response. This analysis can be performed as investment law, regardless of its isolationism and substantive closure, is not alone in confronting these problems. Other areas of international law, and other courts and tribunals, have been confronted with similar problems and have adopted conflict resolution techniques that can be fruitfully analysed in order to assess their usefulness and efficacy. That is why, before examining how investment tribunals have used the tools available to them, we review some significant approaches and conflict resolution techniques as employed in other areas of international law.

The chapter is structured as following: in the first part, a general classification of norms and conflicts is provided, as the way in which conflicts are defined has a bearing on their resolution. The chapter then moves on a discussion of the available conflict resolution techniques, starting with interpretation and integration and then moving on more technical rules, with more emphasis on rules based on specificity and temporality. Each section is accompanied by the discussion of some illustrative cases from international courts and tribunals. The choice was made to deal with interpretation first, as some conflicts might appear to be so, or might be presented as such by the parties, but might be capable

of being solved through ‘systemic integration’. We are not taking a position as yet on the value of such methods or the rationale underlying them, nor to their efficacy; nonetheless, it seemed best to approach the problem from the easiest, ‘apparent’ conflicts, to the most intractable conflicts which might result in the court or tribunal issuing a judgment of *non liquet* or pointing to a *lacuna* in the law. It was by choice that non-investment cases were chosen as illustrative examples, as investment case law is going to be analysed separately. However, where possible, cases involving environmental law were chosen, to ascertain how other areas of law have dealt with the problem of conflicting obligations involving the environment. The scope of this thesis is to investigate how investment law can be ‘greened’; another way of putting it is that investment law does possess entry points, both procedurally and substantially, through which non-investment norms can be taken into account and form part of the development of the law and the practice of tribunals. Equally, other areas of law have been exposed to this form of cross-fertilisation and have reacted accordingly. One WTO Panel declared that ‘the General Agreement [GATT] is not to be read in clinical isolation from public international law’<sup>429</sup>. The opposite can also be said to be true, in the sense that investment law can be seen not as the self-contained regime into which one tries to find the way in, but as the ‘outsider looking in’ or as the bilateral obligation amongst parties also belonging to another, more complete system of rules. We are thinking specifically of the way in which the European legal system, a *sui generis* system of quasi-constitutional status, has dealt with the bilateral investment instruments undertaken by its member states<sup>430</sup>. At the end of

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<sup>429</sup> *United States - Standards for Reformulated and Conventional Gasoline*, 29 April 1996, WT/DS2/AB/R, p. 17.

<sup>430</sup> On the possible conflicts, see Wierzbowski, M. and Gubrynowicz, A., ‘Conflict of norms stemming from intra-EU BITS and EU legal obligations: some remarks on possible solutions’, in Binder *et al.*, 2009: 544.

the chapter, three cases decided by the European Court of Justice<sup>431</sup> will be analysed for this purpose. Inter-regime collisions are a matter of perspective of course. This thesis has chosen the perspective of environmental law interacting with investment law. These are two discrete regimes of rules that are specific to a particular field. To this extent they differ from general international law; the conflict between sub-regimes and general international law has been central in the development of the discourse on fragmentation and conflict resolution. The European legal system can be equated more to the public international law system as one that aspires at completeness. Its interaction with the investment law system, as represented by the bilateral investment obligations of the European member states, therefore represents the classic conflict between the general and the particular. At the end of the chapter we will draw some conclusions on how conflicts have been dealt with in international law generally before moving on to the specific case of investment tribunals in Chapter 7.

## 5.2 Norms classification

A conflict of obligations presupposes a conflict of norms<sup>432</sup>. It is a fundamental principle of legal logic that norms can be classified as prescriptive (imposing an obligation to do something), prohibitive (imposing an obligation not to do something), permissive (granting a

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<sup>431</sup> *Commission of the European Communities v. Republic of Austria*, Judgment of the Court (Grand Chamber) of 3 March 2009, Case C-205/06; *Commission of the European Communities v. Kingdom of Sweden*, Judgment of the Court (Grand Chamber) of 3 March 2009, Case C-249/06; *Commission of the European Communities v. Republic of Finland*, Judgment of the Court (Grand Chamber) of 19 November 2009, Case C-118/07.

<sup>432</sup> On norms classification for the purpose of hierarchical order, see Shelton, D., 'Normative hierarchy in international law', 100 *AJIL* (2006): 291; Weil, P., 'Towards a relative normativity in international law?', 77 *AJIL* (1983): 413.

right to do something) and exemptive (granting a right not to do something). This taxonomy is relevant both for the distinction between investment and non-investment norms and for the classification of conflicts. The main distinction is between norms imposing duties (positive or negative) and norms granting rights (again positive or negative). In the first case the state is obliged to act in a certain way (either performing a positive duty of action or a negative duty of restraint); in the second case the state retains its freedom of choice to exercise or not a right. In order for that right to be defined as a right however, it must be capable of being exercised. Limitations to the exercise of a right can be inherent, i.e. pertain to the nature of the subject possessing that right, or contingent to legal constraints (freedom of speech is contingent on limitations imposed by hate speech legislation for example). Finally, in the absence of any norms granting a right, either positive or negative, or establishing an obligation, the state retains the inherent right of action, as stated in the *Lotus* principle<sup>433</sup>.

Investment treaties' norms can be expressed as obligations of conduct or as rights granting norms. As an example of the first kind, prescriptive norms, most standards of treatment norms establish positive duties for host states in relation to the treatment afforded to the foreign investor. For example, Article 3 of the United States 2004 Model BIT is as following:

Each Party shall accord to investors of the other Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion,

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<sup>433</sup> *The Case of the S.S. Lotus (France and Turkey)*, Judgment, 7 September 1927, PCIJ, Ser. A., No. 10, 1927, III: 'International law governs relations between independent States. The rules of law binding upon States therefore emanate from their own free will as expressed in conventions or by usages generally accepted as expressing principles of law and established in order to regulate the relations between these co-existing independent communities or with a view to the achievement of common aims. Restrictions upon the independence of States cannot therefore be presumed.'



management, conduct, operation, and sale or other disposition of investments in its territory.

As an example of prohibitive norms, most norms on performance requirements prohibit the imposition of these requirements on foreign investor; Article 8 of the US Model BIT states:

Neither Party may, in connection with the establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of an investment of an investor of a Party or of a non-Party in its territory, impose or enforce any requirement or enforce any commitment or undertaking:...

Articles on denial of benefits in investment treaties constitute an example of exemptive norms, allowing the host state to exercise its right not to confer certain benefits to the foreign investor<sup>434</sup>. Article 17 of the US Model BIT provides:

A Party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if persons of a non-Party own or control the enterprise and the denying Party:

- (a) does not maintain diplomatic relations with the non-Party; or
- (b) adopts or maintains measures with respect to the non-Party or a person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Treaty were accorded to the enterprise or to its investments.

This and other exception clauses contained in investment treaties do not, strictly speaking, confer original rights to state, but rather allow states not to be subject to negative or positive duties with regards to investors. Therefore, rather than creating new rights, they carve out exceptions to existing duties. But this should not necessarily be seen as symptomatic of a limitation of sovereignty. On the contrary, it is in principle a recognition of the continued validity of the *Lotus* principle to dictate that treaties can only impose obligations based on consent, and allow for the lifting of these obligations in a predetermined set of circumstances;

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<sup>434</sup> See Wälde, T., 'Interpreting investment treaties: experiences and examples', Binder *et al.*, 2009: 724

beyond the area of legal duty created by the treaty, the state remains unfettered and capable of exercising its positive and negative rights without the necessity of the treaty spelling out precisely what these are.

Investment treaties can also contain permissive rights norms; typically taxation measures (and the corollary right of imposition of these measures) are carved out from the area of applicability of the investment obligations. For example, according to Article 21 of the US BIT: ‘Except as provided in this Article, nothing in Section A shall impose obligations with respect to taxation measures.’ Finally, but importantly, expropriation receives a special treatment in investment treaties. In international law expropriation is considered a lawful exercise of governmental power, subject to conditions. The exercise of the right is contingent on the respect both of positive duties (payment of compensation) and negative duties (non-discrimination). Typically, the right is couched in negative terms, establishing a prohibition to expropriate unless certain conditions are respected, rather than as a positive right. For example, Article 6 of the US Model BIT states:

Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization (“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 and Article 5 [Minimum Standard of Treatment](1) through (3).

This is a complex article, containing within itself duties and rights that need careful balancing: for the purposes of compliance, the state is tasked with assessing how to act without exceeding the limits imposed by the norm. The kind of normative conflicts that we are investigating in this chapter constitute an egregious case of what is contained within almost any norm reaching this level of complexity. The introduction of extraneous elements (environmental obligations in the specific case) simply triggers into action the balancing provisions contained in the

article with respect to the duties and rights on the basis of which the state acts.

### 5.3 Conflicts classification

Norms can either accumulate or conflict in their reciprocal interaction. The general presumption against conflict<sup>435</sup> dictates that every treaty norm is to be interpreted with reference to general international law and in conjunction with it: it is presumed that successive norms will accumulate<sup>436</sup>, and states will be able to fulfil their international obligations without incurring in a breach of other obligations<sup>437</sup>. This approach is evident in the case law. In the *Rights of Passage Case*, the ICJ explicitly referred to the rule that interpretation must have as its purpose the accumulation, and not conflict, of norms, in the following terms<sup>438</sup>: ‘... it is a rule of interpretation that a text emanating from a Government must, in principle, be interpreted as producing and intended to produce effects in accordance with existing law and not in violation of it.’ And in the *Gabčíkovo-Nagymaros* case the Court had this to say<sup>439</sup>:

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<sup>435</sup> This principle was reaffirmed in *Murray v. Schooner Charming Betsy*, 6 U.S. 64, 118 (1804) at 6: ‘It has also been observed that an act of Congress ought never to be construed to violate the law of nations if any other possible construction remains.’

<sup>436</sup> See the Arbitration Tribunal in the *Southern Bluefin Tuna Case (Australia and New Zealand/Japan)* Award of 4 August 2000 (Jurisdiction and admissibility) *UNRIIAA* Vol. XXIII (2004) p. 23, § 38 (c).

<sup>437</sup> As summarised by Pauwelyn, 2003 at 207: ‘... when new law is created there is a presumption in favour of continuity or against conflict, in the sense that if a treaty does not contract out of a pre-existing rule, the pre-existing rule – being of the same inherent value as the new one (unless the new one is of *jus cogens*) – continues to apply. Only if it can be shown that the new treaty does, indeed, contradict a rule of general international law will that rule be disappplied in respect to the treaty in question.’

<sup>438</sup> *Case concerning the Right of Passage over Indian Territory (Preliminary Objections) (Portugal v. India)*, I.C.J. Reports 1957 p. 142.

<sup>439</sup> *Gabčíkovo-Nagymaros Project (Hungary/Slovakia)*, Judgment, ICJ Reports 1997, p. 7, § 100.

...the Treaty does not contain any provision regarding its termination. Nor is there any indication that the parties intended to admit the possibility of denunciation or withdrawal. On the contrary, the Treaty establishes a long-standing and durable regime of joint investment and joint operation. Consequently, the parties not having agreed otherwise, the Treaty could be terminated only on the limited grounds enumerated in the Vienna Convention.

In the *ELSI Case*, discussing the applicability of the local remedies rule in a dispute involving the treatment of a US investor, the Court also noted<sup>440</sup>:

...no doubt that the parties to a treaty can therein either agree that the local remedies rule shall not apply to claims based on alleged breaches of that treaty; or confirm that it shall apply. Yet the Chamber finds itself unable to accept that an important principle of customary international law should be held to have been tacitly dispensed with, in the absence of any words making clear an intention to do so.

The presumption against conflict can be reinforced by concrete steps taken in order to minimise the occurrence of conflict. The express clauses that we have examined in the previous chapter are the main way in which states can try to avoid conflicts between successive treaties. Lacking express provisions, it is accepted that conflicts will have to be dealt with by means of general application, derived from the VCLT in the first instance or other general principles of law. In addition, to the extent that a treaty remains silent on an issue, it accepts that changes in customary law will influence its content. However, even without entering the debate on self-contained regimes<sup>441</sup>, investment tribunals are normally faced not with the potential incompatibility of investment law with general international law, but with the problem of the compatibility of different primary substantive rules of international law (investment and environment, human rights, etc.). Whatever the source or the content of the rules, it can be the case that norms will not accumulate and a genuine conflict will occur. This occurrence is dependent on the definition of

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<sup>440</sup> *Eletronica Sicula S.p.A. (ELSI) (United States of America v. Italy)*, Judgment, ICJ Reports 1989, p.15, § 50.

conflict one has adopted. While there is agreement in terms of the objective elements of the sort of overlap that has to be present between the norms, not the same kind of agreement has formed on the subjective element of states' behaviour. As for the objective element, there is agreement that there has to be an overlap in terms of *ratione materiae*, *personae* and *temporis*<sup>442</sup>; this means there must be overlapping in terms of subject matter, of state parties (in the sense that at least one party must be bound by both rules), and of the chronological coincidence.

The subjective element does not meet with the same degree of consensus. According to Jenks's definition<sup>443</sup>: 'Conflict in the strict sense of direct incompatibility arises only where a party to the two treaties cannot simultaneously comply with its obligations under both treaties.' Pauwelyn, in his work on conflict of norms within the WTO system<sup>444</sup>, adopted a broader, purposive definition of conflict, according to which<sup>445</sup>: '...two norms are...in a relationship of conflict if one constitutes, has led to, or may lead to, a breach of the other.' If states are at liberty (have the right) to follow or not a certain behaviour, conflicts need not arise as long as states do not exercise their rights in direct violation of an express prohibition or command (what he defines as apparent conflicts). Courts and tribunals have interpreted conflicts differently too, sometimes adopting the stricter definition of a conflict of

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<sup>441</sup> For which see especially ILC's study on fragmentation.

<sup>442</sup> On the *ratione materiae* requirement, Pauwelyn, 2003, at 364-65: '...if there is a genuine conflict between two treaty norms, the two treaty norms must necessarily deal with the same subject matter. If not, there would be no conflict in the first place since there would be no overlap *ratione materiae* (that is, one of the preconditions for there to be conflict...).'

<sup>443</sup> Jenks, W., 'Conflict of law-making treaties', 30 *BYIL* (1953): 401 at 426.

<sup>444</sup> Pauwelyn, 2003, especially 169 ff.

<sup>445</sup> Page 175-176. Hans Kelsen had adopted a similar approach in 'Derogation', in Klecatsky, H., Marcic, R. and Schambeck, H. (eds), *Die Wiener Rechts-theoretische Schule* (1968), ii, at 1429: '[a] conflict between two norms occurs if in obeying or applying one norm, the other one is necessarily or possibly *violated*'.

obligations and sometimes of rights and obligations. In the *Lockerbie Case*, Libya argued that Article 103 of the Charter as a conflict clause only establishes that the Charter prevails over other treaty obligations, but not over conflicting rights. The Court however endorsed the UK's argument<sup>446</sup> to the effect that in a situation of conflict, Article 103 is controlling, regardless of the type of conflict (strictly between obligations, or also between rights and obligations).

A necessary or inherent conflict in Pauwelyn's classification will always result in a breach. A potential conflict however will not materially happen until the state applies the permissive norm, triggering the conflict between its obligation to do X and its right to do Y. From the point of view of the proponents of a strict definition of conflict, there is no conflict until there is a material breach of an obligation, which is caused by a state being obliged to respect conflicting duties, or deciding not to perform one of the conflicting duties. For the classification of conflicts, the objective overlap and its consequences are only two of the elements that tribunals are asked to consider; additional elements are the sources of the conflicting obligations (between treaties, between different sources of international law, involving municipal law, including constitutional norms, or contractual obligations). Umbrella clauses in investment

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<sup>446</sup> 'The obligation to comply with Security Council decisions applies fully both to decisions affecting the *rights* and those affecting the *obligations* of States. The relevant provisions of the Charter are phrased broadly and are intended to be broad in effect. They must be in order to assure the effectiveness of the regime of Chapter VII and in interpreting this aspect of the Charter this Court has not recognized any distinction between 'rights' and 'obligations' ...Moreover, this suggested limitation creates serious difficulties. Suppose a bilateral treaty gives the nationals of each party the right to invest in the territory of the other. Surely the Charter gives the Security Council the power in a Chapter VII situation to require that one party prohibit investments by its nationals in the territory of the other, notwithstanding these treaty provisions.' *Questions of Interpretation and Application of the 1971 Montreal Convention arising from the Aerial Incident at Lockerbie (Libyan Arab Jamahiriya v. United Kingdom)*, Judgment, ICJ Reports, 1998, p.9.

treaties can function as a sort of conflict norm, by establishing the binding force of the contractual obligations of the host state as a matter of international law. However, to the extent that umbrella clauses cover, amongst the contractual obligations, a stabilisation clause freezing the regulatory environment at the time of the contract, they can constitute an effective way to ‘shut the door’ to non-investment obligations, or, more correctly, to any amendments to non-investment obligations that the host state might wish to undertake. Acting in this manner they can be used by investors as a countermeasure to any attempt to ‘green’ investment law. In this sense, umbrella clauses can also prevent the progressive development of law, including by harmonisation and systemic integration.

Paradoxically, the multiplication of treaties has not been accompanied by an equally developing system of rules for dealing with conflicts and by case law developed by courts and tribunals. On the contrary, it has been noted that ‘There is relatively little – in fact, until recently, astonishingly little – judicial or arbitral practice on normative conflicts’<sup>447</sup>. In other words, the juridification of several areas traditionally associated with international relations and diplomacy or with national policy making has not been accompanied by a systematic approach to the resolution of the inevitable normative conflicts, which are still left to be solved politically or diplomatically by inter-state negotiations outside courts and tribunals.

Regardless of the way in which conflicts are classified *a priori*, this thesis will approach the issue pragmatically, by looking at how courts and tribunals have been asked to deal with conflicts in the context of a defence presented by the state. To do so, we will review the conflict resolution techniques available to tribunal and look at selected non investment cases which are illustrative of the possible solutions.

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<sup>447</sup> ILC *Fragmentation Report*, § 41.

## 5.4 Conflict resolution techniques

International law presumption against conflict acts as a guiding principle of interpretation and harmonisation between norms. When faced with potentially conflicting rules, courts and tribunals can have recourse to several more or less technical tools to deal with the conflicting obligation in a manner that either avoids, harmonises or solves the conflict. The general rules of interpretation can be used in order to avoid the conflict by means of harmonisation, or systemic integration. Effectively, interpretation is a form of legal reasoning or legal logic. The ILC's approach, encapsulated in the following statement, seems to reflect a reasonable way to consider the issue<sup>448</sup>:

This Report adopts a wide notion of conflict as a situation where two rules or principles suggest different ways of dealing with a problem. Focusing on a mere logical incompatibility mischaracterizes legal reasoning as logical subsumption. In fact, any decision will involve interpretation and choice between alternative rule-formulations and meanings that cannot be pressed within the model of logical reasoning.

If interpretation cannot provide the means to harmonise the rules so as to avoid a conflict, tribunals and courts have at their disposal a series of technical rules: *lex specialis*, *lex prior*, *lex posterior* and hierarchical rules (*ius cogens*, *erga omnes* obligations and Article 103 of the UN Charter). In the next section, we will consider how the general rule of interpretation as laid down in the Vienna Convention can be and has been used by tribunals.

### 5.4.1 Interpretation and systemic integration

Tribunals facing a dispute in which the possibility of a conflict is raised have recourse in the first instance to interpretation techniques. There is no instance in which any system of law, however complete, can be



considered as being ‘clinically isolated’ from the normative background upon which it is created, and there is no ‘contracting out’ from international law, at least in principle. The Vienna Convention on the Law of Treaties (VCLT) lays down the main rule on treaty interpretation in Articles 31 and 32. Article 31 [General Rule of Interpretation] provides as follows:

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
  - (a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
  - (b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. There shall be taken into account, together with the context:
  - (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
  - (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
  - (c) any relevant rules of international law applicable in the relations between the parties.
4. A special meaning shall be given to a term if it is established that the parties so intended.

Article 32 [Supplementary Means of Interpretation] provides:

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

- (a) leaves the meaning ambiguous or obscure; or
  - (b) leads to a result which is manifestly absurd or unreasonable.
- As evinced by the articles, tribunals have at their disposal different techniques to aid in their interpretations of the treaty’s language:

- 1) Interpretation in the context of all other treaty provisions (article 31(1) VCLT);

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<sup>448</sup> ILC *Fragmentation Report*, § 25.

- 2) Effective treaty interpretation (*ut res magis valeat quam pereat*)<sup>449</sup>;
- 3) Interpretation with reference to norms outside the treaty (articles 31 and 32 VCLT).

As noted by Sands, ‘Article 31(3)(c) reflects a “principle of integration”’<sup>450</sup>; much has been written lately on ‘systemic integration’ as the solution for the perceived problem of the fragmentation of international law; we are not here entering on the theoretical debate on fragmentation, but we refer to Chapter 2 and to the Concluding Remarks section for some comments on the matter. A treaty can be interpreted with reference to other law; furthermore, its application always has to take place ‘in context’. According to the principle of ‘inter-temporal law’<sup>451</sup>, ‘...a juridical fact must be appreciated in the light of the law contemporary with it, and not the law in force at the time when a dispute in regard to it arises or falls to be settled.’<sup>452</sup> From this doctrine, Waldock

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<sup>449</sup> On the principle of effectiveness, see the Commentary of the ILC, *YBILC* (1966), II: 219: ‘The Commission, however, took the view that, in so far as the maxim *ut res magis valeat quam pereat* reflects a true general rule of interpretation, it is embodied in Article 31, Vienna Convention....When a treaty is open to two interpretations one of which does and the other does not enable the treaty to have appropriate effects, good faith and the objects and purposes of the treaty demand that the former interpretation should be adopted.’

<sup>450</sup> See especially McLachlan, C., ‘The principle of systemic integration and Article 31(3)(c) of the Vienna Convention’, 54 *ICLQ* (2005): 279-320; ILC *Report on Fragmentation*: 208 ff. For the way in which the Article 31(3)(c) has been interpreted by the ECtHR, see Tzevelekos, V.P., ‘The use of Article 31(3)(c) of the VCLT in the case law of the ECtHR: an effective anti-fragmentation tool or a selective loophole for the reinforcement of human rights teleology?’, 31 *Michigan Journal of International Law* (2010): 5621.

<sup>451</sup> *Island of Palmas Case (Netherlands v. US)* (1928), PCA, sole arbitrator, Judge Huber, 2 *RIAA* 829.

<sup>452</sup> However, Judge Huber added: ‘....a distinction must be made between the creation of rights and the existence of rights. The same principle which subjects the act creative of a right to the law in force at the time the right arises, demands that the existence of right, in other words its continued manifestation, shall follow the conditions required by

derived, in his Third Report on the Law of Treaties<sup>453</sup>, the following Article [56 – The inter-temporal Law]:

1. A treaty is to be interpreted in the light of the law in force at the time when the treaty was drawn up;
2. Subject to paragraph 1, the application of a treaty shall be governed by the rules of international law in force at the time when the treaty is applied.

By differentiating between the interpretation and the application, both the textual and the contextual approaches are taken into consideration, while the textual approach is given relevance (it is after all, the primary rule in Article 30 of the VCLT, which significantly refers to the ‘general rule’, not rules, of interpretation<sup>454</sup>). Textual interpretation has to be performed within the treaty as drafted at the time, while the norms have to be applied in the context at the time of application<sup>455</sup>. The ILC, in its report on fragmentation, stresses that interpretation and conflict resolution have to be seen as themselves not in conflict, but as contiguous forms dealing with normative overlap. In the introductory section on systemic integration, the Commission has this to say<sup>456</sup>:

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the evolution of law.’ For a history of the development of Article 42 of the VCLT, see also Klabbers, J., ‘Reluctant grundnormen: Articles 31(3)(c) and 42 of the Vienna Convention on the Law of Treaties and the fragmentation of international law, in Craven, M., Fitzmaurice, M. and Vogiatzi, M. (eds.), *Time, History and International Law*, Leiden, Brill, 2007: 141.

<sup>453</sup> Waldock, H., ‘Third report on the law of treaties’, II *Yearbook of the International Law Commission* (1964), at [http://untreaty.un.org/ilc/documentation/english/a\\_cn4\\_167.pdf](http://untreaty.un.org/ilc/documentation/english/a_cn4_167.pdf).

<sup>454</sup> Aust, A., *Modern Treaty Law and Practice*, Cambridge, CUP, 2007.

<sup>455</sup> This distinction is not always kept; the ICJ itself, in the *Case concerning the Dispute regarding Navigational and Related Rights (Costa Rica v. Nicaragua)*, General List No. 133, Judgment of 13 July 2009, argues for the meaning to be given to treaty terms as open to evolutionary interpretation, albeit under certain circumstances, so that both kinds of fall back, interpretation and application, can be given an ‘evolutionary spin’. (See §§ 57 ff.). For a recent review of how the PCIJ and the ICJ have dealt with the issue of textual interpretation, see Simma and Kill, in Binder *et al.*, 2009: 678, at 683 ff.

<sup>456</sup> ILC *Fragmentation Report*, § 412.

... conflict-resolution and interpretation cannot be distinguished from each other. Whether there is a conflict and what can be done with *prima facie* conflicts depends on the way the relevant rules are interpreted. This cannot be stressed too much. Interpretation does not intervene only once it has already been ascertained that there is a conflict. Rules appear to be compatible or in conflict *as a result of interpretation*. Sometimes it may be useful to stress the conflicting nature of two rules or sets of rules so as to point to the need for legislative intervention. Often, however, it seems more appropriate to play down that sense of conflict and to read the relevant materials from the perspective of their contribution to some generally shared - “systemic” - objective.

In other words, it is through its interpretative work that the tribunal itself establishes the strategy to be adopted, be it through ‘technical rules’ of conflict resolution or through integration. Interpretation itself, as we have already hinted, can refer to different means to deal with potential conflict: either norms can be interpreted in the context of the treaty (including by application of the principle of effectiveness) or in the context of other norms, be they treaty or custom (either through *renvoi* or by means of systemic integration). For the purposes of conflict avoidance involving diverse sub-systems of law, such as investment and environment, the applicability of the third interpretative technique, as codified in Article 31(3)(c) of the Vienna Convention, has the strongest potential to allow for cross-fertilisation and integration of norms<sup>457</sup>. It is important however not to overstate the role of Article 31(3)(c). As noted by Simma and Kill<sup>458</sup>, it cannot be seen ‘as a sort of master key enabling the systemic integration of otherwise disparate legal regimes’. We have already remarked that the role of interpretation is symbiotically dependent to the action of conflict resolution. This dependency should not be confused with interchangeability. A tribunal tasked with interpreting a BIT together with the relevant (and applicable in the relation between the parties) rules of international law is not empowered to modify the treaty rules (not so by Article 31(3)(c) in any event) but

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<sup>457</sup> The Appellate Body Report, *US – Shrimp*, referred to Article 31(3)(c) directly, see § 158 and footnote 157.

<sup>458</sup> Simma and Kill, in Binder *et al.*, 2009: 678 at 694.

simply to have, as its *telos*, the application of the treaty rules so that the presumption of compliance is respected. If one were to envision the work of the tribunal as part of a network, it would be to interpret every norm so as to connect with any other norm that might be applicable<sup>459</sup> to the facts in a network-compatible way.

We will consider next two cases where the ICJ and the WTO Appellate Body dealt with the issue of interpretation<sup>460</sup>. The first dispute concerns a joint investment between Hungary and (then) Czechoslovakia for the construction of a dam on the Danube River, which was suspended by Hungary (together with the treaty that established it) on the grounds, amongst other things, of ‘ecological necessity’. The second case, brought in front of the Appellate Body of the WTO, also involves a conflict between the WTO agreement and environmental law<sup>461</sup>.

#### 5.4.1.1 *The Gabčíkovo-Nagymaros Case*

This case, brought by Hungary against Slovakia, concerned a construction project for a dam and a power plant on the Danube river; the agreement was sealed in a Treaty signed in 1977 and ratified in 1978 (‘the 1977 Treaty’). Hungary, which suspended work on the project and terminated the treaty, argued that Slovakia had unlawfully undertaken the ‘provisional solution’<sup>462</sup> of damning up the river in its territory, with unfavourable consequences for Hungary as concerned water intake and navigation. For the purposes of our topic, what is of interest is one of the

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<sup>459</sup> It is, as always, the application of the principle to be problematic: what is intended by ‘relevant’, ‘rules’ and ‘applicable in the relations between the parties’?

<sup>460</sup> *Gabčíkovo-Nagymaros Project (Hungary v. Slovakia)*, Judgment, ICJ Reports 1997, p. 7.

<sup>461</sup> *United States – Import Prohibition of Certain Shrimp and Shrimp Products* (12 October 1998) WT/DS58/AB/R, DSR 1998.

<sup>462</sup> ‘Variant C’ in the text.

arguments put forward by Hungary as justification for non-performance and ultimately termination of the 1977 Treaty<sup>463</sup>:

Finally, Hungary argued that subsequently imposed requirements of international law in relation to the protection of the environment precluded performance of the Treaty. The previously existing obligation not to cause substantive damage to the territory of another State had, Hungary claimed, evolved into an *erga omnes* obligation of prevention of damage pursuant to the “precautionary principle”. On this basis, Hungary argued, its termination was “forced by the other party’s refusal to suspend work on Variant C”.

While the Court did not accept Hungary’s contention that conflicting environmental obligations entitled it to terminate the 1977 Treaty, it did rely on the principle of integration to the effect that:

...newly developed norms of environmental law are relevant for the implementation of the Treaty and that the parties could, by agreement, incorporate them through the application of Articles 15, 19 and 20 of the Treaty. These articles do not contain specific obligations of performance but require the parties, in carrying out their obligations to ensure that the quality of water in the Danube is not impaired and that nature is protected, to take new environmental norms into consideration when agreeing upon the means to be specified in the Joint Contractual Plan.....By means of Articles 15 and 19, new environmental norms can be incorporate in the Joint Contractual Plan<sup>464</sup>.

The Court did not strictly interpret the 1977 Treaty in light of evolving standards of international environmental law in order to harmonise its obligations, as much as stated that these standard could be taken into account through incorporation, thanks to specific provisions to that effect contained in the main treaty. It is therefore more correctly a case of fall-back in application rather than in interpretation. Nonetheless, the Court also added that:

...new norms and standards have been developed, set forth in a great number of instruments in the last two decades. Such new norms have to be taken into consideration, and such new standards given proper

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<sup>463</sup> Judgment, § 97.

<sup>464</sup> Judgment, § 112.

weight, not only when States contemplate new activities but also when continuing with activities begun in the past<sup>465</sup>.

The Vice-President of the Court, Judge Weeramantry, in his Separate Opinion, argued for the principle of sustainable development to ‘hold the balance’ between the conflicting principles of development and protection of the environment. In the Opinion, Judge Weeramantry stated:

If the Treaty was to operate for decades into the future, it could not operate on the basis of environmental norms as though they were frozen in time when the Treaty was entered into. This inter-temporal aspect of the present case is of importance to all treaties dealing with projects impacting on the environment. Unfortunately, the Vienna Convention offers very little guidance regarding this matter which is of such importance in the environmental field. The provision in Article 31, paragraph 3(c), providing that “any relevant rules of international law applicable in the relations between the parties” shall be taken into account, scarcely covers this aspect with the degree of clarity requisite to so important a matter. Environmental concerns are live and continuing concerns whenever the project under which they arise may have been inaugurated. It matters little that an undertaking has been commenced under a treaty of 1950, if in fact that undertaking continues in operation in the year 2000. The relevant environmental standards that will be applicable will be those of the year 2000<sup>466</sup>.

#### 5.4.1.2 *The Shrimp-Turtle Case*

In this case, several East Asian countries requested a panel report in connection with their complaint on import restrictions of shrimp, which the United States had introduced in compliance of its Endangered Species Act of 1973<sup>467</sup>. In its Report, the Panel declared the import ban to be inconsistent with Article XI:1 of GATT 1994, and not justified under Article XX of GATT 1994. The United States appealed certain

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<sup>465</sup> Judgment, § 140.

<sup>466</sup> Separate Opinion of Judge Weeramantry, page 114.

<sup>467</sup> For the relevant factual details, see *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, Panel Report, WT/DS58/R, §§ 2.1-2.16.

sections of the Report. The Appellate Body (AB) expanded on the interpretative exercise to be performed on GATT XX. In line with ‘systemic interpretation approach’, the AB embraced the concepts of evolutionary interpretation in light of conditions obtaining at the time of the dispute, including by application of the principle of sustainable development, although it referred to the principle of effectiveness more specifically when adopting a definition of ‘exhaustible natural resources’ as to include also living natural resources, rather than relying on similar interpretations adopted in international environmental instruments, quoted in the Report<sup>468</sup>. On the substance of the claim, the AB performed a balancing exercise between different provisions of the GATT (namely Article X.1 and XX<sup>469</sup>), in order to: ‘... [strike] a balance ... between the *right* of a Member to invoke an exception under Article XX and the *duty* of that same Member to respect the treaty rights of the other Members’<sup>470</sup>. We are here dealing with a possible intra-treaty conflict by application of Article 31(3)(c) of the VCLT. The AB made explicit reference to this Article<sup>471</sup>, when it stated<sup>472</sup>: ‘our task here is to interpret

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<sup>468</sup> The Appellate Body incorporated the criteria established by the CITES in order to ascertain the applicability of Article XX(g) to the species protected by the US legislation, specifically sea-turtles, and decided that, since sea-turtles are listed in Appendix 1 of the CITES they are to be considered an exhaustible natural resource for the purposes of Article XX(g).

<sup>469</sup> Where Article XX is the exception which would excuse the violation of Article X.1.

<sup>470</sup> Report, § 156.

<sup>471</sup> As recently did the Panel in *United States – Definitive Anti-dumping and Countervailing Duties on Certain Products from China* (Report of 22 October 2010, WT/DS379/R), at § 7.1. The Panel, in the context of considering the applicability of the Draft Articles on State Responsibility for the purpose of attribution, as pleaded by China, and referring to the use made of the Articles by previous panels, stated that: ‘...the various citations to the Draft Articles have been as conceptual guidance only to supplement or confirm, but not to replace, the analyses based on the ordinary meaning, context and object and purpose of the relevant covered Agreements.’ (At § 8.87) The reference to other instruments as *conceptual guidance* in the interpretation of the covered agreements has to be seen in context here of a specific discussion on the role of the Articles rather than extended uncritically on the role of international law in general



the language of the chapeau [of Article XX GATT], seeking additional interpretative guidance, as appropriate, from the general principles of international law.’ However, on the merits of the appeal, the Appellate Body in the end did not accept that the measures had been adopted in a non-discriminatory manner<sup>473</sup>. The AB made the same distinction between substantive and procedural requirements adopted, as we have seen, in the Model US BIT, with respect to regulatory measures, by stating that:

... the application of a measure may be characterized as amounting to an abuse or misuse of an exception of Article XX not only when the detailed operating provisions of the measure prescribe the arbitrary or unjustifiable activity, but also where a measure, otherwise fair and just on its face, is actually applied in an arbitrary or unjustifiable manner. The standards of the chapeau, in our view, project both substantive and procedural requirements.

#### 5.4.2 *‘Technical rules’ of conflict resolution*

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in interpretation: in other words, the Panel argued for the Articles *not* to be seen as ‘rules of international law applicable in the relations between the Parties’, as per Article 31(3)(c). Therefore, international law in general can serve as conceptual guidance when not explicitly applicable to the dispute, in confirmation of its role as normative background. On the facts, the Panel stated in no uncertain terms that: ‘... we do not find that the Draft Articles are “relevant rules of international law applicable to the relations between the parties”, such that we should “take them into account, together with the context” in the sense of Article 31(3)(c) of the Vienna Convention.’ (At § 8.91)

<sup>472</sup> Appellate Body Report, § 158; the reference to Article 31(3)(c) is actually contained in footnote 157.

<sup>473</sup> The Appellate Body placed great emphasis on the fact that the import ban measures were unilaterally imposed by the United States, and not based on a multilateral instrument for the protection of marine life. Simma, B., ‘Of planets and the universe: self-contained regimes in international law’, 17 *EJIL* (2006): 483, at 511: ‘...the Appellate Body referred to international environmental instruments outside the WTO to counter the image of the WTO as a cold-hearted trade-over-everything institution. Adopting such a unitary discourse did not even require the Appellate Body to reverse the recommendation of the panel in substance.’

Faced with a potential conflict, courts and tribunals can resort to interpretation in order to allow for the integration of the conflicting obligations. A successful resolution in this respect would be the result of ‘apparent conflicts’; however, as pointed out by Pauwelyn, interpretation’s function stops where the conflict’s result in an actual breach of one of the two obligations<sup>474</sup>. A genuine conflict can be solved by application of the relevant conflict rule which will determine the applicable law, or more precisely, which rule has priority of application. As noted by the ILC, there are three main criteria for the resolution of a conflict<sup>475</sup>:

1. Specificity (*lex specialis*)
2. Temporality (*lex prior* or *lex posterior*)
3. Hierarchy (*ius cogens* or *erga omnes* obligations).

The hierarchical criterion for the resolution of conflicts would result in one of the two norms being considered invalid or illegal (for example, by application of the *ius cogens* principle). Since this has never been the case in an investment dispute, it will not be dealt with extensively in this Chapter or in Chapter 7, and more attention will be paid to the first two criteria. The scope of this work does not allow us to delve into the more theoretical aspects of normative conflicts. Suffice to notice that conflict rules can themselves be in conflict (for example the application of the temporality criterion can result in the prior or the successive rule being selected, depending on the priority given to the criteria), being themselves subject to higher level principles such as the freedom of contract on the one hand and the sanctity of pacts on the other. Therefore the successive modification of a treaty can be the expression of the freedom of contract of the parties and be applicable to their relation (*lex*

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<sup>474</sup> See Pauwelyn, 2003, especially page 272-3.

<sup>475</sup> § 412 ILC *Fragmentation Report*.

*posterior*) but not be opposable to parties to the first treaty but not the second (*pacta sunt servanda*)<sup>476</sup>.

#### 5.4.2.1 Specificity (*lex specialis*)

The VCLT does not contain a specific provision on *lex specialis*, which constitutes the other major criterion for the resolution on normative conflicts based on the principle of specificity (as between general law and an interpretation or exception to it, or between two special provisions<sup>477</sup>). There is an inevitable overlap between the two criteria<sup>478</sup>, as a special provision will inevitably be successive to the general rule it claims to interpret or provide the exception for, or successive to another special rule (one can hardly believe that two treaties in potential conflicts would be ratified at precisely the same time therefore nullifying the applicability of the requirement of temporality<sup>479</sup>). This is not to say that the *lex specialis* rule is never applicable or it is subject to the *lex*

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<sup>476</sup> And validity of *inter se* agreements, also encapsulated in the *pacta tertiis nec nocent nec prosunt* maxim. For an in-depth discussion of these principles, see Pauwelyn, 2003, Chapter 7; ILC *Fragmentation Report*, especially Sections C and D.

<sup>477</sup> See ILC *Fragmentation Report*, §§ 47 ff.

<sup>478</sup> For a case in which the relationship between the two principle was considered by the court, see the Lockerbie Cases, *Questions of Interpretation and Application of the 1971 Montreal Convention arising from the Aerial Incident at Lockerbie (Libyan Arab Jamahiriya v. United States of America)*, Preliminary Objections, Judgment, *I.C.J.Reports* 1998, p. 115; *Questions of Interpretation and Application of the 1971 Montreal Convention arising from the Aerial Incident at Lockerbie (Libyan Arab Jamahiriya v. United Kingdom)*, Preliminary Objections, Judgment, *I. C.J. Reports* 1998, p. 9; see also Pauwelyn, 2003: 385 ff, especially at 396: The...*lex specialis* principle is only really put to the test in case it is not at the same time the *lex posterior*.

<sup>479</sup> Pauwelyn, 2003, 396, also notes the exceptional nature of this occurrence, but does provide a couple of examples, both concerning not two treaties, but two declarations and a treaty and a declaration. Equally interesting is the application of the principle for the resolution of a conflict between two norms contained in the same instrument (or more realistically, a series or related instruments, such as the WTO Treaty).

*posterior* rule<sup>480</sup>. However, while the *lex specialis* rule allows to establish an ‘informal hierarchy’<sup>481</sup> in which the rule that is disapplied in the particular instance remains in the background, in the case of the temporality rule, the ‘losing’ rule loses its validity altogether, at least as concerns the relation between the parties to both rules, and it is not simply dis-applied in the specific dispute. Furthermore, the relational character of the general/special distinction<sup>482</sup> does not allow, it seems, for an application of *lex specialis* as a discrete self-standing criterion for the resolution of a potential conflict, but points to its usefulness as an interpretative principle. The ILC goes as far as to say that this principle ‘cannot be meaningfully codified’<sup>483</sup>. Surely at a high enough level of generality, any rule can always be conceptualised as special with reference to its normative background (and as general with reference to its application). It is also true that courts usually do not act at this level of generality, which is taken for granted. To this effect, *lex specialis* seems at its most useful and relevant the ‘closer to the normative ground’ it is<sup>484</sup>. On the other hand the risk is then that either the principle collapses into the *lex posterior* one or it is reduced to the application of legal logic rather than a specific method of resolution of a normative conflict. This is especially so as long as one attributes to the rule the double function of distinguishing between general and particular in a cumulative as well as in an exclusionary way. As an example one can look at the codification

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<sup>480</sup> This is particularly relevant if the *lex specialis* is also *lex prior*: see Pauwelyn, 2003: 405 ff.

<sup>481</sup> ILC *Fragmentation Report* § 85.

<sup>482</sup> ILC *Fragmentation Report* § 112.

<sup>483</sup> ILC *Fragmentation Report* § 119.

<sup>484</sup> Another way of putting it is that *lex specialis* functions more as a principle of legal logic when acting in a cumulative way, and more as a technical tool for the resolution (or better, recognition) of conflict when acting in an exclusionary way.

by the ILC in the Draft Articles on State Responsibility, at Article 55 (*Lex Specialis*)<sup>485</sup>:

These articles do not apply where and to the extent that the conditions for the existence of an internationally wrongful act or the content or implementation of the international responsibility of a state are governed by special rules of international law.

We will see next how the WTO has applied the *lex specialis* criterion with respect to an inter-systemic conflict between trade and environmental law<sup>486</sup>. The fact itself that what is defined as an informal hierarchical criterion can be employed to solve a conflict between two sub-systems of general international law begs the question of how exactly specificity is supposed to come into play in discerning the applicability of rules of international law that do not share the same subject matter. The most straightforward application of the rule is in the context of two related treaties, one of which is of a more general nature and the other more specific: for example, a treaty implementing the obligations set out in the ‘framework’ treaty or a treaty that sets out in more detail the general terms of a previous agreement<sup>487</sup>, or more generally, when considering the obligations contained in a treaty in the context of international law, as stated by the ICJ in the *Gabčíkovo-Nagymaros Case*<sup>488</sup>:

It is of cardinal importance that the Court has found that the 1977 Treaty is still in force and consequently governs the relationship between the Parties. That relationship is also determined by the rules of other

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<sup>485</sup> International Law Commission, *Report on the Work of its Fifty-third Session, Official Records of the General Assembly, Fifty-Sixth Session, Supplement No. 10* (A/56/10), at 58.

<sup>486</sup> *European Communities - Measures Concerning Meat and Meat Products (Hormones)* 13 February 1998, WT/DS26/AB/R, WT/DS48/AB/R (*Beef Hormones Case*).

<sup>487</sup> As in *Mavrommatis Palestine Concessions* (Jurisdiction), PCIJ, *Ser. A, No.2* (1924) at 30, 31.

<sup>488</sup> *ICJ Reports* 1997, § 132.

relevant conventions to which the two States are party, by the rules of general international law and, in this particular case, by the rules of State responsibility; but it is governed, above all, by the applicable rules of the 1977 Treaty as a *lex specialis*.

In considering an application of the *lex specialis* principle not in the context of investment tribunals' case law, once again we turn to a WTO Appellate Body Report, in which the status of the precautionary principle was discussed.

#### **5.4.2.1.1.1 The Beef Hormones Case**

The Appellate Body considered the appeal brought by the European Communities against the United States and Canada in 1997. This came from a long standing dispute on the ban of beef and beef products from cattle treated with growth promotion hormones. The Panel Report appealed by the defendants had found the European Communities to be acting inconsistently with the requirements of the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement). The Appellate Body confirmed the conclusions of the Panel Report. Part of the Report dealt with the issue of the applicability of the 'precautionary principle'. For ease of analysis, we report the arguments from the disputing parties and the opinion of the Appellate Body. The European Communities' position, as reported by the Appellate Body, was the following:

The precautionary principle is already.... a general customary rule of international law or at least a general principle of law, the essence of which is that it applies not only in the management of a risk, but also in the assessment thereof. It is claimed that the Panel therefore erred ....in suggesting that that principle might be in conflict with those Articles [5.1 and 5.2 of the SPS Agreement].

The United States argued, on the status of the principle, as follows:

...the claim of the European Communities that there is a generally-accepted principle of international law which may be referred to as the “precautionary principle” is erroneous as a matter of international law. The United States does not consider that the “precautionary principle” represents a principle of customary international law; rather, it may be characterized as an “approach” – the content of which may vary from context to context.

Canada agreed with the United States, but went a bit further in the direction of recognition, stating that:

The “precautionary principle” should be characterized as the “precautionary approach” because it has not yet become part of public international law. Canada considers the precautionary approach or concept as an *emerging* principle of international law, which may in the future crystallize into one of the “general principles of law recognized by civilized nations”, within the meaning of Article 38(1)(c) of the *Statute of the International Court of Justice*.

The Appellate Body rejected the argument of the European Communities. In its report it stated:

The precautionary principle is regarded by some as having crystallized into a general principle of customary international *environmental* law. Whether it has been widely accepted by Members as a principle of *general* or *customary international law* appears less than clear. We consider, however, that it is unnecessary, and probably imprudent, for the Appellate Body in this appeal to take a position on this important, but abstract, question. We note that the Panel itself did not make any definitive reading with regards to the status of the precautionary principle in international law<sup>489</sup> and that the precautionary principle, at least outside the field of international environmental law, still awaits authoritative formulation.

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<sup>489</sup> The Panel had found that: ‘To the extent that this principle could be considered as part of customary international law and be used to interpret Articles 5.1 and 5.2 on the assessment of risks as a customary rule of interpretation of public international law.... we consider that this principle would not override the explicit wording of Articles 5.1 and 5.2, in particular since the precautionary principle has already been incorporated and given a specific meaning in Article 5.7 of the SPS Agreement [on provisional measures adopted ‘in cases where relevant scientific information is insufficient – the article was not invoked by the EC].

The statement by the Appellate Body is ‘problematic’ in the words of the ILC’s report<sup>490</sup> and not only because the delimitation between the different fields of law is not normative as much as descriptive and not settled. It is also because, by refusing to pronounce on the status of the principle, the Appellate Body effectively refused to acknowledge it as a principle of general international law, rather than environmental law, and actually stepped back even from the pronouncement of the Panel in its report, which had admitted that the principle had been incorporated in the SPS Agreement and therefore accepted by the WTO Members<sup>491</sup>. And, most importantly, the Appellate Body noted that the Members (of the WTO) might not have accepted this principle as pertaining to general international law: it is submitted that it is not for the Members to accept the customary status of this principle, but for states in general and that, if this status is confirmed, it is not for Members to decide if the customary status is to be recognised and applied within the context of the WTO Agreement<sup>492</sup> on a case-by-case basis, in the absence of a specific ‘contracting out’. The Appellate Body took a clear position on the insularity of legal regimes, to the extent that it seemed to advance the view that principles might be ‘regime-specific’ and therefore not

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<sup>490</sup> § 55.

<sup>491</sup> Even if it is debatable that general principles need incorporation to have effect: *lex specialis* requires explicit ‘contracting out’, not ‘contracting in’ (see *ELSI case*).

<sup>492</sup> In accordance with Article 3(2) of the Dispute Settlement Agreement, which states: ‘The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system. The Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements.’ For how this has been interpreted for the relationship between the WTO treaty and general international law, see especially *United States - Standards for Reformulated and Conventional Gasoline*, 29 April 1996, WT/DS2/AB/R, p. 17; *Korea - Measures Affecting Government Procurement*, 1 May 2000, WT/DS163/R, § 7.96. See also ILC report, §§ 165 ff.



applicable across regimes. It is as if the Appellate Body rejected the possibility of *lex specialis* being used to solve inter-systemic conflict; as if, in other words, the only way in which the *lex specialis* principle is operative is for an incompatibility between a special regime and general international law, but, as long the incompatibility is between two regimes, the adjudicating body is bound to apply only the regime-specific rules. It might be that, as a jurisdictional matter, this is the correct position to take in the context of the WTO, because of the wording of Article 3(2) of the DSU<sup>493</sup>, or at least, that this is a defensible position. The distinction between jurisdiction and applicable law is well understood and does not need restating here<sup>494</sup>. The usual fall-back rule would not include treaty norms, in compliance of the *pacta tertiis* rule. To claim that a principle of law is only applicable in the regime in which it originated is to extend the *pacta tertiis* rule to cover customary and general principles (equalling it to regional custom) and begs the question of who decides on the ‘borders’ of each regime, as stated by the ILC when commenting that ‘the responses are bound to vary depending on which one [regime] one chooses as the relevant frame of legal interpretation’<sup>495</sup>. We will see in Chapter 7 how investment tribunals have dealt with the application of the *lex specialis* principle in an arbitration under the NAFTA regime<sup>496</sup>.

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<sup>493</sup> ‘The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system. The Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements.’ Text available at [http://www.wto.org/english/tratop\\_e/dispu\\_e/dsu\\_e.htm#3](http://www.wto.org/english/tratop_e/dispu_e/dsu_e.htm#3).

<sup>494</sup> See for example the ILC’s *Report on Fragmentation*, §§ 44 ff.

<sup>495</sup> § 55.

<sup>496</sup> See *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas v. United Mexican States (ADM v. Mexico)*, Award, 21 November 2007.

#### 5.4.2.2 Temporality (*lex posterior and lex prior*)

Article 30 (Application of successive treaties relating to the same subject-matter) of the VCLT codifies the temporality principle:

1. Subject to Article 103 of the Charter of the United Nations, the rights and obligations of States parties to successive treaties relating to the same subject-matter shall be determined in accordance with the following paragraphs.

2. When a treaty specifies that it is subject to, or that it is not to be considered as incompatible with, an earlier or later treaty, the provisions of that other treaty prevail.

3. When all the parties to the earlier treaty are parties also to the later treaty but the earlier treaty is not terminated or suspended in operation under article 59, the earlier treaty applies only to the extent that its provisions are compatible with those of the latter treaty.

4. When the parties to the later treaty do not include all the parties to the earlier one:

(a) as between States parties to both treaties the same rule applies as in paragraph 3;

(b) as between a State party to both treaties and a State party to only one of the treaties, the treaty to which both States are parties governs their mutual rights and obligations.

5. Paragraph 4 is without prejudice to article 41, or to any question of the termination or suspension of the operation of a treaty under article 60 or to any question of responsibility which may arise for a State from the conclusion or application of a treaty, the provisions of which are incompatible with its obligations towards another State under another treaty.

A tribunal faced with a conflict between applicable laws, is facing two norms that, while both legal and valid, result in a breach in one of the two ‘regimes’ if applied at the same time. To reach this result, the tribunal should proceed in steps, to ascertain, first, if one of the two norms is invalid (by application of the relevant rules of the law of treaties); if both are valid, it could still be that one of them is illegal, for example because it conflicts with a norm of *ius cogens* (in which case the application of the norms on state responsibility is triggered, with the understanding that the ratification itself of an agreement which conflicts with a *ius cogens* norms constitutes an ‘act’ for the purposes of Article 1 of the Draft Articles). If both norms are legal and valid, the tribunal

needs then to establish which norm prevails, by application in the first instance of Article 30 of the VCLT, that is, by applying the principle of temporality as the most accurate way of ascertaining the most current expression of states' will, in accordance with the freedom of contract principle. In the last instance, the tribunal will apply the secondary rules of state responsibility if one of the two norms is breached and the other norm is said to prevail (with due regard to the application of special regimes of state responsibility such as the investment or the trade regime, especially as concerns countermeasures<sup>497</sup>); alternatively, the tribunal might find that it is impossible to establish which of the two norms prevails. For the tribunal to be able to apply the temporal rules for the resolution of the conflict, there has to be a temporal overlap between the instruments, and the conflict can be solved keeping in accordance to the chronology of the obligations entered by the parties, either by application of the *lex posterior* rule, or of the opposite *lex prior* rule. The two principles, themselves in conflict, find their most common application respectively in public law and in contract law<sup>498</sup>. Behind them, one can see looming the higher level principles of *pacta sunt servanda* and contractual freedom respectively. However, as recognised by the ILC and as predicted, in practice, the same subject-matter restriction becomes the defining criterion. While for successive treaties by the same parties on the same subject (or within the same regime), the application of Article 30 is relatively unproblematic, what of treaties in different regimes between different parties, concluded over time and containing no conflict resolution clauses or conflicting ones, or ambiguous ones? The *pacta tertiis* rule, as codified in Articles 41 and 58 of the VCLT can modify the outcome of the conflict, with the character of the obligations also bearing

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<sup>497</sup> For this debate in the investment context, see especially *ADM v. Mexico*.

<sup>498</sup> If principles derived from domestic contexts can be applied by analogy to the international law context. See *ILC Fragmentation Report*, 117 footnote 296.

on the selection of the prevailing norm<sup>499</sup>. When discussing the applicability of the *lex posterior* principle in the context of WTO law, Pauwelyn noted<sup>500</sup>:

...in case the WTO rule can be defined as the later in time..., it could be seen as in inter se agreement modifying earlier integral human rights or MEA [multilateral environmental agreement] obligations.... If this is the case – that is, if the WTO rule deviates from earlier human rights or MEA obligations as between WTO members only – then the WTO rule would not only affect WTO members but also third parties... In addition, the later WTO rule could then even be seen as incompatible with the ‘effective execution of the object and purpose of the [human rights or MEA] treaty as a whole.’ Consequently, as between parties to the earlier MEA or human rights treaty,... the particular WTO provisions..., to the extent of the conflict, would then be illegal pursuant to Arts. 41/58 of the Vienna Convention.

The technical intricacies related to the application of these principles when tribunals are faced with multilateral treaties with different parties are mostly restricted to the field of academic discussion, as normally conflicts of this kind rarely are left to courts to be resolved. To this extent, it seems superfluous to provide here a complete taxonomy of the possible combinations<sup>501</sup>. What interests us is to show what tools are available for tribunals that are willing to consider non-investment obligations, and as part of this, we are looking at how other international courts and tribunals have taken conflicting norms into consideration.

Especially when dealing with inter-regime conflicts, or conflicts between treaties amongst different parties<sup>502</sup>, the usefulness of a technical rule such as the *lex posterior* rule decreases, or more precisely, the rule

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<sup>499</sup> Respectively on Agreements to modify multilateral treaties between certain of the parties only, and Suspension of the operation of a multilateral treaty between certain of the parties only.

<sup>500</sup> 322.

<sup>501</sup> For which we refer at recent treatments, such as the ones provided by the ILC in its report and by Pauwelyn, 2003.

<sup>502</sup> It is likely that successive treaties between different parties are also straggling between different regimes.

becomes subject to other criteria, such as the distinction between ‘integral’ and ‘reciprocal’ obligations. Typically, in an inter-regime conflict such as the one between environmental and investment obligations, the environmental obligations will be contained in a multilateral treaty of the integral kind, the investment obligations in a bilateral treaty of the reciprocal kind. As Pauwelyn noted<sup>503</sup>: ‘An *inter se* modification to a multilateral treaty is, in principle, only permissible when such modification relates to obligations *of the reciprocal type*.’ While he made this remark with reference to the possibility of later agreements deviating from WTO rules, what is relevant is the permissibility of modifications contained in a bilateral investment treaty of multilateral obligations contained in an environmental treaty. Article 41 of the VCLT regulates the modification of multilateral treaties in the following fashion:

1. Two or more of the parties to a multilateral treaty may conclude an agreement to modify the treaty as between themselves alone if:
  - (a) the possibility of such a modification is provided for by the treaty;
  - or
  - (b) the modification in question is not prohibited by the treaty and:
    - (i) does not affect the enjoyment by the other parties of their rights under the treaty or the performance of their obligations;
    - (ii) does not relate to a provision, derogation from which is incompatible with the effective execution of the object and purpose of the treaty as a whole.
2. Unless in a case falling under paragraph 1(a) the treaty otherwise provides, the parties in question shall notify the other parties of their intention to conclude the agreement and of the modification to the treaty for which it provides.

The determination of incompatibility between the modifying provision and the object and purpose of the original treaty, while potentially difficult, might be rendered unnecessary by the application of the second condition, reflecting the *pacta tertiis* rule<sup>504</sup>. Finally, the difference has

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<sup>503</sup> Pauwelyn, 2003: 53.

<sup>504</sup> See also Pauwelyn, 2003, 306: ‘...there might be instances also where the *inter se* agreement ...relates to a provision derogation from which is against the ‘object and purpose’ of the treaty. However, in my view, those cases would then fall also under the

been noted between the criteria of temporality and specificity to the effect that, while the second one can be considered provision by provision, the first one is applicable only to treaties as instruments considered in their entirety. This for two reasons: logically, treaties have to be considered *in toto* with respect to their place in time (they are not agreed or ratified provision by provision); secondly, the VCLT regulates treaties as instruments, and therefore its articles are applicable to the treaties seen in their entirety, not to provisions considered singularly<sup>505</sup>. The most important criterion, that of sameness and relevance, can be applied restrictively, as proposed in the *travaux préparatoires* of the Vienna Conference<sup>506</sup>, or more widely, as advocated by the ILC report<sup>507</sup>. In any case, the problem seems related more to the applicability of Article 30 than to the overlap of treaties on subject matter. It will be the case that either the treaties are successive and cover the same subject matter for the purposes of Article 30, which the court or tribunal can apply in order to establish which treaty prevails, or *lex specialis* is applicable between two provisions of different treaties, and in this case the wider approach can be adopted to the effect that:

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second ground of illegality under Arts. 41/58 (that is, illegality based on the *pacta tertiis* principle).’

<sup>505</sup> See S. Rosenne, *Breach of Treaty*, Hersch Lauterpacht Memorial Lectures, Cambridge, Grotius Publications 1985: 4-7; A. Gourgourinis, *Lex Specialis in WTO and investment protection law*, Society of International Economic Law Second Biennial Global Conference, Barcelona 2010, Online Proceedings Working Paper No. 2010/37: 32.

<sup>506</sup> See *United Nations Conference on the Law of Treaty: Second Session, Vienna 9 April – 22 May 1960: Official Records: Summary Records of the Plenary Meetings and the Meetings of the Committee of the Whole* (A/CONF.39/C.1/SR.86): 222: ‘The phrase in question [relating to the same subject-matter] should be construed strictly and should not be held to cover cases where a general treaty impinged indirectly on the content of a particular provision of an earlier treaty; in such cases, the question involved was one of interpretation or of the application of such maxims as *generalia specialibus non derogant*’.

<sup>507</sup> Section B generally and § 254 with specific reference to Article 30 of the VCLT.

The requirement that the instruments must relate to the same subject-matter seems to raise extremely difficult problems in theory, but may turn out not to be so very difficult in practice. If an attempted simultaneous application of two rules to one set of facts or actions leads to incompatible results it can be safely assumed that the test of sameness is satisfied<sup>508</sup>.

It stands to reason that, according to the general rules of interpretation, the words ‘relating to the same subject matter’ have to have a meaning, and that meaning is obviously supposed to circumscribe the applicability of the rule. In other words, if the problem is the application of successive treaties *tout-court*, there is no need to include the ‘relating to the same subject matter’ criterion. In its report on fragmentation<sup>509</sup>, the ILC argues that:

The criterion of “subject-matter” leads to a *reductio ad absurdum*. Therefore, it cannot be decisive in the determination of whether or not there is a conflict....The criterion of “same subject-matter” seems already fulfilled if two different rules or sets of rules are invoked in regard to the same matter, or if, in other words, as a result of interpretation, the relevant treaties seem to point to different directions in their application by a party.

The commission argued that the criterion is not decisive; however, the wording of the Article itself seems to imply that it is a criterion not for interpretation, but for exclusion *a priori*, in other words an issue of classification rather than interpretation. Incompatibility between treaties relating to the same subject matter is to be solved in accordance with the rules provided in the first part of the article, but this is without prejudice to the possibility of state responsibility for concluding or applying a treaty whose provisions are incompatible with another treaty’s. In principle, a treaty on the protection of the environment and a treaty on

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<sup>508</sup> E.W. Vierdag, ‘The time of the ‘conclusion’ of a multilateral treaty: Article 30 of the Vienna Convention on the Law of Treaties and related provisions’, *BYIL* 59 (1988): 100; see also ILC *report*, §§ 22 ff. Vierdag’s comment is made in relation to Article 30 though.

<sup>509</sup> § 22.

foreign investment do not have any overlap in terms of subject matter. However, their application can result in the violation of the norms of the respective other treaty. It is an often repeated argument that the conflict can be framed according to the interest of the respective parties, and also that, as stated by the ILC repeatedly, and to paraphrase, ‘subject-matter’ is neither a settled issue nor a standard classification in international law. It seems important to distinguish between the way in which the subject matter requirement and the temporality principle interact. In principle, we fail to see why a wider reading of the requirement is any help in applying the principle, as the principle’s application leads to random results. There is no reason why a human rights treaty follows or precedes a trade treaty or vice-versa, as treaties are concluded and ratified all the time, so temporality is not a good indication of intent<sup>510</sup>; to this extent the only possible way to apply the subject matter criterion is the strictest possible, as that is the only way in which the randomness of the temporality principle is tempered by the deliberateness of the subject matter criterion. It is certainly not within the scope of this thesis to solve this controversy, but some conclusions can be drawn which will be relevant for the way in which conflicts between regimes are dealt with:

1. Article 30 of the VCLT covers the application of successive treaties relating to the same subject matter;
2. To the extent that disputes arise because of an allegation of a breach and therefore involve state responsibility, Article 30 is not the applicable law (see Article 30(5)) for the purposes of attribution of responsibility, as evidenced by the fact that paragraph 5 refers to the ‘conclusion or application of a treaty’ rather than just the application of successive treaties which is the remit of Article 30 first four paragraphs<sup>511</sup>;

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<sup>510</sup> Namely, the most recent treaty does not necessarily trump the older one as the most recent expression of intent.

<sup>511</sup> The distinction between conclusion and application points to the difference between conflicts in which one of the norms is illegal (Articles 41 and 58 of the VCLT) and conflicts in which both norms are legal, but their simultaneous application creates a conflict, which calls for a priority of applicability. Invalidity can result only from



3. Faced with a claim of a breach and a defence of conflicting obligations, a court or tribunal has to establish in the first instance which instrument prevails: let's assume the dispute arises for a breach of instrument X and the State A (defendant) claims instrument Y required conduct which resulted in breach of instrument X. If the court establishes that instrument X prevails, it will find in favour of the State B (claimant); if the court finds that instrument Y prevails, there will be no breach for the purposes of the dispute; if both are found to apply, the court will adjudicate on the dispute which has been brought in front of it; this without prejudice to the responsibility for the breach of the other instrument resting with State A and involving possibly a State C (or the same state B which might have decided to bring a dispute only with respect to instrument X). In case of instruments belonging to the same regime, it might be that, even if it is within the jurisdiction of the court or tribunal to adjudicate on the possible breach, for reasons of judicial economy, it will not do so<sup>512</sup>. If both norms are valid and applicable to the respective parties (so A is bound to B by the first norm, and to C by the second conflicting norm), and there is no priority rule (see article 30(4)(b)), then, according to Pauwelyn<sup>513</sup>: 'It is then up to A to make a political choice as to whether it will comply with the AB norm or with the AC norm. The law of treaties does not direct A either way'<sup>514</sup>. This

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inherent normative conflicts (for example, a norm conflicting with a norm of *jus cogens* is invalid – Article 53 VCLT) while illegality can only result from conduct in breach of an international obligation: it then means that the conflicting norm does not constitute a valid defence for the offending behaviour.

<sup>512</sup> WTO panels often act this way; see for example Panel Report, *United States – Customs Bond Directive for Merchandise Subject to Anti-Dumping/Countervailing Duties*, WT/DS345/R, adopted 1 August 2008, as modified by Appellate Body Report, WT/DS343/AB/3, §§ 7.165-7.169.

<sup>513</sup> At 427.

<sup>514</sup> Or, as W. Karl put it [‘Conflicts between treaties’, in R. Bernhardt (ed.), *Encyclopaedia of Public International Law*, Amsterdam, North-Holland, 1984, VII, 468, at 470-01]: ‘With the law stepping back, a principle of political decision takes its

of course does not eliminate the issue of State A responsibility for breach of its obligations with State C in compliance with its obligations with State B (or vice-versa) as per Article 30(5)<sup>515</sup>. If State A, in order to avoid a breach arising from a conclusion of a treaty with State C with respect to State B, ceases the existence of the offending norm, it will incur in international responsibility with respect to State C. If the conflict is in the applicable law, State A will engage in international responsibility as soon as it applies the treaty with respect to State C in violation of its obligations with respect to State B (or vice-versa). Therefore, either in the case of inherent normative conflict or conflict of applicable law, the state is internationally responsible for a breach, either because of concluding a treaty or for implementing a treaty. In the first case, the breach is consequent to the conclusion of the second treaty, so that in principle, the state is in breach only in respect of State C (as at the time of the conclusion of the first treaty, there could not be a violation, as the other treaty had not been entered into yet, and remembering that the offending norms are not illegal, but that the second one is invalid with respect to the first one); in the second case, the state can be in breach of its obligations with respect to either state, depending which obligations it decides to honour, and regardless of the priority of them (having being established that neither the *lex posterior* neither the *lex prior*, or the *lex specialis* apply to the conflict). State C could also incur in international responsibility for having aided state A in breaching its responsibility with respect to state B: this might reduce the quantum of damages to be paid to state B by state A<sup>516</sup>.

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place whereby it is left to the party to the conflicting obligations to decide which treaty it prefers to fulfil.’

<sup>515</sup> As stated by Crawford: ‘...Thus it is no excuse under international law for non-compliance with a subsisting treaty obligation to State A that the State was simultaneously complying with a treaty obligation to State B.’ Crawford, J., *Second Report on State Responsibility*, International Law Commission, A/CN.4/498., § 9.

<sup>516</sup> See Article 27 of the 1996 ILC Draft Articles on State Responsibility; However, the 2001 draft articles replaced article 27 with article 16, which states:

In any case, it seems that Article 30 is applicable when the defining relationship between instruments is their temporal contiguity, which is irrelevant for the purposes of *lex specialis*. If the application of Article 30 were to lead to an ‘absurd outcome’<sup>517</sup>, then one could presume that Article 30 is not the applicable law and that the meaningful relation between the instruments is not based on temporality, but possibly on specificity or hierarchy or indeed that there is a *lacuna* in the law or, more precisely, an excess of law without the means to establish a useful hierarchy of applicability between the conflicting obligations. Pauwelyn<sup>518</sup> has supported a positive reading of this outcome, by concluding that:

There is...one important benefit linked to declaring a *non liquet* in case of ‘non-resolvable’ conflict. States should then realise that it will not suffice to let potential conflicts linger without political solution. For negotiators to leave the interaction between treaty provisions ambiguous would hence imply a serious risk: if the conflict turns out to be an ‘unresolvable’ one, the international judge may declare a *non liquet* and simply apply neither of the two rules, thereby nullifying the effect of both treaties or both treaty provisions.

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A State which aids or assists another State in the commission of an internationally wrongful act by the latter is internationally responsible for doing so if:

- (a) That State does so with knowledge of the circumstances of the internationally wrongful act; and
- (b) The act would be internationally wrongful if committed by that State.

Clause (b) eliminates the issue of international responsibility of C in an AB/AC situation.

<sup>517</sup> Pauwelyn, 2003: 377. After all, it is the VCLT itself, at Article 32, to point to supplementary means of interpretation when Article 31 ‘leads to a result that is manifestly absurd or unreasonable’ and the VCLT, like any other treaty is subject to the basic rule of interpretation laid out in Article 31, including for the interpretation and application of Article 30. A consequence is that, by referring to the *travaux préparatoires*, a stricter definition of the *ratione materiae* requirement is bound to be adopted.

<sup>518</sup> At 421.

## 5.5 Inter-regime conflicts involving investment law as ‘the outsider’

The relationship between the European legal order and international law in general, and bilateral instruments involving Member States and third countries in particular, has been the object of increased attention recently, not least because of the commitment in the Lisbon Treaty to include foreign investment amongst the Community competencies<sup>519</sup>. The relationship can be seen from the point of view of arbitral tribunals dealing with EC law<sup>520</sup>, but this would be the subject more properly of Chapter 7, or of the Court of Justice of the European Union (ECJ) dealing with BITs obligations of Member States. In 2009 the ECJ issued three judgments<sup>521</sup> in the matter of the presumed incompatibility between certain provisions of bilateral investment treaties of the Member States in questions with third countries on the free movement of capital and Arts. 57(2)EC, 59EC, 60(1)EC on capital movement restrictions and found the Member States to be in breach of Article 307(2) EC. Article 307 EC is worth quoting in full, as it functions as a subordination clause to solve

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<sup>519</sup> See for example Vis-Dunbar, D., *The Lisbon Treaty – Implications for Europe’s international investment agreements*, November 2009, at <http://ictsd.org/i/news/tni/59585/>; Seattle to Brussels Network, *EU Investment Agreements in the Lisbon Treaty Era: A Reader*, 2010, at [http://www.tni.org/sites/www.tni.org/files/download/eu\\_investment\\_reader.pdf](http://www.tni.org/sites/www.tni.org/files/download/eu_investment_reader.pdf).

<sup>520</sup> The first investment dispute to address this relationship was *Eastern Sugar B.V. (Netherlands) v The Czech Republic*, UNCITRAL *ad hoc* arbitration, SCC no. 088/2004, Partial Award, 27 March 2007, available at <http://ita.law.uvic.ca>. See Potestá, M., ‘Bilateral investment treaties and the European Union. Recent developments in arbitration and before the ECJ’, 8 *The Law and Practice of International Courts and Tribunals* (2009): 225. See most recently *AES Summit Generation Limited AES-Tisza Erömu KFT v. The Republic of Hungary* (ICSID Case No. ARB/07/22), Award, 23 September 2010, Section 7.2.

<sup>521</sup> *Commission of the European Communities v. Austria*, *Commission of the European Communities v. Sweden*, and *Commission of the European Communities v. Finland*, see *infra*.

incompatibilities between EC law and previous international agreements entered by Member States:

The rights and obligations arising from agreements concluded before 1 January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of this Treaty.

To the extent that such agreements are not compatible with this Treaty, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established. Member States shall, where necessary, assist each other to this end and shall, where appropriate, adopt a common attitude.

In applying the agreements referred to in the first paragraph, Member States shall take into account the fact that the advantages accorded under this Treaty by each Member State form an integral part of the establishment of the Community and are thereby inseparably linked with the creation of common institutions, the conferring of powers upon them and the granting of the same advantages by all the other Member States.

In the first two cases, against Austria and Sweden, the ECJ performed a very short analysis of the facts before coming to its conclusions (based on the potential for the BITs provisions to impede the Community to exercise its powers to restrict capital flows) that those BITs were incompatible with EC law and that Sweden and Austria had failed to fulfil their obligations under Article 307 to take appropriate steps to stop the incompatibility. The judgments have been criticised for extending the concept of incompatibility to cover ‘potential future incompatibility’ and in so doing, extending the competencies of the Communities and making them exclusive, to the effect that Community law prevails even where ‘the Community has not yet exercised the powers available to it under the Treaty’<sup>522</sup>. The ECJ endorsed a wide definition of conflict, along the lines of Kelsen’s and Pauwelyn’s definitions. It then applied the incompatibility with respect to the ‘conclusion’ of a treaty<sup>523</sup>, in this way rebutting the argument by the defendants that an hypothetical incompatibility is no incompatibility at all; secondly, reaffirmed that the

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<sup>522</sup> *Commission of the European Communities v. Finland*, § 46.

<sup>523</sup> See Article 30(5) of the VCLT.

EC Treaty takes precedence to the extent of the conflict, so that the incompatibility has to be resolved in favour of the treaty, including possible denunciation and termination of the conflicting instrument; however, on the merits of the case, denunciation, suspension and termination were disregarded as feasible remedies if urgent measures for the capital flows restrictions (including in compliance of UN Security Council resolutions) needed to be implemented. This oblique reference to the Security Council<sup>524</sup> hints at a hierarchy of obligations (namely by application of Article 103 of the UN Charter) that is not developed fully by the Court<sup>525</sup>. A certain criticism can be moved to the Court for its quick dismissal of renegotiation and termination as possible forms of resolution of the conflict, and for failing to distinguish and to give due regard to the differences between the relevant BITs. The Court placed great emphasis on the urgency of the measures to be adopted in regulating capital movement, while not all the relevant EC Articles concern urgent measures. Secondly, the Court considered the BITs as homogenous instruments, without taking into account the textual differences. This is particularly relevant, and came to be considered, in the *Commission v. Finland Case*, where the BIT between Finland and Sri Lanka contained the following clause:

Every contracting party guarantees under all circumstances, within the limits authorised by its own laws and decrees and in conformity with international law, a reasonable and appropriate treatment of investments made by citizens or companies of the other Contracting Party.

Finland argued that, ‘by virtue of the direct effect of Community law’, the restrictive provisions that the Community might wish to implement

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<sup>524</sup> *Commission of the European Communities v. Finland*, Case C-118/07, § 25.

<sup>525</sup> Essential for the pronouncements of the ECJ on the relationship between European and International Law is the *Kadi Case*, *Yassin Abdullah Kadi and Al Barakaat International Foundation v. Council of the European Union and Commission of the European Communities*, Joined Cases C-402/05 P and C-415/05 P, 2008.

form part of Finnish law and are covered by the aforementioned clause<sup>526</sup> which effectively solves the incompatibility in favour of Community law. The ECJ rejected this argument in the following terms:

It must be observed, as the Republic of Finland rightly submitted, that restrictive measures, which may be adopted by the Council... form part of the Finnish legal order. However, it is not clear whether such measures, in the light of the bilateral investment agreements at issue, may be regarded as part of Finnish law.

The Court went on to say that, in compliance with the rule of treaty interpretation as codified in Article 30 of the VCLT, the BITs have to be interpreted as to require its parties to allow for free transfer of money and therefore the provisions relied upon by Finland ‘would not be sufficient to ensure the compatibility of the agreements challenged by the Commission with Article 307 EC’. One fails to see what are the implications of the distinction made by the Court between the Finnish legal order and Finnish law, to the effect that the EC restrictive measures might be part of the first one but not of the second and that this might be the case ‘in light of the bilateral investment agreements’.

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<sup>526</sup> § 37. In any case the standard provisions on free transfer of currency, by ensuring freedom of transfer without ‘undue delay’ already allow for justified delay in compliance of restrictions imposed by Community measures, especially if dictated by UN resolutions under chapter VII; also, and as argued by Austria and Sweden, the *rebus sic stantibus* principle can be applied in order to excuse non-performance of certain BIT obligations.

## 5.6 Concluding remarks

The application of conflict resolution techniques based on specificity, temporality or hierarchy, or systemic integration can help court and tribunals to avoid or harmonise conflicts, therefore maintaining the ‘unity of international law’. But a conflict is also the cause and the consequence of a breach, and as such has to be dealt with by application of the law of state responsibility. Investment law possesses its own secondary rules for violations of breaches of substantive or primary investment rules<sup>527</sup>. To the extent that a state is responsible for the violation of non-investment obligations in the pursuit of its investment obligations, the tribunals simply do not have jurisdiction to deal with the consequences of these breaches. While the ILC in its report on fragmentation rightly stressed that ‘although a tribunal may only have jurisdiction in regard to a particular instrument, it must always *interpret* and *apply* that instrument in its relationship to its normative environment,’<sup>528</sup> it is the consequences of that application that are relevant. Inasmuch as the tribunals do not recognise conflicting obligations as an excuse for non performance of the state’s investment obligations, they are empowered to enforce the

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<sup>527</sup> It is a ‘self-contained’ regime in the sense suggested by the Commentary to Article 55 of the ILC’s Draft Articles on State Responsibility, see § 5 in Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 10 (A/56/10), 2001) pp. 358-359. The term ‘self-contained’ with reference to a system of rules is attributed to the PCIJ in the *S.S. Wimbledon Case*, PCIJ, *Ser. A, No. 1*, at 23. See also the ICJ in *Case concerning the United States Diplomatic and Consular Staff in Tehran (United States of America v. Iran)* I.C.J. Reports 1980 p. 41, § 86. The ILC in its fragmentation report, page 82, suggested to replace the use of the misleading term ‘self-contained regime’ with the more appropriate ‘special regime’, with reference either to a special system of secondary rules or to a more integrated system of primary and secondary rules. A third, even wider definition, of such a regime as equivalent to ‘branches’ of international law such as trade, environment, etc., is not advisable either. On self-contained regimes and the rules on State responsibility, see also Simma, B. and Pulkowski, D., ‘Of planets and the universe: self-contained regimes in international law’, 17 *EJIL* (2006): 483.

<sup>528</sup> § 423.



secondary rules of state responsibility contained in the investment instrument (by awarding compensation to the investor). However, the tribunal does not have jurisdiction for a breach of a non-investment obligation, in the widest sense of not being empowered to declare on the existence of the breach, and some would say, being an institution created within one of the two conflicting regimes, possessing a systemic or structural bias towards the regime that created it. The germane issue of the applicability of the rules on state responsibility for special regimes has been the object of academic and jurisprudential attention<sup>529</sup>; to summarise, the general rules of international law on state responsibility codified by the ILC remain as fall-back in case of failure or incompleteness of the special regime, as a ‘residual’ regime for dealing of breaches (the difficulties of defining what constitutes a failure, and what is residual in this context are beyond the scope of this work<sup>530</sup>). It is accepted, as we have said, that investment law constitutes a special regime in this sense, having its own rules for dealing with breaches of investment treaties and, more specifically, rules on *locus standi*. To this extent, the investment regime is similar to the human rights regime, which also allows for individuals complaints of human rights violations (the human rights regime of course does not offer as strong remedies as the investment regime<sup>531</sup>). There is no difference between the secondary

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<sup>529</sup> See the ILC Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries, *Yearbook of the International Law Commission, 2001*, vol. II, Part Two; ILC *Report on Fragmentation*, Simma and Pulkowski, *supra*.

<sup>530</sup> For example, Simma remarked that none of these so-called self-contained regimes contains specific provisions on the application of the general rules on state responsibility (501).

<sup>531</sup> A direct comparison between human rights obligations and investment obligations is not useful is because the human rights regime is a legal regime based on public international law, in its substantive and procedural aspects. The investment regime, on the other hand, is a *sui generis* regime, a hybrid sub-system of international law combining private, commercial and public elements, with overlapping municipal and international jurisdictions, in which, in short, horizontal and vertical planes intersect, and that cannot be reduced to its public international or private trans-national *lex*

rules on state responsibility and the presumption against conflict and the completeness of the international law system which guide the usual fall-back mechanism. As Bruno Simma noted in his treatment of self-contained regimes and state responsibility<sup>532</sup>, ‘Sociological regime differentiation does not preclude normative compatibility with general international law’<sup>533</sup>. In this thesis, vertical compatibility between investment law seen as a special regime and general international law, including its rules on responsibility is not the focus of the analysis<sup>534</sup> as much as horizontal compatibility between discrete special regimes, investment and environment being an example.

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*mercatoria* elements. Furthermore, while the investment regime is international in its purpose and is supposed to protect foreigners from abuses of host states, the human rights regime it’s international in its character, but it is supposed to establish a system of protections mainly aimed at shielding citizens from the abuses of their own state. In this respect at least, the human rights regime is more innovative with respect to its substantive provisions, while the investment regime is more innovative with respect to its procedural provisions. In other words, the novelty of the human rights regime is that it creates a new category of rights opposable directly to one’s own state; the novelty of the investment regime is that it allows investors to exercise their rights directly against a foreign state, not their own. The source of the rights is always international, but the relationship between a human rights claimant and the state is normally not international, so that international law interposes itself in an essentially domestic context. In the case of the investment regime, the relationship itself is, or should be, international.

<sup>532</sup> See footnote above, page 485.

<sup>533</sup> As Teubner suggested, ‘Legal fragmentation cannot itself be combated. At the best, a *weak normative compatibility* [italics added] of the fragments might be achieved .... dependent upon the ability of conflicts law to establish a specific network logic, which can effect a loose coupling of colliding units’. Fischer-Lescano, A., and Teubner, G., ‘Regime collision: the vain search for legal unity in the fragmentation of global law’, 25 *Michigan Journal of International Law* (2004): 999 at 1004.

<sup>534</sup> And of course, investment treaties as a special regime are created specifically in order to allow for dispute settlement to be available to investor (customary rules of investor protection being subsumed as rules of aliens protection against injury and being restricted to diplomatic protection), and in this sense secondary rules constitute the *raison d’être* of the special regime of investment treaty law.

## Chapter 6: Procedural means of incorporation

### 6.1 Introduction

Non-investment obligations can be taken into account by state parties to an investment treaty in drafting the treaty, through the inclusion of express provisions. Additionally, when recourse to express provisions is not possible, because they are not available in the applicable instruments, tribunals still have at their disposal rules of conflict resolution deriving from general international law. In this chapter we will consider what procedural means are available to tribunals to incorporate the host states' non investment obligations. While in the previous chapter examples of conflict resolution taken from other areas of international law were presented, this chapter will not be followed by a similar analysis of how procedural means of incorporation are tackled in other areas of law, as investment law constitutes a *sui generis* regime procedurally, therefore comparisons are not warranted. While the link between express provisions and conflict resolution techniques on the one side, and non-investment (environmental) obligations on the other is immediately obvious, this is not necessarily so for procedural changes in the investment framework. How do openness, transparency, and third-party participation increase the visibility and the importance of environmental issues in investment arbitrations? The answer is to be found in the field in which foreign investors are traditionally been active (energy, mining, land development), which tend to have a significant environmental fall-out, and in the emergence of disputes involving developed states, such as the United States and Canada, with a vocal and well organised civil society. It is the combination of the potential for environmental negative externalities and a community aware and weary of them, to have brought about the demand for an increase of this form of procedural openness. In turn, this procedural openness increases the likelihood that 'green issues' will be raised. It is, in other words, both for historical and for political

reasons that procedural openness has acquired its prominence in discussions about the status of investment law as a closed system. As often happens when discussion turns on ‘transparency’, it is easy to overestimate the importance of what is obtained, as we will argue later in the chapter. On the other hand, undoubtedly there will be behavioural changes in the parties as a consequence of their awareness that what is being said in the proceedings will be public knowledge.

Investment disputes are characterised by confidentiality and privacy of the proceedings, not conducive to taking into consideration public interest issues. Additionally, traditionally these disputes have been strictly a ‘two-parties’ affair, with participation by third parties, interveners, *amici curiae* and other similar arrangements not being taken into consideration either by the parties or by the tribunals. Transparency of proceedings has therefore been demanded as a first step in guaranteeing that the public interest is adequately protected. Different institutional settings have tackled these demands differently, with more or less openness and publicity allowed. The distinction between confidentiality and privacy on the one hand, and transparency and inclusiveness on the other, which has been outlined elsewhere,<sup>535</sup> refers to publicity and participation in investment arbitrations: in short, the circle of knowledge holders and of participants. Who has the right to be informed of investment disputes and how much should they know about it (awards, all documents)? Who has the right to participate in the proceedings and in which capacity (as passive listeners, with non-party status, as third parties)? These debates have been conducted with particular vigour in the last ten years and have brought about significant changes in the structure of investment disputes, with differing degrees of openness being achieved. A general argument can be made on the public

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<sup>535</sup> See Asteriti, A. and Tams, C., ‘Transparency and representation of the public interest in investment treaty arbitration’, in Schill, S. (ed.) *International Investment Law and Comparative Public Law*, Oxford, OUP, 2010: 787.

interest of investment arbitrations and therefore the necessity of transparency; equally, a generic appeal to the necessity for certain public interest arguments to be heard by the tribunal can militate in favour of some form of participation to the proceedings. The first argument is couched in terms of procedural transparency; the second one relies on public interest standing discourses, familiar from domestic contexts. Both demands are bound to interact with the incorporation of environmental obligations in investment law and investment arbitration. This interaction can be conceptualised as a bijective function in which each element is connected to the other and acts on the other with a feedback loop. So more transparency allows for more information from investment disputes to be shared with third parties: the information received informs their participation to the proceedings and in turn affects the disputing parties and the tribunal and consequently, the information issuing from the disputes and so on. However, the feedback loop might not close: as there is no obligation for investment tribunals to act on the submissions received by the *amici curiae* (or indeed to read them), they might not let the information received influence or inform their awards<sup>536</sup>. The second problem, which is much more serious, is a problem of *legitimacy* and is only indirectly affected by these debates. The legitimacy of third parties participants has been questioned: if they raise issues of public interest and appeal to the public interest in order to obtain the right to participate and intervene in the proceedings, on what ground is their legitimacy based? How can they claim to speak for the public and what interests do they defend? To whom are they accountable?<sup>537</sup> However interesting this

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<sup>536</sup> Also states can be included in this information loop; for the effect on them, see through the prism of ‘normative expectations’ see for example Schill, S., ‘International investment law and comparative public law – an introduction’, in Schill, S. (ed.), 2010: 3, at 19.

<sup>537</sup> See for example Thomas Wälde’s contribution to *International Investment and the Protection of the Environment. The Role of Dispute Resolution Mechanisms*, edited by the International Bureau of the Permanent Court of Arbitration, Papers emanating from

aspect of the legitimacy debate, it lies beyond procedural transparency<sup>538</sup>. The legitimacy of the tribunals is more closely connected to issues of transparency and representation. The fact that the members of the tribunals are chosen by the parties, while in accordance with the rules of commercial arbitration, sits uneasily with the guarantees of impartiality and respect of the *nemo iudex in causa sua* principle. Systemic bias and substantive closure can only be strengthened where there is no possibility of appeal and where arbitrators come from a restricted group of experts in commercial and investment law<sup>539</sup>.

## 6.2 Non-disputing parties participation

Non-investment obligations are likely to concern issues that have a strong public interest element, such as the environment, or human rights, labour rights etc. Participation of third parties in investment proceedings constitutes the main procedural means to introduce non-investment issues in the dispute and therefore can be seen as one of the ‘entry points’ for environmental issues. Different stages can be distinguished in the way in which tribunals have accepted the participation of third parties to the proceedings, from total closure to relative openness. While in most municipal systems some form of public interest standing is allowed,

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the Second PCA International Law Seminar, May 17 2000, The Hague, Kluwer Law International, 2001, at 50 ff.

<sup>538</sup> Given their role as *amici curiae*, it is the task of the tribunal, in accordance with the procedural rules under which it is established, to ascertain the usefulness and the *bona fide* character of their submissions, and not of their democratic legitimacy as organisations and individuals.

<sup>539</sup> The issue of the permeability of the categories and resulting problems of conflicts of interest and self-serving development of the case law are obvious systemic problems that procedural transparency did not even attempt to address. For the role of arbitrators, see Malintoppi, L., ‘Independence, impartiality and the duty of disclosure of arbitrators’, *Oxford Handbook*, 2008: 789; Sheppard, A., ‘Arbitrator independence in ICSID arbitration’, Binder *et al.*, 2009: 131.

investment law does not allow for more than participation as non disputing party, mainly in the form of *amicus curiae* submissions. The adversarial nature of the proceedings, modelled on common law systems, accounts for the preference for this form of participation. More direct forms of participation as a disputing party, or institutionally protected roles, such as the French *rapporteur public*, would not be possible within investment disputes as they are currently structured. Given the structural limitations, third parties are restricted to written submissions, in the form of *amicus curiae* briefs.

Investment arbitration has moved from a complete denial of participation, through some limited forms of *ad hoc* participation<sup>540</sup> to more open recognition (NAFTA, ICSID Convention). The original ICSID Convention Rules of Procedure did not allow any form of third party participation. Since tribunals have to follow the procedural rules of the institutional framework the parties have selected or the *ad hoc* set-up autonomously chosen, there is no bar to third parties participation if the parties consent to it. In the *Aguas del Tunari Case*, the Tribunal rejected the request to participate as *amicus curiae* made by the NGO Earth Justice,<sup>541</sup> stating that it would have been beyond its powers to do otherwise, lacking consent of the parties or a provision to that effect either in the ICSID Convention as the governing framework for procedural matters or in the applicable BIT. But already at the time of the *Aguas Del Tunari* decision, things were changing; in its letter to Earth Justice, the Tribunal referred to the 2003 US-Singapore FTA, in which written submissions are contemplated by Article 15.19, which states as follows: ‘The Tribunal shall have authority to accept and consider *amicus curiae* submissions from a person or an entity that is not a disputing

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<sup>540</sup> The Arbitration Rules of the main international arbitration seats, International Chamber of Commerce (ICC), London Court of International Arbitration (LCIA), Stockholm Chamber of Commerce (SCC), do not allow for *amicus curiae* submissions.

<sup>541</sup> See *Aguas Del Tunari SA v. Republic of Bolivia* (ICSID Case No. ARB/02/3), Decision on Respondent’s Objection to Jurisdiction, 21 October 2005, Appendix III.

party.’ This same clause is contained in the US Model BIT of 2004, as Article 28(3). In the same year, the Free Trade Commission issued a statement binding on NAFTA Parties on non disputing parties participation to proceedings initiated under the NAFTA. The statement clarified the procedure for submission, which included the submission of an application for leave to file and the submission itself, and elucidated the criteria for acceptance of briefs from non parties. These can be identified in the following terms:

1. the submission has to provide the tribunal with knowledge or insight that is ‘different from that of the disputing parties’ which can help the tribunal determine factual or legal issues related to the dispute;
2. the non disputing party has to have a ‘significant interest’ in the arbitration; and
3. the subject matter of the arbitration has to have a public interest element.

Similarly, and as a consequence of the developments in the NAFTA regime, the ICSID Member States introduced new arbitration rules in 2006 which allow for third parties participation as non-disputing parties<sup>542</sup>, again through the submission of briefs<sup>543</sup>. Rule 37(2) of the Arbitration Rules is as follows:

After consulting both parties, the Tribunal may allow a person or entity that is not a party to the dispute (in this Rule called the “non disputing party”) to file a written submission with the Tribunal regarding a matter within the scope of the dispute. In determining whether to allow

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<sup>542</sup> The first tribunal to apply the new rule with regards to submissions by *amici curiae* was *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania* (ICSID Case No. ARB/05/22), Procedural Order No. 5, 2 February 2007.

<sup>543</sup> In *AES Summit Generation Limited and AES-Tisza Erőmű Kft. v. Republic of Hungary* (ICSID Case No. ARB/07/22), Procedural order concerning the application of a non-disputing party to file a written submission pursuant to ICSID Arbitration Rule 37(2), 26 November 2008 (not public), the Tribunal allowed the intervention of the European Commission under the modified ICSID Rules..



such a filing, the Tribunal shall consider, among other things, the extent to which:

(a) the non-disputing party submission would assist the Tribunal in the determination of a factual or legal issue related to the proceeding by bringing a perspective, particular knowledge or insight that is different from that of the disputing parties;

(b) the non-disputing party submission would address a matter within the scope of the dispute;

(c) the non-disputing party has a significant interest in the proceeding.

The Tribunal shall ensure that the non-disputing party submission does not disrupt the proceeding or unduly burden or unfairly prejudice either party, and that both parties are given an opportunity to present their observations on the non-disputing party submission.

The ICSID rules do not go as far as the NAFTA ones, in that ‘consultations’ with the parties are required (even if the final decision as to the possibility of admitting written submissions rests with the tribunal). The criteria are similar to those applicable within the NAFTA regime, minus the public interest element. But even before the NAFTA Parties and the Member States of the ICSID Convention introduced these changes formally, tribunals had adopted them by acting to accept submissions by NGOs in cases that had a strong public interest element. They did so by interpreting the arbitration rules under which they were acting as allowing non disputing parties submissions. For example, the *Methanex* Tribunal accepted submissions by several environmental NGOs even without an express rule authorising it to do so<sup>544</sup>. The claim, submitted for a violation of Chapter Eleven of the NAFTA, was governed by the UNCITRAL Rules. By its interpretation of Rule 15(1), the Tribunal established that it had the discretion necessary to authorise the submissions, provided it acted in accordance to ‘procedural equality and fairness’ towards the parties. The Tribunal clearly distinguished between granting non disputing parties substantive rights or party status, which was precluded, and granting them lesser procedural rights, which it considered to be within the scope of Article 15(1).

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<sup>544</sup> See *Methanex Corporation and the United States of America*, Decision on Authority to Accept Amicus Submissions, 15 January 2001. This case will be analysed in Section 7.6.1.

The Norway Model BIT and the IISD Model Agreement consolidate and augment the criteria for participation by non parties. Article 18(3) and 18(4) of the Norway BIT are as follows:

3. The Tribunal shall have the authority to accept and consider written *amicus curiae* submissions from a person or entity that is not a disputing Party, provided that the Tribunal has determined that they are directly relevant to the factual and legal issues under consideration. The Tribunal shall ensure an opportunity for the parties to the dispute, and to the other Party, to submit comments on the written *amicus curiae* observations.

4. The Tribunal shall reflect submissions from the other Party and from *amicus curiae* in its report.

While clause 18(3) does not differ from what already granted in ICSID and NAFTA, with Article 18(4) the draft establishes a novel duty for tribunals to take into consideration third parties submissions, which is a significant departure from the traditional position, according to which tribunals are under no obligation to take such submissions in any consideration at all (not even being under the obligation to read them, let alone reflect their content in their award). Article 8(1) of Annex A in the IISD Model Agreement does not go as far in its formulation: ‘The tribunal shall have the authority to accept and consider *amicus curiae* submissions from a person or entity that is not a disputing party (the “submitter”)',<sup>545</sup>.

## 6.4 Openness of the proceedings

Procedural transparency refers to the disclosure of information about investment disputes to third parties<sup>546</sup>. This can be accomplished by opening the hearings to the public, which is the topic of this section, or

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<sup>545</sup> The other paragraphs of the Article detail the procedure to be followed in the submissions of *amicus* briefs.

<sup>546</sup> On third parties participation, see also Yannaca-Small, C., ‘Transparency and third-party participation in investor-state dispute settlement procedures’, *OECD Working Papers on International Investment*, No. 2005/1, at <http://www.oecd.org/investment>.

through publication of the award and related materials, which will be reviewed in the next section. In this respect the last ten years have also witnessed a remarkable change in attitude, from complete closure to relative openness.

Investment arbitration, modelled on private commercial arbitration, did not traditionally allow open proceedings. This approach is still followed by institutions that, while empowered to conduct mixed arbitrations (investor-state) developed their rules in a strictly private commercial environment. Institutional settings such as the International Chamber of Commerce (ICC) or the London Court of International Arbitration (LCIA) do not allow the participation of third parties in any form, unless by consent of the arbitral tribunal and the parties<sup>547</sup>, or by consent of the parties or order of the tribunal<sup>548</sup>. Even the revised UNCITRAL Arbitration Rules still only provide for hearings *in camera* unless the parties agree otherwise<sup>549</sup>. However, the UNCITRAL set up a Working Group on Arbitration and Conciliation tasked with the consideration of transparency as an urgent issue; it was decided though that this issue should not delay the revision of the generic rules, completed in 2010<sup>550</sup>.

Institutional settings created for the express purpose of allowing investor-state arbitrations, mainly ICSID, or instruments allowing for arbitration to take place in *ad hoc* tribunals but in compliance of certain rules, such as NAFTA, have undergone the most dramatic developments (though ICSID to a lesser extent).

The un-amended ICSID Rule 32(2) did not allow participation to the hearings unless by consent of the parties; the debates following the

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<sup>547</sup> Article 21(3) of the ICC Rules of Arbitration in force as from 1 January 1998.

<sup>548</sup> Article 19(4) of the LCIA Arbitration Rules effective 1 January 1998.

<sup>549</sup> Article 28(3) of the UNCITRAL Arbitration Rules as revised in 2010.

<sup>550</sup> See Report of the Working Group II (Arbitration and Conciliation) on the work of its fifty-third session, (Vienna, 4-8 October 2010), A/CN.9/712

publication of a Discussion Paper by the ICSID Secretariat in 1994<sup>551</sup> resulted in the approval by the ICSID Administrative Council of a revised set of rules in 1996, which still only contemplated open hearings by the parties' consent<sup>552</sup>, even if more openness had been proposed in the debates preceding the vote<sup>553</sup>. Further amendments in 2006 have not changed the situation in this regard, with the new Rule 32(2) providing as follows:

Unless either party objects, the Tribunal, after consultations with the Secretary-General, may allow other persons, besides the parties, their agents, counsel and advocates, witnesses and experts during their testimony, and officers of the Tribunal, to attend or observe all or part of the hearing, subject to appropriate logistical arrangements. The Tribunal shall for such cases establish procedures for the protection of proprietary or privileged information.

The NAFTA has from the beginning set a higher standard with regards to transparency, thanks to the approach of its States Parties. Both United States and Canada issued a statement in 2003 in support of open hearings for all NAFTA Chapter Eleven arbitrations<sup>554</sup>, and were joined by Mexico in 2004<sup>555</sup>. This practice has been followed consistently and has taken place smoothly in institutional settings such as those provided by

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<sup>551</sup> *Possible Improvements of the Framework of ICSID Arbitration*, 22 October 2004, at [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=NewsReleases&pageName=Archive\\_%20Announcement14](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=NewsReleases&pageName=Archive_%20Announcement14).

<sup>552</sup> Rule 32(2) of the ICSID Arbitration Rules. Effectively the Parties still retain the power to block public participation to the hearings (but note the different procedure if the NAFTA or the CAFTA are the applicable treaties, below).

<sup>553</sup> 'Watered-down changes to arbitration' at <http://www.brettonwoodsproject.org/art-547592>.

<sup>554</sup> Department of Foreign Affairs and International Trade News Release No. 152, *NAFTA Commission Joint Statement*, (7 October 2003), at [http://w01.international.gc.ca/minpub/Publication.asp?publication\\_id=380398&Language=E](http://w01.international.gc.ca/minpub/Publication.asp?publication_id=380398&Language=E).

<sup>555</sup> NAFTA Free Trade Commission Joint Statement, *Decade of Achievement*, (16 July 2004), at <http://www.dfait-maeci.gc.ca/nafta-alena/JS-SanAntonio-en.asp>.

the ICSID Secretariat. Equally, the United States and Canada Model BITs prescribe that hearings shall be open to the public and assign the tribunal the responsibility of any logistical arrangements<sup>556</sup>.

The approach taken by the states parties to the NAFTA can be contrasted with the much more traditional approach taken in another multilateral instrument, the Energy Charter Treaty (ECT) where those disputes arising under this instrument are not settled by ICSID<sup>557</sup>, in which case openness of hearings is in any case precluded. We will see in the next section how publicity is effectively precluded in this instrument as well.

## 6.5 Publicity

By publicity is intended the dissemination of information about the existence of a dispute (through registration) and its outcome (through publication of the awards and other dispute-related materials). While at the lowest level of openness (involving neither participation nor standing), it can be the most difficult to guarantee both as a matter of tribunal procedure, because it is difficult for tribunals to ‘police’ the conduct of the parties and unilateral disclosure is always a possibility<sup>558</sup>, and as a jurisdictional matter, because disclosure might be required by the *lex situs*<sup>559</sup>.

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<sup>556</sup> Article 29(2) of the 2004 US Model BIT; Article 38 of the 2004 Canada Model BIT. See also Article 10.21(2) of the CAFTA.

<sup>557</sup> For example for disputes submitted to the Stockholm Chamber of Commerce (SCC) under its Arbitration Rules; for the privacy of proceedings, see Article 27(3). See also next section.

<sup>558</sup> The problems raised in the *Biwater Gauff* dispute are emblematic, see especially *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania* (ICSID Case No. ARB/05/22), Procedural Order No. 3, 29 September 2006. See also the language of the confidentiality rules of the ICC.

<sup>559</sup> Express rules on confidentiality are rare in arbitration statutes, but can be implied by reference to common law (see for example the UK Arbitration Act of 1996, Chapter 23

The same pattern that we have observed for third parties participation and privacy repeats itself for confidentiality. The rules of the ICC and the LCIA, and the UNCITRAL rules, guarantee the highest level of confidentiality, with no requirement of registration of the disputes<sup>560</sup> and of publication of awards and documents<sup>561</sup>. The three sets of rules are not identical, with the tightest rules provided for by the ICC, while both the LCIA and the UNCITRAL rules make reference to disclosure in compliance with a legal duty or in pursuance of a legal right or for enforcement or appeal. Furthermore, the UNCITRAL rule is worded as a permissive rule ('An award might be made public by consent of the parties...') rather than as a prohibition<sup>562</sup> ('...copies shall be made available ... to the parties, but no one else.').

The ICSID Convention originally did not allow the publication of the awards unless by consent of the parties<sup>563</sup>; however the rule was partially amended in 1984 to allow the publication of 'excerpts of the legal

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or the Federal Arbitration Act, 9 U.S.C.A. §§ 1-16; in English law *Emmott v. Michael Wilson Partnership* [2008] EWCA Civ 184; *WLR (D)* 82 confirmed the principle that confidentiality is implied in an arbitration agreement). The recent Arbitration (Scotland) Act 2010 contains an express duty of confidentiality (Rule 26), unless by agreement by the parties, but also allows for a series of exceptions, including if the disclosure is 'in the public interest' or 'necessary in the interests of justice'. One would imagine the first exception could be applicable in a mixed arbitration involving a state but of course this has not been tested yet. Equally, freedom of information legislation might mandate disclosure of documents related to investment proceedings if held by the state.

<sup>560</sup> Article 4 of the ICC Rules of Arbitration and Article 6 of Appendix 1 and Article 1 of Appendix II (with general rules on confidentiality); Article 30 of the LCIA Arbitration Rules (which covers all aspect of confidentiality); Article 17 of the UNCITRAL Arbitration Rules.

<sup>561</sup> Article 28(2) of the ICC Rules of Arbitration; Article 30 of the LCIA Arbitration Rules; Article 34(5) of the UNCITRAL Arbitration Rules. See also general confidentiality rules listed in footnote above.

<sup>562</sup> Article 28(2) of the ICC Rules.

<sup>563</sup> Rule 48(5) of the pre-1984 Rules.

reasoning of the Tribunal'<sup>564</sup>; furthermore, all cases are registered and the list is publicly available on the ICSID website. In the most recent development, the ICSID Secretariat has announced that it will actively pursue a policy of getting all awards published and to this effect it will contact all parties to previously unpublished awards to request permission for publication<sup>565</sup>. The Secretariat also provides statistics about the caseload of the Centre<sup>566</sup>.

The American instruments, including the NAFTA, the CAFTA and the US and Canadian Model BITs, allow the greatest degree of publicity, including mandatory registration of the disputes and publication of the awards and related materials, including party submissions and transcripts of the hearings<sup>567</sup>. In contrast, disputes initiated under the ECT do not have to be communicated to the ECT Secretariat; even when they are, awards might not be publicly available<sup>568</sup> and other materials never are<sup>569</sup>.

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<sup>564</sup> Rule 48(4).

<sup>565</sup> See ICSID News Release of 5 May 2010, 'Publication of ICSID's Decisions and Awards with Parties' consent', at <http://icsid.worldbank.org/ICSID/FrontServlet>.

<sup>566</sup> See ICSID News Release of 3 February 2010, 'The ICSID Caseload-Statistics now available on the ICSID website', at <http://icsid.worldbank.org/ICSID/ICSID/ViewNewsReleases.jsp>.

<sup>567</sup> For the NAFTA: see Statement on Notices of Intent to Submit a Claim to Arbitration, 7 October 2003, at [http://www.naftaclaims.com/disputes\\_us\\_methanex.htm](http://www.naftaclaims.com/disputes_us_methanex.htm) and Article 1137(4); for the CAFTA, Article 10.21 (Transparency of Arbitral Proceedings); see also Article 29 of the US 2004 Model BIT and Article 38(3) and 38(4) of the Canada 2004 Model BIT.

<sup>568</sup> However, of the 7 rendered awards listed on the website, all 7 were available, at <http://www.encharter.org/index.php?id=213>.

<sup>569</sup> A forum of choice for disputes arising from the ECT is the Stockholm Chamber of Commerce under the Arbitration Rules of its Arbitration Institute, as amended in January 2010; on the confidentiality of the award, see Article 46.

## 6.6 Concluding remarks

In Chapter 2 we argued that procedural closure is the default position of investment arbitration; however, the citadel walls have been breached, and complete confidentiality and privacy are now increasingly unlikely. The reasons for advocating openness and transparency (governance, legal obligations, domestic systems analogy etc.) are manifold; here we are more interested in the consequences of this openness, rather than its justifications.

It has been argued elsewhere that in its present shape, international investment law would have considerable difficulties in accommodating far-reaching public interest representation, borrowing what is available in some domestic legal systems with regards to ‘public interest standing’: investment tribunals would simply have no jurisdiction to entertain suits brought by NGOs or associations seeking to vindicate societal concerns in proceedings against states or investors. This is an argument for the limited validity of the domestic analogy rationale for advocating greater participation, because third parties have not only no option, but also no need to sue their own states in an investment tribunal, having access to better forms of public interest representation within their domestic legal system (through judicial review and administrative proceedings). Equally, actions against investors by private citizens within the framework of investment arbitration are precluded. In the end there is no possibility other than some forms of non-standing representation coupled with transparency, as means to open up investment arbitrations to outside interests, including environmental demands. However, it is important to note that even provisions along the lines of Article 37 of the ICSID Rules, recognising the right of tribunals to receive *amicus* briefs, are a far cry from domestic law approaches accepting that representatives of public interests may acquire party status.



With respect to available information about proceedings, international investment law has traditionally been premised on confidentiality. This has important consequences on the various aspects of transparency and is particularly evident with respect to access to court, with the preservation of the power of veto to the opening up of proceedings. If the goal of investment law, as of any branch of law, is the balancing of competing interests, and if participation is the procedural tool necessary to allow this balancing, the power of veto is the power to impede any balancing of interests. In other words, if the argument rests on the possibility to allow entry points in investment law, the reality has to be acknowledged that two potentially powerful weapons for closing down these entry points are available to investors and investment tribunals: substantially, a wide application of umbrella clauses in order to ‘trigger’ stabilisation clauses, especially of the ‘freezing’ variety<sup>570</sup>; procedurally, the veto power of the parties to exclude third parties from the hearings and to limit knowledge of the awards and other materials.

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<sup>570</sup> As we have seen in Chapter 2.

### Part III: The application

The final part is dedicated to the application of all the tools outlined in the second part in actual investment arbitrations. In Chapter 7, each of the express means of incorporation of non-investment obligations is tested in the context of disputes that arose where environmental obligations were either raised as defences by the state, or independently considered by the tribunal, or brought into the dispute by *amici curiae* submissions.

The taxonomy presented in Chapter 4 constitutes a comprehensive review of all the possible ways in which express incorporation of non investment obligations can be accomplished. However, the potential has to be realised by the actors according to their powers and competencies. In the first instance, it is up to states when drafting investment treaties. Conflict avoidance by way of careful drafting is arguably the most efficient way to deal with potential problems of normative dissonance. It also restricts the power of tribunals to exercise discretion in their decision-making. Vague or insufficient provisions in investment treaties, on the other hand, will inevitably confer to tribunals more discretionary power when adjudicating disputes with an environmental element.

In Chapter 7 the focus is on the ‘judicial moment’ rather than the legislative one, i.e. on the way tribunals have interpreted the express provisions listed in Chapter 4, made use of the general conflict rules which form the topic of Chapter 5, and finally adopted, in their procedure, the open approach to arbitration outlined in Chapter 6. It can be anticipated in this introduction that what emerges is a mixed picture. The tools are there (as we have seen in Chapter 4), and the demands that they be used are pressing, especially in certain institutional settings and under certain instruments (the most obvious example being the NAFTA). On the other hand, the response of the tribunals has been somewhat

mented. It is also difficult to neatly distinguish awards on the basis of the taxonomy provided. It is still to be seen if this is a problem of the taxonomy itself or of the jurisprudence produced by the tribunals, not attentive enough to the language of the treaties and the intentions of the drafters. Finally, political considerations seem to come to the forefront with greater evidence. More detailed conclusions will be drawn after the analysis of the individual cases and in the concluding remarks of the chapter, and then of course, in the following, final chapter.

The second chapter in this Part 3 is also the concluding chapter of this work. In it, the main conclusions reached through the analysis of the material are presented. The impetus for this thesis was, as is often the case, the recognition of a problem. We have referred to this problem several times in different ways, as a problem of isolationism, normative dissonance, normative or constitutional conflict, procedural closure. It is indeed rather a cluster of interconnected issues rather than a single, discrete problem, which undoubtedly accounts for the difficulties in identification and resolution. None of the proposed solutions can be said to be in themselves immune from criticism and negative repercussions<sup>571</sup>. In the thesis we have often remarked on the downsides of drawing too close a comparison between investment arbitration and judicial review of governmental conduct on the one hand, and on attributing to investment tribunals the power to conduct a proportionality analysis in order to assign priority to conflicting fundamental rights or between rights of individuals and the public interest on the other. However, these are two of the proposed ‘system-internal solutions’ to the normative conflicts arising from the collision of environmental and investment legal commitments of host states. To the extent that this project is intended to be essentially one of discovery, we are more

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<sup>571</sup> We have concentrated in this work in legal, system-internal solutions, but many more have been proposed (a more developed appeal system, a permanent court, more express duties for investor in investment instruments, etc.).

interested in having reached a clear picture of the state of investment law with regards to its relationship with environmental law obligations than in proposing ‘solutions’ that inevitably remain untested.

## Chapter 7: Conflicts in investment arbitration - investment and environment

### 7.1 Introduction

One of the defining characteristics of international investment arbitration is the fact that it is modelled on commercial arbitration. The advantages that this model of dispute resolution presents for the parties are well known: confidentiality of the proceedings, speed in the resolution of the disputes, and the efficiency and ease of the process, coupled with the perception of it being ‘investor-friendly’. These are not the only reasons why investment arbitration has become a popular avenue for investors to address their grievances. There are historical, political and economic reasons behind the increased role of private investors in development programmes, the changes in international investment law in order to confer *locus standi* to investor in dispute against host states, and the ‘depoliticisation’ of the investor-state relationship by way of avoidance of a direct inter-state disputes. These developments have created almost *ex-nihilo* a field of law with its own substantive content, procedural rules, system of remedies, and a mobile and well-connected community of practitioners. However, all throughout this work, we have considered how this insular world can be opened to its outside, to its environment, and, more specifically, to issues arising from its interaction and effect on environmental legal obligations of the host states. Finally, in this chapter, we examine more closely how tribunals react to these stimuli, as they are brought into the dispute by the parties (normally by the states as defences for non-compliance of their investment treaty obligations, as part of the instruments that the tribunals are bound to apply, or by third parties through the device of *amicus curiae* submissions).

In the next section we will consider how these conflicts have been tackled by tribunals when the applicable instrument contained express

provisions, as detailed in Chapter 4. Then we will consider how tribunals have made use of conflict clauses derived from general international law, and finally how they have availed themselves of procedural means of incorporation in disputes containing an environmental element. Each section is accompanied by an illustrative example.

NAFTA jurisprudence is the natural starting point for an analysis of how arbitration tribunals have learned to deal with normative conflicts with an environmental element. One of the reasons for this is in the highly developed status of environmental law in two of the three state parties of the NAFTA, United States and Canada. The high level of sophistication of environmental law and jurisprudence in both countries, the penetration of this field of law in many areas of public intervention, and the considerable level of public interest all contribute to give raise to claims by investors alleging that environmental regulations by the host state violated their protected treaty rights. As NAFTA contains express means to deal with this kind of conflicts, as we have seen in Chapter 4, it is our task to assess what use state have made of them in order to construct their defences, and how tribunals have received their arguments. As a consequence, most of the cases considered in the following sections will be ones in which the tribunals were asked to apply Chapter Eleven of the NAFTA.

## 7.2 Exception clauses

Investment treaties do not normally contain express exceptions to the obligations contained therein. When they do, they are GATT-style exception provisions, which are problematic in their wording, having being imported from the different framework of the WTO<sup>572</sup>. While there

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<sup>572</sup> As we have seen in Chapter 4, Article XX of the GATT applies to the trade in goods (allowing an 'environmental' exception, see Article XX(g) at

are no cases where this kind of exception clause was brought up in the proceedings, virtually all NAFTA tribunals have considered the jurisprudence arising from the WTO in their awards<sup>573</sup>, including where at issue was the application of the General Exception Article of the GATT (Article XX) albeit for taxation rather than environmental measures<sup>574</sup>. There are no investment arbitrations yet in which the tribunal applied the kind of exception clauses that we have listed in Chapter 4. Exclusions contained in Annexes have not been used extensively for environmental exceptions, neither have they been employed by states. The *Tecmed* Tribunal however, in considering a claim of regulatory expropriation by a Spanish investor in Mexico, conducted a thorough balancing exercise, as we shall see, which effectively allowed for the introduction of a police powers exception in a treaty that did not contain such a clause<sup>575</sup>, even if ultimately finding against the state and granting compensation.

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[http://www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm)); a similar provision is not contained in the GATS, which regulates the trade in services (of which investment can be an example, see Article I(2)(b) (Scope and Definition) and Article XIV (General Exceptions) of the GATS, at [http://www.wto.org/english/docs\\_e/legal\\_e/26-gats\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm)). The NAFTA and the 2004 US Model BIT contain the specific environmental exception that is absent from the GATS.

<sup>573</sup> See Kurtz, in Schill, 2010: 244. (With reference to the national treatment clause, but the statement can easily be extended to all the early jurisprudence arising under the NAFTA).

<sup>574</sup> See *Archer Daniels Midland Company and Tate & Lyle Ingredients America Inc. v. United Mexican States*, ICSID/NAFTA (ICSID Case No. ARB(AF)/04/05), Final Award, 21 November 2007, §§ 89 ff. These ‘sugar’ cases involving Mexico and the United States developed as state-state disputes under Chapter XX of the NAFTA; investor-states disputes under Chapter XI of the NAFTA; and finally as inter-state disputes under the DSU of the WTO.

<sup>575</sup> See Kingsbury, B. and Schill, S., ‘Public law concepts to balance investors’ rights with state regulatory actions in the public interest – the concept of proportionality’, in Schill, S. (ed.), *International Investment Law and Comparative Public Law*, Oxford, OUP, 2010: 75, at 92. The police powers exception (which is recognised in CIL) had

### 7.2.1 *The Tecmed Case*

Técnicas Medioambientales, TECMED S.A., is a company organised under Spanish law and the parent company of TECMED, TECNICAS MEDIOAMBIENTALES DE MEXICO, S.A. DE C.V. (Tecmed), incorporated under Mexican law, which held over 99% of the shares of CYTRAR, S.A. DE C.V. (Cytrar), the locally incorporated company through which the investment was made.

The dispute arose out of the purchase by Tecmed in 1996 of a hazardous waste landfill in the municipality of Hermosillo in the state of Sonora. In 1998 Tecmed applied for the renewal of the licence to operate the landfill, but this was rejected by the National Ecology Institute of Mexico (INE) (previously, when it had been owned by an agency of the municipality, the landfill had been granted a licence for an indefinite time).

Tecmed claimed that there had been a violation of Mexican law, the Spain-Mexico BIT and international law. Specifically, it argued that representations made at the federal level were frustrated by the conduct of the municipal and state authorities, which, for political reasons, had incited the local population to oppose the operation of the landfill. It further argued that the federal authorities finally gave in and rejected the application for the licence in order to appease the local officials. Tecmed had committed certain violations in relation with the operation of the landfill and especially with transportation there of hazardous waste from another location, and it had been under investigation, but it argued the violations were minor (fines had been imposed) and did not warrant the refusal to renew the licence. Additionally there was widespread and

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been argued by Mexico in its Counter-memorial and closing statements, see Award, § 97 and footnote 76.



sustained local opposition to the operation of the landfill, because of its location in the proximity of the municipality of Hermosillo<sup>576</sup>.

Tecmed claimed Mexico had breached the BIT's Articles on national treatment, fair and equitable treatment, MFN, and expropriation, and requested remedies in the form of restitution (issuing the relevant licence) and compensation.

This case developed shortly after the *Metalclad Case*<sup>577</sup>, and also involved Mexico, but arose out of a bilateral investment treaty between Mexico and Spain. As the Tribunal accepted that, by acquiring the landfill, Metalclad had also acquired vested rights in its operation, the reasoning of the Tribunal was dependent on the traditional international law doctrine of vested rights<sup>578</sup>. However, in applying Article V(1) of the Spain-Mexico BIT<sup>579</sup>, as requested by Tecmed, the Tribunal had to assess if the measures taken by Mexico (specifically the refusal to grant the licence), constituted an expropriation. To do so, the Tribunal first considered if the effects of the measure were severe enough as to be

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<sup>576</sup> According to Mexican law, landfills have to be located at a distance of 25 km from any town with a population exceeding 10,000 (such as in the present case); however the landfill was only 8 km from the city. This was not imputable to Tecmed, as the authorisation for locating the landfill was granted before the purchase (see § 106 of the Award) and at the time of purchase, the relevant law had not taken effect. The Tribunal repeatedly referred to this location problems as 'socio-political' issues (see for example § 129 of the Award); however, if the location was indeed unlawful in Mexican law, the community protests should have been considered by the INE as the expression of a legitimate concern that law be respected by the municipality as well as by the company, and therefore well within its remit for consideration in the assessment of the licence renewal request. While laws cannot be applied retroactively, arguably the new regulation on landfill location could have influenced the renewal of a licence.

<sup>577</sup> See Section 7.3.1.

<sup>578</sup> At § 91.

<sup>579</sup> Article V(1) of the Spain-Mexico BIT refers to '*medidas equivalentes a expropiación o nacionalización*' [measures equivalent to expropriation or nationalisation].

defined as expropriatory<sup>580</sup>, and then assessing, on the basis of the ‘characteristics’ of the measures, whether compensation was due or if the police powers exception applied<sup>581</sup>. The novelty of the reasoning, in investment law context at least, is that, in order to ascertain the applicability of the police powers exception<sup>582</sup>, the Tribunal performed a proportionality test, and made explicit reference to the jurisprudence of the ECtHR<sup>583</sup>. The Tribunal stated<sup>584</sup>:

After establishing that regulatory actions and measures will not be initially excluded from the definition of expropriatory acts ... the Arbitral Tribunal will consider, in order to determine if they are to be characterized as expropriatory, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the

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<sup>580</sup> Applying the usual standard of substantial and permanent deprivation, see § 116 of the Award.

<sup>581</sup> At § 115 of the Award the Tribunal cited Article 5(1) of the BIT incorrectly, stating that the Article mentioned also ‘...any other measure with similar characteristics or effects [emphasis in the original]...’ For the original text of the Article see footnote 579 above.

<sup>582</sup> Again, not in compliance with the treaty, but with the customary law standard (as we have noted above, the reference to Article 5(1) is incorrect, as this Article does not make any reference to the criteria applicable to an indirect expropriation – specifically, the assessment of the ‘characteristics and effects’ of the measures, which the Tribunal nonetheless repeated at § 118 of the Award). The Tribunal also cited the *Santa Elena Case* incorrectly, in support of its statement that ‘regulatory administrative actions are per se excluded from the scope of the Agreement [the BIT], 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’ (at § 121). That award concerned a *direct* expropriation, where the dispute centred on the quantum of compensation, and it should not be used in support of awarding compensation for environmental measures alleged to have an expropriatory effect.

<sup>583</sup> Specifically to the *Case of James and Others*, Judgment of February 21, 1986, 50, pp.19-20, and 63, p. 24. For an analysis of this case, and its influence in investment jurisprudence, see Section 3.3.1.

<sup>584</sup> At § 122.

significance of such impact has a key role upon deciding the proportionality. [The] Arbitral Tribunal [will examine] the actions of the State in light of Article 5(1) of the Agreement to determine whether such measures are reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of who suffered such deprivation. *There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure.* [Italics added] To value such charge or weight, it is very important to measure the size of the ownership deprivation caused by the actions of the state and whether such deprivation was compensated or not. On the basis of a number of legal and practical factors, it should be also considered that the foreign investor has a reduced or nil participation in the taking of the decisions that affect it, partly because the investors are not entitle to exercise political rights reserved to the nationals of the State, such as voting for the authorities that will issue the decisions that affect such investors. [Citations omitted]

It is important to note, before considering the significance of the approach adopted by the Tribunal, what was excluded from the assessment of the proportionality of the measures. The Tribunal repeatedly remarked that the INE was (improperly) ‘driven by socio-political factors’<sup>585</sup>, when deciding on the renewal of the licence. It is true that, as a public agency, its powers were limited to the application of the relevant legal requirements<sup>586</sup>; a more general point can be made however, by contrasting the position taken by the *Tecmed* Tribunal on the issue of the political background of the dispute, with the comments made by the *AES* Tribunal, where the Claimant had similarly argued that measures introduced by the Hungarian government to reduce the profits made by the company in the energy sector were politically motivated<sup>587</sup>:

Having concluded that Hungary was principally motivated by the politics surrounding so-called luxury profits, the Tribunal nevertheless is of the view that it is a perfectly valid and rational policy objective for a

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<sup>585</sup> At § 130 of the Award, for example.

<sup>586</sup> But we have already remarked that there were legal issues with the location of the landfill that might have warranted the refusal of the licence on legal grounds. The Tribunal however strictly applied the non-retroactivity principle, at § 141.

<sup>587</sup> *AES Summit Generation Limited and AES-Tisza Erőmű Kft. v. Republic of Hungary* (ICSID Case No. ARB/07/22), Award, 23 September 2010, § 10.3.34.

government to address luxury profits. And while such price regimes may not be seen as desirable in certain quarters, this does not mean that such a policy is irrational. One need only recall recent wide-spread concerns about the profitability level of banks to understand that so-called excessive profits may well give rise to *legitimate reasons for governments to regulate or re-regulate*. [Italics added]

While the *AES* Tribunal was willing to consider the political background of the measures as a legitimate reason for action, the *Tecmed* Tribunal only would have accepted to do so if, for example, the civil unrest consequent to the location of the landfill would have risen to the level of an emergency<sup>588</sup>. Taking into account that, in expressly relying on the ECtHR *James Case*, the Tribunal placed great emphasis on the ‘vulnerability’ of foreign investors to domestic legislation, because they are ‘not entitled to exercise political rights reserved to nationals’<sup>589</sup>, it is interesting how in this case the political background of the dispute assumed great relevance both as an excuse for granting rights (to investors) and a reason to establish duties (of the state’s agencies), effectively raising the bar for testing the legitimacy of the governmental measures<sup>590</sup>.

The Tribunal moved beyond the ‘least restrictive approach’ to an analysis that more explicitly engaged in proportionality *stricto sensu*<sup>591</sup>, that is, a balancing between the measure and the interest being protected (in our case, the expropriatory effect of the measure and its environmental protection goal). It is only in this case that an effective balancing takes place, in which, in other words, tribunals do not stop at assessing the legitimacy and necessity of the measures, but engage in a true constitutional exercise of balancing competing principles. The difference between least restrictive approach and proportionality *stricto sensu* is in

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<sup>588</sup> See its reference to the *ELSI Case*, which had been presented by the Respondent, as the standard, not met in the present case, justifying uncompensated expropriation.

<sup>589</sup> At § 122.

<sup>590</sup> The first step in performing a proportionality analysis; see Schill, 2010: 86.

<sup>591</sup> Alexy, R., ‘On the structure of legal principles’, 13 *Ratio Juris* (2000): 294 at 298.

the ‘reflexive’ nature of the second approach, where tribunals are tasked with assessing competing principles against each other balancing effect and purpose, so that the higher the detrimental effect, the more fundamental the principle to be defended. In contrast, the ‘least restrictive approach’ betrays a more insular nature, where, once recognised that there is a legitimate interest to be protected, there is an obligation for the state to adopt the measure least restrictive of the right being affected. While on the face of it, this approach is more deferential, the balancing is performed within the range of the available measures (hence the insularity)<sup>592</sup>.

The proportionality approach adopted by the *Tecmed* Tribunal is vitiated, in our opinion, by the initial high threshold imposed upon the state with regards to the legitimacy of the measures in light of the political background of the dispute. However, the Tribunal at least showed a willingness to engage with public and constitutional law concepts such as proportionality. The fact that it did so well beyond the limits imposed by the language of the treaty might be a reason for concern.

### 7.3 Balancing clauses

Clauses that allow non-investment obligations to be taken into account in order to assess if and to what extent the host state has breached its investment obligations are present in many treaties, especially post-NAFTA ones, as we have seen in Chapter 4. Much of the literature dedicated to the issue of environmental measures and investment protection compliance develops the ‘balancing’ argument in one form or another. There is however, precious little case law by investment

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<sup>592</sup> The suitability of the measures to the interest being defended is particularly problematic for environmental measures, where causality is not necessarily as clearly established as law requires.

tribunals in which balancing clauses have been explicitly referred to, both by states and by tribunals. This trend is not necessarily negative, as tribunals normally make reference to their obligation to balance different commitments that states have even when not expressly relying on a specific treaty clause, and equally states normally will appeal to their domestic regulatory role or international commitments in order to justify the alleged non-performance of an investment treaty obligation. Conversely, a tribunal might make specific reference to a clause such as Article 1114 of the NAFTA and yet fail to take into due account the environmental obligations of the state or perform a proper balancing exercise; even if it might not necessarily be unjustified in doing so, the following case can be seen as a failure of the tribunal to consider the facts in a balanced way, *even if* the award's main conclusions might not be faulted.

### 7.3.1 *The Metalclad Case*

Metalclad is a US corporation which brought the first NAFTA arbitration against Mexico. Metalclad had intended to open a hazardous waste disposal facility in the municipality of Guadalcázar, in the State of San Luis Potosí, by acquiring a locally incorporated company, COTERIN, through its own locally incorporated subsidiary, ECONSA<sup>593</sup>. In 1993, when Metalclad exercised its option to buy COTERIN, this company was in possession of the federal and (conditional) state permits for the facility. The municipal permit upon which the state permit was conditional was missing, but the company had been reassured that it was not necessary to obtain one, as it was up to the federal authorities to grant permits for hazardous waste disposal. There followed a long period for

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<sup>593</sup> Metalclad claimed that it had been invited to run the facility; see Wagner, J. M., 'International investment, expropriation and environmental protection', 29 *Golden Gate University Law Review* (1999): 465 at 488 footnote 91.

which conflicting accounts were given by the parties as to the conduct of the local authorities and to the necessity of this permit to be granted. Metalclad in its claim asserted that the federal authorities had advised it to obtain the municipal permit in order to ‘facilitate an amicable relationship’ with the municipality. In the end the city of Guadalcázar refused to grant the permit (and this formed the main issue of the dispute and informed the reasoning of the Tribunal to a great extent). The state governor at the end of his term in office, in September 1997, issued an Ecological Decree, which established a Natural Area for the protection of a local rare species of cactus, encompassing the site of the proposed landfill. At the time, Metalclad had already filed its Notice of Arbitration (January 1997); in its Notice, Metalclad claimed a violation of Article 1102 (National Treatment), 1103 (Most-Favoured-Nation), 1104 (Standard of Treatment) 1105 (International Minimum Standard), 1106 (Performance Requirements) and 1110 (Expropriation).

This case acquired a certain notoriety, as the first arbitration to be initiated under the NAFTA, the only successful claim for expropriation, and one with an environmental element. For all these reasons, the case initiated the debate (then fuelled by the trio of Canadian cases, *Ethyl, Pope & Talbot* and *S.D. Myers*) on the effect of Chapter Eleven on the regulatory powers of the NAFTA Parties, and more specifically for what concerns their power to implement environmental measures. We have chosen this case to be presented in the section dedicated to balancing clauses because of the reference the Tribunal made to Article 1114 (Environmental Measures) of the NAFTA. In its Counter-memorial, Mexico’s counsel had argued that Article 1105, namely the ‘fair and equitable’ clause, had to be interpreted in the context of other provisions of the NAFTA, namely Article 1114, the Preamble, and especially the NAAEC<sup>594</sup>. In doing so, it sought to justify its actions with reference not

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<sup>594</sup> *Metalclad Corp. v. United Mexican States*, Mexico’s Counter-memorial, 17 February 1998, § 838.

to conflicting international obligations<sup>595</sup>, but as a matter of treaty interpretation, precisely arguing that it is NAFTA *itself* to allow for environmental considerations to be taken into account in interpreting the state's obligations towards foreign investors.

The Tribunal, which placed great reliance, in its reasoning against Mexico, on the lack of transparency of the permit approval process, had this to say on the way Article 1114 should guide the interpretation of the substantive protections accorded by the NAFTA<sup>596</sup>:

The actions of the Municipality following its denial of the municipal construction permit, coupled with the procedural and substantive deficiencies of the denial, support the Tribunal's finding, for the reasons stated above, that the Municipality's insistence upon and denial of the construction permit in this instance was improper. This conclusion is not affected by NAFTA Article 1114, which permits a Party to ensure that investment activity is undertaken in a manner sensitive to environmental concerns. The conclusion of the *Convenio*<sup>597</sup> and the issuance of the federal permits show clearly that Mexico was satisfied that this project was consistent with, and sensitive to, its environmental concerns.

The Tribunal did not so much say that Article 1114 was not applicable, but that the actions of the federal government proved that it was possible to take environmental concerns into consideration *and* allow the investor to proceed with its project. The fact is that this dispute, and the resulting award, stood uneasily in the middle of a conflictual relationship between

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<sup>595</sup> It was the Claimant to appeal to Mexico's international environmental obligations in order to construct its argument in support of its presence in Mexico, see Investor's Reply, 21 August 1998, Section 3 (Respondent is a party to the Basel Convention), § 21, and Section 4 (Respondent's putative system and its Basel Convention obligations), § 407 (more specifically on the possibility of municipalities to veto hazardous waste remediation in their territory and how this would conflict with Mexico's obligations under the Convention).

<sup>596</sup> Award, §§ 97-98. (Paragraph numbers omitted).

<sup>597</sup> An agreement that had been reached by Metalclad and Mexican federal environmental agency, which was challenged in court by the municipality with an action of *amparo*; the action was eventually dismissed by the Mexican court.



the Mexican municipal authorities, exposed to the usual *nimbyism* associated with controversial hazardous waste disposal projects<sup>598</sup> and the pressure of local and international environmental organisations<sup>599</sup>, and the federal authorities, eager to attract foreign investment and under the pressure exerted by the US officials supporting the project<sup>600</sup>.

It is equally clear that the Tribunal accepted almost wholesale the reconstruction of the events and the legal analysis provided by Metalclad, including on Mexican constitutional law and how it applied to the actions of the municipality. This is not the place to dissect the legal reasoning of the Tribunal in detail<sup>601</sup>; rather, to consider how little the environmental background, which supposedly informed the actions of the investor<sup>602</sup> and of the municipality, was left by the wayside. Two statements of the Tribunal reveal how little it took the environmental obligations of Mexico into account, regardless of the way in which it reaffirmed the applicability of Article 1114. At §§ 70-75, the Tribunal listed the objectives of NAFTA as ‘transparency and the increase of investment opportunities’, ‘a predictable commercial framework’, and the prompt publications of law and regulations<sup>603</sup>, but failed to make any reference to the objective stated in the Preamble, ‘[to] strengthen the development

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<sup>598</sup> Something a US company should have been very familiar with.

<sup>599</sup> The local Greenpeace started criminal proceedings against the Mexican government as a consequence of its approval of the Metalclad landfill operation.

<sup>600</sup> The US ambassador to Mexico threatened to put San Luis Potosi in a ‘black list’ for US investors, and several US congress representatives were involved at different stages of the dispute by Metalclad.

<sup>601</sup> But to take one small fact: Metalclad stated that, and it was reported in the contract, that when it acquired COTERIN it assumed also its liabilities. These must have included the environmental damage of which the company had been responsible in the past; however, at no time did Metalclad seem to undertake remediation action in order to mitigate the damage, even if this had been requested at different stages and by different parties; Metalclad went as far as to state that it had no obligation to do so.

<sup>602</sup> As its reference to the obligations of the Basel Convention proves.

<sup>603</sup> The objectives are taken from Article 102(1)(c), the Preamble and Article 1802(1).

and enforcement of environmental laws and regulations’. Equally, in the section of the award dedicated to the claim of indirect expropriation, the Tribunal stated:

The Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree. Indeed, a finding of expropriation on the basis of the Ecological Decree is not essential to the Tribunal’s finding of a violation of NAFTA Article 1110. However, the Tribunal considers that the implementation of the Ecological Decree would, in and of itself, constitute an act tantamount to expropriation.

A similarly worded statement was given by the *Santa Elena* Tribunal in a case involving the *direct* expropriation of a parcel of real estate in Costa Rica<sup>604</sup>. This has often been misquoted in reference to indirect expropriation, to the effect that the environmental intent of the state does not matter<sup>605</sup>. As in that case the property was expropriated by decree, it was not a case of expropriatory environmental measures, as much as an expropriation motivated by environmental policy, and therefore the *Santa Elena* Tribunal correctly noted that an expropriation carries with it the

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<sup>604</sup> *Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica* (ICSID Case No. ARB/96/1), Award, 17 February 2000. The similarity is not coincidental, as Professor Elihu Lauterpacht was a member of both panels, as a President in the *Metalclad* Tribunal; the *Santa Elena* Award was rendered on 17 February 2000, the *Metalclad* one on 2 September 2000.

<sup>605</sup> The *Santa Elena* Tribunal said this with respect to the expropriation (at §§ 71-2): ‘While an expropriation or taking for environmental reasons may be classified as a taking for a public purpose, and thus may be legitimate, the fact that the Property was taken for this reason does not affect either the nature or the measure of the compensation to be paid for the taking. That is, the purpose of protecting the environment for which the Property was taken does not alter the legal character of the taking for which adequate compensation must be paid. The international source of the obligation to protect the environment makes no difference. Expropriatory environmental measures—no matter how laudable and beneficial to society as a whole—are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state’s obligation to pay compensation remains.’ [paragraph numbers omitted]

obligation to pay compensation, regardless of the policy that motivated the state to take the property. In the *Metalclad* case, the Tribunal was instead confronted with measures that did not directly take the property; to equate them to a direct expropriation constitutes the most direct, and to date the only, application of the sole effect doctrine<sup>606</sup>. This is what the Tribunal said<sup>607</sup>:

[...] expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.

It is the reference to *incidental interference* that created most anxiety, shared by Judge Tysoe in his judicial review of the award<sup>608</sup>; the impression was that this interpretation could cast a very wide net over *bona fide* regulation. While the language adopted by the Tribunal might be particularly infelicitous, it is submitted that this statement does no more than confirm the 'sole effect' doctrine with regards to expropriation, coupled with the understanding that it is substantial deprivation ('in whole or significant part') to be the controlling standard in defining what constitutes compensable expropriation.

The award was appealed by Mexico in the Supreme Court of British Columbia. In his Judgment and Reasons for Decision,<sup>609</sup> the Canadian Judge set aside the section of the award that granted compensation to

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<sup>606</sup> This reiteration is to be considered an *obiter dictum*, as the Tribunal found the regulatory expropriation to have taken place before the Ecological Decree was issued.

<sup>607</sup> Award, § 103.

<sup>608</sup> For which see *infra*. For an analysis of the case and particularly for the review of the case by the British Columbia Court, see Prujiner, A., 'L'expropriation, l'ALENA et l'affaire Metalclad', 5 *International Law FORUM du droit international* (2003): 205.

<sup>609</sup> *The United Mexican States v. Metalclad Corporation*, In the Supreme Court of British Columbia, 2 May 2001 (2001 BCSC 664).

Metalclad for the violation of Article 1105, as he considered that the Tribunal's incorporation of the obligation of transparency into the standard was beyond its jurisdictional powers and that its analysis 'of Article 1105 infected its analysis of Article 1110'<sup>610</sup>. In other words, its finding of a violation of Article 1105, in itself based on the purposed lack of transparency, incorrectly constituted the basis for the finding of conduct constituting indirect expropriation and a measure tantamount to expropriation (without clarification if these are equivalent or concurrent).

The *Metalclad* award is significant for the history of the NAFTA. In retrospect, the anxieties that were raised by some sectors of the media and the environmental community might have been exaggerated. The dispute shed some light on the situation of the hazardous waste disposal

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<sup>610</sup> At § 68: 'On my reading of the Award, the Tribunal did not simply interpret Article 1105 to include a minimum standard of transparency. No authority was cited or evidence introduced to establish that transparency has become part of customary international law. In the *Myers* award, one of the arbitrators wrote a separate opinion and surmised an argument that the principle of transparency and regulatory fairness was intended to have been incorporated into Article 1105. The arbitrator crafted the argument by assuming that the words "international law" in Article 1105 were not intended to have their routine meaning and should be interpreted in an expansive manner to include norms that have not yet technically passed into customary international law. However, the arbitrator did not decide the point because it had not been fully argued in the arbitration and he was not aware of the argument having been made in any earlier case law or academic literature. In my view, such an argument should fail because there is no proper basis to give the term "international law" in Article 1105 a meaning other than its usual and ordinary meaning.' The Judge also rejected the interpretation of the standard given by the *Pope & Talbot* Tribunal, and accepted by the *S.D. Myers* Tribunal, again on the grounds that it added elements to the standard of treatment which are extraneous to the customary law standard, taken from treaty agreements, in contravention to the intention of the State parties.

regulatory system in Mexico, and as a consequence, new legislation was introduced to regulate the sector more effectively<sup>611</sup>.

#### 7.4 Carve-out and clarification clauses

These clauses are a recent innovation in investment treaty law and in themselves, regardless of the use made by them by states in the context of an arbitration or tribunals in their awards, testify to a shift in the focus of investment law towards a more frank recognition of the context in which investors operate, and a move away from the ‘absolute protection’ approach of older treaties. However, their presence in investment treaties is not sufficient to guarantee a more balanced approach, if their effectiveness is not tested. It is often remarked that bilateral investment treaties function as ‘signalling devices’<sup>612</sup>, to signal that the ratifying country is investment-friendly. To that extent, even treaties signed between developing countries, which are highly unlikely to invest in each other’s territory, can fulfil this function. It is submitted that these clauses might be said to have a similar function within the treaty, to signal the state’s commitment to a certain level of environmental protection, not necessarily to be tested by arbitration tribunal (and not to be raised as a defence by the state). Furthermore, given the tendency of investors to ‘usurp’ the role of their home state in claiming the observance of the treaty obligations on an international plane, and the substitutive role of the system of investment protection – which can be contrasted with the supplementary or subsidiary role of human rights protection – the tendency can develop, and arguably it has, for investors to dictate the

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<sup>611</sup> See Gaines, S., ‘Environmental policy implications of investor-state arbitration under NAFTA Chapter 11’, at [http://www.cec.org/Storage/58/5068\\_Final-Gaines-T-E-Symposium05-Paper\\_en.pdf](http://www.cec.org/Storage/58/5068_Final-Gaines-T-E-Symposium05-Paper_en.pdf), at 14.

<sup>612</sup> As we have remarked elsewhere; the literature on the rationale for BITs signing is vast and has been summed up in the previous chapters. We are not aware of similar

development of investment law's substantive content (hence the self-centred debates on the content of the fair and equitable treatment standard). The insertion of carve-out and clarification clauses in the treaties can then be interpreted as a way to shift the balance, not necessarily from investment to non-investment obligations, but certainly from investors to states.

In the following case, the Tribunal gave a measured and balanced view of how contrasting obligations shape the way investment jurisprudence should develop and set up some helpful markers.

#### *7.4.1 Expropriation - The Chemtura Case*

The Chemtura Corporation (formerly Crompton Corporation) is a US corporation, producer of lindane, a pesticide used on canola (rapeseed) crops. Because of its toxicity level, lindane's use has been restricted in many countries, including the United States, where lindane-based products cannot be used to treat canola crops. In 1998 the US Environmental Protection Agency (EPA) announced that import of lindane-treated canola was going to be allowed in the US only until 1 June 1998<sup>613</sup>. In Canada, the use, import and export of lindane was

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comments being made on the presence of 'balancing', 'carve-out' and exception clauses in investment treaties.

<sup>613</sup> This followed a communication about the export from Canada of lindane-treated canola seed, in contravention of the applicable legislation; the information was given to the EPA by a fully owned subsidiary of Chemtura, Gustafson, producer in the US of a lindane-replacement product, Gaucho. Chemtura requested that, in order to comply with the voluntary de-registration of lindane, the PMRA approve the use of Gaucho products. Chemtura's strategy of getting a foothold in the market of lindane-replacement products ahead of its Canadian competitors can easily be evinced by these facts and finds confirmation in confidential correspondence disclosed by the Claimant and cited by the tribunal in its award, at § 177: 'Gentlemen, please find attached a copy of a letter provided to PMRA regarding voluntary withdrawal of lindane. This letter is not to be

regulated through registration by the Pest Management Regulatory Agency (PMRA) in compliance with the Pest Control Products Act and Regulations.

Following the EPA's decision, the Canadian canola industry, worried about trade restrictions, requested a voluntary removal of canola from the list of lindane-treated products. Chemtura agreed, subject to conditions (including granting of registration to replacement products and a common removal policy for all producers of lindane). As a consequence of disagreements on the conditions, Chemtura withdrew its offer. In 1999, the PMRA announced the beginning of a review of the use of lindane, which eventually resulted, in 2001, in the suspension or termination of all lindane registrations. Chemtura disputed the fairness of the review process and began a series of applications for judicial review of the Agency's decision. A Board of Review was established, which submitted some recommendations to the PMRA, following which the Agency started a re-evaluation process; its conclusions were disputed by Chemtura. At the same time, the EPA in the United States was conducting a final review of lindane-treated products, which resulted in the cancellation in 2006 of the registration of all pesticides containing lindane.

On 10 February 2005, Chemtura submitted a Notice of Arbitration under the UNCITRAL Arbitration Rules in which it alleged that Canada had breached Article 1105 (Minimum Standard of Treatment), Article 1103 (Most-Favoured-Nation) and Article 1110 (Expropriation) of the NAFTA. Chemtura requested remedies were restitution, by means of the reinstatement of registration of Lindane products, damages, and costs.

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shared with the industry. We have requested several regulatory concessions [sic] and do not wish to share this with our competitors. The position we are talking [sic] publicly is "We have agreed to the voluntary withdrawal of lindane by January 31, 1999, at the request of the canola growers". Upon input from growers and the industry we have requested expeditious registrations of our new Gaucho formulations'.

The Tribunal conducted a straightforward analysis of the facts in order to ascertain if there had been an Article 1110 violation<sup>614</sup>. When disposing of Chemtura's claim of an Article 1105 breach, in which the corporation had argued that the PMRA initiated its review of lindane because the issue constituted a 'trade irritant', rather than for any environmental concern, the Tribunal had already rejected the claimant's implied allegation of bad faith, also by reference of Canada's international environmental obligations<sup>615</sup>. This also informed the analysis of the measures for the purpose of the Article 1110 claim. The Tribunal referred to the three-stepped approach generally adopted by NAFTA tribunals in Article 1110 claims, which required it to ascertain, in order, if there was an investment, if there had been an expropriation of this investment, and finally, if the criteria of Article 1110 had been met. On the first point, the Tribunal accepted an extensive reading of the definition of investment, to include elements such as goodwill, customer and market share (covered investments for the purpose of Article 1139 of the NAFTA<sup>616</sup>). Having

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<sup>614</sup> Which is the focus in this section; the Tribunal also dealt with the Article 1105 claim in an interesting way: while confirming that the analysis of the facts has to be the guiding principle, it made reference to the 'margin of appreciation' that regulatory agencies inevitably will have in managing 'specialized domains involving scientific and public policy determinations' (at § 123); however, it also added that such margin cannot act as a legal doctrine 'circumscribing' the assessment of the facts. Additionally, it emphasised that, in order to ascertain if Canada had breached its due process obligations (which formed part of Chemtura's Article 1105 claim), the Tribunal had to consider the review process (conducted by the PMRA) 'as a whole' (at § 145), adding that: 'the mechanisms of review of regulated products ... are set out in a complex array of laws and regulations, the purpose of which is precisely that any decisions taken by the authorities in this context are subject to procedural checks and balances'.

<sup>615</sup> Specifically, the ratification by Canada of the 1998 Aarhus Protocol on Persistent Organic Pollutants to the Convention on Long Range Transboundary Air Pollution of 1979.

<sup>616</sup> But, importantly, only as 'accessories' of an enterprise; the Tribunal did not clarify if it considered these elements to be investments *per se* (as it claimed that this argument had not been raised by Chemtura); consequently, it did not enter the 'conceptual severance' debate (but we have already noted in Section 3.3.1 that the Tribunal seemed



cleared the first requirement, the Tribunal moved on to consider if this investment had been expropriated. We have already noted in Chapter 3 that, on the facts, the Tribunal did not consider that there had been a ‘substantial deprivation’ of the investment, which is one of the most universally recognised criteria for an indirect expropriation. Having answered the second question negatively, the Tribunal did not need to consider if the criteria of Article 1110 had been met. However, the Tribunal went on to say the following<sup>617</sup>:

Irrespective of the existence of a contractual deprivation, the Tribunal considers in any event that the measures challenged by the Claimant constituted a valid exercise of the Respondent’s police powers. As discussed in detail in connection with Article 1105 of NAFTA, the PMRA took measures within its mandate, in a non-discriminatory manner, motivated by an increasing awareness of the dangers presented by lindane for human health and the environment. A measure adopted under such circumstances is a valid exercise of the State’s police powers and, as a result, does not constitute an expropriation.

By adding this *dictum*, the Tribunal clarified that the claim could have been resolved (had the deprivation been substantial) by application of the police powers exception, which would have relieved Canada of its obligation to pay compensation. In this very measured and balanced award, the Tribunal seemed to want to ‘calm the waters’ and allay the fears and misconceptions that have been dominating the debate on the influence of the NAFTA on the power of states to regulate in the public interest and especially in environmentally sensitive areas of public

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to take position in the related denominator question). The same approach had been taken already by the *Methanex* Tribunal, which had similarly argued that these items do not represent ‘stand alone’ property rights capable of being expropriated, see Final Award, Part IV – Chapter D, § 17. *Contra*, see for example *Sea-Land Services Inc. v. Iran*, 6 Iran-USCTR, Rep. 149, 163 (1984): ‘The Court is unable to see in his original position – which was characterised by the possession of customers and the possibility of making a profit – anything in the nature of a genuine vested right’.

<sup>617</sup> At § 266.

intervention<sup>618</sup>. In effect, this *dictum* seems the straightforward application of Annex B of the 2004 US Model BIT, which was the outcome of those very same debates and anxieties generated by the first ten years of NAFTA jurisprudence. It is still to be seen if in this, as in the developments on the transparency of investment arbitration, NAFTA will set the tone for the coming years. On the other hand, for those who worry about the constitutionalisation of investment protections and the role of the state in the post-regulatory world, some sections of the award might raise further alarm. In response to the allegation by Chemtura that it had acted because lindane constituted a trade irritant and not because it had any real concern about the environment, the PMRA claimed (and the Tribunal readily accepted) that the Withdrawal Agreement (of lindane registration) was ‘industry-led’ and that the PMRA had only intervened as a ‘facilitator’<sup>619</sup>. We have briefly referred, in Chapter 2, to the role of the state in a post-regulatory environment, where political choice is replaced by economic rationale underpinned by a compliant legal system, and this frank admission by the PMRA, that it acted not because Canada was about 30 years late in taking regulatory measures to restrict the use of this highly toxic pesticide, but because the canola industry feared trade restrictions, is clear proof of this state of affairs.

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<sup>618</sup> It ought to be stressed that some of these fears are unjustified on the facts; so far only one claim for expropriation under Chapter Eleven has been successful, *Metalclad*.

Additionally the United States, where the critical voices have been particularly vocal, has yet to lose a NAFTA arbitration: the latest successfully defended claim is *Grand River Enterprises, Six Nations Ltd. et al., v. United States of America*, NAFTA, notice of the 12 January 2011 award at <http://www.state.gov/r/pa/prs/ps/2011/01/154691.htm>.

<sup>619</sup> At § 167. Of course the Tribunal could not help but notice that Chemtura was part of the industry and consequently, the ‘ambiguity’ of its position with respect to the nature of the PMRA’s course of action. As for the economic rationale, suffice to remember that the Vice-President of the Canola Council of Canada is quoted as saying that lindane used in Canada is worth maybe \$20 million, but the canola industry is worth \$1.8 billion, \$600 million of which are in trade with the United States.

#### 7.4.2 Standards of treatment - The Parkerings Case

This case arose out of a contract for the construction of a parking lot in the city of Vilnius in Lithuania<sup>620</sup>. Parkerings-Compagniet AS, a Norwegian company, participated in a tender, through its wholly owned Lithuanian subsidiary, Baltijos Parkingas UAB (BP) (and together with another company, Egapris UAB), for the construction of a parking lot in the centre of Vilnius. The contract included the management of the on-street parking system<sup>621</sup>. The consortium formed by Egapris and BP won the tender and was granted an exclusive, 13-year right to operate on-street parking. Following changes in the regulatory system, the consortium lost the right to collect parking fees and was restricted in its ability to collect clamping fees<sup>622</sup>. Additionally, the National Monument Protection Commission objected to the plan for the construction of the multi-story-parking submitted by the consortium on environmental and cultural protection grounds, as did the local Environmental Protection Department and the State Monument Protection Commission. The city had granted approval for the construction at the disputed site but,

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<sup>620</sup> *Parkerings-Compagniet AS v. Republic of Lithuania* (ICSID Case No. ARB/05/8), Award, 11 September, 2007.

<sup>621</sup> The legality of the collection of part of the fee by the company (with the reminder to be corresponded to the municipality) was disputed, with conflicting advice from the legal counsels of the parties (see §§ 78 ff. of the award) and with the national government's representative challenging the legality of the municipality's decision to grant the consortium the right to collect the fees for the on-street parking. The petition was accepted by the Vilnius Administrative Court, but not on the grounds of the City of Vilnius acting *ultra vires* in granting the right to collect the fee, but because the hybrid parking fee (partly to be paid to the municipality, partly to the company) was inconsistent with current laws and regulations (§§ 124-125). The Supreme Administrative Court, to which the decision was appealed, repealed and sent the case to the Vilnius First County Court.

<sup>622</sup> And subsequently, also the power of municipalities to conclude contracts with private contractors.

following the opposition, it repealed its approval and stopped the project, allowing the construction only on one of the proposed sites.

After protracted and increasingly fruitless negotiations, hampered by the changing regulatory framework in which both the municipality and the consortium were acting, the city of Vilnius decided to cancel the agreement on 27 January 2004, citing material breach by the consortium and seeking recovery: the Vilnius Regional Court did not grant and the decision was confirmed on appeal on 20 October 2005.

On 11 March 2005, Parkerings filed a Request for Arbitration with the ICSID Secretariat, for breach of Article III (FET standard<sup>623</sup>), IV (MFN treatment standard) and VI (expropriation) of the Norway-Lithuania BIT, seeking damages in the amount of NOK 176.4 million, plus interest and costs.

We have chosen this case for the way in which the Tribunal interpreted the standard of treatment obligations of the Respondent in light of other international obligations. Parkerings had argued discrimination with respect to another company, Pinus Proprius. The Tribunal deferred the discussion on the claim of discrimination to the MFN breach claim<sup>624</sup>. Both parking lots (the one proposed by Parkerings – and rejected –and

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<sup>623</sup> Which is defined as ‘equitable and reasonable’ in the applicable treaty; Parkerings argued this standard was higher than the usual FET standard but its argument was not accepted by the Tribunal.

<sup>624</sup> The Claimant had included it in its claim of FET violation; however, the Tribunal argued that ‘discriminatory conduct is in violation of the standard of fair and equitable treatment’ (at § 287), citing *CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/08), Award, 12 May, 2005, § 290, and therefore that, ‘in order to determine if there is discrimination.... one has to make a comparison with another investor in similar position (*in like circumstances*) (at § 288); the import of the ‘in like circumstances’ criterion in the ‘absolute’ FET standard seems completely unwarranted. In any case, the Tribunal, as we said, deferred this analysis to the MFN claim, considering it ‘unnecessary’ to perform it also in the context of the FETclaim.

the one accepted by the municipality and proposed by its competitor Pinus Proprius) were to be located in the Old Town of Vilnius, which is a protected area designated by the UNESCO. However, the project proposed by Parkerings was much more intrusive; as we have already mentioned in the case summary, several cultural agencies had expressed their disapproval of the BP project. In particular, the State Monument Protection Commission stated<sup>625</sup>:

In case construction [*sic*] of underground garages in the old city of Vilnius embarked now, it can be stated that Lithuania failed to perform obligation undertaken upon signing in November 1999 of the Convention for the Protection of the Architectural heritage of Europe and the European Convention on the Protection of the Archaeological heritage. All legal acts concerning regulation of territorial planning, land relationship, heritage protection, environment protection and construction would be infringed [...].

The Tribunal did take these circumstances into account, when it concluded:

... the fact that BP's MSCP project in Gedimino [the area of the Old Town chosen for the parking lot by Parkerings] extended significantly more into the Old Town as defined by the UNESCO, is decisive. Indeed, the record shows that the opposition raised against the BP projected MSCP [multi-story car parking] were important and contributed to the Municipality decision to refuse such a controversial project. The historical and archaeological preservation and environmental protection could be and in this case were a justification for the refusal of the project. The potential negative impact of the BP project in the Old Town was increased by its considerable size and its proximity with the culturally sensitive area of the Cathedral. Consequently, BP's MSCP in Gedimino was *not similar* [emphasis added] with the MSCP constructed by Pinus Proprius.

The Tribunal did not consider the issue of the potential breach of the other international obligations (so normative conflicts are not central here), even if the Respondent had used them as a defence, by presenting the evidence of the State Commission to that effect. Rather, the non-investment obligations constituted a background criterion for the

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<sup>625</sup> Cited at § 388 of the Award.

application of the MFN, specifically, environmental (widely intended) obligations were sufficient to render the investment ‘unlike’ another investment and to this extent, they constituted a defence for non-compliance with the MFN obligation. This is potentially a way for conflicts to be solved in favour of non-investment obligations, at least as far as the MFN clause is concerned. It could still be found that the measures constitute a form of compensable indirect expropriation, but there would be no discrimination element<sup>626</sup>. In this way, environmental obligations can be considered a legitimate element to allow differential treatment that would otherwise be considered in breach of the MFN or national standard of treatment<sup>627</sup>.

## 7.5 General conflict rules

The rules available in international law for the resolution of normative conflicts have been discussed in Section 5.4. These include the general rule of interpretation and systemic integration, and more technical rules for conflict resolution. These rules have been developed in international

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<sup>626</sup> A similar approach, with regard to the assessment of the international minimum standard (which however, does not include the ‘in like circumstances’ clause) was taken by the *Chemtura* Tribunal, at § 123 of its Award: ‘In assessing whether the treatment afforded to the Claimant’s investment was in accordance with the international minimum standard, the Tribunal must take into account all the circumstances, including the fact that certain agencies manage highly specialized domains involving scientific and public policy determinations.’

<sup>627</sup> See also the OECD International Investment and Multinational Enterprises: National Treatment of Foreign Controlled Enterprises, Paris, OECD, 1985, at 17: ‘As regards the expression “in like situations”, the Committee, first of all, agreed that comparison between foreign-controlled enterprises is valid only if the comparison is made between firms operating within the same sector. The Committee also agreed that more general considerations, such as the policy objectives of Member countries in various fields, could be taken into account in order to define the circumstances in which comparison between foreign-controlled and domestic enterprises is permissible inasmuch as those objectives are not contrary to the principle of National Treatment’.

law to deal with conflicts that arise in the course of inter-state disputes (where state A claims that its obligation X towards state C conflicts with its obligation Y towards state B, the alleged non-performance of which gave rise to the dispute). While it can be generally accepted that one of the functions of law is to allow the balancing of conflicting interests (as expressed in rules), investment law presents peculiar problems in accomplishing this balancing, related to its hybrid nature. The fact that one of the parties is not a state constitutes a problem when it comes to define standing and what rights and duties attach to the non-state actor; conversely, because one of the parties is a state, there are jurisdictional problems connected with the power of review of governmental measures by a tribunal selected by the parties according to the commercial arbitration model. Additionally, we have already seen how states seem reluctant to employ the clauses that are available in the applicable investment treaties when defending against a claim by the investor, and the argument has been advanced that this has partially to do with the normative weakness of these clauses<sup>628</sup>.

In any case, states do often refer to their conflicting international obligations, and we will examine some cases when they have done so. In this case, it is incumbent upon the tribunal to apply the general conflict rules in order to decide the dispute. As we have previously remarked, a certain investment bias, borne out of the commercial arbitration framework adopted by investment tribunals, spills into the way in which tribunals conduct their interpretative work<sup>629</sup>. The following case constitutes an example of the recourse to the defence of conflicting

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<sup>628</sup> Arguments that we have presented and discussed in Chapter 4.

<sup>629</sup> Wälde talked about a 'struggle for the soul of investment arbitration between international commercial arbitration and (public) international law bars': Wälde, T., 'Interpreting investment treaties: experiences and examples', Binder *et al.*, 2009: 724 at 725.

obligations<sup>630</sup> by the defendant state (Canada) where environmental measures were taken

### *7.5.1 The S.D. Myers Case*

S. D. Myers Inc. (SDMI) is an American company based in Ohio and involved in remediation of polychlorinated biphenyl (PCB)<sup>631</sup> from oil and related equipment. In the 1990s, as its market share in the US diminished, SDMI decided to expand its activities in the Canadian market, by importing PCB waste from Canada for treatment in its US facilities. The NAFTA claim was initiated because of a temporary ban on the export of the PCB issued by the Canadian government in 1995. SDMI had lobbied both in the US and Canada to lift import restrictions on PBA and had obtained an 'enforcement discretion' from the US Environmental Protection Agency (EPA) which would have allowed it to export the PCB from Canada. The EPA had acted without consulting with the Canadian authorities, which responded with the export ban. SDMI claimed the real reason for the ban was the desire of the Canadian government to protect the domestic PCB-disposal industry. The border was opened again for export of PCB into the US in February 1997, and then closed permanently in July of the same year, following a decision of the US Ninth Circuit Court of Appeal overturning the EPA enforcement discretion order.

On 21 July 1998, SDMI served a Notice of Intent to submit a claim; in it, SDMI claimed that Canada had violated Article 1102 – National

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<sup>630</sup> Canada was prevented from using the conflict clause available in the NAFTA, Article 104, as not applicable to the invoked instrument.

<sup>631</sup> PCB, a highly toxic product, had been banned in Canada since 1977 and in the US since 1980; the ban included the import and the transportation across borders.



This is one of the first NAFTA cases and one in which the tribunal had to deal with a defence based on conflicting environmental obligations<sup>632</sup>. The law applicable to the dispute included the United States and Canada 1986 Transboundary Agreement, which contained the following passage<sup>633</sup>:

Recognizing that the close trading relationship and the long common border between the United States and Canada engender opportunities for a generator of hazardous waste to benefit from using the nearest appropriate disposal facility, which may involve the transboundary shipment of hazardous waste<sup>634</sup>.

Additionally, in 1989 Canada had ratified the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes ('the Convention'); however the United States was not bound by it, having signed it but not ratified, so the exception clause contained in Article 104 NAFTA (which mentions the Basel Convention) was not applicable, as this is triggered into function when all three NAFTA parties have ratified the Convention<sup>635</sup>. The Convention prohibits the export and import of

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<sup>632</sup> For commentaries on the case, see De Pencier, J., 'Investment, environment and dispute settlement: arbitration under NAFTA Chapter Eleven, 23 *Hastings International & Comparative Law Review* (1999-2000): 409; Hodges, B. T., 'Where the grass is always greener: foreign investors' actions against environmental regulations under NAFTA's Chapter 11, *S.D. Myers Inc. v. Canada*', XIV *Georgetown International Environmental Law Review* (2001): 367; Schneiderman, 2008: 86 ff..

<sup>633</sup> Quoted at § 103 of the Partial Award.

<sup>634</sup> Canada argued that this agreement did not cover PCB because PCB was not classified as 'hazardous waste' in the US (the US position, related by SDMI, was that the classification is not required by the Transboundary Agreement).

<sup>635</sup> In fact, Canada did not construct its defence on Article 104.

hazardous wastes from and to states that are not party to it – Article 4(5)<sup>636</sup>.

At a domestic level there was the US legislation prohibiting the trans-border transportation of PCB<sup>637</sup>, against which the EPA had granted its ‘enforcement discretion’<sup>638</sup>, and the 1995 Canadian Interim Order banning the export of PCB, confirmed later in the year by a Final Order. The EPA order was subject to judicial review proceedings, with the US Ninth Circuit Court of Appeals overturning the EPA enforcement discretion for being *ultra vires*, following a petition by the environmental NGO Sierra Club, in which SDMI participated as an intervener<sup>639</sup>. At the time SDMI served its Notice of Intent, it could not, as a matter of US law, have imported PCB in the United States for treatment<sup>640</sup>.

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<sup>636</sup> See § 106 of the Partial Award. Article 11 of the Basel convention allows for shipment of hazardous waste to non parties if there are bilateral, multilateral or regional agreements not less stringent than the Basel convention (such as the Transboundary Agreement).

<sup>637</sup> Chiefly, for the purposes of this case, the US 1976 Toxic Substances Control Act, U.S.C. §§ 2601-2692, which contains a categorical ban on the production and import of PCB, with very limited exceptions, and which was overridden, without authority, as established by judicial review, see *infra*, by the EPA through its enforcement discretion. In Canada, the government had added PCBs in 1977 to the list of toxic substances in the Environmental Contaminants Act (now superseded by the Canadian Environmental Protection Act or CEPA), supplemented by the PCB Waste Export Regulations 1990.

<sup>638</sup> The US EPA would not enforce the US regulation banning import of PCBs against SD Meyers, provided the company met the detailed conditions that were attached to the US EPA’s Oct 26 1995 letter (see § 119 of the Partial Award).

<sup>639</sup> *Sierra Club v. EPA*, 118 F.3d 1324, 1327 (9<sup>th</sup> Cir. 1997).

<sup>640</sup> In its Memorial on the Merits of 20 July 1999, at 15, SDMI claimed that ‘the Court’s decision did not affect the ability of the EPA to grant individual enforcement discretions to companies such as S.D. Myers, Inc.’. This is technically true, but the Ninth Circuit Court made it clear that the EPA only had the power to grant exemptions to the import ban of no more than one year, and given the ruling of the Court, it seemed clear that this would not be renewable (At section III: Thus the absolute ban on manufacturing PCBs includes an absolute ban on their import, and EPA may not promulgate a rule governing the disposal of PCBs that would violate this categorical ban. There is, however, a lone

Canada argued that its obligations under the Basel Convention relieved it of its duties towards SDMI to the extent that they existed at all (Canada raised a jurisdictional objection to the effect that SDMI was not an investor and that there was no covered investment, and that its Interim Order affected trade and not investment, so that Chapter 3 of the NAFTA was applicable, and, in case of conflict between Chapter Eleven and another Chapter of the NAFTA, the other chapter prevailed to the extent of the inconsistency).

It is unfortunate that the Tribunal did not proceed by examining the applicable law and determining if there was a potential conflict between international and/or domestic obligations, what the nature of the conflict was and if it was possible to interpret the different treaty clauses in such a way as to avoid a conflict or if a breach of one or more of these obligations was to be found<sup>641</sup>. Instead, the Tribunal started its reasoning on the facts with the following statement<sup>642</sup>:

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exception to TSCA's broad ban on the manufacture and import of PCBs. TSCA § 6(e)(3)(B)(i) provides that the EPA Administrator may grant an exemption if the Administrator determines that "an unreasonable risk of injury to health or environment would not result. Such exemption may not last for more than one year." EPA, therefore, may not promulgate-as it did here-a rule to dispose of PCBs which allows parties to "continue importing [PCBs] indefinitely without interruption."

<sup>641</sup> As noted by Wälde, in Binder *et al.*, 2009, at 730, 'Interpretation of legal texts is often in judicial determination not the *ex-ante* way to reach a particular outcome, but rather a *post-hoc* rationalization of an outcome chosen for reasons of perceived equity, ideological and political preference, for bargaining and consensus dynamics within a tribunal ... or even because of the need of the arbitrators.... to develop and maintain a well-balanced profile.'

<sup>642</sup> At § 162. Another case involving Canada in which the investor argued protectionist intent (and with an environmental angle) is *Ethyl Corporation v. Government of Canada*. In this case, from 1998, the company, producer and importer of the fuel additive MMT complained that the ban implemented by Canada had the goal of protecting the domestic industry. The measure had been subject to judicial review domestically as well, and the government had lost; Canada settled the claim with Ethyl

The evidence establishes that CANADA's policy was shaped to a very great extent by the desire and intent to protect and promote the market share of enterprises that would carry out the destruction of PCBs in Canada and that were owned by Canadian nationals. Other factors were considered, particularly at the bureaucratic level, but the protectionist intent of the lead minister in this matter was reflected in decision-making at every stage that led to the ban.

The determination that Canada acted because of protectionist intent (in the words of the minister, that PCB waste should be disposed of 'in Canada by Canadians'<sup>643</sup>) 'coloured' the entire award, so that the finding of a breach came as no surprise<sup>644</sup>. Effectively, the Tribunal treated intent as a preliminary issue, before it even considered to what extent other, non-investment obligations, were applicable. The Tribunal established that, whatever the extent of these obligations, Canada was in breach of its investment obligations because there was also a protectionist element to its actions. What interests us here is how the Tribunal analysed Canada's actions with respect to its environmental obligations, beside the fact that NAFTA would be breached because of the protectionist motive behind the actual ban to export. Would it have been possible for Canada to

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for \$13 million, and repealed the ban. (*Ethyl Corporation v. Government of Canada*, UNCITRAL, Award on Jurisdiction, 24 June 1998).

<sup>643</sup> Quoted at § 169.

<sup>644</sup> The wisdom of such an approach is beyond our analysis here. Suffice to say that faced by a similar claim from Chemtura the Tribunal took a different position (or maybe Canadian ministers learned to keep certain thoughts to themselves), and that the US Supreme Court has rejected in the past the protectionist intent argument, stating for example that: 'Few governmental actions are immune from the charge that they are "not in the public interest" or in some sense "corrupt." . . . The fact is that virtually all regulation benefits some segments of the society and harms others; . . . determination of "the public interest" in the manifold areas of government regulation entails not merely economic and mathematical analysis but value judgment, and it was not meant to shift that judgment from elected officials to judges and juries.' (*City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 377 (1991)). Of course in the Supreme Court case, it is the deference to the legislature to dictate this outcome: investment arbitration is not fettered by certain considerations, arguably to the detriment of public interest concerns.

comply with its environmental obligations without harming the interest of the investor? And, would it had been possible for Canada to reconcile these three competing interests, that is, the American investor's, the domestic PCB disposal industry's, and the environment?

The Tribunal considered all the different sets of obligations (the Basel Convention, the Transboundary Agreement, the NAFTA, and the NAEEC) and came to this conclusion<sup>645</sup>:

... 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*. [Italics added] This corollary also is consistent with the language and the case law arising out of the WTO family of agreements.

Quite clearly the Tribunal considered the measures taken by Canada not in absolute against the conflicting investment obligations, but relative to all the measures that *could have been taken* by Canada and would have been 'less inconsistent' with Canada's obligations under the NAFTA<sup>646</sup>. In other words, the tribunal tested the proportionality of the measures not against the goal to be attained, but amongst themselves (where only the least restrictive one of trade and investment would do) in a procedural rather than substantive way, that is, without balancing the conflicting interests or rights. While this approach is justifiable under the NAFTA, it does raise the question of how the dispute was presented in the first place. If it was an unreasonable restriction on trade, Chapter Eleven arbitration should not have been available. If it was an investment dispute, was it possible for the investor to argue national treatment, for

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<sup>645</sup> At § 221.

<sup>646</sup> See also the Separate Concurring Opinion to the Partial Award, at § 27: 'On the standard by which environmental measures are to be judged, unnecessary ... means ... that the government could have accomplished the same environmental objective by an alternative measure that was reasonably available and that would have infringed less on those free trade norms.' Specifically, the Tribunal suggested, as a legitimate measure, that Canada could have '[granted] subsidies to the Canadian industry' (at § 255 of the Partial Award).

example, as the ban was general and included Canadian as well as American investors in the PCB remediation industry? What exactly was expropriated? These questions go beyond the issue of conflict, which was solved by the Tribunal with reference to ‘systemic integration’ WTO-style, that is, with the ‘least restrictive of trade’ approach).

## 7.6 Procedural means of incorporation

We have remarked on a certain reluctance of defendant states to avail themselves of the kind of clauses included in investment treaties to account for non-investment obligations. These obligations are sometimes raised as defences, but rarely, as we have seen, is the defence constructed directly on these clauses.

The introduction of procedural means of incorporation of non-investment obligations in the dispute environment, or at the very least of public interest issues and concerns, is consistent with the adversarial nature of investment proceedings. On the other hand, two observations ought to be made: firstly, and differently from the entry points we have considered so far, by allowing procedural incorporation of non-investment obligations, the tribunal, and in the last instance the parties, allow some form of third party participation in what had always been strictly a two-party confidential and private legal relationship. We have described this form of participation as weak, and to the extent that there is no obligation on the tribunal to take the *amici* submissions into account in its award, it might promise more than it delivers, or might even be seen as a way to placate certain sectors of the public with an ineffectual participation that is not picked up by a system of dispute resolution ill-equipped, legally as well as politically<sup>647</sup>, to do so<sup>648</sup>. Secondly, and coherently with the first

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<sup>647</sup> And might say structurally, see following footnote.

observation, the very necessity of third party intervention might be read as a structural failure of the dispute system, a failure which the intervention of third parties can hardly be expected to remedy, because of the problems outlined above. In other words, the fact itself that certain arguments will not be raised by the defendant state, who is entitled and indeed duty-bound to do so, points in a deeper way to the democratic deficit intrinsic to investment arbitration<sup>649</sup>. Equally, the coincidence of interests between interveners and claimants in normal administrative or judicial review proceedings can be contrasted with the clash of interests in investment arbitration, where, as in the case outlined below, a Canadian environmental NGO intervened effectively against a Canadian investor<sup>650</sup>, in order to further an environmental argument ultimately carried by the United States as the defendant state. Additionally, the umbrella term ‘third parties’ conceals a considerable diversity of interests and demands. An undiversified approach to submissions risks underestimating the legitimate interests raised by the *amici*.

We will now examine the first NAFTA case in which the Tribunal allowed the participation of environmental NGOs to the proceedings, via submissions of *amici curiae* briefs.

### 7.6.1 The Methanex Case

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<sup>648</sup> The value of an utterance is in its reception. Luhmann’s insight that communication constitutes the atom of social organisation is the starting point, but meaningful communication within a system (such as, in this case, the court room widely intended) is a communication that can be heard and that will be heard. (Luhmann: 1995).

<sup>649</sup> Simma, B., and Kill, T., ‘Harmonizing investment protection and international human rights: first steps towards a methodology’, Binder, C. *et al.*, *International Investment Law for the 21<sup>st</sup> Century*, Oxford, OUP, 2009.

<sup>650</sup> Of course officially as a non-disputing party and as a ‘friend of the court’.

The Methanex Corporation is a Canadian corporation producing and selling methanol, a component of the petrol additive MTBE. Methanex claimed to be the largest supplier in California of MTBE. The dispute arose out of a series of measures taken by the government of California which resulted in the ban on the sale and use of MTBE as an oxygenating additive<sup>651</sup>. The measures included the California Senate Bill 521 of 9 October 1997, which directed a University of California study on the effects on the environment of MTBE, to be followed by public hearings. The Bill established a duty of certification by the governor, who had to declare if MTBE posed or not a 'significant risk to the environment'. All the other impugned measures depended upon this Bill, yet Methanex withdrew this Bill from the list of measures alleged to be in breach of the NAFTA<sup>652</sup>. Following the findings of the study and the public hearings, the governor declared (by Executive Order of 25 March 1999) that MTBE did pose a significant risk to health and the environment, mainly because of leakage from underground storage tanks into drinking water supplies. This certification, made pursuant to Section 3(e)(2) of the California Bill, obliged him to take further action, which took the form of the California Phase III Reformulated Gasoline Regulations and the Amended California Regulations of May 2003. The total effect of these regulations was to ban the use of MTBE as an oxygenating additive in gasoline sold in the state of California.

On 3 December 1999, Methanex presented a first statement of claim, alleging violation by the United States of Article 1105(1) and Article 1110(1) of Chapter Eleven, and sought damages of US\$ 970 million, plus interest and costs. This was rejected by the Tribunal<sup>653</sup>, which

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<sup>651</sup> These additives are used to reduce carbon monoxide and other by-products of incomplete combustion that are dangerous to the environment and to public health.

<sup>652</sup> Second Amended Claim, Part III.

<sup>653</sup> The procedural history of this case is complex and disputed; it is not within the scope of this chapter to review it; all the relevant documentation is available at [http://www.naftaclaims.com/disputes\\_us\\_methanex.htm](http://www.naftaclaims.com/disputes_us_methanex.htm).



nonetheless allowed a second amended claim, submitted by Methanex in November 2002. In it, Methanex also alleged a violation of Article 1102. The main thrust of Methanex's argument was that, in banning MTBE, California had acted out of a protectionist intent, in order to support the largely US-based ethanol industry (ethanol being another oxygenating additive and, according to Methanex, a 'like product' to methanol), and had been swayed by donations made by ADM, the biggest US producer of ethanol (Methanex never did argue corruption as such<sup>654</sup>).

This case is important in many respects. In this section we will consider its influence in establishing a trend towards greater transparency (it was the first Tribunal to allow open hearings) and participation by non-disputing parties (by submission of *amici curiae* briefs made by several environmental NGOs). Before considering these elements, it is worth making a few observations on another two important aspects of the Award, namely its treatment of the claim of standards of treatment violations (specifically national treatment and international minimum standard) and of the claim of regulatory expropriation.

As for the first element, Methanex had submitted that the Tribunal should consider GATT jurisprudence in order to determine 'likeness' for the purposes of applying Article 1102<sup>655</sup> and specifically, the idea that the

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<sup>654</sup> As summarised by the Tribunal, Methanex argued that, by 'connecting the dots', that is, by considering the totality of the evidence provided, the ulterior motive of the defendant, the protection of the US ethanol industry, and the way in which this was accomplished (by undue influence, mostly through monetary donations to the relevant officials) would emerge (Final Award, Part III – Chapter B). The Tribunal did not reject in principle this strategy, but questioned the significance of some of these 'dots' and the relevance of their connection, in the end not finding in support of the claimant.

<sup>655</sup> Methanex had also claimed that, by implementing its ban, California had violated several provisions of the GATT, but this argument was rejected by the Tribunal, for lack of jurisdiction.

basic test for likeness is competition<sup>656</sup>. The Tribunal, in response, agreed that '[it] may derive guidance from the way in which a similar phrase in the GATT has been interpreted in the past'<sup>657</sup>. On the facts, however, the Tribunal did not find that, even by application of the test of likeness adopted in WTO case law, the ethanol and methanol industry would be 'in like circumstances' and that, where identical comparators exist (in this case, US methanol producers), it would be wrong to use 'less like' comparators (US ethanol producers). Importantly, for the purposes of this Section, the Tribunal approvingly quoted a remark made by one of the NGOs which had submitted a brief, the IISD, to the effect that it is incorrect to assume that, 'trade law approaches can simply be transferred to investment law'<sup>658</sup>.

On the second element, the Tribunal distanced itself somewhat from the approach taken by the *Metalclad* Tribunal, which had favoured a strict application of the sole effect doctrine. Instead, in rejecting the claim by Methanex, the Tribunal appealed to the 'effect and purpose' approach, defining indirect expropriation in the following terms<sup>659</sup>:

In the Tribunal's view, Methanex is correct that an intentionally discriminatory regulation against a foreign investor fulfils a key requirement for establishing expropriation. But as a matter of general international law, 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

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<sup>656</sup> Final Award, Part IV – Chapter B. Methanex relied specifically on *European Communities–Measures Affecting Asbestos and Asbestos-Containing Products* (Eur. Comm. v. Can.), WT/DS135/AB/R, (2001) 40 *ILM* 1408. For a critical appraisal of the use the Tribunal made of the GATT jurisprudence (as too restrictive), see Kurtz, J., in Schill, 2010: 243, at 258 ff.

<sup>657</sup> Final Award, 9 August 2005, §6.

<sup>658</sup> Final Award, Part IV – Chapter B, § 27.

<sup>659</sup> Final Award, Part IV, Chapter D, § 7. It is worth noting that a violation of the same article of NAFTA Chapter 11 is claimed in both cases.

contemplating investment that the government would refrain from such regulation<sup>660</sup>.

This case is one to have allowed for environmental instances to be introduced via the intervention of non-disputing parties. We have already remarked that, to the extent that what the interveners contribute to the proceedings is effectively disregarded, their significance is nullified. So the question to be asked is, what difference does the participation of third parties make to the outcome? There are indicators that help assess the effects of this participation, such as the response of the parties to the issues raised by the *amici*, or the way in which their submissions are acknowledged by the Tribunal and if they influence in any way the outcome of the dispute and if so, in what way.

As we have already seen in Chapter 6, the *Methanex* Tribunal accepted the submission of *amici* briefs through interpretation of Article 15(1) of the UNCITRAL Arbitration Rules<sup>661</sup>, against the stated wishes of the claimant. This first decision was superseded by the second amended statement of claim by Methanex, following which the petitioners (IISD, Communities for a Better Environment, Bluewater Network, and the Center for International Environmental Law) submitted a Joint Motion to the Tribunal<sup>662</sup>, requesting that the Tribunal establish the modality of

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<sup>660</sup> This section of the award has attracted criticism with regards to its reference to stabilisation clauses: see Mann, H., *The Final Decision in Methanex v. United States: Some New Wine in Some New Bottles*, August 2005, at <http://www.iisd.org>. See also Weiler, T., 'Methanex Corp. v. USA: Turning the page on NAFTA Chapter Eleven?', 6 *JWI&T* (2005): 903, at 918: '...compensable takings could only be found in cases of detrimental reliance on governmental promise?'. In its *amicus* submission, the IISD had argued that the distinction was between a categorical inclusion and a categorical exclusion of governmental measures within the purview of the takings clause: '... whether normal, non-discriminatory and bona fide regulations get defined as expropriations subject to compensation except in exceptional circumstances, or whether regulations are not expropriations and therefore not subject to compensation unless a complainant can show they are not bona fide. It is ... a binary choice for the Tribunal.'

<sup>661</sup> Decision on Authority to Accept Amicus Submissions, 15 January 2001.

<sup>662</sup> On 31 January 2003.

their participation. The petitioners reiterated their request that hearings be open (which had been previously refused) on the grounds that another NAFTA tribunal had, in the intervening time, allowed open hearings<sup>663</sup>. This request provoked a statement by the Free Trade Commission on non-disputing parties' participation on 7 October 2004, which set out the procedures for their participation and was used by the Tribunal as the blueprint for the rules regarding the written submissions. But, beyond such procedural matters, important as they are, stand the substantive issue of the effect of the submissions on the proceedings. The impression cannot be dispelled that the tribunal in *Methanex* could not, or maybe was not willing to, depart from conferring procedural rights to the *amici* without engaging with their submission at a substantive level<sup>664</sup>.

Since the *Methanex* Award, the submission of *amicus curiae* briefs has (almost) become commonplace in investment arbitration, and the time might have come to look back and consider what effect, if any, they have had in the decision-making process of investment tribunals. We take as an example on the one hand the statement made by the *Glamis* Tribunal<sup>665</sup>:

[...] inasmuch as the State Parties to the NAFTA have agreed to allow *amicus* filings in certain circumstances, it is the Tribunal's view that it should address those filings explicitly in its Award to the degree that they bear on decisions that must be taken. [...] Given the Tribunal's holdings, however, the Tribunal does not reach the particular issues addressed by these submissions.

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<sup>663</sup> *United Parcel Service of America, Inc. v. Government of Canada*

NAFTA/UNCITRAL Arbitration Rules Proceeding, ICSID Press Release, <http://www.worldbank.org/icsid/ups.htm>

<sup>664</sup> See also Levine, E., 'Amicus curiae in international investment arbitration: the implication of an increase in third-party participation', 29 *Berkeley Journal of International Law* (2011): 101 at 114.

<sup>665</sup> *Glamis Gold Ltd v United States of America*, Award, June 8 2009, § 8.

On the other, the *Foresti* Tribunal's decision to allow disclosure of the parties' filings to the non-disputing parties<sup>666</sup>, despite the objections of one of the parties; additionally, the Tribunal established that both the parties and the interveners provide feedback, following the arbitration, on the procedure adopted by the Tribunal. However, since the proceedings were discontinued, these innovative steps were actually never implemented<sup>667</sup>.

The risk, it is submitted, is that no substantive value is attributed to the contribution made by non-disputing third parties and that they are used as a way to demonstrate the alleged openness of the dispute to public interest concerns only in a very superficial way. The well-known argument that something needs not only be done, but 'be seen to be done' loses much of its value when the appearance (in this case the procedural opening) is not accompanied by the facts (the *bona fide* consideration of the issues raised by the third parties). Consider the statement made by the *Methanex* Tribunal<sup>668</sup>:

... there is an undoubtedly public interest in this arbitration. The substantive issues extend far beyond those raised by the usual transnational arbitration between commercial parties. This is not merely because one of the Disputing Parties is a State: there are of course disputes involving States which are of no greater general public interest than a dispute between private persons. The public interest in this arbitration arises from its subject-matter, as powerfully suggested in the Petitions. There is also a broader argument, as suggested by the Respondents and Canada: the ... arbitral process could benefit from being perceived as more open or transparent; or conversely be harmed if seen as unduly secretive. In this regard, the Tribunal's willingness to receive amicus submissions might support the process in general and this

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<sup>666</sup> See <http://www.iisd.org/itn/2009/10/10/an-icsid-tribunal-introduces-innovative-steps-into-non-disputing-party-procedure/>.

<sup>667</sup> *Piero Foresti, Laura de Carli and others v. Republic of South Africa* (ICSID Case No. ARB(AF)/07/1), Award, 4 August 2010. The Tribunal delivered a decision on the discontinuance and costs.

<sup>668</sup> Decision on Petitions from Third Persons to Intervene as *Amici Curiae*, 15 January 2001, § 49.

arbitration in particular, whereas a blanket refusal could do positive harm.

The ‘perception’ of openness and transparency can or not be matched by substantial willingness to accept, if legitimate and relevant, the arguments advanced by the *amici* submissions<sup>669</sup>.

## 7.7 Concluding remarks

The case law reviewed in this chapter was illustrative of the different approaches taken by tribunals faced with conflicting environmental obligations. Two situations can arise from these potential conflicts, which impact the investor differently and result in distinct claims. The host state’s environmental measures may have an expropriatory impact on the investment; if the investor claims they do, and the host state does not provide compensation, a claim will be raised for a breach of the expropriation clause in the applicable treaty. In that case, the environmental obligations of the state might be used as a defence for non-performance. If the environmental measures do not have an expropriatory impact on the investment, but there is a claim for a breach of one of the standards of treatment, the host state can request that the tribunal use the environmental measure as a qualifier for the ‘in like circumstances’ clause (arguing that the likeness requirement is not

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<sup>669</sup> The *Biwater* Tribunal explicitly stated that: [it] has found the Amici’s observations useful. Their submissions have informed the analysis of claims set out below, and where relevant, specific points arising from the Amici’s submissions are returned to in that context.’ (Award, § 392). However, the Tribunal did not return to any of the points made by the *Amici* in the remainder of its Award, except in footnote 208, with an oblique reference to a point made by them in support of the Government’s action, point that is defeated in the main body of the text. It could be argued that the arguments raised did inform the conclusions reached by the Tribunal, specifically its decision not to award damages even if it found Tanzania to be in breach of its treaty obligations; however the Tribunal did not acknowledge this and framed its decision strictly within the framework provided by the treaty and the arguments advanced by the parties.

satisfied because of the different regulatory framework the comparator investor is subject to). In most cases, as we have seen, it is not an ‘either/or’ situation, as most investors claim that both clauses have been violated (expropriation and standard of treatment). In all cases, tribunals can adopt different approaches in order to deal with the claims raised by the investors and the defences adduced by the state. It is rare, especially in the post-NAFTA environment, for tribunals to adopt the inflexible stance of the *Santa Elena* and *Metalclad* tribunals with respect of the environmental objections raised by the state. While the cases differ on the merits, the first one involving a direct expropriation and the second one an indirect one, the tribunals similarly excluded in principle the influence of non-investment obligations both on the *quantum* of compensation (for direct expropriations) and on the obligation to provide compensation for measures having the effect of an expropriation.

The balancing, or proportionality, approach is now the way in which most tribunals, implicitly or explicitly, deal with this sort of claims. The examined case law shows that tribunals usually show considerable deference to states’ power to regulate for the protection of the environment<sup>670</sup>, and that the presence of an international source for the obligation can support the presumption that the measure is a legitimate exercise of regulatory powers<sup>671</sup>. There is however a question of principle, which has showed recurrently in the course of this work, which

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<sup>670</sup> See *S.D. Myers*, Partial Award, § 263; *Glamis*, Award, § 767.

<sup>671</sup> The *Methanex* Tribunal explicitly connected the highly regulated environmental sector in California with the legitimate expectations of the investor (Part IV – Chapter D, § 9: ‘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. Indeed, the very market for MTBE in the United States was the result of precisely this regulatory process.’).

can be summarised as a question of competencies. Opening investment arbitrations to non-investment obligations inevitably means giving arbitrators the power to, at the very least, interpret these obligations (and ‘interpretation is power’<sup>672</sup>). In this sense, deference and proportionality, which are often considered together (the first one the manifestation in outcome of the second as the approach taken), while constituting a solution for the problem of normative conflict or substantive isolationism, might create their own set of problems.

Approach and results are two sides of the same analysis: at issue is what tribunals effectively accomplish when confronted with disputes in which the claim of violation of a treaty standard is based on the encroachment on the reserved domain of the regulatory powers of the state. The emerging picture is, as we have said at the beginning, mixed. In the following chapter, we will draw some conclusions based on the analysis conducted so far.

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<sup>672</sup> Klabbers, J., ‘Reluctant grundnormen: Articles 31(3)(c) and 42 of the Vienna Convention on the Law of Treaties and the fragmentation of international law, in Craven, M., Fitzmaurice, M. and Vogiatzi, M. (eds.), *Time, History and International Law*, Leiden, Brill, 2007: 141.





## Chapter 8: Conclusions

### 8.1 Introduction

My research on this project started in the winter of 2007. Since then, many things have changed in the world of investment law. It was not long ago that one had to search hard for publications in the field that contained a comprehensive review of the law in the area and attempted to ground it firmly in international law theory and practice. Equally, one could count on awards being published regularly, but not as frequently as has been the case in the past years. There had been a longer trend of negotiation of investment instruments, and an increased willingness to litigate on the part of investors, underpinned by an increase in the amount and spread of foreign investment flows. Then all these trends accelerated and fed off each other, increasing the numbers of instruments, awards, disputes, to an unprecedented and unexpected level. It was a very exciting time to enter the field and embark into a project of this kind.

Recent years have also seen the exponential increase of environmental legal instruments (in their turn underpinned by the raised level of environmental damage from industrial and services development, and the increased public awareness of the environmental risks at a local, national and indeed global level); therefore it was inevitable that, as investment law also grew in scope and content, it would encroach into other areas of international and domestic law: the collision and conflict of these two areas of production of legal norms at the international level was to be expected, yet it seemed to catch the investment community almost by surprise. What has become increasingly clear is that the days of investment arbitrations being cloaked in secrecy are gone forever, if indeed they ever existed under those extreme conditions. Equally gone are the chances for investment law to develop its substantive content in splendid isolation. On the contrary, at the centre of attention of this work,

and of the investment community at large, there have been normative clashes, fragmentation, conflict resolution and a whole cluster of inter-related issues which require legal, political and economic intervention.

It was the *Aguas del Tunari* Tribunal's definition of bilateral investment treaties as 'portals' which influenced the direction and the scope of this project<sup>673</sup>. At the conclusion of this work, we have to acknowledge that the questions we posed in that context – if investment treaties allow for environmental options to be considered, and who guards the doors, if such they are – cannot be answered very easily. A very mixed picture emerges from the analysis of the jurisprudence of the tribunals. This outcome is to a certain extent structurally inevitable: the decentralised nature of investment law, both at the level of legal production (bilateral international investment agreements) and application (*ad hoc* tribunals, non-applicability of *stare decisis*, limited appeal avenues) constitutes an obstacle to consistency and coherence. Actually, it is the relatively *high* level of normative convergence, not dissonance, to be surprising. If this is to be imputed more to political consensus (for example, as to the level of protection to be granted to investor), rather than faithful application of the relevant instrument, is an open question. Certainly tribunals show a considerable deference to previous awards, even when, as is most often the case, those other panels were interpreting a different instrument than the one applicable to the dispute.

## 8.2 Changes in the system

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<sup>673</sup> Not least because of the linguistic and semantic implications of the use of this term, which has come to be identified exclusively with the language of technology, in the year 2000, at the beginning of the internet mass revolution: the inference is that this might be a case in which we see a slippage between the old meaning (door) and the new (an internet site giving access to other sites).

Investment law has undergone significant changes in the last ten years, some of which have been investigated in the course of this work. To summarise, there are quantitative, procedural and substantive changes. The quantitative changes include the exponential increase of investment arbitrations (new instruments' negotiations and ratifications, on the other hand, have slowed down, but the trend is still upward); procedural changes have moved in the direction of increased openness and third parties participation, and have also included the simplification of the conduct of the proceedings, e.g. by allowing for summary dismissal of claims patently without merit (amended Rule 41(6) of the ICSID Convention); finally, changes have been happening at the level of substantive obligations. These have not necessarily gone in the direction of an extension of the scope of protection of the treaty language. In fact, we have seen that states have intervened to limit and hedge the reach of investment protections, especially in the context of the NAFTA and model treaties originating from North America (United States and Canada). Additionally, new kind of clauses has been added, both to introduce exceptions to the substantive obligations guaranteed by the treaty and to allow for the balancing of conflicting obligations.

These changes are reflected in the increased level of debate. The debates are taking place in different *fora*, expressing a variety of opinions and concerns. For ease of analysis, we can consider them as originating from three discrete sources: the states, the investment community (which includes both practitioners and academics) and the public at large. The debates taking place in the states' community, at the level of policy-making and legislative activity (by way of treaty production and ratification) can be characterised as being 'reactive' in nature; in other words, states' policy, with the accompanying debates, is dictated to a certain extent by the developments in investment jurisprudence and their reaction to it. This reaction can be conceptualised both as *sign-posting* and as *claw-back*. What we mean is that some states are, by way of clarifications of existing treaties and production of new, revised, model

treaties, attempting to circumscribe and clarify the extent and the content of the investment obligations. This attempt is directly connected to the accompanying exercise of clawing back some of the protections granted to investors and the power conferred to tribunals to interpret the treaties *in favorem* investor. These developments are connected to the perception that the jurisprudence arising from tribunals expresses an excessive interference with the regulatory powers of states and their freedom to act in the public interest without incurring in claims of violations of international legal obligations<sup>674</sup>.

Equally reactive are the debates taking place in the public at large. To a certain extent, this reactivity is to be distinguished from the approach displayed by states, insofar as it is partially the consequence of an inevitable information deficit. Even taking into account the recent procedural changes, the investment world is still distinguishable for its insularity. The law is not well known outside the compact, and guarded, investment community, and the multiplication of instruments works against any attempt of rationalisation and classification, which would simplify and democratise knowledge. Additionally, there is a considerable level of polarisation around the terms of the debate, especially, again, in cases involving the NAFTA, dependent on the influence of the environmental community in those countries.

Finally, the debates in the investment community are the most heterogeneous. The practitioners and the academics divide themselves on substantive issues and the need to situate investment law in the context of international law or maintain it firmly within the framework of

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<sup>674</sup> As Schill noted, (Schill (ed.), 2010: 88), a good faith interpretation of the treaty will have to take into account that states cannot be presumed to have agreed to instruments that would delimit their decisional powers to such a great extent (and it should be added, in areas not covered by the treaty: in other words, it seems fanciful to presume that states would willingly reduce their power to regulate for the protection of the environment in a treaty on investment protection).

commercial arbitration. However, both groups share a similar theoretical concern and anxiety about the need to develop a sounder and more grounded theoretical basis for investment law. This is more likely to take the form of debates on the substance of certain aspects of the law (in the practitioners community), and of ‘contextual’ debates on the need to situate investment law within the general international law regime (in the academic community), with the germane issues of fragmentation, normative dissonance, balancing of obligations, etc., which we have considered in detail in the previous chapters. All in all, the impression is given of a ‘discipline in search of an identity’.

All these debates share a considerable level of interconnectedness: this manifests itself both in the fact that the topics are shared, at least to an extent, and that these communities are not isolated from each other. The communication between them happens both at the level of the issues we have outlined (for example, academics critiquing the states and the practitioners legislative and legal production, or the practitioners, and the investors, availing themselves of the investment instruments) and through the fact that all these communities share a common interest in the jurisprudence originating from investment arbitral panels. The role of these tribunals in the debate, which they shape and influence to a considerable extent, has been investigated thoroughly in the course of this work.

### 8.3 The role of tribunals

One of the most significant developments in investment law has been in the role of arbitration panels. From acting merely as panels entrusted with the resolution of disputes modelled on international commercial arbitration, they have been reconceptualised, by a certain sector of the

academic community, as international judicial review panels<sup>675</sup>. Certainly the jurisprudence originating from arbitration tribunals<sup>676</sup> has undergone a significant progression both in terms of quantity and of quality. From the concise, terse awards of the even recent past, which focussed very much on the facts of the case and limited the legal reasoning to a minimum, tribunals have come to give considerable attention to the law, more explicitly situating disputes in their jurisprudential and doctrinal context, trying to develop an informal rule of precedent and applying, explicitly or implicitly, the proportionality analysis normally associated with public law contexts, both domestically and internationally.

Part of the debates that we have summarised in the previous section has focussed on the role of the tribunals. Again, different actors have reacted differently. One can recognise the (mostly) positive reaction of the community of practitioners, unsurprisingly so, given that, through investment tribunals, the community itself undergoes a process of ‘identity-making’. This ‘reflexive turn’ within the investment world is in itself part of the process of identity-making, accomplished through reflection on the theoretical basis of the discipline. Within the academic world, where the diversity of opinions cannot be easily subsumed under a general consensus on the investment law regime, the reflexive turn has taken a more explicitly political flavour. This is exemplified by the ‘Public Statement on the International Investment Regime’ issued in 2010 by a collection of critical investment and public international law

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<sup>675</sup> See for example, in a critical spirit, Loughlin, M. and van Harten, G., ‘Investment treaty arbitration as a species of global administrative law’, 17 *EJIL* (2006): 121.

<sup>676</sup> Tribunals are creatures of a particular dispute at a particular point in time, *ad hoc* bodies each delivering their own awards and not tied by any rule of precedent, and nonetheless displaying a considerable amount of deference and developing an overall consistent case law across different instruments with different language, parties, and scope of application.

scholars<sup>677</sup>. Conversely, states can be seen mostly as ‘reluctant participants’: traditionally, host states were passive participants in the production of treaty rules, normally adopting without significant modification the model provided by the developed states parties to the bilateral agreements. On the other hand, developed states were very much in control of the production of the rules: the modification of the role of tribunals has brought into focus for states the potential for discretion and decisional/creative power that arbitration panels might have *vis-à-vis* states in the arbitration context. However reluctantly, most states have kept pace with the thickening web of bilateral obligations, ratifying international investment agreements and acceding the ICSID Convention, at the same time reaffirming their sovereign power to steer the development of the law in this area. Investors are still to a considerable measure passive participants in the process. Their submissions do not contribute directly to the development of the law in this area (while state submissions do, as well as any statement made in connection with the disputes or the negotiation and ratification of the treaties, and of course, the content of the treaties itself). In common with the public at large, they share an information-deficit, albeit on different grounds (because of their status as outsiders in the host state). And, to the extent that investment panels are given the power to balance competing

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<sup>677</sup> Clearly evident in § 5 of the Statement: ‘Awards issued by international arbitrators against states have in numerous cases incorporated overly expansive interpretations of language in investment treaties. These interpretations have prioritized the protection of the property and economic interests of transnational corporations over the right to regulate of states and the right to self-determination of peoples. This is especially evident in the approach adopted by many arbitration tribunals to investment treaty concepts of corporate nationality, expropriation, most-favoured-nation treatment, non-discrimination, and fair and equitable treatment, all of which have been given unduly pro-investor interpretations at the expense of states, their governments, and those on whose behalf they act. This has constituted a major reorientation of the balance between investor protection and public regulation in international law.’ See [http://www.osgoode.yorku.ca/public\\_statement/documents/Public%20Statement.pdf](http://www.osgoode.yorku.ca/public_statement/documents/Public%20Statement.pdf).



commitments, investors stand potentially to see the level of protection guaranteed by the treaties diminished, or at the very least tempered by the conflicting obligations undertaken by states in other fields, such as environmental protection, and taken into account by the tribunals. Finally, the public at large, and especially those sectors that take an active interest in environmental issues, including communities of experts, activists, NGOs, etc., have maintained a high level of critical anxiety. This anxiety is a reaction to the way investment law either isolates itself from its normative environment or encroaches upon the regulatory powers of states and reclassifies public interests measures as regulatory risk and compensable actions, open to challenge within the framework of investment arbitrations, still seen as biased, undemocratic *fora*, whose faults greatly outweigh the advantages.

#### 8.4 Greening investment law: what now?

At the end of this work, we are left with no easy answers. Several conclusions can be drawn however, from the analysis of the activities of tribunal and the legislative production of states. The proliferation of instruments, awards, and also academic research and critical analysis, highlights the fact that we are not here witnessing a legal deficit, but, if anything, a legal overgrowth. What is lacking, arguably, is a systematic approach, interestingly both within and out-with the investment regime. In other words, both within the investment community, and outside of it, there is a general complaint about the vagueness and ambiguity of the law, the lack of consistency, the conflict and clash of provisions and obligations. It is a very modern phenomenon, in a way, a certain ‘democratisation’ of the law, which runs counter to the discourse of constitutionalisation and entrenchment lamented by the critical voices. This state of flux, this ‘liquidity’ of the law, upon which we have already remarked, should not be underestimated. It is within this state that solutions to the normative dissonance between investment and

environment have to be found, unless one argues (and we haven't) for a more hierarchical structure to be put in place (either *ex novo*, by creation of an international investment court, or by addition of a further layer of appeal above the tribunals).

We have opened this work with a reference to 'entry points' for environmental legal obligations in the investment regime: the greening of investment law was to be accomplished precisely in this way. Arguably, in addition to the substantive and procedural entry points examined in the course of this work, each investment tribunal constitutes an entry point in itself. The *modus operandi* of investment tribunals can be contrasted, in order to explain its specificity, to the way in which the International Court of Justice functions as an agent of development of public international law. The ICJ is a highly centralised institution, which 'funnels' international law jurisprudence; in contrast, investment law sets forth through a multiplicity of tribunals. The very existence of these decentralised *loci* of production of case law and precedent (the lack of *stare decisis* notwithstanding, investment law constitutes a case among many of co-evolution or diffusion<sup>678</sup>) testifies to an alternative model of development of the law along multiple lines which tend to converge and coalesce around certain basic principles, such as the principle of good faith, or abstract clusters of substantive rules, such as the fair and equitable standard. The inherently 'democratic' nature of this mode of legal production can lend itself to openness to the outside, where the outside is, in the context of this work, the environmental legal regime and the state as the source of norms, the defendant in arbitration, and the enforcer of the awards.

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<sup>678</sup> We take these concepts and interpretative frameworks from the field of anthropology; see especially McCormick Adams, R., *Evolution of Urban Society: Early Mesopotamia and Pre-Hispanic Mexico*, Piscataway, Aldine Transaction, 2005 (1<sup>st</sup> ed. 1966); Redman, C.L., *The Rise of Civilization – From Early Farmers to Urban Society in the Ancient Near East*, San Francisco, W.H. Freeman and Co., 1976.

There is only so much greening that can be accomplished through this ‘osmotic’ process of diffusion and accretion of rules, and tribunals are, one should not forget, both entry points and guardians of the doors. We made a policy point to stress that the possibility to green investment law can be said to exist already in the law ‘as is’, and that this was not a project of legal reform. Equally, we have stressed before the inherently political character of certain issues. At the end of this work, we return to politics to conclude that, while the investment law regime can be said to be open to its environment to a certain extent, decisions have to be taken at the political level, and at the level of norm production (internationally, through ratification of investment instruments that expressly contain environmental exceptions with ‘normative bite’) in order for investment law to be greened from within.

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