



Reconciling International Investment Law and Sustainable Development with Respect to Host State's Right to Regulate

The Legal Impact of Sustainable Development Objective on Indirect Expropriation Standard and its Legitimate Expectations Sub-element

Ilze Dubava

Thesis submitted for assessment with a view to obtaining the degree of Doctor of Laws of the European University Institute

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European University Institute

Department of Law

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ABSTRACT

It is acknowledged that sustainable development, which is generally understood as the achievement of an equal balance between economic development, social progress and environmental protection, is a new paradigm of international investment protection law which requires finding a balance between the State's regulatory responsibilities and a foreign investor's interests. This new paradigm is to be taken into account when planning domestic investment policies and drafting future investment agreements. However, this study aims to prove that the sustainable development paradigm, and its consequent extension of protected interests in investment law, is already applicable in the currently existing investment protection regime and in the application of the indirect expropriation standard requiring a reconsideration of the methodologies used for the establishment of indirect expropriation.

An investor's protection against indirect expropriation is a basic component of international investment law, and often investors challenge as expropriatory general legislative acts, administrative measures and compliance measures with non-economic international obligations of host States dealing with the protection of non-economic public interests. Investment agreements do not contain a precise definition of indirect expropriation leaving considerable discretion in the hands of adjudicators for deciding what measures do amount to indirect takings in specific cases.

Consequently, arbitrators have developed distinct methodologies for the assessment of the existence of indirect expropriation. These methodologies differ regarding their responsiveness to legitimate public welfare objectives that have motivated a State's interference in a foreign investment raising concerns about the capacity left for host States to exercise their regulatory responsibilities.

Therefore, the thesis is designed to prove that sustainable development has reached a capacity to guide the contextual and effective interpretation of the indirect expropriation standard. It is claimed that sustainable development forms part of the object and purpose of the investment protection regime within which the indirect expropriation standard must be applied. Consequently, it requires altering perceptions of applicable law and the methodologies used for the establishment of indirect expropriation requiring focus on wider interests than the ones of foreign investors.

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Abbreviations

AB – Appellate Body
BIT – Bilateral Investment Treaty
CARIFORUM EPA – Caribbean Forum of African Caribbean and Pacific States-
European Community Economic Partnership Agreement
DSB – Dispute Settlement Body
ECHR – European Convention on Human Rights
ECJ – European Court of Justice
ECT – Energy Charter Treaty or Treaty Establishing European Communities
ECtHR – European Court of Human Rights
EIA – Environment Impact Assessment
EPA – Economic Partnership Agreement
EU – European Union
FDI – Foreign Direct Investment
FET – Fair and Equitable Treatment
First Protocol – European Convention of the Human Rights Protocol 1
FPS – Full Protection and Security
GAL – Global Administrative Law
GATS – General Agreement on Trade in Services
GATT – General Agreement on Tariffs and Trade
ICJ – International Court of Justice
ICSID Convention – the Convention on the Settlement of Investment Disputes
between States and Nationals of Other States
ICSID – International Centre for Settlement of Investment Disputes
IIA – International Investment Agreement
IIL – International Investment Law
ITA – Investment Treaty Arbitration
IUSCT – Iran-United States Claims Tribunal
MAI – Multilateral Agreement on Investment
MFN – Most Favoured Nations Treatment
MS – Member State
NAFTA – North American Free Trade Agreement
NGO – Non-governmental Organization

NIEO – New International Economic Order

NT – National Treatment

NY– New York

OECD – Organization for Economic Cooperation and Development

PCIJ – Permanent Court of International Justice

SD – Sustainable Development

TEU – Treaty on European Union

TFEU – Treaty on the Functioning of the European Union

UNCTAD – United Nations Conference on Trade and Development

VCLT– Vienna Convention on Law of Treaties, 1969

WIR – World Investment Report

WTO – World Trade Organization

INTRODUCTION

The protection of investors against indirect expropriation is a basic component of international investment agreements (IIAs) and customary international law protecting foreign investment.¹ Together with the fair and equitable treatment standard (FET) it is the core investment guarantee that foreign investors invoke in order to challenge the regulatory and administrative measures of a host State that may have a detrimental effect on their investments like revocations of licences and changes to domestic regulatory frameworks.

However, IIAs do not contain a precise definition of indirect expropriation. IIAs mostly refer to indirect takings as ‘measures having effect equivalent to nationalization or expropriation’ or ‘measures tantamount to nationalization or expropriation’.² Hence, a textual meaning of the definition of the standard provides only a limited guidance for the conduct of States leaving considerable discretion in the hands of adjudicators for deciding what measures amount to indirect takings in specific cases.³ Using their wide discretion, arbitrators have developed distinct methodologies for the assessment of the existence of indirect expropriation, such as those focusing on the context and public interest of the interference in foreign investment on the one hand and those limited to the protection of the interests of foreign investors on the other. These methodologies differ regarding their responsiveness to environmental considerations, the crisis management actions of a State, or other essential interests for the entire population that have motivated the interference of a State in foreign investment and which foreign investors have challenged as indirect expropriation.

¹ It is assumed that the network of IIAs refers to customary international law on expropriation, see *Pope & Talbot Inc v The Government of Canada*, Interim Award, June 26, 2000, NAFTA, UNCITRAL [96], [104]; *S.D.Myers, Inc. v Government of Canada*, Partial Award, November 13, 2000, NAFTA, UNCITRAL [285]-[286]; *Glamis Gold, Ltd. v The United States of America*, UNCITRAL (NAFTA), Award, 8 June 2009 [354].

² UNCTAD, *Taking of Property*, UNCTAD/ITE/IIT/15 (UN 2000) 18. Historic reasons for this situation are explained in UNCTAD, *International Investment Agreements: Key Issues, Volume 1*, UNCTAD/IIT/2004/10 (UN 2004) 236-237. The Tribunal in *Feldman* noted: ‘The Article 1110 [of the NAFTA] is of such generality as to be difficult to apply in specific cases’, see *Marvin Roy Feldman Kappa v United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award, 16 December 2002 [98].

³ On arbitral jurisprudence as the main developer of the particular content of the vague investment guarantees see SW Schill, *The Multilateralization of International Investment Law* (CUP 2009) 321-357. See also Ole K Fauchald, ‘The Legal Reasoning of ICSID Tribunals – An Empirical Analysis’, 19 EJIL (2008) 301.

While not always neglectful of public policy objectives pursued by the host State, several investment tribunals have perceived a narrow focus on foreign investor's protection as being their central mission. The possibility that an adjudicator will focus exclusively on foreign investment protection, disregarding other interests involved, has raised concerns about the capacity left for host States to exercise their regulatory responsibilities to protect legitimate public welfare objectives.⁴ These concerns of States are grounded in the fact that foreign investors have challenged a vast array of general legislative acts,⁵ administrative measures⁶ and compliance measures with non-economic international obligations of host States⁷ (allegedly) dealing with the protection of non-economic public interests as expropriatory measures.

Currently, it is possible to assess these concerns from the perspective of sustainable development which is generally understood as the achievement of an equal balance between economic development, social progress and environmental protection at every level of decision-making.⁸ The concept of sustainable development is process based,⁹ namely it implies flexibility for each and every state to take its own particularities into account in deciding what best suits its developmental needs and to choose the appropriate means for its facilitation.¹⁰

⁴ F Francioni, 'Access to Justice, Denial of Justice and International Investment Law', in (2009) Vol.20 EJIL No.3, 729-747, 729; Susanne A Spears, 'The Quest for Policy Space in a New Generation of International Investment Agreements' (2010) 13 JIEL 4, 1037-1075.

⁵E.g., in *Methanex v United States*, UNCITRAL (NAFTA) Final Award, 3 August 2005, which involved general legislation banning a toxic gas ingredient that polluted the environment. In *Glamis Gold v US* (n⁵²), California imposed new restrictions on gold mining. California invoked internationally protected rights of indigenous groups among the reasons for limiting rights to gold extraction in the area of cultural property of Indian tribes.

⁶E.g., *Técnicas Medioambientales Tecmed S.A. v The United Mexican States* (ICSID Case No. ARB (AF)/00/2), Award of 29 May 2003 that involved the revocation of the operation licence by the local municipality for alleged environmental protection purpose.

⁷E.g., *Chemtura v Canada*, NAFTA, UNCITRAL, Award August 2 2010, in which the gradual phase-out by Canada of the agro-chemical lindane was supported by the 1998 Aarhus Protocol on Persistent Organic Pollutants and the Stockholm Convention on Persistent Organic Pollutants. Lindane was gradually eliminated because it endangered public health and the environment.

⁸ M-C Cordonier Segger, 'Sustainable Development in International Law' in Hans Christian Bugge and Christina Voigt (eds), *Sustainable Development in International and National Law* (Europa Law Publishing 2008) 139.

⁹ V. Lowe, 'Sustainable Development and Unsustainable Arguments' in A. Boyle and D. Freestone (eds.), *International Law and Sustainable Development: Past Achievements and Future Challenges*, (Oxford: Oxford University Press, 1999), 17.

¹⁰ P. Birnie, A. Boyle, C. Redgwell, *International Law & the Environment*, (3.rd ed., Oxford: Oxford University Press, 2009), 126-7; A. Boyle, C. Chinkin, *The Making of International Law*, (Oxford: Oxford University Press, 2007), 224.

Foreign direct investment (FDI)¹¹ promotion and protection is generally associated with such economic development-related inputs as long-term capital in-flows in the host State, transfer of technology, access to new markets and knowledge spillovers;¹² hence, attracting FDI is intended to function as one of the principal tools for pursuing economic development in the globalized world.¹³

Since FDI protection is inherently a related field of (economic) development law,¹⁴ the sustainable development perspective requires its extension so that it also covers the other two pillars of sustainable development, namely the social and the environmental dimensions.

The necessity to shift the narrow focus of foreign investment protection as an element of economic development to consider wider development implications is reflected by

¹¹ The OECD defines FDI as: “[A] category of cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor. The motivation of the direct investor is a strategic long-term relationship with the direct investment enterprise to ensure a significant degree of influence by the direct investor in the management of the direct investment enterprise. The “lasting interest” is evidenced when the direct investor owns at least 10% of the voting power of the direct investment enterprise [...] The objectives of direct investment are different from those of portfolio investment whereby investors do not generally expect to influence the management of the enterprise.” OECD, OECD Benchmark Definition of Foreign Direct Investment (4.th ed, 2008) 17 [11].

¹² P Economou, JH Dunning, KP Sauvant, ‘Trends and Issues in International Investment’, in KP Sauvant (ed) *Yearbook on International Investment Law & Policy 2008-2009*, (OUP 2009) 26-27; AT Guzman, ‘Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties’, (1997-1998) 38 *Virginia Journal of International Law*, at 666-686.

¹³ Jeffrey D. Sachs, *Common Wealth. Economics for a Crowded Planet* (Penguin Books, 2008) 208-212. J.E. Stiglitz, *Making Globalization Work*, (W.W. Norton & Company: New York, London, 2006), 187-210; Johannesburg Plan of Implementation of the World Summit on Sustainable Development, 2002, UN Doc A/AC.257/32 [47]. Aaron Broches, ‘Convention on the Settlement of Investment Disputes between States and Nationals of other States of 1965, Explanatory Notes and Survey of its Application’ (1993) 18 *Yearbook Commercial Arbitration* 627, at 641-647; Parra, ‘Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments’, 12 *ICSID Rev-FILJ* 287 (1997) 301. UNCTAD Report, *Development Implications of International Investment Agreements* (2007), UNCTAD/WEB/ITE/IIA/2007/2; Theodore H Moran, *Harnessing Foreign Direct Investment for Development. Policies for Developed and Developing Countries* (Brooking Institution Press 2006); International Bank for Reconstruction and Development, Report of the Executive Directors on the ICSID Convention, March 18, 1965 (Report of the Executive Directors), [12]; *Phoenix Action, Ltd. v. the Czech Republic*, ICSID Case No. ARB/06/5, Award, April 15, 2009 [87], *Mr. Saba Fakes v. Republic of Turkey*, ICSID Case No. ARB/07/20, Award July 14, 2010, [111].

¹⁴ See P Economou, JH Dunning, KP Sauvant, ‘Trends and Issues in International Investment’, in KP Sauvant (ed) *Yearbook on International Investment Law & Policy 2008-2009* (OUP 2009), 26-27; Vaughan Lowe, ‘Changing Dimensions of International Investment Law’, University of Oxford Faculty of Law Legal Studies Research Paper Series, Working Paper No 4/2007, March 2007 <<http://papers.ssrn.com/Abstract=970727> at 25> accessed on 31 March 2012; AT Guzman, ‘Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties’, 38 *Virginia Journal of International Law* (1997-1998) 666-686.

the recent UNCTAD Investment Policy Framework for Sustainable Development¹⁵ that acknowledges sustainable development as a new paradigm of international investment protection law. For this reason, it proposes drafting future IIAs and, among others, the indirect expropriation standard in a way that would explicitly balance a State's regulatory responsibilities and foreign investor's interests.¹⁶

However, the aim of this study is to prove that the sustainable development paradigm, and its consequent extension of protected interests in investment law, is already applicable in the investment protection regime which currently exists and in the application of the indirect expropriation standard, which requires a reconsideration of the role that investment arbitrators have, altering perceptions of applicable law and the methodologies used for the establishment of indirect expropriation.

Structure of the Thesis

In order to prove the existence of the legal consequences sustainable development has on the interpretation process of indirect expropriation standard, the study consists of four main parts and focuses on the proposition that sustainable development is the actual object and purpose of the network of IIAs within which the indirect expropriation standard must be applied. As an object and purpose it guides the contextual and effective interpretation¹⁷ of the indirect expropriation standard requiring a focus on wider interests than merely those of foreign investors. Furthermore, it is claimed that sustainable development has the capacity not only to guide the contextual interpretation process but is itself a legal principle leading to precise outcomes – namely, the integration of economic and non-economic concerns in the assessment of the existence of indirect expropriation.

The second chapter of the thesis focuses on the impact the sustainable development objective has on the jurisdiction and applicable law in investment treaty arbitration. While being limited in their jurisdictional competence, investment tribunals have also shown a tendency to look too narrowly at the applicable law when it comes to

¹⁵ UNCTAD, World Investment Report 2012, *Towards a New Generation of Investment Policies* (UN 2012).

¹⁶ *ibid* 139, 148, 153.

¹⁷ Article 31(1) of the Vienna Convention on the Law of Treaties; see R Gardiner, *Treaty Interpretation* (OUP 2008) 148, 161; on effective treaty interpretation see also *Iron Rhine ("Ijzeren Rijn") Railway*, (Belgium/Netherlands) PCA, Award May 24, 2005, [79]-[81]; *United States – Import Prohibition of Certain Shrimp and Shrimp Products (US-Shrimp/Turtle I)*, AB-1998-4, Report of the Appellate Body 6 November 1998, WT/DS58/AB/R, [152], [154].

considering and applying non-investment international law in the context of indirect expropriation claims. Consequently, the narrow focus is leading to the impression of investment tribunals acting in isolation from other fields of law. This could happen because investment tribunals often adopt a mindset that is centred on foreign investment protection, which is the directly pronounced purpose of the system of BITs. The narrow focus of the applicable law makes arbitral tribunals less likely to consider wider public policy considerations that are often grounded in external, non-investment international obligations by host States. It also makes the tribunals less likely to focus on the protection of third party stakeholders' interests related to social or environmental considerations of host States. It is argued that the sustainable development objective requires a change in the mindset of those investment arbitrators that have taken the approach which is predisposed to investment protection. Further, it is proposed that the sustainable development objective establishes the necessary bond between investment rules and *prima facie* external rules, the lack of which has contributed to the reluctance to address potential normative conflicts between investment and non-investment international law.

Against this background, the third chapter of the study assesses the compatibility of the methodologies used for the interpretation of the indirect expropriation standard with the sustainable development objective and principle. The chapter deals with the assessment of which of the methodologies or doctrines guarantee that commercial interests are not prioritized but balanced and reconciled with competing non-economic interests in the interpretation of indirect expropriation standard. In essence, sustainable development calls for the process of weighing and balancing conflicting investment protection and public policy goals aimed at safeguarding human rights, the environment, public health and cultural heritage¹⁸ limiting or excluding some of the existing ways of interpreting indirect expropriation.

The last chapter is designed to establish that, methodologically, the most appropriate way for incorporating wider societal concerns in setting the scope of the indirect

¹⁸ Taking the position of Boyle and Chinkin that the principle of sustainable development requires 'development decisions to be the outcome of a *process* which promotes sustainable development', rather than fulfilment of a certain standard of substance, see A. Boyle, C. Chinkin, *The Making of International Law*, (Oxford: Oxford University Press, 2007), 224 (emphasis added). See also V. Lowe, 'Sustainable Development and Unsustainable Arguments', in A. Boyle and D. Freestone (eds.), *International Law and Sustainable Development: Past Achievements and Future Challenges*, (Oxford: Oxford University Press, 1999), 17; P. Birnie, A. Boyle, C. Redgwell, *International Law and the Environment* (3rd ed, OUP 2009), 126-7.

expropriation standard is through the effective interpretation of its legitimate expectations element. It is suggested that a careful interpretation of legitimate expectation sub-element of indirect expropriation standard allows for the internalization of the required balance between investor's private interests and the State's public responsibilities, taking the wider context rather than the narrow commercial interests of foreign investors into account. Legitimate expectations element has an inherent flexibility that stems from interpretation of its sub-elements – the reasonableness of investor's expectations for stability and predictability of a business and legal regime, general knowledge about business and the legal framework in the host State, competent businessman criterion and the investor's own conduct. It is suggested that deliberate and effective interpretation of these sub-elements (in the context of sustainable development) implies balancing investor's private interests and the State's regulatory responsibilities.

Overview of the functioning of international investment protection regime

Before going into a detailed analysis of the indirect expropriation standard and its interpretation in light of sustainable development, it is necessary to give a brief insight into the complexity of the organization of international investment protection law, since its heterogeneous structure directly contributes to the varied understanding of the role of arbitrators and clashing interpretations of the investment guarantees.

Unlike many other international legal regimes, the international investment protection regime¹⁹ consists of a network of international investment agreements (IIAs) rather than of one multilateral treaty. The network of IIAs is established to protect FDI from potential mistreatment (political risks) by States who receive investment (the so-called host States) through various investment protection guarantees.

Presently, there are around 2,800 'common-form' bilateral investment treaties (BITs), with some of them being gradually replaced by free trade agreements (FTAs)²⁰ and

¹⁹ On the network of IIAs as a legal regime, see Jeswald W. Salacuse, *The Law of Investment Treaties* (Oxford University Press) 2010, 1-17. Cf. Stephan W. Schill, *The Multilateralization of International Investment Law* (Cambridge University Press) 2009.

²⁰ BIT-like chapters in these treaties have no substantial difference with BITs, apart from the tendency to include more innovative language with respect to the acknowledgement of competing non-investment public policy goals, see UNCTAD, World Investment Report 2010, *Investing in a Low-Carbon Economy*, (UN 2010), 83-86.

another 309 multilateral, regional and sectoral IIAs,²¹ such as the most frequently used, the ECT,²² the NAFTA²³ and the CAFTA²⁴. EU law is gradually gaining importance in the regulation of FDI.²⁵ In addition, there are several voluntary instruments addressing social and environmental aspects of foreign investment like corporate social responsibility.²⁶

There have been three unsuccessful attempts within the OECD (in 1962, 1967 and 1995) to propose multilateral agreement on investment.²⁷ Several non-governmental initiatives have been established to create a multilateral treaty but they were never adopted by States.²⁸ Similarly, all United Nations efforts to establish multilateral rules on FDI protection have failed except for the UN General Assembly (GA) Resolution 1083 of 1962 on permanent sovereignty over natural resources.²⁹ The 1974 GA Declaration on the Establishment of a New International Economic Order (NIEO),³⁰ the Charter of Economic Rights and Duties of States³¹ and the 1976-1992 General

²¹ For the data available for 2010, see UNCTAD, World Investment Report 2011, *Non-Equity Modes of International Production and Development*, (UN 2011), 100.

²² Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents. A Legal Framework for International Energy Cooperation* (2004), available at www.energycharter.org, accessed on 23 March 2013.

²³ North American Free Trade Agreement, Dec. 17, 1992, Can.-Mex.US, 32 ILM 605.

²⁴ The United States-Dominican Republic-Central America Free Trade Agreement 2004.

²⁵ Angelos Dimopoulos, *Regulation of Foreign Investment in EU External Relations Law*, EUI doctoral thesis, March 2010.

²⁶ For example, The *International Labour Organization's* 1977 Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy, The Global Compact, http://www.unglobalcompact.org/docs/news_events/8.1/GC_brochure_FINAL.pdf.

²⁷ See G.A. van Hecke, 'Le Projet de convention de l'OCDE sur la protection des biens étrangers' (1964) 68 *Revue générale de droit international public* 641; On reasons, why MAI in 1995 fall apart, see Société française de droit international (ed.), *Un accord multilatéral sur l'investissement: d'un forum de négociation à l'autre?* (1999); see also UNCTAD, *Lessons from the MAI: UNCTAD Series on Issues in International Investment Agreements* (1999).

²⁸ The ICC proposed International Code of Fair Treatment for Foreign Investment, ILA Draft Statutes of the Arbitral Tribunal for Foreign Investment and the Foreign Investment Court, 1959 Draft Convention on Investment Abroad, 1961 Draft Convention on the International Responsibility of States for Injuries to Aliens. All those attempts on providing multilateral rules to foreign direct investment included minimum standard of treatment, protection against unreasonable and discriminatory measures, and just and effective compensation for expropriation. 1929 Harvard Law School project on the "Responsibility of States for Injuries in their Territory to the Person or Property of Foreigners".

²⁹ Declaration on Permanent Sovereignty over Natural Resources, UNGA, Res. 1803 (XVII) (1962); N.Schrijver, *Sovereignty over Natural Resources: Balancing Rights and Duties*, (Cambridge: Cambridge University Press, 1997).

³⁰ Declaration on the Establishment of a New International Economic Order, UN Doc. A/RES/S-6/3201 (1974), reprinted 13 ILM 715.

³¹ Charter of Economic Rights and Duties of States, UN Doc. A/RES/29/3281(1974).

Code of Conduct on MNEs³² had never gained the support of developed countries and thus they did not result in internationally binding investment rules.

All these multilateralization attempts have failed mainly because of the stark disagreement on the substance of (customary) international law governing the protection of property of aliens that was a topical issue during the decolonization process after the Second World War. The process of decolonization led to the establishment of new states in the 1950s and 1960s. These newly developed nations maintained hostility towards investors from former colonial States. They nationalized and expropriated the aliens' property and terminated various concession contracts in extracting industries as an attempt to gain back their economic sovereignty and to establish a new order of justice.³³

The only two multilateral agreements on foreign investment that States managed to agree on were the ICSID Convention establishing the International Centre for Settlement of Investment Disputes (ICSID) and its Additional Facility³⁴ and the MIGA Convention.³⁵

In the meantime, general international law on diplomatic protection and the ICJ³⁶ proved to be insufficient for the needs of the international business society and for both developed and developing States,³⁷ the latter realizing that FDI attraction through

³² See P.T.Muchlinski, *Multinational Enterprises and the Law*, (2.nd ed., OUP, 2007), 660-662. See also UNCTAD, *World Investment Report 1993: Transnational Corporations and Integrated International Production* (Geneva: United Nations, 1993), 33; United Nations, *Multinational Corporations in World Development* (New York: United Nations, 1973).

³³ Rosalyn Higgins, 'The Taking of Property by the State: Recent Developments in International Law', 176 *Recueil des Cours* 259 (1982); Zeyad al-Quarashi, *Arbitrating International Petroleum Disputes: An Analysis of Key Substantive Law Issues*, 2004, available at www.gasanoil.com/ogel. For example, in 1951 Iran annulled the concession agreement on petroleum extraction and nationalized Anglo-Iranian Oil Company. United Kingdom submitted the case to the ICJ, however, the Court declared lacking jurisdiction on the subject matter. *Anglo –Iranian Oil Concessions Case*, (UK v. Iran), [1952] ICJ Rep.93.

³⁴ The Convention on the Settlement of Investment Disputes between States and Nationals of Other States establishing the International Centre for Settlement of Investment Disputes came into effect in 1966. On the history of its conclusion see A.Broches, *L'Évolution du CIRDI*, *Revue de l'Arbitrage* 323 (1979) and A.Broches, *The "Additional Facility" of the International Centre for Settlement of Investment Disputes (ICSID)*, 4 *Yearbook Commercial Arbitration* 373 (1979).

³⁵ The convention establishing the Multilateral Investment Guarantee Agency was formed in 1988. The purpose of MIGA is to encourage foreign investment flows to and among developing states by providing political risk insurances against such political risks as war, expropriations and non-payment of awards against a host State. See N.Rubins, N.S.Kinsella, *International Investment, Political Risk and Dispute Resolution. A Practitioner's Guide*, (Oxford: Oceana Publications, 2005), 98-99.

³⁶ See Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (The Netherlands: Wolters Kluwer Law & Business, 2009), 35-39.

³⁷ J.Paulsson, 'Arbitration without Privity', 10 *ICSID Review* 232 (1995), 231, 255.

its protection might facilitate their development.³⁸ In particular, the ICJ judgement in *Barcelona Traction Case*,³⁹ in which the Court rejected the protection of shareholders for the harm done to the company,⁴⁰ led to the ‘treatification’⁴¹ away from customary international law on the protection of aliens.

Since multilateral negotiations on FDI rules were already heavily politicized, developed and developing States shifted to the bilateral negotiations of investment protection rules. Thus, with the first bilateral investment treaty (hereinafter: BIT) concluded between Germany and Pakistan in 1959, states commenced the alternative bilateral and regional treaty approach to the multilateral protection of foreign investment, creating the network of IIAs and deviating from secondary norms of state responsibility under customary international law.⁴²

Investor-state arbitration and its *raison d'être*

A highly specific characteristic of foreign investment protection law is its novel dispute settlement mechanism. Most of the IIAs⁴³ supplement the state-state dispute settlement mechanism⁴⁴ with the investor-state arbitration clause. Investor-state dispute settlement mechanism was first introduced in the BIT between Indonesia and

³⁸ Olivier de Schutter, ‘Transnational Corporations as Instruments of Human Development’ in P. Alston, M. Robinson (eds.), *Human Right and Development, Toward Mutual Reinforcement*, (OUP, 2005), 404; Andrew T. Guzman, ‘Why LDCs sign treaties that hurt them: explaining the popularity of bilateral investment treaties,’ *Virginia Journal of International Law*, vol. 38 (1998), 639-688. See also T.W. Waelde, ‘North/South Economic Corporation and International Economic Development Law: Legal Process and Institutional Considerations’ in J.D. Lambert, F. Fesharaki (eds.), *Economic and Political Incentives to Petroleum Exploration*, (International Law Institute, Washington, D.C.), 30.

³⁹ For criticism see F.A. Mann, ‘Protection of Shareholder’s Interests in the Light of the *Barcelona Traction Case*’, in F.A. Mann (ed), *Further Studies in International Law* (Oxford: Clarendon Press, 1990), 217.

⁴⁰ Case concerning the *Barcelona Traction, Light and Power Co Ltd* (New Application: 1962) (Belgium v. Spain) (Preliminary Objections) [1964] ICJ Rep 6 [88, 89].

⁴¹ Jeswald W. Salacuse, ‘The Treatification of International Investment Law: A Victory of Form over Life? Or Crossroads Crossed?’ (2006) 3 TDM 3.

⁴² For instance, Article 27 of the ICSID Convention clearly excludes diplomatic protection, and Article 26 - exhaustion of local remedies. See also *Ahmadou Sadio Diallo (Republic of Guinea v. Democratic Republic of the Congo)*, Judgement on Preliminary Objections, 24 May, 2007 [88] and Case concerning the *Barcelona Traction, Light and Power Co Ltd* (New Application: 1962) (Belgium v. Spain) (Preliminary Objections) [1964] ICJ Rep 6 [90].

⁴³ FTA and EPAs such as CARIFRUM EPA provide only a state-to-state dispute resolution mechanism.

⁴⁴ The more traditional inter-State (state-state) arbitration is left for solving issues that arise directly between the signatories of IIAs, see, for instance, the discontinued *Lucchetti S.A. and Lucchetti Peru S.A. v. Republic of Peru*, ICSID Case No. ARB/03/4.

the Netherlands (1968).⁴⁵ Since then, investor's direct access to arbitration has been seen as the most essential element of the BIT regime.⁴⁶ The investor-state arbitration mechanism allows persons or entities other than states to invoke state responsibility before *ad hoc* tribunals, usually consisting of three party-selected arbitrators.⁴⁷ IIAs usually leave an investor with a choice between different arbitral venues like ICSID, ICSID Additional Facility (ICSID has been the most frequent forum for a settlement of investor-state disputes⁴⁸), UNCTIRAL, the Dispute Resolution Rules of the International Chamber of Commerce (ICC), the London Court of International Arbitration (LCIA) or the Arbitration Institute of the Stockholm Chamber of Commerce.

The investor-state arbitration mechanism was established with the intention to depoliticize foreign investment disputes, since the objectivity and effectiveness of domestic courts was subject to doubt when ruling against foreigners. The previously used diplomatic protection mechanism also contained political tensions between the home State of an investor and the investment-receiving host State.⁴⁹ The rationale of depoliticization and impartiality is also reflected by the narrow range of remedies available to investors, mainly entitling them to compensation for monetary damages in the case of a violation of host State obligations towards a foreign investor.⁵⁰

In sum, international investment protection standards contained in IIAs and investor's direct access to a dispute settlement mechanism are meant to be tools for encouraging

⁴⁵ Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (The Netherlands: Wolters Kluwer Law & Business, 2009), 44-46. The first arbitral award rendered in investor-state arbitration was *SPP v. Egypt*, see *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, Case No. ARB/84/3, Decision on Jurisdiction 1, 27 November 1985, 3 ICSID Reports 112. It started the 'arbitration without privity' era, see J. Paulsson, 'Arbitration without Privity', 10 ICSID Review 232 (1995), Antonio Parra, 'Provisions on the Settlement of Investment Disputes in modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment', 12 ICSID Rev./FILJ 287 (1997).

⁴⁶ *Eastern Sugar B. V. v. Czech Republic*, SCC Case No. 088/2004, Partial Award, 27 March 2007 [165].

⁴⁷ J. Paulsson, 'Arbitration without Privity', 10 ICSID Review 232 (1995), 255-6.

⁴⁸ UNCTAD, World Investment Report 2010, *Investing in a Low-Carbon Economy*, (UN: New York and Geneva, 2010), 83.

⁴⁹ Shihata, 'Towards a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA' (1986) 1 ICSID Rev – FILJ 1.

⁵⁰ For example, Article 1135 of the NAFTA, Article 26(8) ECT. See also Endicott, 'Remedies in Investor-State Arbitration: Restitution, Specific Performance and Declaratory Awards', in Kahn and Waelde (eds.), *New Aspects of International Investment Law*, (2007), 517. See also Merrill & Ring Forestry L.P. v. Canada, UNCITRAL, ICSID Administered Case (NAFTA) Award, 31 March 2010 [236]; T.W. Wälde, B. Sabahi, 'Compensation, Damages, and Valuation', in Peter Muchlinski, Frederico Ortino and Christoph Schreuer (eds) *The Oxford Handbook of International Investment Law* (OUP 2008), 1049-1055.

in-flows of foreign investment in States, and thus, contributing to their development.⁵¹

Inconsistency and unpredictability of the scope of indirect expropriation standard

The protection of foreign investors against indirect expropriation is a basic component of IIAs and customary international law protecting foreign investment;⁵² it occurs ‘when measures short of an actual taking, result in the effective loss of management, use or control, or a significant depreciation of the value of the assets of a foreign investor’.⁵³

However, IIAs do not contain a precise definition of indirect expropriation. IIAs mostly refer to indirect takings as ‘measures having effect equivalent to nationalization or expropriation’ or ‘measures tantamount to nationalization or expropriation’.⁵⁴ A typical clause on expropriation may be found in, for example, the US-Ecuador BIT (1997)⁵⁵ Article III(1):

Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization (“expropriation”) except: for a public purpose; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law and the general principles of treatment provided for in Article II(3). Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier (...).

⁵¹ Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, International Bank for Reconstruction and Development, March 18, 1965, part III, recitals 10,13; A Broches A, ‘Convention on the Settlement of Investment Disputes between States and Nationals of other States of 1965, Explanatory Notes and Survey of its Application’, 18 Yearbook Commercial Arbitration 627, 641-647 (1993).

⁵² It is assumed that the network of IIAs refers to customary international law on expropriation, see *Pope & Talbot Inc v The Government of Canada*, Interim Award, June 26, 2000, NAFTA, UNCITRAL [96], [104]; *S.D.Myers, Inc. v Government of Canada*, Partial Award, November 13, 2000, NAFTA, UNCITRAL [285]-[286]; *Glamis Gold, Ltd. v The United States of America*, UNCITRAL (NAFTA), Award, 8 June 2009 [354].

⁵³ August Reinisch, ‘Expropriation’ in Peter Muchlinski, Frederico Ortino and Christoph Schreuer (eds) *The Oxford Handbook of International Investment Law* (OUP 2008) 421- 422 (footnotes omitted).

⁵⁴ UNCTAD, *Taking of Property*, UNCTAD/ITE/IIT/15 (UN 2000) 18. Historic reasons for this situation are explained in UNCTAD, *International Investment Agreements: Key Issues, Volume 1*, UNCTAD/IIT/2004/10 (UN 2004) 236-237. The Tribunal in *Feldman* noted: ‘The Article 1110 [of the NAFTA] is of such generality as to be difficult to apply in specific cases’, see *Marvin Roy Feldman Kappa v United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award, 16 December 2002 [98].

⁵⁵ Treaty Between the United States of America and the Republic of Ecuador Concerning the Encouragement and Reciprocal Protection of Investment.

The textual meaning of indirect expropriation standard is overly abstract⁵⁶ providing only a limited guidance for the conduct of States and making it difficult to interpret the standard ‘in accordance with the ordinary meaning’ as required by customary treaty interpretation principles codified in Article 31 of the VCLT. These kinds of international norms have been characterized as ‘open-textured’, unsettled, vague or ambiguous because they provide only a limited guidance for the conduct of States.⁵⁷ As a consequence, adjudicators enjoy considerable discretion and policy choices in deciding what measures amount to indirect takings in specific cases.⁵⁸

Although the scope of the indirect expropriation standard has been among the key matters of concern in international investment protection law already for decades, dating back to the period of decolonization and the New International Economic Order,⁵⁹ it has received considerable attention since the *Ethyl Corporation v. Canada* claim in the late 1990s.⁶⁰ In the *Ethyl* claim, an American producer and exporter of fuel additive (MMT) sued Canada in the first arbitration case under the NAFTA Chapter 11 claiming compensation for an alleged expropriation of its investment.⁶¹ The company claimed that the legislation banning intra-provincial and international trade of the fuel additive (MMT) for human health and environmental protection reasons constituted indirect expropriation. The case was settled amicably but part of the settlement required a revocation of the MMT ban and a significant compensation to the investor.⁶² The *Ethyl* claim thereby opened up room for challenging general legislations and administrative measures adopted by host States for such public policy

⁵⁶ See Marvin Roy Feldman Kappa v United Mexican States, ICSID Case No. ARB(AF)/99/1, Award, 16 December 2002 [98].

⁵⁷ On arbitral jurisprudence as the main developer of the particular content of the vague investment guarantees see Stephan Schill, *The Multilateralization of International Investment Law* (2009), at 321-357. See also Ole K. Fauchald, ‘The Legal Reasoning of ICSID Tribunals – An Empirical Analysis’, 19 EJIL (2008) 301.

⁵⁸ On arbitral jurisprudence as the main developer of the particular content of the vague investment guarantees see S Schill, *The Multilateralization of International Investment Law* (2009) 321-357. See also Ole K Fauchald, ‘The Legal Reasoning of ICSID Tribunals – An Empirical Analysis’, 19 EJIL (2008) 301.

⁵⁹ Thomas M Frank, *Fairness in International Law and Institutions* (Oxford University Press) 2002, 23, 441, 473. On the general interaction between NIEO and sustainable development see D.French, “‘From Seoul with Love’ – The Continuing Relevance of the 1986 Seoul ILA Declaration on Progressive Development of Principles of Public International Law Relating to a New International Economic Order’, (2008) LV NILR at 3.

⁶⁰ *Ethyl Corporation v Canada*, UNCITRAL (NAFTA), Decision on Jurisdiction, 24 June 1998.

⁶¹ See UNCTAD, *Taking of Property*, UNCTAD/ITE/IIT/15 (UN 2000) 6-10.

⁶² http://www.appletonlaw.com/files/cases_ethyl.pdf (accessed on 31 March 2010); see also J. Soloway, ‘Environmental Regulations as Expropriation: The Case of NAFTA’s Chapter 11’, (2000) 33 Canadian Business Law Journal 92, 116.

goals as human rights protection, public health and the environmental protection as potential acts of expropriation. The *Ethyl* case also raised the question of the scope of the regulatory capacity left for States to adopt precautionary actions for the environmental and health protection with an effect of banning investors' activity.

A further significant contribution to the unexpectedly wide reach of the indirect expropriation standard was established by *Metalclad v. Mexico* award, where the Tribunal declared that measures 'tantamount to expropriation':

*[I]ncludes 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**.*⁶³

Ever since, foreign investors have increasingly sought compensation under indirect expropriation standard for alleged damages to their investments caused by host State's general legislative acts,⁶⁴ administrative measures⁶⁵ or compliance measures with the non-economic international obligations of host States⁶⁶ that are purportedly designed to safeguard non-economic public interests like the environment or public health (see Box 1 in Appendix⁶⁷).

These claims may arise out of a genuine misconduct on the part of the host State that intends to hide its *mala fide* behind public interest.⁶⁸ At other times, foreign investors threaten to initiate investment treaty arbitration and claim violations of investment guarantees as an attempt to block the effort of a host State to regulate important public interest issues. For instance, in *Piero Foresti v. South Africa*,⁶⁹ investors complained about the South Africa's Black Economic Empowerment programme requiring the

⁶³ *Metalclad Corporation v. The United Mexican States* (ICSID Case No. ARB(AF)/97/1), Award, 30 August 2000 [103] (emphasis added).

⁶⁴ E.g., in *Methanex v United States*, UNCITRAL (NAFTA) Final Award, 3 August 2005, which involved/s the ban of a toxic gas ingredient.

⁶⁵ E.g., in *Técnicas Medioambientales Tecmed S.A. v The United Mexican States* (ICSID Case No. ARB (AF)/00/2), Award of 29 May 2003 that involved the revocation of the operation licence of the investor's hazardous waste facility.

⁶⁶ E.g., *Chemtura v Canada*, NAFTA, UNCITRAL, Award August 2 2010 that dealt with the gradual phase-out of the agro-chemical lindane that was necessitated by the 1998 Aarhus Protocol on Persistent Organic Pollutants and the Stockholm Convention on Persistent Organic Pollutants.

⁶⁷ Box 1. Interpretation of the indirect expropriation standard concerning public interest measures by the host state.

⁶⁸ For instance, in *S.D.Myers v. Canada*, the Tribunal found no 'real public' interest for which the Canadian measures on banning exports of a specific chemical were taken.

⁶⁹ *Piero Foresti, Laura de Carli and ors v Republic of South Africa* ICSID Case No ARB(AF)/07/1, Award, 4 August 2010.

introduction of compulsory equity divestiture benefiting the historically disadvantaged South Africans. Italian investors claimed that these South African attempts to deal with the consequences of apartheid amounted to expropriation of Italian investment in the granite sector. In the end, investors discontinued the claim because they managed to reach an agreement with the State on individual Black Economic Empowerment arrangements;⁷⁰ however, the indirect expropriation claim was used as a mechanism to put pressure on the State. Exerting such a pressure was possible because the scope of the indirect expropriation standard is rather unpredictable, fuelling concerns that the indirect expropriation standard permits overly broad limitations on a host State's ability to safeguard legitimate public welfare objectives unduly limiting its administrative, legislative and judicial powers.⁷¹ This concern is strengthened by the fact that the line between a State's legitimate non-compensable regulatory activity interfering in foreign investment and compensable indirect expropriation is deeply fact-sensitive⁷² and mostly contingent on arbitral jurisprudence as the main instrument for filling the vague standard with content in specific cases.⁷³ Different international courts and tribunals under various treaties have relied on different criteria for guiding the distinction between indirect expropriation and non-compensable regulation developing various methodologies or doctrines, 'such as those recognizing the public interest on the one side and those protecting the integrity of property rights on the other'⁷⁴, by which to assess if a State's regulatory action amounts to indirect expropriation. The parallel existence of these doctrines contributes to the uncertainty and unpredictability of whether a State's responsibility for safeguarding public interest and therefore interfering in foreign investment is a measure 'tantamount' to expropriation requiring compensation (see

⁷⁰ Ibid [79].

⁷¹ F Francioni, 'Access to Justice, Denial of Justice and International Investment Law', in (2009) Vol.20 EJIL No.3, 729-747, at 729; Susanne A Spears, 'The Quest for Policy Space in a New Generation of International Investment Agreements' (2010) 13 JIEL 4, 1037-1075.

⁷² G.C. Christie, 'What Constitutes a Taking of Property under International Law' (1962) 38 BYIL 307.

⁷³ Stephan W Schill, *The Multilateralization of International Investment Law* (CUP 2009), 262; UNCTAD, *Investor-State Dispute Settlement and Impact on Investment Rulemaking*, (UN: New York and Geneva, 2007); TW Waelde, 'The Specific Nature of Investment Arbitration' in Philippe Kahn, Thomas W Waelde (eds), *New Aspects of International Investment Law* (Martinus Nijhoff 2007), 43-46.

⁷⁴ *Continental Casualty v. Argentina*, Decision on Jurisdiction, ICSID Case No.ARB/03/9, February 22, 2006 [277].

Comments in Box 1 in Appendix) or is a non-compensable exercise of State's police powers.

Thus, for instance, the *Metalclad v. Mexico*⁷⁵ award is a textbook example of the 'sole effects' doctrine. In making a decision of whether indirect expropriation takes place the 'sole effects' doctrine focuses exclusively on the intensity of the State's interference on foreign investor's property. In *Metalclad*, the Tribunal was asked to analyze, *inter alia*, a municipal Cactus Protection Decree with a stated purpose to safeguard a rare cactus habitat. The Tribunal focused merely on the effect that the Decree had on the foreign investor and concluded that the Ecological Decree was in itself an act of indirect expropriation as it prohibited any commercial activity on the investor's property.⁷⁶ The Tribunal's line of reasoning excluded any other qualifying elements save for the effect on the assessment of the existence of indirect expropriation, leaving other circumstances like the legitimate and predictable interests of the local population or investor's competence outside of consideration.

A different approach is represented by the so-called 'proportionality doctrine' developed by *Tecmed v. Mexico*.⁷⁷ The claim involved a revocation of the investor's waste landfill operation licence. The local municipality insisted that the revocation of the licence was done for environmental protection reasons. In its assessment of the existence of indirect expropriation, the *Tecmed* Tribunal supplemented the paramount 'effects' criterion with an assessment of whether the expropriatory effect was imposing on the investor an 'individual and excessive burden'.

Some other investment tribunals give emphasis to customary rights of the State to regulate for public interest as far as a regulation affecting foreign investment is performed in good faith, for instance the *Methanex v. US*⁷⁸ award which dealt with the suppression of trade in a harmful gasoline additive that polluted the environment. The company producing the banned chemical initiated investor-state arbitration claiming its market share had been indirectly expropriated. In contrast to the sole-effects methodology, the *Methanex* Tribunal started its analysis with a statement that a *bona fide* non-discriminatory regulation for public purpose affecting foreign investment,

⁷⁵ *Metalclad Corporation v. The United Mexican States*, ICSID Case No.ARB(AF)/97/1, Award August 30, 2000, NAFTA.

⁷⁶ *Ibid*, [111].

⁷⁷ *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States* (ICSID Case No. ARB (AF)/00/2), Award of 29 May 2003 (Spain/Mexico BIT), [122].

⁷⁸ *Methanex v. United States*, UNCITRAL (NAFTA) Final Award, 3 August 2005.

was not deemed to be expropriatory and compensable.⁷⁹ Thus, in its assessment of the existence of indirect expropriation, the so-called ‘context doctrine’ emphasizes respect for wider circumstances for which an interference in a foreign investment occurs rather than a narrow focus on foreign investment protection.

These three landmark awards represent the diversity of approaches to drawing the line between compensable expropriation and non-compensable regulation for public interest. There is no consistency and predictability regarding the choice of the criteria and doctrines which arbitral tribunals are going to apply in setting the content of the vague and ambiguous indirect expropriation standard; that choice mostly falls to the discretion of arbitrators. Hence, interpretation and application of the indirect expropriation standard may or may not be well-balanced between the investor’s interest in protecting its investment and the host State’s responsibilities to safeguard public interest that may result in interference with a foreign investment.⁸⁰ That is to say, even if some arbitral awards appear to balance a host State’s and investors interests in the application of indirect expropriation standard, it does not mean that other arbitral tribunals will find that line of argumentation persuasive;⁸¹ therefore the alleged *de facto* practice of precedent in investment treaty adjudication⁸² does not solve the situation.

For that reason this study argues that the current meaning of the inherent object and purpose of the foreign investment protection regime is sustainable (economic) development. It consequently leads to limiting arbitrators’ discretion in choosing the

⁷⁹ Ibid, Part IV - Chapter D - Page 4, para.7.

⁸⁰ Hachez and Wouters have noted, that “[t]here is a feeling that going to arbitration, for a host State, can be like playing Russian roulette when public interests are involved”, see Nicolas Hachez, Jan Wouters, ‘International Investment Dispute Settlement in the 21st Century: Does the Preservation of the Public Interest Require an Alternative to the Arbitral Model?’ Leuven Centre for Global Governance Studies, Working Paper No.81, February 2012, <<http://ssrn.com/abstract=2009327>> accessed on 10 July 2012, 14.

⁸¹ See, for instance, *Fireman Funds on Tecmed* ECtHR inspired proportionality balancing, *Fireman’s Fund Insurance Company v. Mexico*, Award, NAFTA, ICSID Case No.ARB(AF)/02/01, 17 July 2006, para.174(j), footnote 161.

⁸² E.g., A.K. Bjorklund, ‘Investment Treaty Arbitral Decisions as Jurisprudence Constante’ (2010) 7 TDM 1; Christop Schreuer, Matthew Weiniger, ‘Conversation Across Cases- Is There a Doctrine of Precedent in Investment Arbitration?’, (2007) TDM 1. See also *Saipem S.p.A. v. The People’s Republic of Bangladesh*, ICSID Case No. ARB/05/07 (Bangladesh/Italy BIT), Decision on Jurisdiction and Recommendation on Provisional Measures, 21 March 2007, [67]: ‘[S]ubject to compelling contrary grounds, it has a duty to adopt solutions established in a series of consistent cases.’ However, the more recent *Chevron and Texaco v. Ecuador* noted that ‘the decisions of other tribunals are not binding on this Tribunal’ as they are merely a subsidiary means of interpretation, see *Chevron Corporation (USA) and Texaco Petroleum Company (USA) v Ecuador*, UNCITRAL Arbitration, Partial Award on the Merits, March 30, 2010 [163]. See also *Chemtura v. Canada* [109].

criteria for establishing the existence of indirect expropriation excluding the sole focus on the effect of the measure. It also requires arbitrators to adopt methodologies which allow for the integration of wider interests than merely economic ones in setting the scope of investment guarantees.

Potential clinical isolation problem

Another interrelated aspect that significantly contributes to the uncertainty and unpredictability of the scope of the indirect expropriation standard is its application in a way which contributes to the ‘fragmentation of international law’,⁸³ i.e., investment tribunals often do not take account of arguments based on external (non-investment) sources of law brought forward by defending host States or *amicus curiae* (see Box 2 and Box 3 in Appendix⁸⁴). Fears of clinically isolated or ‘self-contained’ international investment law regime emerged after the notorious pronouncement by *Santa Elena v. Costa Rica*⁸⁵ Tribunal:

*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.*⁸⁶

In this paragraph the *Santa Elena* Tribunal unduly reduced Costa Rica’s argument that its international obligations to protect the site had an effect on the fair market value of the expropriated property to the mere declaration that even a lawful expropriation for environmental protection reasons raises the duty for the expropriating state to pay compensation (a fact that was never questioned by Costa Rica). The Tribunal did not consider the 1972 UNESCO Convention, obligations of which served as a motivation to expropriate the site. Hence, the *Santa Elena* Tribunal crafted the content of the

⁸³ On the phenomenon of fragmentation of international law, see UN General Assembly, International Law Commission, Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law – Report of the Study Group of the International Law Commission, 13 April 2006, UN Doc. No. A/CN.4/L.682, [13]; P.M.Dupuy, ‘A Doctrinal Debate in the Globalization Era: On the Fragmentation of International Law’, EJLS, 2007, Vol.1, No.1, available at <http://www/ejls.eu>.

⁸⁴ Box 2. Unsuccessful Attempts to Invoke Non-Investment Obligations

⁸⁵ *Compania del Desarrollo de Santa Elena S.A. v. Costa Rica*, ICSID Case No. ARB/96/1, Final Award, 17 February 2000, International Legal Materials, Vol. 39, (ICSID 2000).

⁸⁶ Ibid [71].

indirect expropriation standard and its compensation requirement solely in the context of investment law, autonomous from other legal regimes. Such an interpretation unjustifiably excludes the possible effect that a host State's non-investment commitments may have on the content of indirect expropriation and, in particular, on its sub-elements like investor's legitimate expectations.

These two aspects, namely the uncertainty whether, and to what extent, the surrounding circumstances and State's regulatory responsibilities to safeguard such public interests as the environment and a State's crisis management actions⁸⁷ will be taken into account for the determination of whether the regulation mechanisms of the State is a measure 'tantamount' to expropriation. And, secondly, the unpredictability regarding the importance and effects non-investment international law might have on the content of the indirect expropriation standard and its sub-elements have resulted in the ambiguity of indirect expropriation and insecurity surrounding the policy space left for host States to safeguard non-investment public interests.

Consequently, there is substantial doubt among the international community whether the legal regime of FDI protection actually promotes development of host States.⁸⁸ Fears from an overly limited regulatory space for public interests have created a negative attitude towards the international investment protection regime, effectively impeding instead of promoting the development of host States. These fears are not merely theoretical; in the most extreme way they are made material, for example in the case of Bolivia,⁸⁹ Venezuela⁹⁰ and Ecuador⁹¹ withdrawing from or limiting the jurisdiction of the ICSID system and Australia's opposition to investor-state dispute settlement in its future IIAs⁹² by claiming that investor-state arbitration is lacking

⁸⁷ F. Francioni, 'Access to Justice, Denial of Justice and International Investment Law', in EJIL (2009), Vol.20, No.3, at 729; SC.H.Brower, S. Schill, 'Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?', (2009) 9 China Journal of International Law 471.

⁸⁸ Susanne A Spears, 'The Quest for Policy Space in a New Generation of International Investment Agreements' (2010) 13 JIEL 4, 1037-1075.

⁸⁹ ICSID News Release, 'Bolivia Submits a Notice Under Article 71 of the ICSID Convention', May 16, 2007, available at <http://www.worldbank.org/icsid/highlights/05-16-07.htm>.

⁹⁰ TDM News, Issue 1, Week 05, 31 January 2012, available at <http://www.transnational-dispute-management.com/news/tdmnewsdigest.htm> (accessed on 31 January 2012).

⁹¹ ICSID News Release, Ecuador's notification Under Article 25 (4) of the ICSID Convention, Dec.5, 2007, available at <http://www.worldbank.org/ICSID/Index.jsp>.

⁹² J.Kurtz, The Australian Trade Policy Statement on Investor-State Dispute Settlement, ASIL Insights, August 2, 2011, Volume 15, Issue 22, available at <http://www.asil.org/insights110802.cfm> (last accessed on 3 August 2011). Australia's statement is a response to the new investor-state claim against Australia initiated by Philip Morris Asia under the Hong Kong-Australia BIT in relation to its plain packaging requirements on tobacco products preventing them using trade marks on cigarette

fairness, legitimacy, and democratic accountability and arbitrators are using overly flexible and inconsistent interpretative practices.⁹³ Therefore, limiting access to investor-state arbitration is believed to protect States from possible policy and financial restrictions on their policy space to legislate for social, environmental and economic matters.⁹⁴

Suggestions for improving the balance between State's regulatory responsibilities to safeguard non-economic public interests and investor's property protection

There are other less radical doctrine, treaty drafting and investment policy planning⁹⁵ suggestions on how to ensure that states regain trust in the system of international investment protection which most of them consider being unduly prejudiced towards the interests of foreign investors. In one way or other, all these suggestions call for a consistent approach in reviewing state regulatory behaviour by arbitral tribunals always paying due respect to a State's 'public interest' defence based on domestic or international commitments and policies.

Propositions for solving the potential clinical isolation or 'fragmentation' problem

Some authors insist that only treaty negotiators may alleviate the fragmentation problem associated with the *Santa Elena* award through future treaty drafting. They propose, for instance, the inclusion of explicit indications in treaties that treaty

packages, see 'Another Tobacco Investment Treaty Claim', a John Boscariol tweet, July 27 2011, available at <http://worldtradelaw.typepad.com/ielpblog/> (last accessed on 3 August 2011).

⁹³ On the so-called 'legitimacy crisis' see 'Public statement on the international investment regime,' August 31, 2010, available at: http://www.osgoode.yorku.ca/public_statement; Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford: Oxford University Press, 2007); David Schneiderman, *Constitutionalizing Economic Globalization: Investment Rules and Democracy's Promise* (Cambridge: Cambridge University Press, 2008); M. Sornarajah, 'A Coming Crisis: Expansionary Trends in Investment Treaty Arbitration' in Karl P Sauvant (ed), *Appeals Mechanisms in International Investment Disputes* (OUP 2008), 39-45; Gus van Harten, *Investment Treaty Arbitration and Public Law* (OUP, 2007).

⁹⁴ Aust. Gov't, Dep't of Foreign Aff. & Trade, Gillard Government Trade Policy Statement: Trading Our Way to More Jobs and Prosperity 14 (Apr. 2011), available at <<http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.html>>. See also Gus Van Harten, 'Five Justifications for Investment Treaties: A Critical Discussion', 2(1) TRADE L. & DEV. 19 (2010), 19-58; Peter T. Muchlinski, 'Statement by Professor Peter T. Muchlinski' (2008) 5 TDM 1.

⁹⁵ Some States undertake revision of their foreign investment protection policies; see Luke Eric Peterson, 'South African Government Releases Draft Paper Reviewing its BIT Program, and Calling for Major Revisions to Approach', *Investment Arbitration Reporter*, July 17, 2009.

investment guarantees are not to be read in isolation but must be interpreted in light of other international law and domestic policies.⁹⁶ Treaty interpretation to that effect is seen as a second best solution.⁹⁷ That same position is reflected in the World Investment Report 2012 that discloses the UNCTAD Investment Policy Framework for Sustainable Development. It summarizes various best-practice solutions of already existing IIAs, arbitral jurisprudence and doctrine and advocates for explicit balancing in future treaty drafting between the interests of investors and the host States' non-investment policies and agendas. For instance, the UNCTAD Investment Policy Framework proposes the inclusion of various reservation and general exceptions clauses for public policy regulations diminishing the exposure of a host State to investment treaty claims.⁹⁸

However, as the experience with the aborted Norwegian Model BIT shows,⁹⁹ fundamental changes are difficult to achieve by treaty drafting and, if possible, they are time consuming.¹⁰⁰ Hence, the work will offer ways to mitigate the imbalances in the application of the indirect expropriation standard as it currently stands.

Other scholars insist on the need to reconsider the application of customary methods of interpretation in a way that would resist the fragmentation of international law. Scholars indicate that the proper use of customary treaty interpretation principles, in particular the much neglected Article 31(3)(c) VCLT, which requires interpretation of treaty obligations in light of 'relevant rules of international law applicable in the

⁹⁶E.g., Anne Van Aaken, 'Fragmentation of International Law: The Case of International Investment Protection', 17 *Finnish Yearbook of International Law* 91 (2008) 485.

⁹⁷ Ibid.

⁹⁸ UNCTAD, *World Investment Report: Towards a New Generation of Investment Policies 2012* (UN 2012) 139, 148, 153.

⁹⁹ The Norwegian Model BIT attempted to impose a human rights approach to expropriation of property, see 2007 Norway Model BIT <http://ita.law.uvic.ca/documents/NorwayModel2007.doc> Article 6; Comments on the Model for Future Investment Agreements <http://ita.law.uvic.ca/documents/NorwayModel2007-commentary.doc> 22-23; Model BIT 2007 available at <http://www.asil.org/ilib080421.cfm#t1> (accessed on 27 March 2010). See also Damon Vis-Dunbar, 'Norway shelves its draft model bilateral investment treaty', 8 June 2009, available at <<http://www.iisd.org/itn/2009/06/08/norway-shelves-its-proposed-model-bilateral-investment-treaty>> (accessed on 31 March 2012).

¹⁰⁰ See T.W.Wälde, 'Improving the Mechanisms for Treaty Negotiation and Investment Disputes: Competition and Choice as the Path to Quality and Legitimacy', in Karl P Sauvant (ed), *Yearbook on International Investment Law & Policy 2008-2009*, (New York: Oxford University Press, 2009), 512-516. See also IISD Model International Agreement on Investment for Sustainable Development available at http://www.iisd.org/pdf/2005/investment_model_int_agreement.pdf (accessed on 27 March 2010).

relations between the parties’, should avoid the ‘self-contained’ regime approach.¹⁰¹ Kingsbury and Schill, on their part, note that the potential clinical isolation problem may be dealt with by ‘a good faith reading of the text of the applicable treaty in its context and in the light of the object and purpose of the treaty’.¹⁰² A good faith reading of the treaty ‘may well indicate that interpretation calls for a balance to be struck between investor protection and state regulatory power’.¹⁰³

A broader perspective is taken by Petersmann who argues for a ‘constitutional’ framework, in which international economic law should operate,¹⁰⁴ subsequently affecting the role of adjudicators. By ‘constitutionalization’ Petersmann means the possibility to identify certain elements of a specific status in international law that must be given special weight in international adjudication.¹⁰⁵ Typical elements of this kind are *jus cogens* norms, basic human rights, the transnational rule of law and its associated elements of due process and access to justice.¹⁰⁶ The special status of these elements stems from Article 1 of the UN Charter and the Preamble of the VCLT that calls for dispute resolution ‘in conformity with principles of justice’ and by taking into account ‘universal respect for human rights and fundamental freedoms for all’.¹⁰⁷

¹⁰¹ Anne Van Aaken, ‘Defragmentation of Public International Law Through Interpretation: A Methodological Proposal’, 16 *Indiana Journal of Global Legal Studies* 483 (2009). Anne Van Aaken, ‘Fragmentation of International Law: The Case of International Investment Protection’, 17 *Finnish Yearbook of International Law* 91 (2008); Moshe Hirsch, ‘Interactions between Investment and Non-Investment Obligations’, in Peter Muchlinski, Federico Ortino, and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law*, Oxford, Oxford University Press, 2008, pp. 154-181; Campbell McLachlan, ‘Investment Treaties and General International Law’, 57 *International and Comparative Law Quarterly* 361 (2008).

¹⁰² Benedict Kingsbury and Stephan W. Schill, ‘Public Law Concepts to Balance Investors’ Right with State Regulatory Actions in the Public Interest – the Concept of Proportionality’ in Stephan W. Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010), 88, 104. They see that good faith reading of applicable law would allow the integration of proportionality analysis in setting the scope of investment guarantees, that ‘has the potential to help structure (...) the relationship between international investment law and other sub-areas of international law’ and ‘it may provide one way to counter risks of clinical isolation of international investment law, and to build some degree of coherence into aspects of an international economic order’.

¹⁰³ Ibid.

¹⁰⁴ E.U. Petersmann, ‘Introduction and Summary: „Administration of Justice” in International Investment Law and Adjudication?’ in P.M. Dupuy, F. Francioni, E.U. Petersmann (eds.), *Human Rights in International Investment Law and Arbitration*, Oxford: Oxford University Press, 2009; E.U. Petersmann, ‘Future of International Economic Law: A Research Agenda’, EUI Working Papers, Law 2010/06, available at <<http://ssrn.com>>.

¹⁰⁵ Alex Stone Sweet, ‘Investor-State Arbitration: Proportionality’s New Frontier’ (2010) 1 *Law & Ethics of Human Rights* 4, Article 4, 58 refers to Ernst-Ulrich Petersmann, ‘Multilevel Trade Governance Requires Multilevel Constitutionalism’ in Christian Joerges, Ernst-Ulrich Petersmann (eds) *Constitutionalism, Multilevel Trade Governance and Social Regulations* (2006) 5.

¹⁰⁶ E.U. Petersmann, ‘International Economic Law, ‘Public Reason’, and Multilevel Governance of Interdependent Public Goods’, in (2011) 14 *JIEL* 1, at 24. See also E.U. Petersmann, ‘The Future of International Economic Law: A Research Agenda’, EUI Working Papers, Law 2010/06, 23, 25.

¹⁰⁷ Ibid 63.

This customary judicial administration of justice is in the hands of international adjudicators¹⁰⁸ requiring them to provide reasoned interpretation, application and clarification of legal principles and rules so as to ‘balance all private and public interests affected by the dispute’.¹⁰⁹ Consequently, Petersmann sees all the international courts and tribunals as balancing judges guarding the values of the whole system of international law.¹¹⁰

However, the substantive problem with the above-mentioned doctrinal and treaty drafting proposals for the more scrupulous application of customary treaty interpretation principles is their high level of abstraction. Use of customary treaty interpretation principles that are in the hands of international adjudicators provide equal amounts of solutions and problems, since the methods of application are much debated¹¹¹ – by using the same customary treaty interpretation principles arbitral tribunals often reach conflicting conclusions.¹¹² The inability to determine connections between the terms of high levels of generality has contributed to the clinical isolation and imbalance concerns of investment law. For instance, even the NAFTA containing explicit references to the promotion of sustainable development and environmental protection has been interpreted in a way that has raised serious concerns about the ability of States to safeguard these particular values and inflamed

¹⁰⁸ However, Fauchald’s research on the legal reasoning of ICSID tribunals indicates ‘the relatively low number of cases that used the context, object and purpose (...) and general principles of law in their argumentation, see Ole K. Fauchald, ‘The Legal Reasoning of ICSID Tribunals – An Empirical Analysis’, (2008) 19 EJIL 301, at 326, 357.

¹⁰⁹ Ernst-Ulrich Petersmann, ‘International Rule of Law and Constitutional Justice in International Investment Law and Arbitration’ (2009) 16 Ind. J. Global Legal Stud. 513.

¹¹⁰ See also Alex Stone Sweet, ‘Investor-State Arbitration: Proportionality’s New Frontier’ (2010) 1 Law & Ethics of Human Rights 4, Article 4, 59.

¹¹¹ E.g., Mark E. Villiger, *Commentary on the 1969 Vienna Convention on Law of Treaties* (Martinus Nijhoff); R. Gardiner, *Treaty Interpretation*, (New York: Oxford University Press, 2008); J. Pauwelyn, *Conflict of Norms in Public International Law. How WTO Law Relates to Other Rules of International Law* (Cambridge University Press, 2003); Enzo Cannizzaro (ed) *The Law of Treaties Beyond the Vienna Convention* (OUP 2011); I Van Damme, *Treaty Interpretation by the WTO Appellate Body* (OUP 2009). It is even more so with Article 31(3)(c), since none of the known arbitral awards has applied it in practice, see A Van Aaken, ‘Fragmentation of International Law: The Case of International Investment Protection’ (2008) U. of St. Gallen Law & Economics Working Paper No. 2008-1. Available at SSRN: <http://ssrn.com/abstract=1893692> (accessed at 12 December 2011), 16: ‘ICSID tribunals have heavily relied on the application of the VCLT, especially Art. 31 (1) of the VCLT. They have not however resorted explicitly to Art. 31 (3) (c) of the VCLT for interpreting the clauses of BITs, even if they used other special international law for interpretation.’ (footnotes omitted).

¹¹² See Ole K. Fauchald, ‘The Legal Reasoning of ICSID Tribunals – An Empirical Analysis’, (2008) 19 EJIL 301. See the sub-section of Chapter 1 ‘1.3.1. Interpretation of object and purpose of ‘old generation’ BITs: pro investore, in dubio mitius presumptions and balanced approach ’ below.

doubts about the practical value of these clauses.¹¹³ The arbitral jurisprudence examined in Box 2 and Box 3 in the Appendix reflects the need to find a clear and predictable justification of considering non-investment law in informing the content of indirect expropriation and other investment guarantees.

Thus, one takes up the positions by Kingsbury, Schill and Petersmann of the need of scrupulous employment of customary treaty interpretation principles and the acknowledgement of the potential capacity of arbitrators to act as balancing judges between the equally important interests of host States and foreign investors. However, the study is aimed at establishing a definite connection or link of interpretative value that provides a clear guideline for interpreting concepts of high levels of generality, such as the indirect expropriation standard, in a way that necessarily integrates other concepts of high levels of generality like the promotion of sustainable development, human rights and safeguarding the environment. It is argued that the link is established through the interpretation of the very object and purpose of international investment law. This study argues that it can be defined as sustainable development, the content of which is definite enough for limiting or guiding the discretion of investment arbitrators in their employment of customary treaty interpretation principles and tools of resolution of normative conflicts. Thus, the sustainable development objective affects the application of Article 31 of VCLT that requires interpretation of the treaty ‘in the light of its object and purpose’ guiding teleological and effective treaty interpretation of the indirect expropriation standard towards an outcome that integrates economic and non-economic interests. It also allows the extension of the understanding of the clause ‘the same subject matter’ within Article 31 of the VCLT beyond the mere focus on investment rules when applying the indirect expropriation standard.¹¹⁴

¹¹³ J. Soloway, ‘Environmental Regulations as Expropriation: The Case of NAFTA’s Chapter 11’, (2000) 33 Canadian Business Law Journal 92, 116.

¹¹⁴ The point that is also left unspecified is the issue on how exactly other international norms, if they are decided to be relevant, affect the content of the loose indirect expropriation standard or its sub-elements. With the exception of Kingsbury and Schill who limit the application of Article 31(3)(c) to integration of proportionality analysis as a general principle of law and thus arguing that this external international norm provides a rational process for weighing and balancing investment guarantees, see Benedict Kingsbury and Stephan W. Schill, ‘Public Law Concepts to Balance Investors’ Right with State Regulatory Actions in the Public Interest – the Concept of Proportionality’ (2010), 88.

Propositions for solving the potential imbalance between State's and investor's interests by improving the methodology of setting the content of international investment guarantees

With regard to the inconsistency in criteria establishing the content of indirect expropriation, the UNCTAD Investment Policy Framework proposes the inclusion of factors in future IIAs that should be taken into account in establishing the existence of indirect expropriation and for calculating appropriate compensation.¹¹⁵

For the interpretation of the existing IIAs, a number of scholars propose the implementation of additional standards of review in investment treaty arbitration, taken from comparative public international and domestic law,¹¹⁶ that could help to mitigate potential imbalances in the assessment of whether the conduct of a host State is in violation of international investment guarantees, in particular within the application of the FET standard. These scholars propose extracting common principles from comparable legal regimes, such as international human rights law¹¹⁷ and WTO law, that share the so-called 'common paradigm of global administrative law'¹¹⁸ and influential domestic regimes employing balancing mechanisms between

¹¹⁵ UNCTAD, *World Investment Report 2012: Towards a New Generation of Investment Policies* (UN 2012) 139, 148, 153. For instance, one of the propositions is to specify in IIAs that 'only expropriations violating any of the three substantive conditions (public purpose, non-discrimination, due process), entail full reparation', see page 148, [4.5.3.]. It is also suggested to draft IIAs indicating that the amount of compensation 'shall be equitable in light of circumstances of the case', taking into account the country's level of development, limiting recoverability of lost profits and excluding recoverability of punitive and/or moral damages (page 153 [6.4.2]).

¹¹⁶ William W. Burke-White and Andreas von Staden, 'Private litigation in a public law sphere: The standard of review in investor-state arbitrations,' (2010) 35 *Yale Journal of International Law* 283, 285; Markus Perkampus, 'The Concept of Indirect Expropriation in Comparative Public Law- Searching for Light in the Dark' in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010) 109, 147. Perkampus analyses indirect expropriation under the ECtHR jurisprudence and in selected national legal systems and tries to extract common principles that can be used to interpret the 'ordinary meaning' of indirect expropriation in the context of IIAs. A Stone Sweet, 'Investor-State Arbitration: Proportionality's New Frontier' (2010) 4(I) *Law and Ethics of Human Rights*, 47, 73 available at <http://works.bepress.com/lehr/vol4/iss1/arb4>; Benedict Kingsbury and Stephen W Schill, 'Public Law Concepts to Balance Investors' Right with State Regulatory Actions in the Public Interest – the Concept of Proportionality' in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010).

¹¹⁷ Both investment and human rights treaties have a common origin of aliens' protection abroad and they provide protections in case of expropriation of property. The right to property is protected under Article 1 Protocol 1 of the European Convention on Human Rights; however, IIAs and ECtHR jurisprudence differ considerably regarding the standard of compensation in cases where an expropriation is found. For differences see U. Kriebaum, 'Is the European Court of Human Rights an Alternative to Investor-State Arbitration?', in P.M. Dupuy, F. Francioni, E.U. Petersmann (eds.), *Human Rights in International Investment Law and Arbitration*, (OUP, 2009).

¹¹⁸ In essence, GAL means governing the relationship between the State and an individual in exercising international legitimacy review of governmental actions, see S.W. Schill, *The Multilateralization of International Investment Law* (CUP 2009), 377.

one's rights and rights-limiting policy actions. Scholars suggest these balancing argumentation methods which would create room for the accommodation of the impact of non-investment related matters on the scope of investment guarantees may be implemented in investor-state arbitration as general principles of international law¹¹⁹ or as part of the inherent procedural powers of adjudicators.¹²⁰ However, there is disagreement on the most appropriate interpretative techniques to be employed and on their foundational justification in investment treaty law. For instance, Burke-White and von Staden argue for 'margin of appreciation' as the most appropriate interpretation technique disagreeing on the capacity of *ad hoc* arbitral tribunals to employ proportionality balancing since they are 'too far removed from the politics over whom they exercise control and may lack necessary expertise in the particular circumstances and fact patterns of the case'.¹²¹ Others note that the margin of appreciation may not be seen as a self-standing standard; it is rather an element of proportionality balancing.¹²² Schill refers to the 'margin of appreciation' not as an interpretative technique but as the most appropriate institutional relationship between domestic legal systems and arbitral tribunals that have the power to review legitimacy

¹¹⁹ Benedict Kingsbury and Stephan W. Schill, 'Public Law Concepts to Balance Investors' Right with State Regulatory Actions in the Public Interest – the Concept of Proportionality' (2010), 104. They see that good faith reading of applicable law would allow integrating proportionality analysis in setting the scope of investment guarantees. I take up the point of contextual interpretation in Chapter 1, but differ with respect to the proportionality as an external element that must be integrated in setting the content of indirect expropriation through Article 31(3)(c); rather I claim for indirect expropriation having an inherent flexibility to balance the State's and investor's interests, and this inner flexibility may be achieved through effective interpretation of the indirect expropriation standard.

¹²⁰ Jean-Pierre Cot, 'Margin of Appreciation', Max Planck Encyclopedia, The Max Planck Encyclopedia of Public International Law, Oxford University Press, 2007, online edition, available at www.mpepil.com, (accessed on 31 March 2010) [12]. Some arbitrators have already shown a tendency in their judicial argumentation to get 'inspiration' from judicial balancing methods from other legal regimes; however, it is often done without sufficient justification, see SR Ratner, 'Regulatory Takings in Institutional Context: Beyond the Fear of Fragmented International Law' (2008) 102 AJIL 3, 475.

¹²¹ William Burke-White and Andreas von Staden, 'The Need for Public Law Standards of Review in Investor-State Arbitrations' in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010) 717. However, there is a general disagreement on what 'margin of appreciation' is. Cot notes that the use of a margin of appreciation exceeds considerably the ECtHR, and it does not need to be necessarily linked with the proportionality balancing as it is used by the ECtHR, see Jean-Pierre Cot, 'Margin of Appreciation', Max Planck Encyclopedia, The Max Planck Encyclopedia of Public International Law, Oxford University Press, 2007, [1], [25], [29]. In contrast, Stone Sweet comments on Burke-White and von Staden understanding of 'margin of appreciation' as a misconception, arguing 'margin of appreciation' forms part of the wider proportionality balancing in the ECtHR way, and it is not a stand-alone doctrine, see A Stone Sweet, 'Investor-State Arbitration: Proportionality's New Frontier' (2010) 4(I) Law and Ethics of Human Rights, 68, footnote 65.

¹²² Andreas Kulick, *Global Public Interest in International Investment Law* (CUP 2012), 194.

of domestic actions¹²³ granting ‘a space for manoeuvre, within which host state conduct is exempt from fully fledged review by an international court or tribunal’.¹²⁴ Stone Sweet, on his part, argues for the use of proportionality analysis. He sees proportionality balancing as the most appropriate interpretative technique for finding a balance between foreign investment protection and a State’s regulatory responsibility to protect public interest. He focuses on the application of FET standard and the treaty specific ‘non-precluded measures’ clause under Article 11 of the Argentina-US BIT, which Argentina has invoked in several arbitrations dealing with its social and economic crisis management measures in 2001-2002.¹²⁵ Stone Sweet likens balancing to proportionality analysis as the best and most developed argumentation technique to be employed in investment treaty arbitration¹²⁶ admitting that this particular proposition is questionable.¹²⁷ He insists on the use of proportionality balancing because ‘it allows arbitrators to “see” the entire contextual field and to narrow or expand their intervention’¹²⁸ and provides an accurate assessment of the balancing process as an analytical way to ‘reduce the losses occurring to the loser as much as is legally possible’.¹²⁹ He claims that *ad hoc* arbitral tribunals have the capacity to employ proportionality analysis because investment protection regime is currently undergoing a process of judicialization. That is, there is a *de facto* precedent system in investment arbitration, acceptance of *amici* briefs and ‘flirtation with the proportionality analysis’ by some arbitral awards¹³⁰ that indicates

¹²³ Stephan W. Schill, ‘Deference in Investment Treaty Arbitration: Reconceptualizing the Standard of Review through Comparative Public Law’, SIEL, Working Paper No. 2012/33, available <<http://www.ssrn.com/link/SIEL-2012-Singapore-Conference.html>> (accessed on 15 August 2012).

¹²⁴ Ibid, 6 referring to Yuval Shany, ‘Toward a General Margin of Appreciation Doctrine in International Law’, 16 EJIL (2005) 907. See also Michael R Hutchinson, ‘The Margin of Appreciation Doctrine in the European Court of Human Rights’, (1999) 48 ICLQ, 638-650, at 639; Jean-Pierre Cot, ‘Margin of Appreciation’, Max Planck Encyclopedia, The Max Planck Encyclopedia of Public International Law, Oxford University Press, 2007 [2].

¹²⁵ A Stone Sweet, ‘Investor-State Arbitration: Proportionality’s New Frontier’ (2010) 4(I) Law and Ethics of Human Rights, 47, at 62.

¹²⁶ Ibid 63.

¹²⁷ Ibid, footnote 40. See, for instance, Arbitrator Nikken, Separate Opinion in Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic, Decision on Liability, 30 July 2010, ICSID Case No. ARB/03/19, [37] disagreeing with the Tribunals capacity to assess the existence of alternative means than might have existed for Argentina during the crisis.

¹²⁸ A Stone Sweet, ‘Investor-State Arbitration: Proportionality’s New Frontier’ (2010) 4(I) Law and Ethics of Human Rights, 47, at 62.

¹²⁹ Ibid 63, see also footnote 43.

¹³⁰ The most recent example of using proportionality language is the *Occidental v. Ecuador* Award that employed the proportionality assessment under the FET standard. The Tribunal referred to the proportionality principle under the Ecuadorian law (and also international law) that was applicable to

the shift towards the public law character of investment treaty arbitrations indicating that arbitrators are ready to function as public law judges.¹³¹

Schill and Kingsbury express similar views on the need to adopt proportionality analysis in the interpretation process, in particular within the FET standard, by noting that its adoption would ‘ensure that tribunals consider the relevant interests under the applicable principles’, and proportionality analysis would ‘produce better and more convincing reasoning, and enable clearer assessment, critique, and accountability of tribunals...justifying their decisions in a detailed fashion’.¹³²

However, arbitrators have differed significantly in their understanding of the scope of their inherent powers and on the necessity to refer to external norms of investment protection and promotion, including various balancing techniques developed under other fields of law.¹³³ This is despite the fact that there are notable developments towards weighing and balancing of investors’ and States’ interests by some arbitral tribunals under some investment guarantees. Fauchald, who undertook empirical analysis on the extent ‘to which ICSID tribunals contribute to creating a predictable legal framework in which the interests of investors, states, and third parties are taken properly into account’, proved the existence of two extremes. At the one end of the spectrum is a ‘dispute oriented’ tribunal that limits itself strictly to the relationship between the parties to the dispute. At the other end of the spectrum is a ‘legislator-oriented’ tribunal, which also considers interests of third parties, ‘the general functioning of the ICSID system, the potential impact of its reasoning or conclusions for future cases, the general need to clarify issues of law, or the need to prevent future disputes’.¹³⁴

determine the legitimacy of Ecuador’s action by terminating an oil contract as a response of the Investor’s breach of that contract, see *Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award, 5 October 2012, US-Ecuador BIT (1997) [384]-[455].

¹³¹ A Stone Sweet, ‘Investor-State Arbitration: Proportionality’s New Frontier’ (2010) 4(I) Law and Ethics of Human Rights, 47, at 62.

¹³² Benedict Kingsbury and Stephen W Schill, ‘Public Law Concepts to Balance Investors’ Right with State Regulatory Actions in the Public Interest – the Concept of Proportionality’ in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010), 103.

¹³³ E.g., criticism by *Fireman Funds* on *Tecmed* ECtHR inspired proportionality balancing, see *Fireman’s Fund Insurance Company v. Mexico*, Award, NAFTA, ICSID Case No.ARB(AF)/02/01, 17 July 2006, para.174(j), footnote 161.

¹³⁴ Ole K. Fauchald, ‘The Legal Reasoning of ICSID Tribunals – An Empirical Analysis’, (2008) 19 EJIL 301, at 306-307. Fauchald also highlighted looking ‘beyond the arguments presented by the parties’ as the main challenge for arbitral tribunals, see p.359.

Therefore, one agrees with Burke-White and von Staden¹³⁵ rejecting Stone Sweet's claim that because of certain arbitral tribunals applying modified proportionality analysis as a balancing mechanism in setting the scope of some particular clause in particular IIAs,¹³⁶ earlier awards applying less balanced approaches 'have now been destroyed'.¹³⁷ The fact that some arbitral jurisprudence appears to pay due respect to public interest involved in the interference of foreign investment does not guarantee that other tribunals will take a similar approach. In other words, there needs to be persuasive arguments put forward for justifying why the non-balanced approaches in establishing content of the protection against indirect expropriation are clearly excluded.

The rationale for introducing these external balancing mechanisms in investment treaty arbitration is to ensure that arbitrators always take the wider context of the case into account and avoid limiting themselves strictly to the focus on the investment promotion and protection that may lead to unjustified limitations on host State's regulatory powers.

In contrast to the above-mentioned proposals, this study aims to prove that the same rationale may be achieved by staying within the framework of foreign investment law through the careful reading of the inherent object and purpose of the regime that equally applies to 'old generation' IIAs, which are mostly based on the model of the OECD 1967 Draft Convention and narrowly focus on foreign investment protection representing the vast majority of IIAs,¹³⁸ and more balanced 'new generation' IIAs.¹³⁹ Namely, the thesis will show that the current meaning of economic development as

¹³⁵ William Burke-White and Andreas von Staden, 'The Need for Public Law Standards of Review in Investor-State Arbitrations' in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010) 716-717.

¹³⁶ As it was done by the *Continental v. Argentina* Tribunal with respect to Argentina's necessity defence under the 'non-precluded measures' clause in Article 11 Argentina- US BIT, see A Stone Sweet, 'Investor-State Arbitration: Proportionality's New Frontier' (2010) 4(I) *Law and Ethics of Human Rights*, 47 at 62.

¹³⁷ *Ibid* 75.

¹³⁸ Not all treaties concluded later in time belong to 'new generation' IIAs, for example, the preamble of the more recent German – Timor Leste BIT (2005) also reflects the 'old generation' BIT approach, see the Treaty between the Federal Republic of Germany and the Democratic Republic of Timor-Leste concerning the Encouragement and Reciprocal Protection of Investments, available at www.italaw.com.

¹³⁹ One may distinguish two main types of IIAs – 'old generation' BITs and 'new generation' IIAs. If the language of 'old generation' BITs mainly focus on foreign investment promotion and protection, texts of 'new generation' IIAs expand to various degrees on *prima facie* external issues of investment protection like environmental protection or the observance of international labour standards, see K. Vandevelde, 'A Brief History of International Investment Agreements', 12 *U.C. Davis J.Int'l & Pol'y* 157 (2005), at 169 et seq.

the inherent objective of international investment promotion and protection is sustainable development. For this conclusion there are several legal consequences. First, by formalizing the content of sustainable development one may extract elements that are directly applicable to the interpretation process of foreign investment guarantees, including the necessity to address investment disputes from a broader perspective than the narrow focus on foreign investment protection. Second, the requirement to take into account the wider context, and third stakeholders' interests, therefore stems from the very international investment protection regime facilitating arbitrators to consider the connection between *prima facie* non-investment aspects and investment protection. Furthermore, good faith, contextual and effective interpretation¹⁴⁰ of the indirect expropriation standard subsequently requires the use of weighing and balancing mechanisms not as external techniques but as internal requirements that may be achieved by scrupulous analysis of the inherent flexibility of the sub-elements of indirect expropriation standard.

To conclude, such proposals as that of introducing changes in future treaty drafting, more careful employment of customary treaty interpretation principles and the inclusion of external standards of review in investment arbitration with the aim of ensuring that arbitrators always take the wider context of the case into account and avoid limiting themselves strictly to the focus on the foreign investment promotion and protection are remarkable. Nevertheless, apart from these suggested improvements in future treaty drafting, they suffer from being overly abstract for clearly linking investment protection (economic development) with other pillars of sustainable development, namely social development and environmental protection. Hence, these proposals do not ensure certainty and predictability with respect to the balanced outcome of their application.

Aim of the thesis

For the above-mentioned reasons the study aims at establishing the required legal link between international investment protection regime as an inherently development oriented field of law and the global commitment to promote sustainable development in the application of indirect expropriation standard. The central claim is that a

¹⁴⁰ By effective interpretation/understanding interpretation of treaty norms that in a way that most effectively fulfills the object and purpose of the treaty, see Ole K. Fauchald, 'The Legal Reasoning of ICSID Tribunals – An Empirical Analysis', (2008) 19 EJIL 301, at 317.

sufficient degree of systematic and conceptual considerations are required when delimiting the meaning of indirect expropriation and its sub-elements, and they are provided by the sustainable development objective.

The thesis will prove two interrelated points.

First, sustainable (economic) development is the inherent object and purpose of the already existing network of IIAs consisting of both ‘old generation’ and more-balanced ‘new generation’ IIAs. This object and purpose requires the assurance that commercial interests are not prioritized but balanced and reconciled with competing non-economic interests in the application and interpretation of the indirect expropriation standard. Subsequently, the promotion of sustainable (economic) development serves as a context, in which the vague indirect expropriation standard must be applied allowing for the internalization of the global commitment to promote sustainable development in the ‘old generation’ IIAs. Due to the context of the legal regime, sustainable development limits the discretion and policy choices of adjudicators for filling the vague standard with content in specific cases and facilitates arbitrators to consider the connection between *prima facie* non-investment aspects and investment protection. Thus, the proposed contextualization of investment protection through the prism of sustainable development will influence and guide the application and interpretation of the indirect expropriation standard without waiting for the adoption of more-balanced future IIAs.

Second, and in contrast to the doctrines which view various balancing mechanisms as external elements to investment guarantees, the study shows that balancing is inherent within the sub-elements of the indirect expropriation standard and its content stems from the inherent object and purpose of the international investment protection regime.

The thesis is not designed to go beyond customary treaty interpretation principles; instead, it endeavours to establish the link of the interpretative value that provides a clear guideline for interpreting indirect expropriation standard in a way that necessarily integrates *prima facie* non-related aspects, e.g., human rights and the safeguarding of the environment. In sum, it will solve the imbalances inherent in the current of the indirect expropriation standard.

Methodology

The study provides an interpretative tool for ensuring that balancing takes place between the divergent interests of foreign investors and host countries within the interpretation process of the indirect expropriation standard, which is a key investment guarantee invoked to challenge the public interest regulations of a host State. Interpretation of the FET standard will also be taken into account, since most of the time investor's allegations under FET and indirect expropriation standards are substantially the same, and these two standards share the legitimate-investment backed expectations element.

As the thesis focuses on the application and interpretation of indirect expropriation, it will analyse developments in treaty drafting and divergent arbitral jurisprudence.

The study will assess the network of IIAs as a legal regime despite the lack of one multilateral treaty. This approach is supported by Salacuse, who notes that the network of IIAs fulfils the regime elements. These elements are the common aim of the regime participants – ‘the belief that increased investment between and among contracting states will increase their prosperity’ and ‘that favourable conditions in host states will [...] lead to increased investment’; the existence of regime norms and regime rules – all IIAs contain similar investment protection guarantees; IIAs provide for state-state and investor-state arbitration as a decision-making procedures of the regime.¹⁴¹ The regime perspective allows applying two levels of object and purpose to IIAs – the ‘immediate’ one of the particular IIA and the overall one of the regime. Since the network of IIAs is not invented from scratch but to a great extent codifies customary international law norms,¹⁴² a comparison of arbitral jurisprudence under various IIAs is justified. At least it is a case of indirect expropriation standard, fair and equitable treatment standard (and/or international minimum standard) and their legitimate expectations element which forms part of the good faith principle. The indirect expropriation standard is also an evolutionary legal term whose content changes over time¹⁴³ justifying the use of international law in force at the time when the standard is applied.

¹⁴¹ J.W. Salacuse, *The Law of Investment Treaties* (OUP, 2010), 1-17. See also S.W.Schill, *The Multilateralization of International Investment Law* (CUP 2009).

¹⁴² T.W.Waelde, ‘The Specific Nature of Investment Arbitration’ in Philippe Kahn, Thomas W Waelde (eds), *New Aspects of International Investment Law* (Martinus Nijhoff 2007), 56.

¹⁴³ Report of the Study Group of the International Law Commission, Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law. Finalized by Koskenniemi (Helsinki, 2007) (Fragmentation Report) [478 (a)].

In order to limit the scope of the thesis, the focus is on the available arbitral jurisprudence dealing with sustainable development related matters (summarized in Box 1- Box 3 in the Appendix).

CHAPTER 1. SUSTAINABLE DEVELOPMENT AS THE INHERENT OBJECTIVE OF FOREIGN INVESTMENT PROTECTION REGIME

INTRODUCTION

Sustainable development is clearly acknowledged as a paradigm of future international investment protection regime, in particular of investment policy making,¹⁴⁴ though the influence of the global commitment to promote sustainable development in the currently existing investment protection regime is still unclear. The current investment regime is criticised as blocking instead of promoting development because of its unpredictability whether host State's measures for safeguarding non-investment public purpose goals will be tolerated.

Investment protection regime consists of both 'old generation' IIAs and more balanced 'new generation' IIAs. Even if 'new generation' IIAs are more balanced between the interests of investors and those of the State – namely these treaties address wider development aspects of the operation of foreign investment than the narrow focus on the investment protection element, e.g. the necessity to respect basic workers rights and to protect the environment, some of them even contain references to sustainable development – they represent only around 8% of all the IIAs.¹⁴⁵ Consequently, the question remains open about the interpretation of 'old generation' IIAs in a way that would not be contrary to the idea of the promotion of sustainable development. Moreover, even those 'new generation' IIAs as the NAFTA are sometimes interpreted in a way that narrowly focuses on the investment protection aspect rather than on their overall development elements.¹⁴⁶ Consequently, the

¹⁴⁴ UNCTAD, World Investment Report 2012, Towards a New Generation of Investment Policies (UN 2012).

¹⁴⁵ E.g., statistically around 8% IIAs include reference to environmental concerns, see Kathryn Gordon, Joachim Pohl (2011), 'Environmental Concerns in International Investment Agreements. A Survey' OECD Working Papers on International Investment 2011/01, OECD Publishing <<http://dx.doi.org/10.1787/5kg9mq7scjh-en>>; see also UNCTAD, World Investment Report, *Investing in a Low-Carbon Economy*, (2010), (UN 2010), 90.

¹⁴⁶ In sum, NAFTA Chapter 11 may be considered as an investment protection treaty, which gives a leeway for sustainable development as approved in the S.D. Myers Award, and non-investment issues have been internalized in NAFTA through annexes and many sub-objectives mentioned in the preamble of the Treaty, which must be reconciled with the goal of market liberalization and investment protection. However, its practical application has not reflected a consistent approach of taking into account these balancing mechanisms. E.g., *Metalclad v. Mexico*, where the Tribunal attributed relevance solely to the effect that the governmental environment measure imposed on the foreign investment, see *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1,

usefulness of NAFTA clauses on non-investment public policy goals has been questioned.¹⁴⁷ This paradoxical situation reapproves the necessity to establish a clear link between statements of ‘high level of generality and abstraction’ of non-investment public interests in these treaties¹⁴⁸ and the content of indirect expropriation standard. The clearness of this link is necessary to ensure that arbitrators always take the wider context of cases into account and avoid limiting themselves strictly to the focus on the investment protection and promotion.

Hence, this chapter aims at demonstrating the required interpretative relationship between indirect expropriation as a specific term in IIAs and the general commitment to promote sustainable development.

The already proposed reconciling mechanisms, through more considerate application of customary treaty interpretation principles, are remarkable. Nevertheless, they suffer from being overly vague in linking the interpretation of specific investment treaty norms in light of such abstract terms and *prima facie* external elements to investment protection as social development and environmental protection. Even more, by using the same treaty interpretation principles arbitral jurisprudence has developed the interpretative arguments, which has raised criticism of the investment protection regime.

Hence, the Study is designed to demonstrate that promotion of sustainable development serves as a context (object and purpose) in which the vague indirect expropriation standard must be applied, limiting discretion and policy choices of adjudicators while filling (interpreting) investment standards with content in specific cases.

This chapter aims to prove the following: (1) there is a global commitment to promote sustainable development; (2) the core content of this global commitment to promote sustainable development is the principle of integration; (3) investment protection regime consisting of ‘old generation’ and ‘new generation’ IIAs has economic development as its inherent object and purpose. It requires a construction of particular

Award August 30, 2000, NAFTA [111]. The sole effects approach was taken despite preambular references to the promotion of sustainable development and environmental protection as a context of the NAFTA.

¹⁴⁷ J. Soloway, ‘Environmental Regulations as Expropriation: The Case of NAFTA’s Chapter 11’, (2000) 33 Canadian Business Law Journal 92.

¹⁴⁸ In words of S.D.Myers Tribunal, see *S.D.Myers, Inc. v Government of Canada*, Partial Award, November 13, 2000, NAFTA, UNCITRAL, [196], [197], [202]; see also *ADF Group v. United States of America*, Award, January 9, 2003, [147].

clauses in IIAs in light of Article 31(1) of the VCLT.¹⁴⁹ From the methodological perspective – since most IIAs are ‘common-form’ because of their comparable historic origin¹⁵⁰ they have a uniform structure and rather standardized language introducing ‘uniform principles of investment protection’¹⁵¹ – it is permissible to draw conclusions about their inherent rationale by analysing just few of them.

(4) Further, it is argued that economic development is intrinsically a generic legal term, and its current meaning is sustainable development. Hence, the study is designed to provide a contextualization of the existing network of IIAs through the perspective of the global commitment to promote sustainable development by arguing that the inherent object and purpose of the international investment protection regime is promotion of sustainable (economic) development. It will be argued that the sustainable development objective applies to both ‘new generation’ IIAs (since they contain direct or indirect references to sustainable development) and to ‘old generation’ IIAs (as an inherent objective of the investment protection regime). (5) Last but not least, it is suggested that sustainable development is a general principle of development related international law, which is applicable as a principle of interpretation in establishing the existence of indirect expropriation. In other words, it guides treaty interpretation in good faith and in light of its object and purpose towards a specific outcome – integration of economic and non-economic interests, excluding those interpretative methodologies that solely benefit foreign investors.

1.1. GLOBAL COMMITMENT TO PROMOTE SUSTAINABLE DEVELOPMENT

The underlying aim of economic globalization, of which FDI protection forms part, is the raising of living standards throughout the world in line with the general assumption that widening market access and attracting foreign investment optimizes economies and prosperity.¹⁵²

¹⁴⁹ R Gardiner, *Treaty Interpretation* (OUP 2008) 199-200; G. Fitzmaurice, *The Law and Procedure of the International Court of Justice*, Vo.I, (Cambridge, Grotius, 1986), 42-3.

¹⁵⁰ Early Model BITs originated from the 1967 OECD Convention on the Protection of Foreign Property with the exception of the US BITs. See Rudolf Dolzer and Christoph H. Schreuer, *Principles of International Investment Law* (OUP, 2008), 18-19.

¹⁵¹ Stephan W Schill, *The Multilateralization of International Investment Law* (CUP 2009), 11, 364.

¹⁵² Jeffrey D. Sachs, *Common Wealth. Economics for a Crowded Planet* (Penguin Books, 2008) 208-212. J.E.Stiglitz, *Making Globalization Work*, (.W.Norton&Company: New York, London, 2006) 187-210.

However, since 1972 and the UN Conference on the Human Environment held in Stockholm it has been realized that economic growth is necessarily limited due to the environment degradation aspect. In 1987, the UN World Commission on Environment and Development in the Report *Our Common Future* (the Brundtland Report)¹⁵³ formulated the concept of sustainable development and brought the concept to the forefront of the international community.¹⁵⁴ The Brundtland Report provides the most often quoted definition of sustainable development:

*Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.*¹⁵⁵

As an expression of community interest¹⁵⁶ or ‘the principle of collective ethics’¹⁵⁷ sustainable development contains the idea of limitations¹⁵⁸ ‘imposed by the present state of technology and social organization on environmental resources and by the ability of the biosphere to absorb the effects of human activities.’¹⁵⁹ Thus, sustainable development is intended as a corrective concept to economic development and various processes of globalization. Its intention is to achieve the overall harmonious growth that benefits all.¹⁶⁰ The concept of sustainable development extends the context in which we think about economic development. As the sole focus on economic development, e.g. in policy making, might lead to possible negative externalities, its current context requires a balancing between economic interests, social development needs and environmental protection.

Furthermore, promotion of sustainable development is not just a theoretical idea. The global community has committed to promote sustainable development in three UN Conferences— in the UN Conference on Environment and Development in 1992,

¹⁵³ World Commission on Environment and Development, *Our Common Future* (OUP 1987) (Brundtland Report).

¹⁵⁴ Judge Weeramantry proposes to trace back the idea of sustainable development to ancient times ‘as one of the most ancient ideas of human heritage’. See Weeramantry, Vice-President, Separate Opinion to Gabčíkovo- Nagymaros Project case (Hungary/Slovakia), ICJ Reports (1997).

¹⁵⁵ Brundtland Report (OUP 1987) 8, 43.

¹⁵⁶ B. Simma, *From bilateralism to community interest in international law*, Recueil des Cours, Vol. 250, 1994, 234-5, 238-243.

¹⁵⁷ F. Francioni, „Revisiting Sustainable Development in Light of General Principles of International Environmental Law” [not published], 3.

¹⁵⁸ Brundtland Report (OUP 1987) 43.

¹⁵⁹ Ibid, 8, 46.

¹⁶⁰ Johannesburg Plan of Implementation, in Report of the World Summit on Sustainable Development, 26 August to 4 September 2002, UN Doc. A/AC.257/32, Chapter .5 [45]- [47].

known as the Earth Summit or Rio Conference,¹⁶¹ in the World Summit on Sustainable Development in 2002,¹⁶² known as the Johannesburg Conference,¹⁶³ and in the Rio+20 Conference on Sustainable Development, which took place in Rio on June 20-22, 2012.¹⁶⁴ All three conferences had had wide attendance by heads of states, representatives of national and local governments, other representatives of states, international organizations, NGOs and businesses. The 1992 Rio Conference involved over 100 heads of state and government, representatives from 178 countries and around 17,000 participants. In the Johannesburg Conference, there were members from 191 governments and participants from intergovernmental and non-governmental organizations.¹⁶⁵ The Rio+20 Conference on Sustainable Development was one of the largest international conferences in recent history with more than 40,000 participants, among them more than fifty heads of state and hundreds of ministers.¹⁶⁶

This wide attendance by the representatives of States and the final documents approved by the attendees indicate the universal commitment to promote sustainable development, creating legitimate expectations towards actions which are in line with this commitment on all development related matters,¹⁶⁷ including protection of foreign investment.

Since 1987, when the concept of sustainable development was formulated, promotion of sustainable development had become a paradigm of international economic law. For instance, reference to sustainable development was included in the preamble of

¹⁶¹ The conference had produced as the final document the Rio Declaration and had opened for signature two conventions - the UN Framework Convention on Climate Change and the Convention on Biological Diversity.

¹⁶² UN Conference on Environment and Development 'Rio Declaration on Environment and Development' (14 June 1992) UN Doc A/CONF. 151/26/Rev 1 vol I, 3.

¹⁶³ Johannesburg Declaration 2002, World Summit on Sustainable Development (Johannesburg Summit) 'Report' (26 August-4 September 2002) UN Doc A/AC.257/32, Chapter 5 is devoted to trade and FDI [45]-[47], and the action plans – Agenda 21 and the Johannesburg Plan of Implementation.

¹⁶⁴ 64th Session of the United Nations General Assembly, UN General Assembly's Resolution 64/236.

¹⁶⁵ Data taken from Earth Negotiations Bulletin, A Reporting Service for Environment and Development Negotiations, available at <http://www.iisd.ca/uncsd/prepp>, Vol.27, No.6, 25 July 2011.

¹⁶⁶ Tseming Yang, 'The UN Rio+20 Conference on Sustainable Development—What Happened?' (2012) 16 ASIL Insights 28. The Conference produced the outcome document 'The Future We Want', United Nations, A/CONF.216/L/1/, Rio de Janeiro, Brazil, 20-22 June 2012.

¹⁶⁷ M-C. Cordonier Segger, 'Sustainable Development in International Law', in HC Bugge, C. Voigt, (eds.), Sustainable Development in International and National Law, (Europa Law Publishing, 2008), 139, 178-182; C.M.Chinkin, 'The Challenge of Soft Law: Development and Change in International Law', (1989) 38 ICLQ 4, 851, at 857. Chinkin notes that: '*State practice is evidenced by what states do, as well by what they say.*'

the WTO Marrakesh Agreement (1994) and some ‘new generation’ IIAs.¹⁶⁸ Integration of sustainable development in economic law is widely supported by scholars, for instance Petersmann has ceaselessly insisted on internalization in international economic law of supply of such international public goods like transnational rule of law, human rights and sustainable development.¹⁶⁹

Sustainable development is also acknowledged as a paradigm of future international investment protection law and policy by the World Investment Report (WIR) 2012.¹⁷⁰ Namely, the WIR 2012 approves that international foreign investment protection has an underlying ‘social function’¹⁷¹ represented by the concept of sustainable development¹⁷² that needs to be taken into account in drafting future IIAs and shaping future investment policies.

Nevertheless, the question remains open of the possibilities and methods of internalizing the global commitment to promote sustainable development in the currently existing regime of international investment protection regime that mostly consists of ‘old generation’ IIAs. The issue is addressed in the following sections.

1.2.THE CORE CONTENT OF SUSTAINABLE DEVELOPMENT – PRINCIPLE OF INTEGRATION

Despite the universal commitment to promote sustainable development, determination of its content has turned out to be a complex and much contested issue.¹⁷³ One way to reveal its content is to look at the so-called ‘international law in the field of sustainable development’¹⁷⁴ that groups various *lex lata* and emerging self-contained

¹⁶⁸E.g., Preamble of the North American Free Trade Agreement (NAFTA).

¹⁶⁹ E.U. Petersmann, ‘The Future of International Economic Law: A Research Agenda’, EUI Working Papers, Law 2010/06, 23, 25. See also E.U. Petersmann, ‘International Economic Law, ‘Public Reason’, and Multilevel Governance of Interdependent Public Goods’, in (2011) 14 JIEL 23-76; EU Petersmann, ‘Introduction and Summary: ‘Administration of Justice’ in International Investment Law and Adjudication?’ in P.M Dupuy, F. Francioni, E.U. Petersmann (eds.), *Human Rights in International Investment Law and Arbitration*, (Oxford University Press) 2009, 1-45.

¹⁷⁰ UNCTAD, World Investment Report 2012, Towards a New Generation of Investment Policies (UN 2012).

¹⁷¹ A.Ali Ghouri, ‘Investment Treaty Arbitration and the Development of International Investment Law as a „Collective Value System”: A Synopsis of a New Synthesis’, JWIT, Vol 10, December 2009, No.6, 922-935.

¹⁷² See also M. Sornarajah, ‘Right to Regulate and Safeguard’, in UN Conference on Trade&Development, The Development Dimensions of FDI: Policy and Rule –Making Perspectives 189, UN Doc. UNCTAD/ITE/IIA/2003/4 (2003), at 205.

¹⁷³E.g., Handl, ‘Sustainable Development: General Rules versus Specific Obligations’, in Winfried Lang (ed.), *Sustainable Development and International Law*, (Graham & Trotman/Martinus Nijhoff, 1995), 36.

¹⁷⁴ Principle 27 of the Rio Declaration, Brundtland Report (OUP 1987), 11, 17, 231-232.

norms under sustainable development as an overarching principle, goal or value.¹⁷⁵ Global legal experts in the Report of ILA New Delhi Conference¹⁷⁶ have specified these principles – the duty to co-operate for the protection of the environment,¹⁷⁷ principles of equity and the eradication of poverty,¹⁷⁸ strengthening rule of law and good governance practices in States,¹⁷⁹ ensuring access to justice and access to information by civil society,¹⁸⁰ and the duty of states to ensure sustainable use of natural resources.¹⁸¹ Newcombe emphasizes a significant overlap and also a clash between these principles and the functioning of international investment protection regime, approving the idea that sustainable development and the investment protection regime interact significantly.¹⁸²

Another way for revealing its content implies assessing sustainable development as a process rather than a fulfilment of a certain standard of substance.¹⁸³ One may narrow down the scope of this process to the essence of integration of economic, social and environmental aspects; this integration aspect has been reapproved in the most recent global conference on sustainable development. The outcome-document of the Rio+20

¹⁷⁵ P. Sands, 'Sustainable Development: Treaty, Custom, and the Cross-fertilization of International Law, in International Law and Sustainable Development-Past Achievements and Future Challenges', in A Boyle and D Freestone (eds.), *International Law and Sustainable Development-Past Achievements and Future Challenges* (OUP 1999) 39-61.

¹⁷⁶ ILA, Report of the Seventieth Conference (Held at New Delhi, 2-6 April 2002) 397-8; M-C Cordonier Segger, 'Sustainable Development in International Law' in Hans Christian Bugge and Christina Voigt (eds), *Sustainable Development in International and National Law* (Europa Law Publishing 2008), 163-176.

¹⁷⁷ The duty to co-operate for environmental protection reasons was highlighted in United States – Import Prohibition of Certain Shrimp and Shrimp Products (US-Shrimp/Turtle I), AB-1998-4, Report of the Appellate Body 6 November 1998, WT/DS58/AB/R [167-168].

¹⁷⁸ On detailed analysis see E.D. Brown Weiss, *In Fairness to Future Generations. International Law, Common Patrimony and Intergenerational Equity*, (New York, 1989).

¹⁷⁹ UNCTAD, World Investment Report, *Investing in a Low-Carbon Economy*, (2010), (UN 2010), 81.

¹⁸⁰ In this respect international investment regime undergoes significant improvements, gradually allowing submissions of *amicus curiae* briefs and amending several Model BITs and the ICSID and UNCITRAL Arbitration rules so as to integrate public hearings and transparency clauses. For example, 2012 U.S. Model Bilateral Investment Treaty, available at www.italaw.com (accessed at 1 April 2012) Article 29.

¹⁸¹ This principle originates from the well-recognized principle of a State's sovereignty over natural resources (Principle 2 Rio Declaration, Schrijver N., *Sovereignty Over Natural Resources: Balancing Rights and Duties*, (Cambridge: Cambridge University Press, 1997), 394) limited with another customary law principle not to cause transboundary damage (P. Sands P., *Principles of International Environmental Law*, (2.nd ed., Cambridge: Cambridge University Press, 2003), 236-246; Legality of the Threat or Use of Nuclear Weapons, Advisory Opinion, I.C.J. Reports 1996 (I), pp. 241-242, [29]) coupled with a duty to protect the environment within a State's own jurisdiction (For example, in Article 2 of the UN Convention on Biological Diversity, 1992).

¹⁸² A. Newcombe, 'Sustainable Development and Investment Treaty Law', (2007) 8 Journal of World Investment and Trade, at 357 *et seq.*

¹⁸³ Alan Boyle, David Freestone, 'Introduction' in Alan Boyle, David Freestone (eds) *International Law and Sustainable Development. Past Achievements and Future Challenges* (OUP 1999) 17.

Conference, ‘The Future We Want’ represents the most recent approval of the so-called principle of integration¹⁸⁴ by declaring in relevant parts:

*We therefore acknowledge the need to further mainstream sustainable development at all levels, integrating economic, social and environmental aspects and recognizing their interlinkages, so as to achieve sustainable development in all its dimensions.*¹⁸⁵

Taking the wide presence in the conference of high-level representatives into account,¹⁸⁶ we may assume that this principle of integration is a commonly accepted content of sustainable development.

Therefore we may conclude that it is generally agreed that the essence of sustainable development means an equal balance between economic development, social development and environmental protection¹⁸⁷ so as to overcome the negative externalities of the purely economic development with an overall aim in mind to achieve intergeneration equity.¹⁸⁸

1.3.PROMOTION OF ECONOMIC DEVELOPMENT AS THE PRINCIPAL OBJECTIVE OF INTERNATIONAL INVESTMENT PROTECTION REGIME

The section is designed to prove that the international investment protection regime contains as its underlying harmonized object and purpose the representation of the will of States participating in the network of IIAs, irrespective of formal objectives of individual IIAs.¹⁸⁹ Thus, the study treats the bundle of ‘old generation’ and ‘new generation’ IIAs¹⁹⁰ as a legal regime¹⁹¹ that has its underlying object and purpose as representing the will of States participating in the network of IIAs. The idea of an

¹⁸⁴ United Nations, A/CONF.216/L/1/, Outcome of the Conference ‘The Future We Want’, Rio de Janeiro, Brazil, 20-22 June 2012 [3].

¹⁸⁵ Ibid.

¹⁸⁶ See footnote 166 above.

¹⁸⁷ M-C Cordonier Segger, ‘Sustainable Development in International Law’ in Hans Christian Bugge and Christina Voigt (eds), *Sustainable Development in International and National Law* (Europa Law Publishing 2008) 139 and ILA Toronto Conference (2006), ‘International Law on Sustainable Development’, 2.

¹⁸⁸ World Commission on Environment and Development, *Our Common Future* (OUP 1987) (Brundtland Report), 51.

¹⁸⁹ For instance, the NAFTA and the ECT deals with wider issues other than investment protection including also market liberalization and harmonization.

¹⁹⁰ On their distinction see K Vandeveld, ‘A Brief History of International Investment Agreements’, 12 U.C. Davis J.INT’L & Pol’y (2005)157.

¹⁹¹ On the criteria of the existence of the legal regime see JW Salacuse, *The Law of Investment Treaties* (OUP, 2010), 1-17. See also SW Schill, *The Multilateralization of International Investment Law* (CUP 2009).

inherent objective of the investment regime is expressed in legal doctrine¹⁹² and in the evolving arbitral jurisprudence applying ‘old generation’ IIAs that usually remain silent on their objectives.¹⁹³

Context of the treaty is often revealed by the preamble as an element of textual and teleological interpretation.¹⁹⁴ Traditionally, object and purpose reflects general tenor and atmosphere of the treaty, the circumstances in which it was made, and reveals the place it has come to have in international life.¹⁹⁵ However, all preambles are not of equal value – some preambles contain detailed analysis of the aims and objectives of treaties and their negotiating history. Others are drafted with less care and they are less elaborate or even remain silent on the context of the respective treaties. The latter situation is often the case with ‘old generation’ IIAs. Their preambles are brief or remain silent on their purposes; at best, their preambles contain the reference to the promotion of economic development of the treaty Parties as their rationale. In addition, such traditional subsidiary sources as *travaux préparatoires* are rarely available for IIAs.¹⁹⁶

Therefore, the context of IIAs has been subject to interpretation, and arbitral jurisprudence has been the main developer of the more precise (and often contradicting) content and meaning of it, addressed below.

1.3.1. Interpretation of object and purpose of ‘old generation’ BITs: pro investore, in dubio mitius presumptions and balanced approach

¹⁹² On the theory of the ‘innate’ purpose of investment protection regime see Thomas W Waelde, ‘The Specific Nature of Investment Arbitration’ in Philippe Kahn, Thomas W. Waelde (eds), *New Aspects of International Investment Law* (Martinus Nijhoff 2007) 109-110; TW Waelde, ‘Interpreting Investment Treaties: Experiences and Examples’ in Christina Binder, Ursula Kriebaum, August Reinisch, Stephan Wittich (eds) *International Investment Law for the 21st Century. Essays in Honour of Christoph Schreuer* (OUP 2009) 748-781; Schill (2009) (n 191) 318; A Van Aaken, TA Lehmann, ‘Investment and Sustainable Development: Developing a New Conceptual Framework’ (2011) U. of St. Gallen Law & Economics Working Paper No. 2011-10 <<http://ssrn.com/abstract=1893692>> accessed on 12 September 2012.

¹⁹³ PM Protopsaltis, ‘The Multilateralization of International Investment Law by Stephan W. Schill (Book Review)’ 8 TDM 1 (2011) [31] <www.transnational-dispute-management.com> accessed 3 January 2012.

¹⁹⁴ R Gardiner, *Treaty Interpretation* (OUP 2008) 186.

¹⁹⁵ G. Fitzmaurice, *The Law and Procedure of the International Court of Justice*, Vo.I, (Cambridge, Grotius, 1986), 42-3.

¹⁹⁶ R Dolzer, CH Schreuer, *Principles of International Investment Law* (OUP 2008), 33-34.

By using teleological interpretation of BITs in light of their object and purpose (Article 31(1) VCLT), arbitral tribunals have arrived at three essentially contradicting starting positions for the further interpretation of investment guarantees.

Thus, for instance, *Noble Ventures v. Romania*,¹⁹⁷ *Aguas del Tunari v. Bolivia*¹⁹⁸ and *Siemens v. Argentina*¹⁹⁹ awards applied *pro investore* presumption that allows applying investment protection provisions extensively for the benefit of foreign investors. This presumption was justified by teleological interpretation, interpreting respectively the scope of an umbrella clause, denying the exclusive jurisdiction of national courts and the scope of the MFN standard. The *Siemens v. Argentina* Tribunal justified the *pro investore* interpretation as best serving the intentions of the contracting Parties of the German –Argentina BIT (1991):²⁰⁰

*The Tribunal shall be guided by the purpose of the Treaty as expressed in its title and preamble. [...] The intention of the parties is clear. It is to create favourable conditions for investments and to stimulate private initiative.*²⁰¹

Similarly, the *SGS v. Philippines* Tribunal excused its overly broad interpretation of the umbrella clause by the reference to the objective of the BIT and stated that:

*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.*²⁰²

In sum, these awards have interpreted the object and purpose of BITs so as to allow ‘one-sided doctrinal advantage’ for foreign investment.²⁰³ It was argued that the pro-

¹⁹⁷ *Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/11 (US/Romania BIT) Award, 12 October 2005, [52]. The Tribunal justified wide and *pro investore* interpretation of the umbrella clause, which, in the Tribunal’s view, was justified by the object and purpose of the BIT.

¹⁹⁸ *Aguas del Tunari S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Respondent’s Objections to Jurisdiction, 21 October 2005, [153], [241], [247].

¹⁹⁹ *Siemens v. Argentina*, ICSID Case No. ARB/02/8 (Germany/Argentina BIT), Decision on Jurisdiction, 3 August 2004, [81].

²⁰⁰ The Treaty between the Federal Republic of Germany and the Argentine Republic concerning the Reciprocal Encouragement and Protection of Investments, signed on April 9, 1991, preamble.

²⁰¹ *Siemens v. Argentina*, Decision on Jurisdiction [81].

²⁰² *SGS v. Philippines*, Decision on Objections to Jurisdiction of 29 January, 2004, ICSID case No. ARB/02/6, <http://www.worldbank.org/icsid/cases/SGSvPhil-final.pdf>, [116]. On the criticism of this interpretation, see TW Waelde, ‘Interpreting Investment Treaties: Experiences and Examples’ in Christina Binder, Ursula Kriebaum, August Reinisch, Stephan Wittich (eds) *International Investment Law for the 21st Century. Essays in Honour of Christoph Schreuer* (OUP 2009), 7.

²⁰³ On the position of an unbalanced approach to investment law in favour of foreign investors, see A. Newcombe, ‘Sustainable Development and Investment Treaty Law’, *Journal of World Investment and Trade*, 2007; see also Pinsolle P., Schlaepfer A.V. and Degos L. (eds.), *Towards a Uniform*

investor approach was legitimately derived from the very titles of BITs, namely they are agreements on the promotion and protection of foreign investment. Also, investors often argue for *pro investore* interpretation claiming it is a logical consequence of the existence of BITs.²⁰⁴ Finally, the tribunals choosing to apply the *pro-investore* approach see themselves as merely ‘dispute oriented’ tribunals. Thus, they limit their interest and fail to take account of issues other than those represented by BITs.²⁰⁵ As a result, argumentation of these tribunals is often overly formalistic for assessing the content of purpose of IIAs. Such a mindset leads to unfair restrictions on the regulatory flexibility of a host State giving the impression that the interests of the investor are placed above the public interests, contributing to the view of the existence of ‘regulatory chill’.

Some other arbitral tribunals, while interpreting comparable ‘old generation’ BITs, have explicitly rejected *in dubio pro investore* presumption as not justified by the teleological interpretation of these BITs.²⁰⁶

Thus, in *El Paso v. Argentina*, the tribunal applied the ‘old generation’ Argentina-US BIT (1991) preamble, which is similar to the above-mentioned German-Argentina BIT, and decided on the balanced approach with respect to the interpretation of substantive norms and is worth quoting at length:

*On the one hand, some contend that the treaty should be interpreted so as to favour State sovereignty; on the other, it has been argued that the interpretation should favour the investor’s protection [...] This Tribunal considers that a **balanced interpretation** is needed, taking into account both State sovereignty and the State’s responsibility to create an adapted and evolutionary framework for the development of economic activities, and the necessity to protect foreign investment and its continuing flow.*²⁰⁷

Also, a pro-state approach has been rejected as not acceptable; the tribunal in *Methanex v. United States* took the position that the intention of the NAFTA Parties

International Arbitration Law, IAI International Arbitration Series No.3., (New York: Juris Publishing, 2005).

²⁰⁴ *Plama v. Bulgaria*, Decision on Jurisdiction, February 8, 2005, ICSID Case No.ARB/03/24), [165], [167].

²⁰⁵ Ole K. Fauchald, ‘The Legal Reasoning of ICSID Tribunals – An Empirical Analysis’, (2008) 19 EJIL 301, at 359.

²⁰⁶ S.W.Schill, *The Multilateralization of International Investment Law* (CUP 2009), 315 – 318, 378.

²⁰⁷ *El Paso Energy International Company v. The Argentine Republic*, Decision on Jurisdiction, 27 April 2006, ICSID Case No. ARB/03/15, [68]-[70] (emphasis added). Preamble of the BIT: ‘*Desiring to promote greater economic cooperation [...] Recognizing that agreement upon the treatment to be accorded such investment will stimulate the flow of private capital and the economic development of the Parties [...]*’

was to interpret the treaty ‘in good faith in accordance with their ordinary meaning (in accordance with Article 31(1) of the Vienna Convention), without any one-sided doctrinal advantage built in to their text to disadvantage procedurally an investor seeking arbitral relief’.²⁰⁸ This statement by the *Methanex* Tribunal illustrates well that such interpretation of IIA that unjustly sides one of the disputing parties is considered to be contrary to the good faith principle.

To conclude, the outcome of the teleological interpretation of ‘old school’ BITs has led to three clashing propositions on how to interpret substantive norms of the BITs.²⁰⁹ The balanced interpretation favouring none is supported by the inherent wider context of economic development concretized by the arbitral jurisprudence and analysed below.

1.3.2. Two tiers of objectives for teleological interpretation: promotion of economic development as the inherent and principal objective

Arbitral jurisprudence has gradually developed two levels of object and purpose – the ‘immediate’ one that is mentioned in a specific IIA and that is mostly related to foreign investment promotion and protection,²¹⁰ and the ‘overall’ or the inherent one of the promotion of economic development, even if this wider context is not explicitly indicated in the IIA.²¹¹

Thus, the tribunal in *Saluka v. Czech Republic*²¹² famously noted:

*The protection of foreign investments is not the sole aim of the Treaty, but rather a necessary element alongside the overall aim of encouraging foreign investment and extending and intensifying the parties’ economic relations.*²¹³

²⁰⁸ *Methanex v. United States*, UNCITRAL (NAFTA), Partial Award, August 7, 2002, [105].

²⁰⁹ However, statistical data of decided cases under the ICSID does not indicate that the por-invesoter approach would have an overly burdensome practical effect for host States, since of the almost hundred concluded cases at the end of 2008, approximately half were decided in favour of States and half in favour of investors, see S.D. Franck, ‘Development and Outcomes in Investment Arbitration’, (2009), 50 *Harv Int’l L J* 435.

²¹⁰ This objective is mainly derived from the titles of bilateral investment treaties, which are treaties between governments concerning the encouragement and reciprocal protection of investment.

²¹¹ *Saluka Investments BV (The Netherlands) v The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006 [298]-[301]; *Joseph Charles Lemire v Ukraine*, Decision on Jurisdiction and Liability, January 14, 2010, ICISD Case No.ARB/06/18 [272]-[273]. See also *Plama v Bulgaria*, Decision on Jurisdiction, February 8, 2005, ICISD Case No.ARB/03/24 [193].

²¹² *Saluka Investments BV (The Netherlands) v The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006 [298]-[301]. The Tribunal distinguished between an ‘immediate’ and ‘broader’ context for interpretation of FET in the Netherlands –Czech/Slovak Federal Republic BIT (1991).

²¹³ *Ibid* [300].

Similarly, the tribunal in *Charles Lemire v. Ukraine* interpreting ‘old generation’ Ukraine-US bilateral investment treaty (BIT) (1996) declared:

*The main purpose of the BIT is thus the stimulation of foreign investment and of the accompanying flow of capital. (...) But this main purpose is not sought in abstract; it is inserted in a wider context, the economic development for both signatory countries.*²¹⁴

As a result, arbitral jurisprudence interpreting object and purpose of ‘old generation’ IIAs has employed the inherent objective in teleological interpretation of individual IIAs and has shifted away from the narrow focus of investment protection as a goal in itself²¹⁵ to investment protection as a tool for economic development of host states.²¹⁶ Even more, in the *Charles Lemire* award the tribunal not only established that economic development is the overall aim of foreign investment protection, it went further by explaining that ‘[e]conomic development is an objective which must benefit all, primarily national citizens and national companies, and secondarily foreign investor’.²¹⁷

Hence, the overall economic development objective of foreign investment protection indicates that the existence of international investment protection law does not stop short at protecting foreign investors and it allows an explanation of the participation of States in the network of IIAs that ‘might bite’²¹⁸ by imposing significant restrictions on State’s regulatory powers.

1.3.3.Support of the inherent objective of international investment protection law in scholarly work

²¹⁴ Joseph Charles Lemire v. Ukraine, Decision on Jurisdiction and Liability, January 14, 2010, ICSID Case No.ARB/06/18 [272]-[273].

²¹⁵E.g., Noble Ventures, Inc. v Romania, ICSID Case No. ARB/01/11 (US/Romania BIT) Award, 12 October 2005 [52]; Aguas del Tunari S.A. v Republic of Bolivia, ICSID Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction, 21 October 2005 [153], [241], [247]; Siemens v Argentina, ICSID Case No. ARB/02/, Decision on Jurisdiction, 3 August 2004 [81]; SGS v Philippines, Decision on Objections to Jurisdiction of 29 January, 2004 (ICSID case No.ARB/02/6 [116].

²¹⁶ Saluka v Czech Republic [298]-[301]. See also Rudolf Dolzer, Margrete Stevens, *Bilateral Investment Treaties* (Martinus Nijhoff 1995) 11-13; Schill (2009) (n⁶⁴³) 318-319; A Broches, ‘Convention on the Settlement of Investment Disputes between States and Nationals of other States of 1965, Explanatory Notes and Survey of its Application’ (1993)18 Yearbook Commercial Arbitration 627, 641-647.

²¹⁷ Lemire v Ukraine [273]. See also Amco Asia Corporation and others v Republic of Indonesia (Decision on Jurisdiction) ICSID Case No ARB/81/1(25 September 1983), 23 ILM 351 (1984) [23]: ‘To protect investments is to protect the general interest of development and of developing countries.’

²¹⁸ Borrowing the phrase from Mary Hallward-Driemeier, ‘Do Bilateral Investment Treaties Attract FDI? Only a Bit ... and They Could Bite’ (2003) World Bank, Policy Research Working Papers, No.WPS 3121 <<http://www-wds.worldbank.org>> accessed 20 November 2012.

The inherent or overall objective of investment protection regime is supported not only by arbitral jurisprudence but also by scholarly work.²¹⁹

Multilateralization theory developed by Schill supports the existence of the inherent object and purpose of the investment regime. Schill has developed a multilateralization theory dealing with the legal effects of the proliferation and the harmonization of the content and application of the network of BITs. Quintessentially, Schill asserts that BITs, although bilateral treaties, function analogously to a truly multilateral system. This is so because BITs ‘establish rather uniform general principles that order the relations between foreign investors and host States in a relatively uniform manner independently of the sources and targets of specific transborder investment flows’.²²⁰ In other words, Schill suggests that sufficient convergence of scope and structure of BITs and substantive investment protection standards of various IIAs has taken place creating a multilateral sub-system of international law rather than a fragmented/bilateral system.²²¹

Most importantly for the present focus, Schill indicates that the overall aim of States participating in the network of BITs is to ‘create an investment-friendly environment that is characterized by stability and predictability and leads to economic growth and development in both home and host states.’²²² Moreover, the existence of common interest of States in uniform foreign investment protection rules ‘demands and justifies that international investment treaties should be interpreted and applied in a uniform manner’.²²³

²¹⁹ On the theory of ‘innate’ purpose of investment protection regime see Thomas W. Waelde, ‘The Specific Nature of Investment Arbitration’ in Philippe Kahn, Thomas W. Waelde (eds.), *New Aspects of International Investment Law* (Martinus Nijhoff, 2007), 109-110. T.W.Waelde, ‘Interpreting Investment Treaties: Experiences and Examples’ in Christina Binder, Ursula Kriebaum, August Reinisch, Stephan Wittich (eds) *International Investment Law for the 21st Century. Essays in Honour of Christoph Schreuer* (OUP 2009), 748-781; S.W.Schill, *The Multilateralization of International Investment Law* (CUP 2009), 318; A.Van Aaken, T.A.Lehmann, ‘Investment and Sustainable Development: Developing a New Conceptual Framework’ (2011) U. of St. Gallen Law & Economics Working Paper No. 2011-10. Available at SSRN: <http://ssrn.com/abstract=1893692>. See also Jan Klabbers, ‘Treaties, Object and Purpose’, in R. Wolfrum (ed.), *The Max Planck Encyclopedia of Public International Law*, (Oxford University Press, 2008), online edition, [www.mpepil.com], visited on 12 December 2011, [16], [21], [23].

²²⁰ Schill, *The Multilateralization of International Investment Law*, 15-16.

²²¹ Ibid, 11-17. See also G. Van Harten, *Investment Treaty Arbitration and Public Law* (OUP, 2007), 24-44; *Saluka v. Czech Republic*. Partial Award, [300].

²²² Schill, *The Multilateralization of International Investment Law*, 318.

²²³ See also A. Stone Sweet, ‘Investor-State Arbitration: Proportionality’s New Frontier’ (2010) 1 *Law & Ethics of Human Rights* 4, Article 4, 61; In particular see *AES Corporation v. The Argentine Republic*, ICSID Case No. ARB/02/17, April 26, 2005, [30]; *Saipem S.p.A. v. The People's Republic of Bangladesh*, ICSID Case No. ARB/05/07 (Bangladesh/Italy BIT), Decision on Jurisdiction and Recommendation on Provisional Measures, 21 March 2007, [67].

Using the words of Schill, ‘investment tribunals do not confine themselves to a strictly bilateral interpretation of BITs’²²⁴ but their interpretation of particular investment treaty affects the interpretation of all BITs thus actively developing international investment law.²²⁵ This conceptual convergence justifies and explains the often practised ‘cross-treaty interpretation referring either to BIT practice of the States involved in the dispute or to BIT practice of wholly unrelated countries or to model treaties or, finally, using teleological interpretation method’.²²⁶

Therefore, according to Schill,²²⁷ it means not only textual convergence of treaties but also conceptual convergence towards an overarching legal framework of foreign investment protection,²²⁸ providing a justification for an innate purpose of international investment protection law that automatically creates an element of teleological interpretation of a specific BIT.

Another argument in support of the existence of the inherent object and purpose of the investment protection regime dwells on the explanation of the motivation for States’ participation in the network of IIAs.

Even if there are disagreements on the reasons why states have created international investment regime as it currently is,²²⁹ it is assumed that participation of states in the network of IIAs is inherently linked with expectations of host States to receive development input from FDI. In other words, FDI protection is associated with the promotion of economic development of host States assuming that the protection of investment will stimulate FDI, and FDI in-flows in country will lead to economic growth and development.²³⁰

²²⁴ Schill, *The Multilateralization of International Investment Law*, 294.

²²⁵ Ibid, 261-277; *Saipem v. Bangladesh*, Decision on Jurisdiction, [67].

²²⁶ Schill, *The Multilateralization of International Investment Law*, 293-321, 357, 367.

²²⁷ For criticism on the theory of common interest of States in creating multilateralized rules, see P.M.Protopsaltis, ‘The Multilateralization of International Investment Law by Stephan W.Schill’, (Book Review), TDM, Issue (provisional), November 2010,14-19. Protopsaltis refers to other motivations, namely the prisoners’ dilemma and ‘race-to-the-bottom’, which has led to the international investment protection law as it is. Paparinskis, on his part, opposes the theory proposed by Schill to go beyond VCLT to explain the reliance by investment treaty arbitration tribunals on the case law of their predecessors. Paparinskis attempts to explain the reliance on *pari materia* jurisprudence through traditional treaty interpretation and application rules. See M.Paparinskis, ‘Sources of Law and Arbitral Interpretations of *Pari Materia* Investment Protection Rules’, available at <http://ssrn.com>, 26.

²²⁸ Schill, *The Multilateralization of International Investment Law*, 321, 339.

²²⁹ E.g., Protopsaltis insists the investment regime has resulted from the ‘race-to-the-bottom’ among States in attracting FDI. P.M.Protopsaltis, ‘The Multilateralization of International Investment Law by Stephan W.Schill (Book Review)’, TDM, Issue (provisional), November 2010, 14-19.

²³⁰ C.Schreuer, U.Kriebaum, ‘From Individual to Community Interest in International Investment Law’ in Ulrich Fastenrath *et al.* (eds), *From bilateralism to community interest: essays in honour of Bruno Simma* (OUP, 2011), 1082.

This assumption holds true irrespective of the controversial empiric evidence supporting the FDI-led growth hypothesis²³¹ and the actual effect of the conclusion of IIAs as an aspect promoting FDI in-flows.²³²

Although IIAs differ in many ways, for instance in the scope of application and institutional setting, all IIAs are comparable in their aim of protecting foreign investment from unjustified interference by host states through their commitment to good governance and rule of law standards.²³³ Hence, conclusion of IIAs is associated with a signal it gives to potential investors, namely that the country is ready to protect their investments while considerably constraining its regulatory capacity. Conclusion of IIAs thus improves the location determinant of the OLI paradigm.²³⁴ Dunning's OLI paradigm attempts to explain investor's motivation to invest in a State, noting that conclusion of IIAs improves State's competitive advantage to be chosen by the investor as a final destination for FDI comparing to other similar states, which have not concluded IIAs.²³⁵

Only States' expectation for development input may explain why States undertake obligations which 'could bite'²³⁶ by considerably constraining their regulatory

²³¹ For *contra* FDI-led growth hypothesis see Gus Van Harten, 'Five Justifications for Investment Treaties: A Critical Discussion', (2010) 2 Trade L. & Dev. 1, at 19.

²³² M. Hallward-Driemeier, 'Do Bilateral Investment Treaties Attract FDI? Only a Bit ... and They Could Bite' (2003) World Bank, Policy Research Working Papers, No.WPS 3121, available at www.wds.worldbank.org/external/default/WDSPContentServer/WDSP/IB/2003/09/23/000094946_03091104060047/additional/105505322_20041117160010.pdf, accessed on 2 January 2012; P Economou, JH Dunning, KP Sauvant, 'Trends and Issues in International Investment', 24; C.H. Schreuer, L. Malintoppi, A. Reinsisch and A. Sinclair, *The ICSID Convention. A Commentary* (2nd ed, Cambridge University Press, 2009), 128-134; Mr. Saba Fakes v. Republic of Turkey, ICSID Case No.ARB/07/20, Award July 14, 2010, [111].

²³³ Dolzer R and Schreuer C, *Principles of International Investment Law* (OUP 2008), 173-174; Sir Arther Watts KCMG QC, 'The Importance of International Law', in M Byers (ed), *The Role of Law in International Politics. Essays in International Relations and International Law* (OUP, 2000), 6-7. Gus Van Harten, 'Five Justifications for Investment Treaties: A Critical Discussion', (2010) 2 Trade L. & Dev. 1, at 19.

²³⁴ John H. Dunning, *Multinational Enterprises and the Global Economy* (Wokingham: Addison-Wesley, 1993). The OLI paradigm displays three economic determinants or cumulative conditions, namely, ownership (specific competitive advantages in a transnational corporation), location (market access, cost reductions, access to natural resources and export platforms, and also skilled and cheap labour) and internalization (presence of superior commercial benefits of going international, for instance, offshoring in order to cut costs) (OLI) to be fulfilled for a firm to have a motive to invest abroad. See also S.D.Amarasinha, J.Kokott, 'Multilateral Investment Rules Revisited' in *The Oxford Handbook of International Investment Law*, (New York: Oxford University Press, 2008), 120-121.

²³⁵ This phenomenon is explained by Guzman with a competitive advantage theory, namely BITs give a capital-importing host country a competitive advantage over other similarly-situated countries without BITs signed, thus even developing States among themselves end up with concluding BITs. A.T.Guzman, 'Why LDCs sign treaties that hurt them: explaining the popularity of bilateral investment treaties', *Virginia Journal of International Law*, vol. 38 (1998).

²³⁶ Borrowing the phrase from Hallward-Driemeier M, 'Do Bilateral Investment Treaties Attract FDI? Only a Bit ... and They Could Bite'.

capacity²³⁷ and why the conclusion of new IIAs shifts away from the historically determined North-South relationship also to South-South dimension.²³⁸

Therefore, one may conclude that the protection of FDI and conclusions of IIAs is not a goal in itself.²³⁹ It is rather a tool for states to achieve a public good – economic development.²⁴⁰

On this score, the distinction provided in economic theory between intermediate and final public goods may add some clarity: one may distinguish between intermediate public goods, like the existence of international regimes, and final public goods, like economic growth.²⁴¹ Hence, the existence of international investment protection regime at most may be considered as an intermediate public good²⁴² that serves to achieve the final public good – development.

1.4. ECONOMIC DEVELOPMENT AS A GENERIC TERM AND ITS CURRENT MEANING – SUSTAINABLE DEVELOPMENT

It is argued that the notion of economic development fulfils the criteria of being a generic term, the interpretation of which requires its adaptation to present-day realities at a time of its application. Thus, it is proposed that the dynamic nature of the term economic development results in the possibility of an evolutive re-interpretation of

²³⁷ T.W.Waelde, 'The Specific Nature of Investment Arbitration' in Philippe Kahn, Thomas W Waelde (eds), *New Aspects of International Investment Law* (Martinus Nijhoff 2007) 61-62. Cf. Gas Van Harten, *Investment Treaty Arbitration and Public Law*, (OUP, 2007). See also Christian W. Konrad, 'Kosovo and Arbitration – the Birth of a New State,' *Investment Arbitration Reporter*, 17 Nov. 2010. Kosovo has clearly recognised the importance of foreign direct investment for building a growing economy.

²³⁸ In accordance with the UNCTAD, *World Investment Report 2010, Investing in a Low-Carbon Economy*, (New York, Geneva: UN, 2010), 82 – 83, 19 of the 82 BITs signed in 2009 were BITs between developing countries, developing countries by now being not only host, but also home states for outward investment. Similarly, developed countries by now are both home and host states of foreign investment, thus also being respondents in investment disputes.

²³⁹ As suggested by, for instance, *Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/11 (US/Romania BIT) Award, 12 October 2005, [52]; *Aguas del Tunari S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction, 21 October 2005 [153], [241], [247]; *Siemens v. Argentina*, ICSID Case No. ARB/02/8 (Germany/Argentina BIT), Decision on Jurisdiction, 3 August 2004 [81]; *SGS v. Philippines*, Decision on Objections to Jurisdiction of 29 January, 2004, ICSID case No.ARB/02/6 [116].

²⁴⁰ *Continental Casualty v. Argentina*, Decision on Jurisdiction, ICSID Case No.ARB/03/9, February 22, 2006 [81]; *Saluka v. Czech Republic*, Partial Award, [298-301]. See also Rudolf Dolzer, Margrete Stevens, *Bilateral Investment Treaties* (Martinus Nijhoff, 1995), 11-13; Stephan W Schill, *The Multilateralization of International Investment Law*, 318-319.

²⁴¹ Inge Kaul, Isabelle Grunberg, Marc Stern (eds.), *Global Public Goods. International Cooperation in the 21st Century* (Oxford University Press, 1999), 13.

²⁴² If one sees international investment protection law as solely benefiting foreign investors' private interests, then the existence of the regime would be considered a 'world-wide club good' or even private good, and not public good, see *ibid*, 12.

‘old generation’ IIAs even if they formally prioritize the economic rather than the social, environmental and human development dimension.

In order to justify evolutive treaty interpretation, international law requires the fulfilment of several preconditions.²⁴³ A treaty (of continuing duration²⁴⁴) must contain a generic legal term that the treaty parties have intended to change its meaning through time. As a logical consequence, it is necessary to identify those authoritative statements that contain the present day meaning of the generic term. In relation to the term ‘economic development’ these criteria are addressed here in turn.

First, presumption of the existence of a generic term is strengthened where the treaty is of continuing duration. Even though a typical duration clause of BITs indicates that they are in force on average for ten years,²⁴⁵ renegotiations of the existing BITs are undertaken hesitantly.²⁴⁶ In case of a renegotiation, BITs are replaced by new BITs or Free Trade Agreements (FTAs) that contain similar investment protection standards with little amendments. Hence, it may be presumed that the network of IIAs functions as a legal regime of continuing duration.

Further, it must be proved that the term has a content, which ‘the parties expected would change through time’.²⁴⁷ Thus, it is claimed that the term ‘economic development’ like the notions of ‘commerce’,²⁴⁸ ‘exhaustible natural resources’,²⁴⁹ ‘environment’,²⁵⁰ ‘sacred trust’²⁵¹ or ‘sound recording distribution services’²⁵² by its very logic and definition is not a static but a dynamic term, requiring its interpretation

²⁴³ For the criteria of generic terms see R Gardiner, *Treaty Interpretation* (OUP 2008) 172-173, 242-324; Pierre-Marie Dupuy, ‘Evolutionary Interpretation of Treaties: Between Memory and Prophecy’ in Enzo Cannizzaro (ed) *The Law of Treaties Beyond the Vienna Convention* (OUP 2011) 131, 137.

²⁴⁴ Dispute Regarding Navigational and Related Rights (Costa Rica v. Nicaragua), Judgment of 13 July 2009, ICJ (San Juan River case) [66]-[67]. See also Gardiner (2008) 172-173.

²⁴⁵ For instance, Argentina-US BIT, Article XIV(1): ‘This Treaty [...] shall remain in force for a period of ten years and shall continue in force unless terminated in accordance with paragraph 2 of this Article.’

²⁴⁶ Stephan W Schill, *The Multilateralization of International Investment Law* (CUP 2009) 265.

²⁴⁷ Kasikili/Sedudu Island (Botswana/Namibia) (1996), Declaration of Judge Higgins, 1113, [2]-[3].

²⁴⁸ Dispute Regarding Navigational and Related Rights (Costa Rica v. Nicaragua), Judgment of 13 July 2009, ICJ (San Juan River case) [64], [67]-[71].

²⁴⁹ AB Report, United States – Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/AB/R, 6 November 1998, DSR 1998:VII, 2755 [129]-[130].

²⁵⁰ Advisory Opinion on the Legality of the Threat or Use of Nuclear Weapons, ICJ Reports 1996 [29].

²⁵¹ Legal Consequences for States of the Continued Presence of South Africa in Namibia (South West Africa) notwithstanding Security Council Resolution 276, (1970), Advisory Opinion, ICJ Reports 1971, [53].

²⁵² China- Publications and Audiovisual Products, AB Report, 21 December 2009, WT/DS363/AB/R, [398].

‘in the light of modern day conditions’.²⁵³ This is because the evolving nature of economic development is clearly approved since at least the UN Conference on the Human Environment in 1972, where the global community acknowledged that economic growth was necessarily limited with the environment degradation aspect.²⁵⁴ Its dynamic nature was later recognized by the *Gabčíkovo-Nagymaros* case,²⁵⁵ where the court declared that there was a need to reconcile economic development with the protection of the environment even for economic activities begun before the clear realization of the potential negative effects that economic development might have upon the environment.²⁵⁶ Therefore, States participating in the network of IIAs must be presumed to be aware of the inherently generic nature of economic development that requires constant adjustments to present day realities.

Finally, there needs to be evidence on the current meaning of the term that is accepted by the treaty parties. Schreuer in his commentary on the *Salini* test,²⁵⁷ which introduced the contribution to host state’s economic development as a characteristic of the existence of an investment, writes:

*Any concept of economic development (...) should not be restricted to measurable contributions to GDP but should include development of human potential, political and social development and the protection of the local and global environment.*²⁵⁸

This logic is reflected by the consensus reached in three UN conferences²⁵⁹ where the global community has realized that the sole focus on economic development should be replaced by the global commitment to promote sustainable development, which, in essence, is a corrective element of various negative externalities that economic development and various processes of globalization might bring.²⁶⁰

²⁵³ Using the phrase from R Gardiner, *Treaty Interpretation* (OUP 2008) 242.

²⁵⁴ Declaration of the United Nations Conference on the Human Environment, U.N. Doc. A/Conf.48/14/Rev. 1(1973); 11 ILM 1416 (1972) [2].

²⁵⁵ *Gabčíkovo-Nagymaros Project* (Hungary/Slovakia), Judgment, I.C.J. Reports 1997, p 78.

²⁵⁶ *Ibid* [140].

²⁵⁷ *Salini Costruttori S.p.A. and Italstrade S.p.A. v Morocco*, ICSID Case No. ARB/00/4 (Italy/Morocco BIT), Jurisdiction, 23 July 2001.

²⁵⁸ CH Schreuer with L Malintoppi, A Reinisch and A Sinclair, *The ICSID Convention. A Commentary* (2nd ed, CUP 2009) 134 [174].

²⁵⁹ UN Conference on Environment and Development, ‘Rio Declaration on Environment and Development’ (14 June 1992) UN Doc A/CONF. 151/26/Rev 1 vol I, 3; UN World Summit on Sustainable Development (26 August to 4 September 2002) UN Doc. A/AC.257/32; UN Rio+20 Conference on Sustainable Development (June 20-22, 2012) UN Doc. A/CONF.216/L.1.

²⁶⁰ See Johannesburg Plan of Implementation, in Report of the World Summit on Sustainable Development, 26 August to 4 September 2002, UN Doc. A/AC.257/32, Chapter 5 [45]- [47].

Even more, this contemporary meaning of economic development is expressly integrated in preambles and operative parts of ‘new generation’ IIAs addressing foreign investment protection from the broader perspective than the narrow focus on economic development that is traditionally associated with foreign investment protection.

Accordingly, several ‘new generation’ IIAs contain preambular acknowledgements of the importance of the enforcement of basic workers’ rights and environmental protection and conservation²⁶¹ or of a more general reservation of customary state’s right to regulate for the public interest.²⁶² Some ‘new generation’ IIAs have ‘corporate social responsibility’ clauses in their preambles or operative parts.²⁶³ Operative parts of numerous IIAs contain ‘no lowering of standards clauses’ (health, environment, safety, labour protection),²⁶⁴ various general exceptions clauses,²⁶⁵ exclusion of

²⁶¹ Preambles to the US-Colombia FTA (2011) and Canada- Colombia FTA (2008), see Spears S A, ‘The Quest for Policy Space in a New Generation of International Investment Agreements’ (2010) 13 JIEL 4, 1037-1075, at 1068, footnote 172. Spears classifies these as ‘self-standing’ objectives of IIAs. Statistically around 8% IIAs include reference to environmental concerns, see Kathryn Gordon, Joachim Pohl (2011), ‘Environmental Concerns in International Investment Agreements. A Survey’ OECD Working Papers on International Investment 2011/01, OECD Publishing <<http://dx.doi.org/10.1787/5kg9mq7scjh-en>> accessed 20 November 2012. Article 18, 19(1) and 19(2) of the Energy Charter Treaty (ECT) (1994) <<http://www.encharter.org>> accessed 20 November 2012.

²⁶² For instance, preambles of the North American Free Trade Agreement between the United States, Canada and Mexico (1994) (NAFTA) <<http://www.ustr.gov/trade-agreements/free-trade-agreements/north-american-free-trade-agreement-nafta>> accessed on 20 November 2012, and the Dominican Republic-Central America Free Trade Agreement (2009) (CAFTA) <<http://www.ustr.gov/trade-agreements/free-trade-agreements/cafta-dr-dominican-republic-central-america-fta/final-text>> accessed on 20 November 2012. See also Article 10.11. US – Colombia FTA <<http://www.ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text>> accessed on 20 November 2012.

²⁶³ E.g., Preamble and Article 816 of the Canada – Colombia FTA (2011) <<http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/colombia-colombie/can-colombia-toc-tdm-can-colombie.aspx?view=d>> accessed on 20 November 2012; Article 72 of the Economic Partnership Agreement between the CARIFORUM States and the European Community and its Member States (CARIFORUM EPA) <<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:289:0003:1955:EN:PDF>> accessed on 20 November 2012. In the CARIFORUM EPA, sustainable development is a core objective of the treaty (preamble, Articles 1 and 3) and of its specific parts like for the chapter on investment (Article 60). Thus, the reference of sustainable development in the CARIFORUM EPA goes beyond mere political significance, linking sustainable development with a body of legal norms that generate rights and obligations, both for states and for citizens, encouraging dispute settlement bodies to use this concept in setting the scope of liberalizing FDI-related provisions of EPA.

²⁶⁴ Article 1114(2) NAFTA; Article 12(2) and 13(2) US Model BIT (2012) <<http://www.italaw.com/sites/default/files/archive/ita1028.pdf>> accessed on 20 November 2012; Article 73 CARIFORUM EPA; Article 10.11 US-Colombia FET; Article 815 Canada-Colombia FTA. For general overview, see UNCTAD Series. Environment. (2001), UNCTAD/ITE/IIT/23.

²⁶⁵ On various types of general exceptions clauses see Spears S A, ‘The Quest for Policy Space in a New Generation of International Investment Agreements’ (2010) 13 JIEL 4, 1037-1075, at 1060 – 1062.

environment-related disputes from investor-state arbitration,²⁶⁶ specific chapters on environmental matters,²⁶⁷ transfer of technology clauses²⁶⁸ and/or guidelines for the interpretation of investment protection standards such as indirect expropriation that aims at ensuring that more than foreign investor's interests are taken into account in the establishment of a violation of investment guarantees.²⁶⁹ Finally, several 'new generation' IIAs not only refer to separate elements of sustainable development but also contain explicit preambular references to the promotion of sustainable development as the objective of foreign investment protection, for instance, in the CAFTA (2004), the NAFTA (1994), the COMESA Common Investment Area Agreement (CIAA) 2007, Canada Model BIT (2004)²⁷⁰ and recent Canada and US free trade agreements (FTAs) like Canada–Peru FTA (2009)²⁷¹ and US-Korea FTA (2011)²⁷² and US-Colombia FTA (2011).²⁷³

The most explicit linkage between sustainable development as a current meaning of economic development and foreign investment protection as its element is provided by EU law. Since the Treaty of Lisbon came into effect, the EU has the exclusive competence to regulate FDI within the common commercial policy as part of the Union's external action.²⁷⁴ Through Articles 3 and 21 TEU, sustainable development

²⁶⁶ UNCTAD, World Investment Report 2010, *Investing in a Low-Carbon Economy* (UN 2010) 88.

²⁶⁷ Chapter 18 of the US-Colombia FTA, and Chapter 4 of the CARIFORUM EPA.

²⁶⁸ E.g., Article 8(1) ECT; Article 1106 (1) (f) NAFTA.

²⁶⁹ E.g., US Model BIT 2012 and related IIAs provide that 'except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations', see Annex B. 4(b) US Model BIT 2012. See also Article 20(8) of the Common Market for Eastern and Southern Africa (COMESA) Common Investment Area Agreement (CIAA) (2007) <http://www.comesa.int/investment/regimes/investment_area/Folder.2007-11-06.4315/Multi-language-content.2007-11-07.1013/en> accessed on 20 November 2012; Annex 10-B 3(b) US-Colombia FET. For a critical approach on these clarifications see M Paparinskis, 'Regulatory Expropriation and Sustainable Development', in MK Cordonier Segger, MW Gehring, A Newcombe (eds), *Sustainable Development in World Investment Law* (Kluwer Law International 2011) 295-329.

²⁷⁰ <<http://italaw.com/documents/Canadian2004-FIPA-model-en.pdf>> accessed on 20 November 2012, preamble: 'Recognizing that the promotion and the protection of investments of investors of one Party in the territory of the other Party will be conducive to the stimulation of mutually beneficial business activity, to the development of economic cooperation between them and to the promotion of sustainable development [...]'

²⁷¹ <<http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/peru-perou/peru-toc-perou-tdm.aspx?lang=eng&view=d>> accessed on 20 November 2012.

²⁷² <http://www.ustr.gov/sites/default/files/uploads/agreements/fta/korus/asset_upload_file755_12697.pdf> accessed on 20 November 2012.

²⁷³ preamble '[i]mplement this Agreement in a manner consistent with environmental protection and conservation, promote sustainable development, and strengthen their cooperation on environmental matters', see US – Colombia FTA <<http://www.ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text>> accessed on 20 November 2012.

²⁷⁴ Articles 3(1)(e) and 207(1) of the Treaty on the Functioning of the European Union (TFEU).

and its elements²⁷⁵ are applicable to all internal and external actions and policies of the EU,²⁷⁶ also with regard to foreign investment.

Even before the changes in the constituting documents of the EU, sustainable development was well reflected as the objective of the EU development policies with Third states²⁷⁷ having been integrated in the Cotonou Agreement²⁷⁸ and such development oriented economic partnership agreements as the CARIFORUM EPA, which has a chapter on investment protection.²⁷⁹ The Future EU Model BIT is expected to contain obligations regarding the promotion of sustainable development since the EU competence under the Common Commercial Policy is linked to the main principles of the EU, including the promotion of sustainable development.²⁸⁰

To conclude, the evidence on the current and extended meaning of economic development is provided by the commitment of the global community to promote sustainable development instead of merely economic development. The same approach is taken in several bilateral and regional legal instruments dealing with international economic law. Thus, the international community nowadays perceives economic development in the context of sustainable development. This paradigm shift is not only reflected by the global commitments achieved within the UN but is also mirrored in 'new generation' IIAs through their elements that shift the sole focus on economic development to wider development implications of FDI protection.

²⁷⁵ Chapter on Common provisions of TEU, Article 3(1), (3) and (5) (ex Article 2 TEU). Preamble TEU "determined to promote economic and social progress for their peoples, taking into account the principle of sustainable development and within the context of the accomplishment of the internal market and of reinforced cohesion and environmental protection, and to implement policies ensuring that advances in economic integration are accompanied by parallel progress in other fields".

²⁷⁶ Article 3(5) and 21 TEU.

²⁷⁷ O.Babarinde, G.Faber, 'From Lomé to Cotonou: ACP-EU Partnership in Transition', in *The European Union and the Developing Countries. The Cotonou Agreement*, O.Babarinde, G.Faber (eds.), (Leiden: Martinus Nijhoff Publishers, 2005), 1-12.

²⁷⁸ The Partnership Agreement between the members of the African, Caribbean and Pacific Group of States of the one part and the European Community and its Member States of the other part, available at http://ec.europa.eu/trade/wider-agenda/development/economic-partnerships/index_en.htm (accessed on 27 March 2010). D.Willem Te Velde, S.Bilal, 'Foreign Direct Investment in the Cotonou Partnership Agreement: Building on Private Sector Initiatives', in *The European Union and the Developing Countries. The Cotonou Agreement*, O.Babarinde, G.Faber (eds.), (Leiden: Martinus Nijhoff Publishers, 2005), 197.

²⁷⁹ J.A.McMahon, 'The Negotiations of the Cotonou Agreement: Negotiating Continuity or Change?', in *The European Union and the Developing Countries. The Cotonou Agreement*, O.Babarinde, G.Faber (eds.), (Leiden: Martinus Nijhoff Publishers, 2005), 52-53.

²⁸⁰ C.M.A. de Mestral, 'A Model EU BIT Possible-or Even Desirable?' *Transnational Dispute Management*, Vol. 7, Issue 1, April 2010, M. Bungenberg, *Centralizing European BIT Making under the Lisbon*, Treaty Paper (draft version) to be presented at the 2008 Biennial Interest Group Conference in Washington, D.C., November 13 – 15, 2008. See Articles 205 and 207 TFEU with reference to article 21 TEU.

Consequently, the object and purpose of IIAs that remain silent on it or reflect it narrowly as economic development are subject to evolutive treaty interpretation.

To conclude, ‘old generation’ BITs, representing the vast majority of IIAs, usually indicate no treaty objectives or, at best, they refer to the promotion of economic development of treaty Parties as their rationale. This may be explained as a consequence of not understanding the full consequence of the BITs at the time of their conclusion²⁸¹ or as the intention to keep silent on controversial issues.²⁸²

Therefore, arbitral jurisprudence has developed the concept of the inherent object and purpose of the foreign investment protection regime, which participates in the interpretation of individual IIAs and also the ‘old generation’ IIAs, formally prioritizing the economic rather than the social, environmental and human development dimension. This inherent rationale of the network of IIAs is economic development, which, the study claims, is a generic legal term subject to evolutionary treaty interpretation. Evolutionary treaty interpretation of this inherent objective indicates that its present day meaning is sustainable development. This conclusion is achieved, first, by the reliance on the very nature of the term ‘economic development’ and its interpretation by the international community through its global commitment to promote sustainable (economic) development instead of economic development, which has been gradually achieved within the UN through several resolutions and declarations and thus has a global coverage. Second, an additional support of it is represented by the current trends in drafting economic law treaties. These new treaties clarify that the economic aspect of investment protection or international trade needs to be reconciled with social and environmental considerations by host States.²⁸³ Thus, the ‘dynamic re-interpretation’ of ‘old generation’ IIAs towards the promotion of

²⁸¹ P.M. Protosaltis, ‘The Multilateralization of International Investment Law by Stephan W.Schill (Book Review)’ (2011) 8 TDM 1, [31] available at www.transnational-dispute-management.com, accessed on 3 January 2012; Luke Eric Peterson, ‘South African Government Releases Draft Paper Reviewing its BIT Program, and Calling for Major Revisions to Approach’, Investment Arbitration Reporter, July 17, 2009.

²⁸² Jan Klabbbers, ‘Treaties, Object and Purpose’, in R. Wolfrum (ed.), *The Max Planck Encyclopedia of Public International Law*, (Oxford University Press, 2008), online edition, [www.mpepil.com], visited on 12 December 2011, [16], [21], [23]; Jan Klabbbers, ‘Some Problems Regarding the Object and Purpose of Treaties’ 8 Finnish Yearbook of International Law (1997), 138–160.

²⁸³ A reinterpretation of various international obligations, including economic ones, in light of sustainable development has also taken place in the jurisprudence of international courts and tribunals (see Section 1.5.2.2.1. ‘Case law analysis using sustainable development as a guideline for interpretation’ below).

sustainable development is justified through the evolutive interpretation of the inherent and generic object and purpose of the network of IIAs.

At the same time, theoretically and in specific cases, ‘re-interpretation’ of ‘old generation’ BITs towards the inclusion of sustainable development might also be achieved by the use of the systemic integration principle (Article 31(3)(c) VCLT), taking into account that its reach is limited by the requirement to apply relevant applicable rules between the disputing parties. Thus, in order to rely on this interpretation principle, disputing parties must prove that they are bound by treaty or customary international law (e.g., on human rights or the protection of the environment), which is relevant for the interpretation of terms in ‘old generation’ BIT (see section 2.2.4. below).

As a result, sustainable development as the inherent object and purpose of the investment protection regime may and should participate in good faith and effective interpretation of the loose indirect expropriation standard and its sub-elements²⁸⁴ requiring the review of the methodologies that arbitral tribunals have used for establishing the existence of indirect expropriation.

Furthermore, indirect expropriation and FET standards are part of customary international law, which are codified in IIAs; thus, they may be compared with provisions in a treaty of a long duration. These standards themselves are considered to be generic in nature and, hence, subject to interpretation, which takes the present day conditions into account.²⁸⁵ These present day conditions are claimed to be the context of the promotion of sustainable development.

1.5. NORMATIVITY OF SUSTAINABLE DEVELOPMENT

It is claimed here that sustainable development not only fulfils the interpretative function of investment treaties as their inherent object and purpose (Article 31 of the

²⁸⁴ On effective treaty interpretation see Gardiner R, *Treaty Interpretation* (OUP 2008) 148, 161. For instance, the Appellate Body (AB) in the Shrimp/Turtle case provides an example of how the Treaty’s objective affects the interpretation of a specific treaty norm. The AB justified evolutive interpretation of the term ‘exhaustible natural resources’ by reference to sustainable development in the preamble of the Marrakesh Agreement, see United States – Import Prohibition of Certain Shrimp and Shrimp Products (US-Shrimp/Turtle I), AB-1998-4, Report of the Appellate Body, WT/DS58/AB/R [129]–[130], [153]. Similarly, in S.D.Myers, the Tribunal took into account the sustainable development objective of the NAFTA as a context of the national treatment standard, see S.D.Myers, Inc. v Government of Canada, Partial Award, November 13, 2000, NAFTA, UNCITRAL [196], [221], [245], [247], [250].

²⁸⁵ Fragmentation Report (2007), [478(a)].

VCLT). This section aims to prove that sustainable development has also gained a status of a legal principle of interpretation²⁸⁶ under Article 38(1)(c) of the ICJ Statutes, which implies general principles of law belonging to international law in general and to some specific domains of international law such as environmental law²⁸⁷ or law of development.

In order to prove this, the section assesses the criteria that a concept must fulfil to be a legal principle: (1) whether sustainable development as a primary norm is recognized in such principal sources of legal authority²⁸⁸ as treaties, practice of States (and other subjects of international law)²⁸⁹ and/or judicial decisions²⁹⁰ indicating the duty of officials to consider (take into account) sustainable development in their decision-making; and (2) whether sustainable development meets the qualitative criteria that a concept ought to fulfil in order to function as a legal principle – whether sustainable development has a critical amount of clarity to guide adjudicators towards a particular outcome. These criteria stem from legal doctrine, analysed below.

1.5.1. Sustainable development as a customary legal rule

There have been various attempts to prove the existence of sustainable development as an international customary legal rule.²⁹¹ However, the leading approach, also taken in this study, is that the concept itself fails the test of being a legal rule (customary law). For being a legal rule, sustainable development lacks several preconditions

²⁸⁶ On international investment protection law as international law of development see P Kahn, 'The Law of Development and Arbitration Tribunals' in F Snyder, P Slinn (eds) *International Law of Development: Comparative Perspectives* (Professional Books 1987) 163-175.

²⁸⁷ Judge C Trindade, Separate Opinion, Pulp Mills on the River Uruguay (Argentina v. Uruguay), Judgement (ICJ, 20 April 2010) [48].

²⁸⁸ See HLA Hart, *The Concept of Law* (2nd ed, OUP 1994) 95, 100. Hart identifies several authoritative criteria (rules of recognition), such as references to authoritative texts, legislative enactments, customary practice or judicial precedent, that allow decision-makers to identify primary rules of obligation.

²⁸⁹ Judge C Trindade, Separate Opinion, Pulp Mills on the River Uruguay (Argentina v. Uruguay), Judgement (ICJ, 20 April 2010) [18].

²⁹⁰ On judicial precedents as a quasi-formal source of legal authority in the international community, see Sir G G Fitzmaurice, 'Some Problems Regarding the Formal Sources of International Law', (1958) *Symbolae Verzijl* 168-172 in Marti Koskenniemi (ed) *Sources of International Law* (Ashgate 2000); W Friedmann, 'The Uses of "General Principles" in the Development of International Law', (1963) 57 *AJIL* 2, 279. See also Judge C Trindade, Separate Opinion, Pulp Mills on the River Uruguay (Argentina v. Uruguay), Judgement (ICJ, 20 April 2010) [38].

²⁹¹ P.Sands, 'International Law in the Field of Sustainable Development', *BYIL*, Vol.65, 1994, 303-382. See also Virginie Barral, 'Sustainable Development in International Law: Nature and Operation of an Evolutive Legal Norm', (2012) 23 *EJIL* 2, 377-400.

which are summarized by Lowe²⁹² and Handl²⁹³ – sustainable development does not have a norm-creating character, namely, it is not sufficiently precise and clear and it does not create an actionable right in itself,²⁹⁴ and there are no justifiable standards of review of its fulfilment. It is rather a specific process of thinking and interpretation than a fulfilment of a certain standard of substance.²⁹⁵ Thus, in line with Dworkin's proposed distinction between rules and principles, sustainable development is not a rule because it is not 'applicable in an all-or-nothing fashion'.²⁹⁶

1.5.2. Sustainable development as a legal principle

Even if most of the hard law references to sustainable development do not indicate its legal status,²⁹⁷ recognition of sustainable development as a legal principle is arguably to be found in the practice of states²⁹⁸ and other subjects of international law.²⁹⁹ Its capacity to function as a legal principle may be read into several judicial decisions by international courts and tribunals.³⁰⁰ Its ability to function as a legal principle is also

²⁹² V. Lowe, 'Sustainable Development and Unsustainable Arguments' in Alan Boyle and David Freestone (eds) *International Law and Sustainable Development. Past Achievements and Future Challenges* (OUP 1999), 26, and V. Lowe, *International Law*, Oxford: Oxford University Press, 2007, 97-99.

²⁹³ G. Handl, 'Sustainable Development: General Rules versus Specific Obligations', in Winfried Lang (ed.), *Sustainable Development and International Law*, (Graham & Trotman/Martinus Nijhoff, 1995), 35-45.

²⁹⁴ The test to prove the existence of a legal rule as it is used in the North Sea Continental Shelf Case (Germany/Denmark, Germany/Netherlands), ICJ Judgement of 20 February 1969 [72].

²⁹⁵ Alan Boyle, David Freestone, 'Introduction' in Alan Boyle, David Freestone (eds) *International Law and Sustainable Development. Past Achievements and Future Challenges* (OUP 1999) 17.

²⁹⁶ R. Dworkin, *Taking Rights Seriously*, (London: Duckworth, 2005), 24.

²⁹⁷ With the exception of the preamble of the Consolidated Version of the Treaty of European Union: '[d]etermined to promote economic and social progress for their peoples, taking into account the principle of sustainable development.'

²⁹⁸ Argentina and Uruguay had referred to sustainable development as a relevant applicable principle of international environmental law in the Pulp Mills case, see Memorial of the Argentina [3.177]-[3.179] <<http://www.icj-cij.org/docket/files/135/15425.pdf>> accessed on 20 November 2012 and Uruguay Counter-Memorial [2.29]-[2.32] <<http://www.icj-cij.org/docket/files/135/15427.pdf>> accessed on 20 November 2012, see also Pulp Mills on the River Uruguay (Argentina v Uruguay), Judgement (ICJ 20 April, 2010) [55], [152]. Nigeria has expressed its acknowledgement of sustainable development as guiding its international relations with respect to international trade, see Nigeria as a Third Participant in United States – Import Prohibition of Certain Shrimp and Shrimp Products (US-Shrimp/Turtle I), AB-1998-4, Report of the Appellate Body, WT/DS58/AB/R, [78].

²⁹⁹ EU (then the European Communities) in the Shrimp/Turtles case has directly expressed its acceptance of the principle of sustainable development, see United States – Import Prohibition of Certain Shrimp and Shrimp Products (US-Shrimp/Turtle I), AB-1998-4, Report of the Appellate Body, WT/DS58/AB/R [67].

³⁰⁰ See also P Sands, 'International Courts and the Application of the Concept of "Sustainable Development"' (1999) 3 *Max Planck Yearbook of United Nations Law*, 389-403; A Boyle, 'Between Process and Substance. Sustainable Development in the Jurisprudence of International Courts and Tribunals' in Hans Christian Bugge and Christina Voigt (eds), *Sustainable Development in International and National Law* (Europa Law Publishing 2008) 203-219.

recognized in such supplementary sources of international law as legal doctrine³⁰¹ and soft law. Therefore, it may be concluded that normativity of sustainable development is recognized in the principal sources of legal authority, addressed here in turn.

1.5.2.1. Recognition of sustainable development as a primary norm in principal sources of legal authority

It is a truism that adjudicators are bound to apply law that is contained in formal and material sources. The main guideline for where to search for legal norms in international law is Article 38 (1) of the Statutes of the International Court of Justice; however, it does not provide an exhaustive list and it does not distinguish clearly between formal and material sources of law.³⁰²

Formal sources mean legal and direct authoritative statements on what law is, for example treaties, state practice and judicial decisions;³⁰³ whereas material sources of law are such indirect records of law³⁰⁴ as legal doctrine and soft law instruments.³⁰⁵ The following sub-sections address references to sustainable development in these records of law.

International Agreements

Since the Report *Our Common Future* (1987)³⁰⁶ formulated the concept of sustainable development, it has developed from a mere political concept to a hard law norm³⁰⁷ because reference to sustainable development is established in such hard law (formal)

³⁰¹ C Voigt, *Sustainable Development as a Principle of International Law* (Nijhoff 2009) 145, 147, 162, 171, 186; P Birnie, A Boyle, C Redgwell, *International Law and the Environment* (3rd ed, OUP 2009) 163; P Sands, *Principles of International Environmental Law*, (2nd ed, CUP 2003) 252, 260, 266.

³⁰² Sir Gerald G. Fitzmaurice, 'Some Problems Regarding the Formal Sources of International Law', (1958) *Symbolae Verzijl*, 153 *et seq.* For instance, Fitzmaurice categorizes natural law and international jurisprudence as formal sources of law, and treaties – as formal sources of obligation, but not as formal sources of law.

³⁰³ W. Friedmann, 'The Uses of "General Principles" in the Development of International Law', (1963) 57 *AJIL* 2, 279.

³⁰⁴ Sir Gerald G. Fitzmaurice, 'Some Problems Regarding the Formal Sources of International Law', (1958) *Symbolae Verzijl*, 153.

³⁰⁵ Sir Gerald G. Fitzmaurice, 'Some Problems Regarding the Formal Sources of International Law', (1958) *Symbolae Verzijl*, 153- 159.

³⁰⁶ World Commission on Environment and Development, *Our Common Future* (OUP 1987).

³⁰⁷ It is common knowledge that any legal system consists of norms, namely – legal rules and principles, see A Allott, *The Limits of Law*, (Butterworths, 1980) 17-18.

sources of law as environmental³⁰⁸ and economic agreements.³⁰⁹ Apart from the Lisbon Treaty, most of the hard law references to sustainable development do not indicate its legal status;³¹⁰ they merely refer to the ‘promotion of sustainable development’ without any other indications of its legal status.

Nevertheless, if there is a reference to sustainable development in a hard law document, irrespective of its enforceability, it may be assumed that the treaty parties have intended it to be ‘taken into account’ in the application process of the document, and, thus, in a legal adjudication.³¹¹ Consequently, the criticism put forward by legal positivists that sustainable development is not a norm, since it is not contained in recognized sources of law, and therefore it is not formally binding,³¹² is already overturned. When principles are incorporated in international agreements they are necessarily legal, even if their reach and strength may vary.³¹³

Soft Law

Declarations of the three UN conferences on sustainable development³¹⁴ are having a significant degree of normative value in drafting and interpreting international treaties. For instance, the Johannesburg Declaration is explicitly integrated in the CARIFORUM EPA through its preambular language, and the Rio Declaration was used as an interpretative argument in *S.D. Myers v. Canada*³¹⁵ award by the

³⁰⁸ For instance, Article 3.4 United Nations Framework Convention on Climate Change 1992, 31 ILM 849 (1992) and Article 2.1. of its Kyoto Protocol.

³⁰⁹ E.g., preamble, Consolidated Version of the Treaty on European Union, Official Journal of the European Union C 115/13, 9.5.2008; Article 3(5), Article 21 (f), Article 11 Consolidated Version of the Treaty on the Functioning of the European Union. Official Journal of the European Union C 115/15, 9.5.2008; preamble, Marrakesh Agreement Establishing the World Trade Organization, 33 ILM 1125 (1994), preambles of several ‘new generation’ IIAs like CAFTA and NAFTA.

³¹⁰ Preamble: ‘[d]etermined to promote economic and social progress for their peoples, taking into account the principle of sustainable development,’ see Consolidated Version of the Treaty on European Union, Official Journal of the European Union C 115/13, 9.5.2008.

³¹¹ S.H. Nasser, *Sources and Norms of International Law. A Study on Soft Law* (Galda+Wilch Verlag 2008), 119.

³¹² See Prosper Weil, ‘Towards Relative Normativity in International Law?’ (1983) *American Journal of International Law*, Vol. 77, 413-442.

³¹³ S.H. Nasser, *Sources and Norms of International Law. A Study on Soft Law* (Galda+Wilch Verlag 2008), 115.

³¹⁴ UN Conference on Environment and Development ‘Rio Declaration on Environment and Development’ (14 June 1992) UN Doc A/CONF. 151/26/Rev 1 vol I, 3; Johannesburg Declaration 2002, World Summit on Sustainable Development (Johannesburg Summit) ‘Report’ (26 August-4 September 2002) UN Doc A/AC.257/32; United Nations, A/CONF.216/L/1/, Outcome of the Conference ‘The Future We Want’, Rio de Janeiro, Brazil, 20-22 June 2012 [3].

³¹⁵ *S.D. Myers, Inc. v Government of Canada*, Partial Award, November 13, 2000, NAFTA, UNCITRAL[247].

investment tribunal and in *Nuclear Weapons* case by the ICJ.³¹⁶ Therefore, these soft law documents pronouncing sustainable development as a principle have a significant degree of normative value.³¹⁷

Moreover, their wide acceptance certainly reflects the importance of sustainable development as a principle and value,³¹⁸ creating expectations towards the conduct of States³¹⁹ that adjudicators are supposed to take into account. Therefore, some scholars suggest that in the case of a conflict between hard and soft law documents, adjudicators are supposed to ‘interpret away’ the conflict by interpreting the hard law documents in light of the soft law documents.³²⁰

Practice of states and other subjects of international law

State practice is a formal source of law that may indicate the existence of a binding legal norm.³²¹ Recognition of sustainable development as a legal principle is found in the practice of states. Argentina³²² and Uruguay³²³ had referred to sustainable development as a relevant applicable principle of international environmental law in the *Pulp Mills* case.³²⁴ Additionally, Nigeria has expressed its acknowledgement of sustainable development as a guiding principle of its international trade relations.³²⁵

³¹⁶ Advisory Opinion on the Legality of the Threat or Use of Nuclear Weapons, ICJ Reports 1996 [30].

³¹⁷ Gregory C. Shaffer, Mark A. Pollack, ‘How Hard and Soft Law Interact in International Regulatory Governance: Alternatives, Complements and Antagonists’, SIEL, Working Paper No. 45/08, available at <http://www.ssrn.com/link/SIEL-Inaugural-Conference.html>, 2.

³¹⁸ C M Chinkin, ‘The Challenge of Soft Law: Development and Change in International Law’, (1989) 38 ICLQ 4, 851, at 861.

³¹⁹ Ibid, 862-865.

³²⁰ J. Klabbbers, ‘The Redundancy of Soft Law’, (1996) Nordic Journal of International Law 65, 167-182, at 177.

³²¹ Theory proposes that ‘for a principle to exist [as a source of international law] it would be necessary that States acknowledge, albeit implicitly, that this principle applies to their international relations’, see G. Gaja, ‘General Principles of Law’, in *The Max Planck Encyclopedia of Public International Law*, (Oxford University Press, 2007), online edition, available at www.mpepil.com, [19].

³²² Memorial of the Argentina, [3.177]-[3.179] ‘L’Argentine et l’Uruguay sont liés par le respect du principe du développement durable lorsque ces deux Etats entreprennent des activités sur le fleuve’, *Pulp Mills on the River Uruguay* (Argentina v. Uruguay.), Judgement (ICJ, 20 April, 2010), [55].

³²³ Uruguay Counter – Memorial, [2.29]- [2.32]; *Pulp Mills Judgement*, [152].

³²⁴ *Pulp Mills on the River Uruguay* (Argentina v. Uruguay.), Judgement (ICJ, 20 April, 2010).

³²⁵ Nigeria as a Third Participant in United States – Import Prohibition of Certain Shrimp and Shrimp Products (US-Shrimp/Turtle I), AB-1998-4, Report of the Appellate Body, WT/DS58/AB/R, [78].

Similarly, the EU (then the European Communities) in the *Shrimp/Turtles* case directly expressed its acceptance of the principle of sustainable development.³²⁶

Even if the state and the EU practice mentioned here is not indicative of the general acceptance of sustainable development as a principle by all civilized states, together with other ‘evidences’ of law, like the outcome documents of the three UN global conferences on sustainable development, it serves as an additional argument for proving the existence of the principle of sustainable development.

Legal Doctrine

There is an additional proof of sustainable development as a norm in legal doctrine, albeit the doctrine remains much divided with respect to the normativity of sustainable development.³²⁷

The most notable proponents of normativity of sustainable development are Judge Weeramantry and Judge Trindade from the International Court of Justice. They link the existence of normativity of sustainable development with natural law or natural justice³²⁸ that has been recognized as a formal (direct) source of law since Grotius.³²⁹

Judge Trindade classifies sustainable development as a general principle of law under Article 38 (1) (c) of the Statute of the ICJ, which, in his opinion, also comprises general principles in specific fields of law such as international environmental law.³³⁰

Judge Weeramantry in his Separate Opinion to *Gabčíkovo-Nagymaros* case attributed normative status to sustainable development by noting that it is a ‘principle with normative value’ being ‘an integral part of modern international law’ because of its

³²⁶ Ibid, [67].

³²⁷ *Contra* normative value of sustainable development: G. Handl, ‘Sustainable Development: General Rules versus Specific Obligations’, in Winfried Lang (ed.), *Sustainable Development and International Law*, (Graham & Trotman/Martinus Nijhoff, 1995). *Pro* normativity: P.Sands, ‘International Courts and the Application of the Concept of "Sustainable Development"’, Vol.3 Max Planck Yearbook of United Nations Law, 1999, 389-403.

³²⁸ Judge C.Trindade, Separate Opinion, Pulp Mills on the River Uruguay (Argentina v. Uruguay.), Judgement (ICJ, 20 April, 2010), available at <http://www.icj-cij.org/docket/index.php?p1=3&p2=3>, [39], [210], Vice-President Weeramantry, Separate opinion, Gabčíkovo – Nagymaros Project case (Hungary/Slovakia), ICJ Reports, (1997), 95.

³²⁹ G.G. Fitzmaurice, ‘Some Problems Regarding the Formal Sources of International Law’, (1958) *Symbolae Verzijl*, 164, 168.

³³⁰ Judge C.Trindade, Separate Opinion, Pulp Mills on the River Uruguay (Argentina v. Uruguay.), Judgement (ICJ, 20 April, 2010), available at <http://www.icj-cij.org/docket/index.php?p1=3&p2=3>, [3]-[4], [48], [205].

‘wide and general acceptance by the global community’, and ‘inescapable logical necessity’.³³¹

1.5.2.2. Qualitative capacity of sustainable development to function as a legal principle

For a legal principle to exist, not only its recognition as a principle is relevant but also its qualitative aspect – whether sustainable development has a critical amount of clarity to guide adjudicators towards a particular outcome.

In this regard, opponents insist that sustainable development is too vague to possess a normative character of a traditional type. For instance, Lowe contends that sustainable development is not sufficiently precise and does not create an actionable right and, thus, cannot itself provide legal guidance typical of principles of customary international law like the principle of equidistance.³³²

However, one may not agree with this argument. Rule-creating or substantive principles of law like the customary principle of equidistance are only one group of general principles of law. Legal scholarship distinguishes other types of legal principles applicable to international legal relations that are autonomous sources of international law³³³ separate from treaty or customary rules,³³⁴ for instance, principles of approach and interpretation to legal relationship such as good faith and minimum standards of procedural fairness like due process.³³⁵ Friedmann highlights that principles of approach and interpretation to legal relationship by themselves do ‘not say anything on the specific content and extent of certain rights’ as their application is case sensitive;³³⁶ however, they provide guidelines for the application of particular norms.³³⁷

³³¹ Vice-President Weeramantry, Separate opinion, *Gabčíkovo – Nagymaros Project case* (Hungary/Slovakia), ICJ Reports, (1997), 95.

³³² V Lowe, ‘Sustainable Development and Unsustainable Arguments’ in Alan Boyle and David Freestone (eds) *International Law and Sustainable Development. Past Achievements and Future Challenges* (OUP 1999) 30-33.

³³³ Separate Opinion of Judge Trindade [17]-[19], [28].

³³⁴ Ibid [39].

³³⁵ W Friedmann, ‘The Uses of “General Principles” in the Development of International Law’, 57 *AJIL* 2 (1963) 287-290. See also B Cheng, *General Principles of Law as applied by International Courts and Tribunals* (Grotius Publications 1987) 105, 299.

³³⁶ B. Cheng, *General Principles of Law as applied by International Courts and Tribunals* (Grotius Publications 1987), 105.

³³⁷ W. Friedmann, ‘The Use of General Principles’ in the Development of International Law’, 57 *AJIL* (1963), p.287- 289.

It is also accepted that general principles of law may belong to specific domains of international law like international environmental law³³⁸ or development related fields of law. These principles may find their expression not only in formal sources or manifestations of international law as treaties and customs but also in sources not listed in Article 38 (1) (c) of the ICJ Statute such as resolutions of international organizations.³³⁹

Even though sustainable development does not fulfil the standard of being a rule-creating legal principle, as it lacks direct legal consequences,³⁴⁰ it nevertheless has a capacity to function as a legal principle of interpretation, ‘which bring out relevant arguments in support of one or another solution’.³⁴¹

In this respect, Dworkin notes that legal principle ‘states a reason that argues in one direction, but does not necessitate a particular decision’. He continues:

*All that is meant, when we say that a particular principle is a principle of our law, is that the principle is one which officials must take into account, if it is relevant, as a consideration inclining in one way or another.*³⁴²

In this connection, Koskeniemi defines ‘binding force’ of principles as their effect to ‘govern the solution of normative problems’ in a way that the solution seems rational.³⁴³

Sustainable development has exactly this capacity, namely it is clear enough to guide adjudicators in their decision-making towards a particular outcome – integration of economic, social and environmental matters. This specific capacity, which is also the minimum content of sustainable development, has been explicitly recognized by states in three global conferences,³⁴⁴ legal doctrine,³⁴⁵ and it is approved by jurisprudence of international courts and tribunals.³⁴⁶ The latter is analysed below.

³³⁸ Separate Opinion of Judge Trindade [48].

³³⁹ Judge C.Trindade, Separate Opinion, [28]. See also A. Boyle, C.Chinkin, *The Making of International Law*, (Oxford: Oxford University Press, 2007), 222-225.

³⁴⁰ V Lowe, ‘Sustainable Development and Unsustainable Arguments’ in Alan Boyle and David Freestone (eds) *International Law and Sustainable Development. Past Achievements and Future Challenges* (OUP 1999) 30-37.

³⁴¹ M. Koskeniemi, ‘General Principles: Reflections on Constructivist Thinking in International Law’ in Marti Koskeniemi (ed) *Sources of International Law* (Ashgate 2000), 134.

³⁴² R. Dworkin, *Taking Rights Seriously* (Duckworth 2005) 24 – 26.

³⁴³ M. Koskeniemi, ‘General Principles: Reflections on Constructivist Thinking in International Law’ in Marti Koskeniemi (ed) *Sources of International Law* (Ashgate 2000) 365.

³⁴⁴ The outcome document of the Rio+20 Conference represents the most recent approval of the integration as the core issue of sustainable development (the so-called principle of integration), see United Nations, A/CONF.216/L/1/, Outcome of the Conference ‘The Future We Want’, Rio de Janeiro, Brazil, 20-22 June 2012 [3]. Earlier the element of integration was established in the Principles 3 and 4

1.5.2.2.1. Analysis of a case law using sustainable development as a guideline for interpretation

The capacity of sustainable development to function as a legal principle of interpretation may be read into several judicial decisions by international courts and tribunals, addressed below.

Legality of the Threat or Use of Nuclear Weapons, ICJ

While answering the question of whether the threat of nuclear weapons as a measure of self-defence is permitted by international law, the ICJ in the *Advisory Opinion on Nuclear Weapons*³⁴⁷ noted:

*Respect for the environment is one of the elements that go to assessing whether an action is in conformity with the principles of necessity and proportionality [...] This approach is supported, indeed, by the terms of Principle 24 of the Rio Declaration.*³⁴⁸

The Court went on by ruling:

*[W]hile the existing international law relating to the protection and safeguarding of the environment does not specifically prohibit the use of nuclear weapons, it indicates important environmental factor that **are properly to be taken into account** in the context of the implementation of the principles and rules of the law applicable in armed conflict.*³⁴⁹

Hence, the ICJ brought to the forefront the core of sustainable development, namely the integration requirement of environmental and social aspects ('quality of life'). The

of the Rio Declaration, see UN Conference on Environment and Development, 'Rio Declaration on Environment and Development' (12 August 1992) UN Doc A/CONF. 151/26(Vol.I). See also Johannesburg Declaration (26 August to 4 September 2002) UN Doc. A/AC.257/32 [47].

³⁴⁵ Separate Opinion of Judge Trindade (n²⁸⁷) [39]-[210], Vice-President Weeramantry, Separate opinion, *Gabčíkovo – Nagymaros Project case* (Hungary/Slovakia), ICJ Reports, (1997), 95. 141; M-C Cordonier Segger, 'Sustainable Development in International Law' in Hans Christian Bugge and Christina Voigt (eds), *Sustainable Development in International and National Law* (Europa Law Publishing 2008) 139 and ILA Toronto Conference (2006), 'International Law on Sustainable Development', 2.

³⁴⁶ Advisory Opinion on The Legality of the Threat or Use of Nuclear Weapons, ICJ Reports 1996, [30]-[33]; *Gabčíkovo-Nagymaros Project* (Hungary/Slovakia), Judgment, I.C.J. Reports 1997, p. 78, [140]; Case Concerning Pulp Mills on the River Uruguay (Argentina v. Uruguay), Judgment, (ICJ, 20 April, 2010) [75], [119]-[120], [177]; AB Report, United States – Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/AB/R, 6 November 1998, [129], [153]; S.D.Myers, Inc. v Government of Canada, Partial Award, November 13, 2000, NAFTA, UNCITRAL [247], [250]; Iron Rhine ('Ijzeren Rijn') Railway, (Belgium/Netherlands) PCA, Award, May 24, 2005 [59], [70], [80].

³⁴⁷ Advisory Opinion on The Legality of the Threat or Use of Nuclear Weapons, ICJ Reports 1996.

³⁴⁸ Ibid.

³⁴⁹ Ibid, [33] (Emphasis added).

Court ruled that this integration element is to be taken into account while exercising other rights under international law.

Gabčíkovo-Nagymaros case, ICJ

The first open reference to sustainable development was done by the ICJ in the *Gabčíkovo-Nagymaros* case analyzing the impact of the Dam Project upon the environment. The Court made notable observations which are worth quoting at length:

*Throughout the ages, mankind has, for economic and other reasons, constantly interfered with nature. In the past, this was often done without consideration of the effects upon the environment. Owing to new scientific insights and to a growing awareness of the risks for mankind - for present and future generations - of pursuit of such interventions at an unconsidered and unabated pace, new norms and standards have been developed, set forth in a great number of instruments during the last two decades. **Such new norms have to be taken into consideration, and such new standards given proper weight, not only when States contemplate new activities but also when continuing with activities begun in the past. This need to reconcile economic development with protection of the environment is aptly expressed in the concept of sustainable development.** For the purposes of the present case, this means that the Parties together **should look afresh** at the effects on the environment of the operation of the Gabčíkovo power plant.*³⁵⁰

In essence, the Court indicates that in order to renegotiate the Treaty on the operation of the Gabčíkovo power plant, the Parties should be lead by the concept of sustainable development, namely they must take into consideration and ‘give proper weight’ to current standards of mitigating environmental risks. Therefore, it may be concluded that the *Gabčíkovo Nagymaros* case proves that sustainable development possesses a normative value and power for governing a solution of a normative problem. Namely, it sets out a goal to be reached under international law in order to negotiate a new Treaty, and consequently excludes a behaviour that goes contrary to that goal.

Pulp Mills case, ICJ

In the *Pulp Mills* case,³⁵¹ the Court recognized an objective of sustainable development in the object and purpose of the 1975 Statute. The Statute was concluded in order to regulate the use of the river; therefore the Court noted ‘that such use

³⁵⁰ Gabčíkovo-Nagymaros Project (Hungary/Slovakia), Judgment, I.C.J. Reports 1997, p. 78, [140], (emphasis added).

³⁵¹ Case Concerning Pulp Mills on the River Uruguay (Argentina v. Uruguay), Judgement, (ICJ, 20 April, 2010), available at <http://www.icj-cij.org>. See also Pulp Mills on the River Uruguay (Argentina v. Uruguay), Provisional Measures, Order of 13 July 2006, I.C.J. Reports 2006, p. 133, [80].

should allow for sustainable development which takes account of the need to safeguard the continued conservation of the river environment and the rights of economic development of the riparian States'.³⁵² As a consequence, the Court determined that the disputing riparian States should co-operate in order to reach the objective of sustainable development.³⁵³ Hence, the sustainable development goal was meant to function as a legal framework for their further cooperation.

Thus, it may be concluded that the Court indirectly applied sustainable development as a legal principle in Dworkin's sense because the reference to it served for stating 'a reason that argues in one direction', namely sustainable development was used for imposing a duty on the disputing Parties to cooperate in a particular way.

Shrimp/Turtles Report, WTO AB

In the *Shrimp/Turtles* Report by the Appellate Body (AB), the AB 'took into account' the objective of sustainable development as expressed in the preamble of WTO Agreement in interpreting the term 'exhaustible natural resources' under GATT Article XX(g).³⁵⁴ The AB stated:

*As this preambular language reflects the intentions of negotiators of the WTO Agreement, we believe it must add colour, texture and shading to our interpretation of the agreements annexed to the WTO Agreement, in this case, the GATT 1994.*³⁵⁵

As a result, the AB applied an effective and evolutionary treaty interpretation method to also include living natural resources in the term 'exhaustible natural resources'. Therefore, sustainable development was applied as a legal principle which led the AB towards the justification of the wide interpretation of the term 'exhaustible natural resources'.³⁵⁶

³⁵² Ibid [75], [119]-[120], [177].

³⁵³ Ibid, [77], [177].

³⁵⁴ AB Report, United States – Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/AB/R, 6 November 1998, [129].

³⁵⁵ Ibid [153].

³⁵⁶ See ILA Committee report 2006 Annex II, Elements of the Principle of Integration in WTO Jurisprudence: Another Look at the *Shrimp* Cases. A Comment prepared for the International Law Association's Committee on the Law of Sustainable Development by Dr. Tomer Broude, Hebrew University of Jerusalem Israel.

S.D.Myers v. Canada Arbitral Award

The NAFTA Tribunal in *S.D.Myers*³⁵⁷ established the legal context of Article 1102 on national treatment, among others against the background of NAFTA's companion agreement, the NAAEC, and principles that are affirmed by the NAAEC (including those of the Rio Declaration), namely – the principle that ‘environmental protection and economic development can and should be mutually supportive’.³⁵⁸ The Tribunal stated:

*[T]he interpretation of the phrase “like circumstances” in Article 1102 must take into account the general principles that emerge from the legal context of the NAFTA, including both its concern with the environment and the need to avoid trade distortions that are not justified by environmental concerns. The assessment of “like circumstances” must also take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest.*³⁵⁹

Hence, the *S.D.Myers* Tribunal indirectly applied the core of sustainable development so as to set the limits on the scope of the national treatment standard in the NAFTA.

Iron Rhine (Belgium/the Netherlands) Arbitral Award

The *Iron Rhine* arbitration³⁶⁰ emerged from plans by Belgium to reactivate a railway line going through the Netherlands. Belgium had a right to do so under the 1839 Treaty of Separation. The Tribunal was asked ‘whether the costs and expenses to be incurred by Belgium should include the costs and expenses of the environmental protection measures required by Netherlands law’.³⁶¹

In order to answer the question, the Tribunal set the legal background that would lead to the answer and remarkably noted:

*Today, both international and EC law require the **integration** of appropriate environmental measures in the design and implementation of economic development activities.*³⁶²

In other words, the Tribunal referred to the core of the principle of sustainable development, namely the principle of integration. The integration requirement led the

³⁵⁷ *S.D.Myers, Inc. v Government of Canada*, Partial Award, November 13, 2000, NAFTA, UNCITRAL.

³⁵⁸ *Ibid* [247].

³⁵⁹ *Ibid* [250].

³⁶⁰ *Iron Rhine ("Ijzeren Rijn") Railway*, (Belgium/Netherlands) PCA, Award, May 24, 2005.

³⁶¹ *Ibid* [70].

³⁶² *Ibid* [59] (emphasis added).

Tribunal to the use of evolutive interpretation of the Treaty concluded back in 1839 and to internalize the necessary environmental protection measures as an integral component of such a railway reactivation project and its costs.³⁶³

1.5.2.3. Interim conclusions

To conclude, sustainable development is applicable and participates in investment treaty interpretation where the relevant IIA contains explicit or implicit reference to it.³⁶⁴ In other cases, i.e., with respect to ‘old generation’ BITs, sustainable development has a capacity to participate in treaty interpretation as the inherent object and purpose of the network of IIAs. Furthermore, sustainable development has definite enough normative content (integration between economic, social development and the protection of the environment) to function as a legal principle, which does not dictate the solution of the case exhaustively, but which brings out relevant arguments in support of one or another solution, thus being a legal principle of approach and interpretation of legal relationships but not of norm-creating capacity. This capacity of sustainable development is directly or indirectly recognized in the practice of states and other subjects of international law, and it may be read into several judicial decisions by international courts and tribunals.

Finally, the integration aspect of sustainable development is definite enough to limit the discretion of decision-makers in setting the content of open-textured indirect expropriation standard, i.e., the decision-maker is bound by an obligation not to focus exclusively on the interests of investor, since such an approach would contradict the sustainable development objective.

1.6. SUSTAINABLE DEVELOPMENT IN THE INTERPRETATION PROCESS OF INDIRECT EXPROPRIATION

First, since the textual meaning of indirect expropriation standard in IIAs is overly abstract making it difficult to interpret the standard in accordance with its ordinary meaning, a reference to object and purpose of the network of IIAs (Article 31(1)

³⁶³ Ibid [80].

³⁶⁴ E.g., S.D. Myers v Canada [245], [247], [250].

VCLT) and to the legal principle that stems from it is justified and necessary for filling the standard with a particular content.

In the process of going beyond the literal meaning of indirect expropriation, arbitrators enjoy a degree of flexibility for choosing their argumentation. Therefore, a reference to the object and purpose of a treaty and its general context is necessary to limit this interpretative discretion and ‘pushing and pulling’ of the boundaries of indirect expropriation standard in a way that is harmonious to the objectives of the regime.

Second, it was previously concluded that the application of a particular IIA requires considering the wider context or background of the investment protection regime as existing independently from individual IIAs. This wider context is of particular importance for the interpretation of ‘old generation’ IIAs that mostly remain silent on their object and purpose or formulate it narrowly by focusing solely on foreign investment promotion and protection. It was established that this inherent context is the promotion of economic development that is a generic legal term, whose contemporary meaning is sustainable (economic) development.

Third, even if sustainable development might be considered a term of ‘high level of generality and abstraction,’ it was demonstrated that sustainable development has precise enough normative content for guiding adjudicators towards a particular outcome (integration of economic, social and environmental concerns) and hence, it has a capacity to function as a legal principle of interpretation. Although it does not dictate the solution of the case exhaustively, sustainable development may bring out relevant arguments in support of one or another solution. Consequently, the integration aspect of sustainable development is precise enough for limiting the discretion of decision-makers in setting the content of the open-textured indirect expropriation standard.

Legal positivists argue that legal principles are applicable only in ‘hard cases’, where an adjudicator needs to fill a *lacunae* in law, and thus they have subsidiary meaning in adjudication processes;³⁶⁵ however, since there is no hierarchy between the sources of international law,³⁶⁶ there is no reason to avoid an application of a legal principle in

³⁶⁵ M. Koskenniemi, ‘General Principles: Reflections on Constructivist Thinking in International Law’ in Marti Koskenniemi (ed) *Sources of International Law* (Ashgate, 2000), 371.

³⁶⁶ With an exception for *jus cogens* and Article 103 UN Charter, see Fragmentation Report [327].

case it may guide a decision-maker in finding a solution for the dispute.³⁶⁷ Consequently, one may conclude that a reference to object and purpose of the network of IIAs and to a legal principle that stems from it is justified and necessary for filling the vague indirect expropriation standard with a content in specific cases.

This conclusion has certain legal consequences. First, the necessity to use contextual interpretation through the prism of sustainable development requires adjudicators to avoid limiting themselves strictly to the focus on investment protection in the interpretation process of indirect expropriation and its sub-elements. Second, the context of sustainable development significantly affects the scope of the ‘background’ of adjudicators.

1.7. IMPLICATIONS OF SUSTAINABLE DEVELOPMENT CONTEXT ON THE ROLE OF INVESTMENT TREATY TRIBUNALS

The context of sustainable development significantly affects the scope of the ‘background’ of adjudicators. Koskenniemi explains that the adjudicators’ ‘background theory’ reflects the interaction of the postulated values and goals of the legal system and a reflection on them by adjudicators, who operate within that legal system.³⁶⁸ While solving a legal dispute, adjudicators identify and apply these principles because their ‘background’ sets it as their institutional function and as part of the expectations directed at them.³⁶⁹

Thus, contextualization of the international investment protection regime through the principle of sustainable development requires adjudicators to act in a way that expresses the values and goals of the legal regime, namely the general commitment to promote sustainable development.

However, the current application of indirect expropriation has caused fears of overly restricted policy space for host States to safeguard public interests that leads to blocking instead of promoting development. These fears stem from the unpredictability of the criteria that investment treaty tribunals are going to take into account when filling the vague indirect expropriation standard with content and whether States regulatory responsibilities will be duly considered.

³⁶⁷ Koskenniemi, ‘General Principles: Reflections on Constructivist Thinking in International Law’, 364.

³⁶⁸ M. Koskenniemi, ‘General Principles: Reflections on Constructivist Thinking in International Law’ in Marti Koskenniemi (ed) *Sources of International Law* (Ashgate 2000), 155-156.

³⁶⁹ Ibid, 138.

More precisely, there is no predictability whether tribunals in their legal reasoning will focus narrowly on foreign investment protection as the main element for setting the content of indirect expropriation or will they consider the wider context that exceeds the allegedly affected interests of foreign investors.

One way to explain this situation is through the analysis of the subjective awareness by arbitral tribunals of their proper role and powers.³⁷⁰ The diversity in approaches towards the role of investment treaty tribunals stems from the ‘hybrid foundations’ of investor-state arbitration.³⁷¹ This form of dispute resolution is a mixture of public international law and private international law.³⁷² Its procedure and enforcement is mainly taken from commercial arbitration³⁷³ but its content is mostly governed by public international law,³⁷⁴ since investor-state arbitration is meant to deal with alleged breaches of host State’s international obligations towards investors.³⁷⁵

Thus, some arbitral tribunals have taken the ‘service providers’ approach as in private commercial arbitrations.³⁷⁶ As ‘service providers’, investment treaty tribunals are limited with addressing the arguments of pleading parties without considering the wider context and consequences of the award.³⁷⁷

³⁷⁰ Fauchald distinguishes two extremes – a ‘dispute oriented’ tribunal that would focus merely on the relationship between the litigating parties, and a ‘legislator –oriented’ tribunal, which would also take into account such factors as third party interests, the general functioning of the ICSID system, the potential impact of its reasoning or conclusions for future cases and so on, see O.K.Fauchald, ‘Legal Reasoning of ICSID Tribunals – an Empirical Analysis’, *European Journal of International Law*, No.2, Issue 19, 2008, 307.

³⁷¹ Z.Douglas, ‘The Hybrid Foundations of Investment Treaty Arbitration’, *BYIL* 151 (2003).

³⁷² *Ibid.*, 282.

³⁷³ A relatively fast *ad hoc* dispute settlement mechanism with no appellate review. The awards are enforceable or set aside under the 1958 New York Convention on the Recognition of Foreign Arbitral Awards. The ICSID Convention regulates its own enforcement under Articles 53 and 54 and national courts have no control over the arbitral awards rendered under the ICSID Convention and thus the ICSID regime.

³⁷⁴ CH Schreuer, L Malintoppi, A Reinsisch and A Sinclair, *The ICSID Convention. A Commentary* (2nd ed, CUP 2009), 560-562, [33-36].

³⁷⁵ See *Compañía de Aguas del Aconquija S.A and Vivendi Universal v. Argentine Republic*, ICSID Case No.ARB/97/3, Decision on Annulment, July 3, 2002, *reprinted in* 19 *ICSID Rev.—FILJ* 89 (2004), [96,113]; *Wintershall Aktiengesellschaft v Argentine Republic* ICSID Case No ARB/04/14, Award, 8 December 2008, [160]: ‘*The ICSID Convention [...] combines a public law system of State liability with private arbitration*’; *Glamis Gold Ltd v US UNCITRAL/NAFTA*, Award, 8 June 2009, [3–9], stating at para 5 that ‘*Chapter 11 of the NAFTA contains a significant public system of private investment protection*’.

³⁷⁶ E.g., *Siemens AG v. Republic of Argentina*, ICSID Case No. ARB/02/8, Decision on Jurisdiction (3August 2004), [81].

³⁷⁷ For an opinion favouring the ‘service providers’ approach see Cordero Moss G., ‘Tribunal’s Powers versus Party Autonomy’, in *The Oxford Handbook of International Investment Law*, P.Muchlinski, F.Ortino, C.Schreuer (eds.), (New York: Oxford University Press, 2008); T.W.Wälde, ‘Interpreting Investment Treaties: Experiences and Examples, in *Investor-state Arbitration*’ in

Other arbitral tribunals that perceive foreign investment protection as ‘an emerging system of public law’³⁷⁸ have taken a ‘guardians of law’ approach recognized in public law.³⁷⁹ This public law approach requires taking into account not only the arguments of pleading parties but also wider circumstances of the case like third party interests and the effect that the case might have on the legal regime as a whole.³⁸⁰

Taking into account that the investor-state arbitration mechanism is intended as an effective replacement of national and international courts in adjudicating the legitimacy of national legislative or administrative acts that are challenged by a foreign investor, there are grounds for dissatisfaction with the ‘service providers’ approach.³⁸¹ Due to this function to review domestic legislative or administrative acts, investor-state arbitration may, and often does, involve public interests that considerably exceed the interests of pleading parties.³⁸² Thus, for instance, in *Glamis Gold v. United States*, the Tribunal noted that ‘the decision in this proceeding has been awaited by private and public entities concerned with environmental regulation, the interests of indigenous peoples, and the tension sometimes seen between private rights in property and the need of the State to regulate the use of property’.³⁸³

International Investment Law for the 21st Century. Essays in Honour of Christoph Schreuer, C.Binder, U.Kriebaum et al (eds.), (Oxford: Oxford University Press, 2009), 724-781.

³⁷⁸ Alex Mills, ‘Antinomies of Public and Private at the Foundations of International Investment Law and Arbitration’ (2011) 14 *Journal of International Economic Law* 2, 469–503, 500.

³⁷⁹ *Glamis Gold, Ltd. v. The United States of America*, UNCITRAL (NAFTA), Award, 8 June 2009, [3–9]; *Biwater Gauff v. Tanzania*, ICSID Case No. ARB/05/22, Procedural Order of 2 February 2007, [52, 64]; *Methanex v. United States (NAFTA)*, Decision on Amici Curiae, 15 January 2001, [47, 49]. Cf. J. Werner, ‘Limits of Commercial Investor-State Arbitration: Need for Appellate Review’ in P.M. Dupuy, F. Francioni, E.U. Petersmann (eds.), *Human Rights in International Investment Law and Arbitration*, (Oxford University Press, 2009), 115-118. See also F. Francioni, ‘Access to Justice, Denial of Justice, and International Investment Law’, in P.M. Dupuy, F. Francioni, E.U. Petersmann (eds.), *Human Rights in International Investment Law and Arbitration*, (OUP 2009), 63-82.

³⁸⁰ *Saipem S.p.A. v. The People's Republic of Bangladesh*, ICSID Case No. ARB/05/07 (Bangladesh/Italy BIT), Decision on Jurisdiction and Recommendation on Provisional Measures, 21 March 2007, [67]; E.g., *Fisheries Jurisdiction (United Kingdom of Great Britain and Northern Ireland v. Iceland)*, 1974 ICJ Reports 3, [17]; *Compania de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic*, ICSID, Case No. ARB/97/3, Annulment, 2 July 2002, 6 ICSID Reports 340, [82-85]; Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (The Netherlands: Wolters Kluwer Law & Business, 2009), 88-89; J. Paulsson, ‘International Arbitration and the Generation of Legal Norms: Treaty Arbitration and International Law’, in ICCA Congress Series No.13, (The Hague: Kluwer Law Internationals, 2007), 879.

³⁸¹ For a criticism of the ‘service providers’ approach, see G. Van Harten, *International Treaty Arbitration and Public Law*, (OUP, 2007), 457; Christoph Schreuer, Ursula Kriebaum, ‘From Individual to Community Interest in International Investment Law’ in Ulrich Fastenrath et al. (eds.), *From bilateralism to community interest: essays in honour of Bruno Simma* (OUP, 2011), 1096.

³⁸² Howard Mann, *Private Rights, Public Problems: A Guide to NAFTA's Controversial Chapter on Investor Rights*, (International Institute for Sustainable Development, 2001).

³⁸³ *Glamis Gold, Ltd. v. The United States of America*, UNCITRAL (NAFTA), Award, 8 June 2009 [8].

Investment litigation may have a significant impact on the future behaviour of host states, their budgets and the welfare of their citizens.³⁸⁴ This aspect is not covered in a case where a tribunal reflects on itself as merely a ‘service provider’ between two litigating parties.

For these reasons, a group of scholars already insist that the ‘service providers’ approach is outdated and replaced by the ‘guardians of law approach’. For instance, Petersmann correlates the need to adopt the ‘guardians of law’ approach with the customary law duty of adjudicators to decide cases in accordance with the principles of justice.³⁸⁵ The prism of sustainable development context allows one to reach exactly the same conclusion; nevertheless, sustainable development context allows filling the abstract term ‘justice’ with specific content requiring rather precise practical implications on the interpretative process of investment guarantees.

To conclude, contextualizing investment protection regime through the prism of sustainable development affects not only investment treaty interpretation in terms of guiding inherent powers of arbitrators to choose and apply interpretative techniques in a way that actually promotes sustainable development. Sustainable development context also allows restructuring the role of investment treaty tribunals and places investment treaty claims in public law dimension, thus ensuring that commercial interests are not prioritized³⁸⁶ but balanced and reconciled with competing public interests.³⁸⁷

³⁸⁴ *Methanex Corporation v. United States of America*, NAFTA case, under UNCITRAL Rules, Decision on Amici Curiae, 15 January 2001, 9, [17] available at http://ita.law.uvic.ca/chronological_list.htm. N.Bernasconi-Osterwalder, E.Brown Weiss, ‘International Investment Rules and Water: Learning from the NAFTA Experience’ in E.Brown Weiss, L.Boisson de Chazournes, N.Bernasconi-Osterwalder (eds), *Fresh Water and International Economic Law* (Oxford: Oxford University Press, 2005), 263-288.

³⁸⁵ Ernst-Ulrich Petersmann, ‘Multilevel Trade Governance Requires Multilevel Constitutionalism’ in Christian Joerges, Ernst-Ulrich Petersmann (eds.) *Constitutionalism, Multilevel Trade Governance and Social Regulations* (2006) 5. See also A. Stone Sweet, F. Grisel, ‘Transnational Investment Arbitration: From Delegation to Constitutionalization’ in P.M. Dupuy, F. Francioni, E.U. Petersmann (eds.), *Human Rights in International Investment Law and Arbitration*, (Oxford University Press, 2009), 118, 127-136; S.W. Schill, *The Multilateralisation of International Investment Law*, 11-17, 118, 364-365, 261-277, 294, 321-339; Stone Sweet, ‘Investor-State Arbitration: Proportionality’s New Frontier’, 50-54.

³⁸⁶ *Ibid*, 34.

³⁸⁷ *Ibid*, 35, 57; see also E.U. Petersmann, ‘The Future of International Economic Law: A Research Agenda’, EUI Working Papers Law, 2010/06, at 6.

INTERIM CONCLUSIONS

Schreuer and Kriebaum have posed the question on ‘whose interests are protected by international investment law?’³⁸⁸ The network of IIAs obviously provides for the protection of individual interests of investors at the international level. That is explicit from the title and structure of IIAs, providing rights for investors to enjoy protection from political risks and duties for host States to comply with international investment protection standards like fair and equitable treatment and protection against indirect expropriation. However, as mentioned earlier, foreign investment protection is not a goal in itself. It is rather a tool for achieving economic development in the host country.

The conclusion that the promotion of economic development was intended to be the inherent objective of the foreign investment protection regime, irrespective of its explicit indication in individual treaties is justified by the analysis of arbitral jurisprudence interpreting the object and purpose of ‘old generation’ IIAs. Arbitral jurisprudence interpreting common-form ‘old generation’ BITs has led to the realization of the existence of two levels of object and purpose of investment protection regime, namely the ‘immediate’ one of investment protection and the ‘overall’ one of economic development. For instance, the *Charles Lemire* award³⁸⁹ not only established that economic development is the overall objective of investment protection but went further by indicating that the overall aim of foreign investment protection – economic development – must benefit all ‘primarily national citizens and national companies, and secondarily foreign investor’.³⁹⁰ A comparable idea has already been expressed more than twenty years ago by *Amco v. Indonesia* Tribunal, which held:

*To protect investments is to protect the general interest of development and of developing countries.*³⁹¹

³⁸⁸ Christoph Schreuer, Ursula Kriebaum, ‘From Individual to Community Interest in International Investment Law’ in Ulrich Fastenrath *et al.* (eds.), *From bilateralism to community interest: essays in honour of Bruno Simma* (Oxford University Press, 2011), 1079.

³⁸⁹ Joseph Charles Lemire v. Ukraine, Decision on Jurisdiction and Liability, January 14, 2010, ICISD Case No.ARB/06/18.

³⁹⁰ *Ibid* [273].

³⁹¹ *Amco Asia Corporation and others v. Republic of Indonesia* (Decision on Jurisdiction) ICSID Case No ARB/81/1(25 September 1983), 23 ILM 351 (1984), [23].

Consequently, application of particular IIA necessitates taking into account the wider context or background of the investment protection regime existing independently from individual IIAs and notwithstanding differing preambular statements on the object and purpose in ‘old generation’ and ‘new generation’ IIAs,³⁹² the former mostly remaining silent on the intentions of treaty parties. Both levels of objectives should participate in setting the proper context for the interpretation of investment guarantees. This wider and inherent context is the promotion of economic development³⁹³ indicating that international investment protection law does not stop short at protecting foreign investors but it is also meant to contribute to the development of host States.

Furthermore, it was suggested that the legal term economic development is generic in nature under the criteria of generic terms set forth by international law and that its current meaning is sustainable development. This conclusion is supported not only by the reliance on the very nature of the term ‘economic development’, which is dynamic and not a static term, i.e., a term the meaning of which must be established in light of present day realities, but is also supported by the UN declarations and resolutions on the development aspects of the international community dating back to 1972, which created legitimate expectations that this commitment to promote sustainable development will be implemented in all development related fields of law including foreign investment protection. Finally, the evolutive nature of economic development is also approved by the current trends in drafting economic law treaties, which attempt to clarify explicitly the generic nature of economic development.

Consequently, and since most ‘old generation’ IIAs remain silent on their formal objectives or focus narrowly on foreign investment protection as a necessary element of economic development, they are now subject to evolutive and effective treaty interpretation. Their interpretations in light of sustainable development should

³⁹² Aaron Broches, ‘Convention on the Settlement of Investment Disputes between States and Nationals of other States of 1965, Explanatory Notes and Survey of its Application’ 18 Yearbook Commercial Arbitration 627, 641-647 (1993); Stephan W. Schill, *The Multilateralization of International Investment Law*, 318 – 319. Alex Mills, ‘Antinomies of Public and Private at the Foundations of International Investment Law and Arbitration’ (2011)14 Journal of International Economic Law 2, 493-494.

³⁹³ Christoph Schreuer, Ursula Kriebaum, ‘From Individual to Community Interest in International Investment Law’ in Ulrich Fastenrath *et al.* (eds.), *From bilateralism to community interest: essays in honour of Bruno Simma* (Oxford University Press) 2011, 1080-1081. See also Alex Mills, ‘Antinomies of Public and Private at the Foundations of International Investment Law and Arbitration’, (2011)14 Journal of International Economic Law 2, 488.

exclude the rather typical prioritization of economic interests in the interpretation process of investment guarantees.

Last but not least, sustainable development has a critical normative content for guiding adjudicators towards a particular outcome (integration instead of competition between economic, social and environmental concerns). In this capacity it is applied by various international courts and tribunals. Thus, sustainable development is able to function as a legal principle having several legal impacts on the application and interpretation of indirect expropriation standard. It affects the ‘background theory’ of adjudicators in setting the content of the open-textured indirect expropriation standard. It explicitly requires that commercial interests are not prioritized but balanced and reconciled with competing public interests by choosing appropriate language and argumentation methods, which gives space for weighing conflicting factors such as investment protection and competing public interests. Hence, the sustainable development objective extends the criteria that should be deliberately taken into account in drawing the line between non-compensable *bona fide* regulations detrimentally affecting foreign investment from compensable regulatory expropriation and thus limiting the unpredictability of creative discretion of adjudicators.

The sustainable development perspective adds to a realization that investor-state arbitration is not exclusively about the protection of foreign investor’s interests. It may considerably exceed the interests of pleading parties, adding to a public dimension of investment protection law, accordingly requiring arbitrators to adopt a role of ‘guardians of law’ instead of ‘service providers’. It is especially so because investment treaty arbitration as an impartial venue is meant to replace national and international courts so as to ensure a careful and objective balance between investor and host state’s interests. So, adjudicators are required to act in a manner that expresses the values and goals of the legal regime, namely the general commitment to promote sustainable (economic) development.

Finally, the overarching goal of sustainable (economic) development adds certain dynamism to treaty provisions, especially in cases of the application of ‘old school’ BITs that do not contain explicit references to safeguarding wider societal interests other than foreign investment protection.

CHAPTER 2. THE IMPACT OF SUSTAINABLE DEVELOPMENT CONTEXT ON JURISDICTION AND APPLICABLE LAW IN INVESTMENT TREATY ARBITRATION

INTRODUCTION

While being limited in their jurisdictional competence, investment tribunals have shown a tendency to look too narrowly at the applicable law when it comes to considering and applying non-investment international law in the context of indirect expropriation claims. Host States often invoke law originating from other sub-systems of international law as part of their defence arguments against alleged violations of investment protection guarantees (see Box 2 and Box 3 in the Appendix). The often narrow focus of the applicable law makes arbitral tribunals less likely to consider wider public policy considerations that are often grounded in external, non-investment international obligations by host States. It also makes the tribunals less likely to focus on the protection of third party stakeholders' interests related to social or environmental considerations of host States, like ensuring the right to water.

For that reason this chapter aims at examining the effect which the sustainable development context and its requirement of integrating investment and non-investment interests have on the scope of applicable law in investment treaty arbitration. It is claimed that the sustainable development context guides the normal task of adjudicators to decide a case where two norms are in conflict with each other towards a specific outcome of integration. Thus, invocation of the sustainable development context exceeds the ordinary task of adjudicators to solve a case.³⁹⁴ It sets forth the integration as an outcome to be reached, necessitating 'systemic' instead of 'self-contained' thinking of investment law. It also necessitates a realization of the inter-dependence between areas of law that fall under the pillars of sustainable development and makes a strict separation between these fields of law artificial. Consequently, the sustainable development context establishes the necessary link between investment rules and *prima facie* external rules creating the necessity to realize and address potential normative conflicts between these rules.

³⁹⁴ Contra: Love, for instance, claims that sustainable development has no normative value as its application does not exceed the normal duty of adjudicators to solve cases by means of conflict avoidance tools and treaty interpretation principles, see V. Lowe, 'Sustainable Development and Unsustainable Arguments' in Alan Boyle and David Freestone (eds) *International Law and Sustainable Development. Past Achievements and Future Challenges* (OUP 1999) 30 *et seq.*

This chapter is structured in the following way: first, it addresses the issue of the limited jurisdiction of investment treaty claims and its correlation with the notion of applicable law. The chapter proceeds with the analysis of the scope of applicable law in investment treaty arbitration. It deals with a role that the sustainable development context should play in applicable law and, thus, on interpretation (informing the content) of investment protection standards.³⁹⁵ The study claims that irrespective of a limited jurisdiction of investment treaty tribunals to deal mainly with disputes arising out of breaches of investment protection standards contained in IIAs, the sustainable development context requires adjusting the understanding of the body of law that lies ‘at the heart of the matter’ of a dispute.

2.1. JURISDICTION OF INVESTMENT TREATY ARBITRATION

There is an institutional fragmentation or ‘division of labour’ between international dispute settlement bodies.³⁹⁶ Each court or tribunal has its own field of competence. Investment tribunals are generally not able to decide claims based on non-investment law instruments. Usually the applicable IIA contains a jurisdictional limitation to disputes concerning the interpretation of that particular IIA, for instance Article 1116(1) of the NAFTA and Article 26(1) of the ECT. Some IIAs provide for a wider formulation of a jurisdiction clause, for instance Article IX (1) of the Lithuania-Norway BIT states that an investment tribunal has jurisdiction for ‘any dispute [...] in connection with the investment’.³⁹⁷ Schreuer and Kriebaum consider that consent clauses of this type go beyond the interpretation and application of the relevant IIA and give a leeway for dealing with such community interests as the environment, cultural and natural heritage protection, and human rights protection in case a dispute is closely connected to an investment.³⁹⁸ This approach has been supported in practice by the Tribunal in *Roussalis v. Romania*, where the Tribunal declared:

³⁹⁵ Pauwelyn indicates the close interrelationship between applicable law and treaty interpretation, thus, these elements are addressed together, see Joost Pauwelyn, ‘Bridging Fragmentation and Unity: International Law as a Universe of Inter-Connected Islands’ (2004) 25 Michigan Journal of International Law at 903, 910.

³⁹⁶ Joost Pauwelyn, ‘Bridging Fragmentation and Unity: International Law as a Universe of Inter-Connected Islands’ (2004) 25 Michigan Journal of International Law at 903, 915- 916.

³⁹⁷ *Parkerings-Comagniet AS v. Republic of Lithuania*, ICSID, Award, Case No. ARB/05/8, September 11, 2007, [261].

³⁹⁸ Christoph Schreuer, Ursula Kriebaum, ‘From Individual to Community Interest in International Investment Law’ in Ulrich Fastenrath *et al.* (eds), *From bilateralism to community interest: essays in honour of Bruno Simma* (OUP, 2011), 1092-1094.

*The Tribunal does not exclude the possibility that the international obligations of the Contracting States mentioned at Article 10 of the BIT could include obligations deriving from multilateral instruments to which those states are parties, including, possibly, the European Convention of Human Rights and its Additional Protocol No.1.*³⁹⁹

Investment disputes under the ICSID Convention are limited by Article 25 (1) of the ICSID Convention which contains a jurisdictional limitation for disputes ‘arising directly out of an investment’.

On the one hand, arbitral jurisprudence has interpreted measures by a host State that may give rise to a breach of an IIA as broadly arising ‘directly out of an investment’.⁴⁰⁰ On the other hand, a host state’s role as a claimant or even as a defendant to bring up issues arising out of investment is considerably limited by the procedural asymmetry of investor-state arbitration.⁴⁰¹ The procedural asymmetry stems from the fact that BITs typically allow only investors to initiate claims in investor-state arbitration,⁴⁰² even if the ICSID Convention does not exclude host state from commencing an arbitral procedure against an investor.⁴⁰³ Only a few BITs may be read in a way which also allows a host state to bring an action against a foreign investor.⁴⁰⁴ Even then, due to the particularity of IIAs by providing rights to an investor and duties to a host state, the host state is very limited in taking an action against an investor.⁴⁰⁵

³⁹⁹ Spyridon Roussalis v. Romania, ICSID Case No.ARB/06/1, Award December 7, 2011, [312].

⁴⁰⁰ *Compañía de Aguas del Aconquija S.A and Vivendi Universal v. Argentine Republic*, ICSID Case No.ARB/97/3, Decision on Annulment, July 3, 2002, *reprinted in 19 ICSID Rev.—FILJ* 89 (2004), [112]; *Parkerings v.Lithuania* [261], [265].

⁴⁰¹ P. Juillard, ‘The Law of International Investment. Can the Imbalance Be Redressed?’ in KP Sauvant (ed) *Yearbook on International Investment Law & Policy 2008-2009*, (New York OUP, 2009), 280; Vaughan Lowe, ‘Changing Dimensions of International Investment Law’, University of Oxford Faculty of Law Legal Studies Research Paper Series, Working Paper No 4/2007, March 2007 available at: <http://papers.ssrn.com/Abstract=970727>, 14-15; Waelde T W, ‘The Specific Nature of Investment Arbitration’ in Philippe Kahn, Thomas W Waelde (eds), *New Aspects of International Investment Law* (Martinus Nijhoff 2007).50-55.

⁴⁰² For example, US Model BIT 2004, Article 24 and Article VI (2), Treaty Between The Government of the United States of America and The Government of the Republic of Latvia Concerning the Encouragement and Reciprocal Protection of Investment, 13.th January, 1995.

⁴⁰³ See Article 36(1) of the ICSID Convention; International Bank for Reconstruction and Development, *Report of the Executive Directors on the ICSID Convention*, March 18, 1965 (*Report of the Executive Directors*), [12], [14].

⁴⁰⁴ For instance, Article 8(1) of the Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Argentina for the Promotion and Protection of Investments (11 December 1990).

⁴⁰⁵ P.Juillard, ‘The Law of International Investment. Can the Imbalance Be Redressed?’ 280.

The host state's ability to initiate investor-state arbitration is not the only restriction, but also its ability to bring a counterclaim.⁴⁰⁶ Not all of consent clauses to arbitration in IIAs allow counter-claims. For instance, the Tribunal in *Roussalis v. Romania* held that the very existence of a counterclaim did not fall within the scope of the consent of the Parties under the Greece-Romania BIT.⁴⁰⁷ In case counterclaims are permitted, they may not exceed the scope of the consent and jurisdiction to arbitration (Article 46 of the ICSID Convention, Article 21(3) of the UNCITRAL Arbitration Rules (2010)); acceptance of counterclaims is interpreted rather narrowly.⁴⁰⁸ For instance, in *Amco v. Indonesia*, the Tribunal rejected Indonesia's counterclaim on alleged tax fraud by the investor since it was beyond its competence *ratione materiae*:

*It was not specially contracted for in the investment agreement and does not arise directly out of the investment'. The Tribunal noted that 'rights and obligations that are applicable to legal or natural persons who are within the reach of a host State's jurisdiction, as a matter of general law [...] in principle fall to be decided by the appropriate procedures in the relevant jurisdiction.'*⁴⁰⁹

It is suggested that the application of the integration principle of sustainable development and teleological and effective interpretation principles may allow the extension of the notion of the subject-matter of the dispute, providing a link between investment protection and *prima facie* non-investment issues, so as to also include counterclaims grounded in relevant domestic law.⁴¹⁰

To conclude, investment treaty tribunals are limited in their jurisdictional competence and cannot adjudicate over external international instruments, for instance in *Biloune v. Ghana*, the Tribunal did not consider alleged human rights violations by Ghana resulting from detention and expulsion of a foreign investor from the country.⁴¹¹

⁴⁰⁶ See generally, Hege Veenstra-Kjos, 'Counter-claims by Host State in Investment Dispute Arbitration „without privity“' in Philippe Kahn, Thomas W Waelde (eds), *New Aspects of International Investment Law* (Martinus Nijhoff 2007); Article 46 of the ICSID Convention.

⁴⁰⁷ Spyridon Roussalis v. Romania, ICSID Case No.ARB/06/1, Award December 7, 2011, [868], [869].

⁴⁰⁸ For instance, *Genin v. Estonia*, Award, 25 June 2001, 6 ICSID Reports 241, 17 ICSID Reports 240 [201, 235, 309, 314, 376-378]; *SGS v. Philippines*, Decision on Jurisdiction, 29 January 2004, 8 ICSID Reports 518 [40].

⁴⁰⁹ *Amco Asia Corp v Republic of Indonesia*, Resubmitted. Decision on Jurisdiction, ICSID, 10 May 1988, 1 ICSID Reports 543, [125]-[127].

⁴¹⁰ On possibilities to extend the notion of the 'same subject matter', see Jorge E. Viñuales, *Foreign Investment and the Environment in International Law* (CUP 2012) 94.

⁴¹¹ *Biloune and Marine Drive Complex Ltd v. Ghana Investments Centre and the Government of Ghana*, UNCITRAL, Award, 27 October 1989, 95 ILR 184, [199]-[205].

2.1.1. Notion of ‘protected investment’

In order to establish jurisdiction, tribunals usually determine whether the investment from which the dispute emerges is covered by the consent to arbitration clause in the relevant BIT and whether it is covered by Article 25 of the ICSID Convention.⁴¹² The ICSID Convention notoriously provides no investment definition, and arbitral jurisprudence has developed certain elements of the investment definition. It has been suggested that the interpretation of the notion of a protected investment and, in particular, its sub-elements of ‘contribution to host state’s economic development’ and ‘compliance with host state’s laws’ may provide a sufficient ‘access-point’ for addressing tensions between investment protection and non-investment public policy issues, which are addressed below.

2.1.1.1. ‘Contribution to host state’s economic development’ as an element of investment definition

The *Salini v. Morocco*⁴¹³ Tribunal famously introduced the element of ‘contribution to development of host state’ as part of the objective investment definition under Article 25(1) of the ICSID Convention. Subsequent arbitral jurisprudence has taken three separate approaches with respect to the *Salini* test. Several ICSID⁴¹⁴ and non-ICSID tribunals⁴¹⁵ have approved the *Salini* criteria and the existence of the objective investment definition under the ICSID Convention including its ‘contribution to development’ element.⁴¹⁶

⁴¹² David A.R. Williams QC and Simone Foote, ‘Recent developments in the approach to identifying an “investment” pursuant to Article 25(1) of the ICSID Convention’, in Chester Brown, Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration*, CUP 2011, 44 – 45.

⁴¹³ *Salini Constuttori SPA and Italstrade v. Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 23 July 2001, [50]-[58].

⁴¹⁴ For example, *Phoenix Action, Ltd. v. the Czech Republic*, ICSID Case No. ARB/06/5, Award, April 15, 2009 [85], [96].

⁴¹⁵ *Romak S.A. v. The Republic of Uzbekistan*, PCA Case No. AA280, Award, November 26, 2009 [193]-[207]; *Societe Generale In respect of DR Energy Holdings Limited and Empresa Distribuidora de Electricidad del Este, S.A. v. the Dominican Republic*, Award on Preliminary Objections to Jurisdiction, 19 September 2008, LCIA Case No. UN 7927, UNCITRAL [33]-[35]. See also Brigitte Stern, ‘The Scope of Investor’s Protection under the ICSID/BIT Mechanisms: Recent Trends’ in Arthur W Rovine (ed), *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers 2010* (Martinus Nijhoff Publishers, 2011), 33; Christoph Schreuer, Ursula Kriebaum, ‘From Individual to Community Interest in International Investment Law’ in Ulrich Fastenrath *et al.* (eds), *From bilateralism to community interest: essays in honour of Bruno Simma* (OUP, 2011), 1083.

⁴¹⁶ See also *Abaclat et al v. Argentina*, Dissenting Opinion, George Abi-Saab, 28 October 2011 [50]. Garcia –Bolívar argues that the element of ‘contribution to economic development’ in the definition of

Others have rejected the *Salini* test and have proposed instead a reliance solely on the investment definition as provided in the relevant IIA,⁴¹⁷ which usually covers a non-exhaustive list of ‘every kind of assets’ with a commercial value as a ‘protected investment’.

The third and intermediate approach accepts the *Salini* test in part. For instance, the *Saba Fakes v. Turkey* award⁴¹⁸ accepts the existence of the objective investment definition consisting of necessary elements of a contribution, certain duration and an element of risk.⁴¹⁹ It rejects the element of ‘contribution to host state’s development’ as too loose and immeasurable to be ‘an independent criterion for the definition of an investment’, and thus, as a necessary requirement for jurisdiction *ratione materiae*.⁴²⁰ Nevertheless, it is acknowledged that the ‘contribution to economic development of a host State’ stems from a proclaimed objective of the ICSID Convention.⁴²¹ Thus, this element may be moved to the merits phase of disputes,⁴²² where it requires ‘a careful balance between the interests of investors and those of host States’.⁴²³

2.1.1.2. Compliance with the host state’s law at the establishment phase of an investment

In situations where the applicable IIA provides that the investor has to comply with domestic legislation in order to be protected, some scholars see the possibility to integrate non-investment international obligations of a host State into investment

investment is a measurable concept and the most important element in establishing the existence of ‘protected investment’ under the ICSID Convention, see Omar E. Garcia –Bolívar, ‘Economic development at the core of the international investment regime’ in Chester Brown, Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (CUP 2011) 586.

⁴¹⁷ For instance, *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania*, ICSID Case No ARB/05/22, Award, 24 July 2008 [311]-[316]. *Biwater Gauff* approach to the investment definition is considered a ‘subjective approach’. For the criticism see Brigitte Stern, ‘The Scope of Investor’s Protection under the ICSID/BIT Mechanisms: Recent Trends’ in Arthur W Rovine (ed), *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers 2010* (Martinus Nijhoff Publishers, 2011), 40. See also *Abaclat et al v. Argentina*, Decision on Jurisdiction, 4 August 2011, [364].

⁴¹⁸ *Mr. Saba Fakes v. Republic of Turkey*, ICSID Case No.ARB/07/20, Award July 14, 2010. See also *Alps Finance and Trade AG v. Slovak Republic*, UNCITRAL, Award, 5 March 2011, [231], [241].

⁴¹⁹ *Saba Fakes v. Turkey* [110].

⁴²⁰ *Ibid*, [108]-[111].

⁴²¹ *Ibid*, [111].

⁴²² See also Christoph H. Schreuer with Loretta Malintoppi, August Reinsisch and Anthony Sinclair, *The ICSID Convention. A Commentary* (2nd ed, Cambridge University Press, 2009), 128 [153].

⁴²³ Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, International Bank for Reconstruction and Development, March 18, 1965, part III, [13].

law.⁴²⁴ It would be so in the case where international law requirements are incorporated in domestic law. Thus, Schreuer and Kriebaum suggests that ‘compliance with host state’s law’ requirement may serve as an effective method for paying due respect to such community interests as the environment and human rights, in case their protection is incorporated in host state’s law’.⁴²⁵ Few ‘new generation’ IIAs specifically indicate that a host state must address such issues as corporate social responsibility in its domestic law⁴²⁶ but consider public international law limitations with respect to the imposition of responsibility on individuals.⁴²⁷

In case an investor has committed grave violations of domestic law and, thus, has acted in bad faith, arbitral jurisprudence has ascertained that foreign investment was established in bad faith⁴²⁸ or in significant violation⁴²⁹ of the host state’s law will not benefit from substantive protection under the relevant IIA as lacking jurisdiction *ratione materiae*,⁴³⁰ *ratione voluntatis*,⁴³¹ will lose its arbitrability⁴³² or the protection will be rejected at the merits phase.⁴³³ This notion holds true irrespective of IIAs containing explicit clauses to that effect.⁴³⁴

⁴²⁴ August Reinisch, ‘How Narrow are Narrow Dispute Settlement Clauses in Investment Treaties?’, (2011) 2 Journal of International Dispute Settlement 1, 115-174.

⁴²⁵ Christoph Schreuer, Ursula Kriebaum, ‘From Individual to Community Interest in International Investment Law’ in Ulrich Fastenrath *et al.* (eds), *From bilateralism to community interest: essays in honour of Bruno Simma* (OUP, 2011), 1095.

⁴²⁶ For instance, Article 72 CARIFORUM EPA delegates to the Contracting Parties a duty to enact necessary domestic laws for corporate social responsibility, such as subjecting foreign investors to anti-corruption laws. See also Canada-Colombia FTA, Article 816.

⁴²⁷ Interim Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises (Ruggies Report), UN Doc E/CN.4/2006/97 (2006).

⁴²⁸ *Inceysa Vallisoletana, S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26, Award, August 2, 2006, [230].

⁴²⁹ Minor violations of national law were not considered a substantial breach to deny jurisdiction in *SwemBalt v. Latvia*, UNCITRAL, Award, October 23, 2000, Latvia- Sweden BIT 1992 [32], [35].

⁴³⁰ *Phoenix Action, Ltd. v. the Czech Republic*, ICSID Case No. ARB/06/5, Award, April 15, 2009 [100]-[103]. See also *Inceysa Vallisoletana S.L.v. Republic of El Salvador*, [79].

⁴³¹ *Mr. Saba Fakes v. Republic of Turkey*, ICSID Case No. ARB/07/20, Award July 14, 2010 [111]-[115].

⁴³² As in the case of investment contract, which was obtained by bribery, see *World Duty Free Company Limited v. The Republic of Kenya*, ICSID Case No. ARB/00/7, Award, 4 October 2006. [143]-[157].

⁴³³ *Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB/03/24 (Energy Charter Treaty), Award, August 27, 2008, [112], [126]-[130], [138]-[139], [146]; Robert Azinian, Kenneth Davitian, *Ellen Baca v. The United Mexican States*, ICSID Case No. ARB(AF)97/2, Award, November 1, 1999, [122]-[124].

⁴³⁴ *Plama v. Bulgaria*, [112, 126-130, 138-139, 146]. *Phoenix Action, Ltd. v. the Czech Republic*, ICSID Case No. ARB/06/5, Award, April 15, 2009 [100]-[103]. Andrew Newcombe, ‘Investor misconduct: Jurisdiction, admissibility or merits?’ in Chester Brown, Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (CUP 2011) 189-193.

However, these propositions for integrating external international obligations within investment protection law are of limited value. The currently decisive aspect of the ability of a host state to raise these impediments to the jurisdiction or merits phase of the dispute is the existence of a violation of domestic law at the establishment phase of an investment.⁴³⁵ The same does not apply to alleged fraud or other misconduct by a foreign investor posterior to the establishment of an investment.⁴³⁶ For instance, *Amco v. Indonesia* and *Saba Fakes v. Turkey* Tribunals indicate that in such circumstances violation of a host state's law does not affect the jurisdiction or arbitrability of a claim, and a host state is expected to use the framework of its domestic law to remedy the breach by the investor.⁴³⁷ In doing so, the host state may not invoke provisions of its internal law as a justification for its failure to perform its international obligations *vis-à-vis* foreign investors⁴³⁸ (Article 27 of the VCLT). Hence, bearing in mind that most of the sustainable development related concerns regarding foreign investment may arise during its operation, the 'compliance with host state's law' clause on its own is not a sufficient safeguard mechanism for balancing investment protection with external international and domestic obligations of a host State. Viñuales argues that it is an overly restrictive reading of the clause that only the illegality arising from a violation of the host State's law relating to the admission of investment bars the claim from admissibility or jurisdiction.⁴³⁹ In case the applicable IIA does not explicitly indicate that the requirement to comply with domestic law relates to the time of the establishment of the investment (as it was in *Saba Fakes v. Turkey*⁴⁴⁰), the effective interpretation of the IIA in light of the sustainable development objective may require a less strict interpretation of this jurisdictional requirement.

⁴³⁵ *Phoenix Action, Ltd. v. the Czech Republic*, ICSID Case No. ARB/06/5, Award, April 15, 2009, [103]. A Carlevaris, 'The Conformity of Investments with the Law of the Host State and the Jurisdiction of International Tribunals' (2008) 9 J World Investment & Trade 35.

⁴³⁶ See Luke Eric Peterson, 'A discussion of the Chevron-Ecuador dispute with Michael Goldhaber of the American Lawyer magazine', *Investment Arbitration Reporter*, May 17, 2011 (accessed on 31 March 2012).

⁴³⁷ *Saba Fakes v. Turkey* [119]. See also *Amco Asia Corp v Republic of Indonesia*, Resubmitted. Decision on Jurisdiction, ICSID, 10 May 1988, 1 ICSID Reports 543, [125]-[127].

⁴³⁸ *Saba Fakes v. Republic of Turkey*, [119].

⁴³⁹ Jorge E Viñuales, *Foreign Investment and the Environment in International Law* (CUP 2012) 98.

⁴⁴⁰ *Saba Fakes v. Republic of Turkey*, [119].

Interim Conclusions

It has been acknowledged that investment treaty arbitration may imply a significant public law dimension which considerably exceeds the interests of pleading parties;⁴⁴¹ however, they are limited by the scope of jurisdiction of investment treaty tribunals of what they can take into account. In general, investment treaty tribunals are limited to deal with violations of investment protection standards, and not, for instance, with adjudication over human rights violations or breaches of environmental protection laws.⁴⁴²

Further, a host state has a limited procedural ability to mention domestic or international public policy matters; firstly, these matters should ‘arise (directly) out of an investment’ but this clause is interpreted rather narrowly.

Regarding defence against jurisdiction, the notion of protected investment gives a host state a limited leeway to put forward its public policy concerns so as to dismiss the claim. Arbitral jurisprudence has strongly determined that investment that is established in a host country through bad faith or in significant violation of a host state’s laws (e.g. corruption) does not enjoy protection under the network of IIAs. However, the same does not apply for violations of a host state’s laws after the establishment of the investment.

Further, the notion of a protected investment and its aspects of ‘contribution to economic development of host state’ and ‘compliance with host State’s laws’ are considered by some to provide a sufficient access point to non-economic public policy issues in investment protection law. This proposition cannot be supported because a host State may not rely on its domestic law for alleged violations of its international investment obligations towards foreign investors because international law prevails in international disputes. Secondly, only some investment tribunals consider the ‘contribution to economic development’ element as a necessary prerequisite for the

⁴⁴¹ Glamis Gold, Ltd. v. The United States of America, UNCITRAL (NAFTA), Award, 8 June 2009 [3]–[9]; Biwater Gauff v Tanzania, ICSID Case No. ARB/05/22, Procedural Order of 2 February 2007 [52], [64]; Methanex v. United States (NAFTA), Decision on Amici Curiae, 15 January 2001 [47], [49]. Cf. J. Werner, ‘Limits of Commercial Investor-State Arbitration: Need for Appellate Review’ in P.M. Dupuy, F. Francioni, E.U. Petersmann (eds.), *Human Rights in International Investment Law and Arbitration*, (Oxford University Press) 2009, 115-118.

⁴⁴² IIA may extend the jurisdiction to violations of investment protection standards contained in sources external to the IIA: see Spyridon Roussalis v. Romania, [117], [312]. “*The Tribunal does not exclude the possibility that the international obligations of the Contracting States mentioned at Article 10 of the BIT could include obligations deriving from multilateral instruments to which those states are parties, including, possibly, the European Convention of Human Rights and its Additional Protocol No.1.*”

existence of the protected investment. The currently prevailing view places the development aspect of foreign investment in the merits phase of the claim, where it may affect the interpretation and application process of investment protection standards under IIAs by raising relevant arguments.

However, limited jurisdiction does not limit the applicable law, and extraneous international law obligations on environmental protection, cultural heritage and human rights may and should be taken into account in the interpretation of IIAs.

2.2. APPLICABLE LAW IN INTERPRETATION OF INVESTMENT GUARANTEES

The sustainable development context of the investment protection regime has a limited capacity to affect the interpretation of narrow jurisdiction clauses in IIAs. However, it has a capacity to affect the understanding of applicable law.

It is a truism that limited jurisdiction does not imply limitations on applicable law as famously noted in the *Fragmentation Report*:

*The jurisdiction of most international tribunals is limited to particular types of disputes or disputes arising under particular treaties. A limited jurisdiction does not, however, imply a limitation of the scope of the law **applicable in the interpretation and application** of those treaties.*⁴⁴³

Invocation of non-investment law in an investment dispute largely depends on the disputing parties and the credibility of their argumentation,⁴⁴⁴ but its application is in the hands of a tribunal and its capacity to see the link between investment protection law and the external sources of law.

The sustainable development objective illuminates the interaction of investment protection law with other sub-systems of international law and it automatically extends the understanding on what issues might ‘lie at the heart’ of a potential investment claim, automatically requiring a ‘systemic’ thinking and unity of

⁴⁴³ M. Koskenniemi, *Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law. Report of the Study Group of the International Law Commission* (Helsinki, 2007), 28 [45] (emphasis added). Cf. Joost Pauwelyn, ‘Bridging Fragmentation and Unity: International Law as a Universe of Inter-Connected Islands’ (2004) 25 *Michigan Journal of International Law* at 903, 915.

⁴⁴⁴ Newcombe A., Paradell L., *Law and Practice of Investment Treaties*, (The Hague: Kluwer Law International, 2009), 88-89.

international law approach⁴⁴⁵ and a careful examination of a possible interaction between these legal regimes.

2.2.1. The scope of applicable law

Law that arbitral tribunals may apply is usually mentioned in the relevant IIA and logically it implies the relevant IIA as a primary source. IIAs usually specify which arbitration rules parties can choose. They usually are ICSID, ICSID Additional Facility or UNCITRAL Arbitration Rules also containing applicable law clauses. For instance, Article 42(1) of the ICSID Convention states:

*Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply [...] such rules of international law as may be applicable.*⁴⁴⁶

Article 26(6) of the ECT and Article 1131 of the NAFTA indicates that arbitral tribunal has to decide the case based on the treaty itself and applicable rules and principles of international law.⁴⁴⁷ Thus, in principle, all international law which is binding on the claiming parties may be part of the applicable law that may exceed the relevant IIA,⁴⁴⁸ e.g. general principles of law⁴⁴⁹ and customary international law.⁴⁵⁰

⁴⁴⁵ In general, unity of international law means the assumption that there is no legal regime outside of general international law and the completeness of international law means that ‘*the most of the fundamental rules, principles, and institutions of public international law are already in place*’ in order to deal with the tensions that may exist in values underlying different legal regimes. See V.Lowe, ‘The Politics of Law-Making: Are the Method and Character of Norm Creation Changing?’ in M Byers (ed), *The Role of Law in International Politics. Essays in International Relations and International Law*, (OUP, 2000.), 212. Fragmentation Report, [1], [13], [25]; M. Koskenniemi, *The Politics of International Law* (Hart Publishing 2011), 346-347; Sir A Watts KCMG QC, ‘The Importance of International Law’, in M Byers (ed), *The Role of Law in International Politics. Essays in International Relations and International Law* (OUP, 2000), 6-7; P-M Dupuy, ‘L’unité de l’ordre juridique international”cours general de droit international public”, RCADI, 2002, Vol.297, 9-490, at 463; M Delmas-Marty, *Global Law: A Triple Challenge* (2003), 74. , Pauwelyn J., ‘Fragmentation of International Law’, in *The Max Planck Encyclopedia of Public International Law*, (Oxford University Press, 2006), online edition, available at www.mpepil.com, [41]. See also B Simma and D Pulkowski, ‘Of Planets and Universe: Self-Contained Regimes in International Law’ (2006) 17 EJIL 483, 506.

⁴⁴⁶ Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Recital 40. As the Report explains ‘*the term “international law” as used in this context should be understood in the sense given to it by Article 38(1) of the Statute of the ICJ, allowance being made for the fact that Article 38 was designed to apply to inter-state disputes*’.

⁴⁴⁷ *Chemtura v. Canada, NAFTA, UNCITRAL, Award August 2 2010* [107]; *S.D.Myers, Inc. v Government of Canada, Partial Award, November 13, 2000, NAFTA, UNCITRAL* [214] – [215].

⁴⁴⁸ A.Parra, ‘Applicable Substantive Law in ICSID Arbitration Initiated Under Investment Treaties’, (2001) ICSID Rev 20, p. 21; see also C.H.Schreuer, ‘Diversity and Harmonization of Treaty Interpretation in Investment Arbitration’, available at

For example, a necessity defence based on customary international law may be part of a self-standing claim on its own merits that is brought before the tribunal. Schreuer and Kriebaum extend this principle so as to suggest that ‘even if a primarily applicable treaty on investment treaty does not refer to human rights and other community interests, the governing law may include treaties and customary rules dealing with these matters’.⁴⁵¹

Nevertheless, the practice of arbitral tribunals is less welcoming for addressing issues based on such external sources to investment law as human rights treaties (see Box 2 in the Appendix). Arbitral tribunals mostly fail to recognize the link in case external sub-fields of international law are invoked before the tribunal as part of a host State’s defence arguments. Thus, for instance, Argentina has pointed to a potential conflict between relevant BITs and Argentina’s human rights obligations in *Azurix v. Argentina*⁴⁵² and *Siemens v. Argentina*;⁴⁵³ these arguments were not addressed by the Tribunals due to the alleged insufficient elaboration on the matter by Argentina. The potential conflict of norms argument was entirely skipped by Tribunals in *Biwater Gauff v. Tanzania*⁴⁵⁴ and *Vivendi v. Argentina (Resubmitted)*.⁴⁵⁵ Thus, investment tribunals often prefer to ignore the question on compatibility of investment protection law with other sub-fields of international law.⁴⁵⁶

http://www.univie.ac.at/intlaw/pdf/cspubl_85.pdf; G Schwarzenberg, ‘The Principles of International Economic Law’, 117 *Recueil des Cours* (1996), 1, 14.

⁴⁴⁹ B Simma and P Alston, ‘The Sources of Human Rights Law: Custom, Jus Cogens and General Principles’, 12 *Australian Yearbook of International Law* (1992) 82, 103.

⁴⁵⁰ *Phoenix Action, Ltd. v. the Czech Republic*, ICSID Case No. ARB/06/5, Award, April 15, 2009 [77]-[78]; Joost Pauwelyn, ‘Role of Public International Law in the WTO Law’ (2001) 95 *AJIL*, at 539. The Tribunal in *Biwater Gauff v. Tanzania* [776] referred back to the Choroow Factory case for general international law on State responsibility and compensation requirements.

⁴⁵¹ Christoph Schreuer, Ursula Kriebaum, ‘From Individual to Community Interest in International Investment Law’ in Ulrich Fastenrath *et al.* (eds), *From bilateralism to community interest: essays in honour of Bruno Simma* (OUP, 2011), 1094.

⁴⁵² *Azurix Corp. v. the Argentine Republic*, ICSID Case No. ARB/01/12, Award, July 14, 2006 [261].

⁴⁵³ *Siemens A.G. v. The Argentine Republic*, ICSID case No. ARB/02/8, Award, February 6, 2007 [75], [79], [312], [354].

⁴⁵⁴ *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania*, ICSID Case No ARB/05/22, Award, 24 July 2008 [434], [436], [814].

⁴⁵⁵ *Compania de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID, Case No. ARB/97/3, Award 20 August 2007, Resubmitted, France-Argentina BIT1991 [3.3.3]-[3.3.5].

⁴⁵⁶ Jorge E Viñuales, *Foreign Investment and the Environment in International Law* (CUP 2012) 182.

So, on the one hand, it is clear that investment protection law is not autonomous from other legal regimes or sub-systems of international law.⁴⁵⁷ On the other hand, it is less clear which sub-systems of international law stand ‘at the heart of the matter’ as being relevant for solving the case. In this respect, Judge Higgins indicates that ‘the widening and thickening of the context of international law’ makes it harder for the court or tribunal to choose the applicable law. Higgins refers to the *Nuclear Weapons Advisory Opinion* of 1996,⁴⁵⁸ where the International Court of Justice refused the application of the International Covenant on Civil and Political Rights and did not accept the principles of environmental law in assessing the legality of nuclear weapons since they were not ‘at the heart of the matter’.⁴⁵⁹ Thus, the establishment of relevance of the external sub-fields of international law to an investment treaty claim is not an easy task. This task necessarily depends on the boundaries of the dispute and the claims of the parties.⁴⁶⁰ Furthermore, it also depends on the subjective perception of arbitrators on what is the proper scope of foreign investment protection law. In this respect, it is argued that the sustainable development context, with its element of integration, necessarily clarifies international rules, which may be relevant for governing the solution of a case or, in other words, which rules may ‘lie at the heart of the matter’. Sustainable development extends the applicable law to its three pillars.

2.2.2. Examples of unsuccessful attempts to invoke non-investment obligations as applicable law in investment treaty claims

The *Santa Elena v. Costa Rica*⁴⁶¹ Tribunal ignored Costa Rica’s request to take into account the 1972 UNCESO Convention, reliance on which served as a motivation and justification for expropriating investor’s property. The Tribunal entirely disregarded the possible legal impact of the UNESCO Convention on the content of investment

⁴⁵⁷ Joost Pauwelyn, ‘Bridging Fragmentation and Unity: International Law as a Universe of Inter-Connected Islands’ (2004) 25 Michigan Journal of International Law at 903, 904, 915-916. Amoco International Finance Corp. v. Iran, 15 Iran-US.C.T.R 189, at 222 [112]; AAPL v Sri Lanka (1990) (Award) 4 ICSID Rep 246 [21]; Phoenix Action, Ltd. v. the Czech Republic, ICSID Case No. ARB/06/5, Award, April 15, 2009 [77]-[78]. Fragmentation Report, [13]; See P.M.Dupuy, “A Doctrinal Debate in the Globalization Era: On the Fragmentation of International Law, EJLS, 2007, Vol.1, No.1 <http://www/ejls.eu>.

⁴⁵⁸ Legality of the Threat or Use of Nuclear Weapons, Advisory Opinion, 1996 ICJ Reports 226.

⁴⁵⁹ R. Higgins, ‘A Babel of Judicial Voices? Ruminations from the Bench’, International and Comparative Law Quarterly, Vol.55, October 2006, p.792 (footnotes omitted, emphasis added).

⁴⁶⁰ Jorge E Viñuales, Foreign Investment and the Environment in International Law (CUP 2012) 111.

⁴⁶¹ Compania del Desarrollo de Santa Elena S.A. v. Costa Rica, International Legal Materials, Vol. 39, (ICSID 2000), http://www.worldbank.org/icsid/cases/santaelena_award.pdf, [76].

protection standards,⁴⁶² in particular on investor's legitimate expectations for the amount of compensation. In contrast, in *SPP v. Egypt*, the Tribunal took the moment of coming into effect of the 1972 UNESCO Convention in Egypt into account, affecting the legitimacy of the investor's project. As a result, the Tribunal limited the scope of the investor's legitimate expectations for fair compensation of the expropriated property.⁴⁶³

In *Biwater Gauff v. Tanzania*,⁴⁶⁴ *Amici* suggested that 'human rights and sustainable development issues are factors that condition the nature and extent of the investor's responsibilities, and the balance of rights and obligations as between the investor and the host State,' and took into account that Biwater's investment was done in the water and sewage systems 'intimately related to human rights and the capacity to achieve sustainable development' and also carrying with it 'very serious risks to the population at large'.⁴⁶⁵ Tanzania, for its part, maintained that its actions were done in order to safeguard its local population's vital rights to water, since the investor was not performing its obligations and had created a real threat to public health and welfare.⁴⁶⁶ Tanzania argued that '[w]ater and sanitation services are vitally important, and the Republic has more than a right to protect such services in case of a crisis: it has a moral and perhaps even a legal obligation to do so'.⁴⁶⁷

The Tribunal found *Amici's* observations useful, but did not find it necessary to elaborate on *Amici's* proposed issues on the investor's responsibility, sustainable development and human rights, and decided the case strictly in accordance with the BITs terms,⁴⁶⁸ concluding that Tanzania had nevertheless acted in *mala fide*.⁴⁶⁹ However, the novel outcome of the case, by not allocating any compensation for damages to the investor even if the FET standard was found to be breached by the State, indicates the indirect weight given to non-BIT considerations.

⁴⁶² *Santa Elena v. Costa Rica*, [72].

⁴⁶³ *SPP v. Egypt* [190]-[191].

⁴⁶⁴ *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania*, ICSID Case No ARB/05/22, Award, 24 July 2008.

⁴⁶⁵ *Ibid* [380].

⁴⁶⁶ *Biwater Gauff v. Tanzania* [434], [436].

⁴⁶⁷ *Biwater Gauff v. Tanzania* [434].

⁴⁶⁸ *Ibid*.

⁴⁶⁹ *Biwater Gauff v. Tanzania* [814].

In *Grand River v. USA*,⁴⁷⁰ investors (indigenous communities) required an interpretation of NAFTA Article 1105 on the FET against the wider body of international law as the applicable rules of international law (NAFTA Article 1131(1)) including US human rights obligations towards indigenous peoples and their practices in the tobacco industry. Investors invoked treaties between the United States and Canada affecting the Haudenosaunee tribe, customary international law affecting indigenous peoples and human rights norms as relevant applicable law. The Claimants maintained that the regulatory changes in the tobacco industry were arbitrary and discriminatory, violating international obligations towards indigenous communities, for instance there was no former consultations as required by these norms.

The Tribunal relied on the authoritative 2001 statement by the NAFTA governments that the breach of some other international law obligations does not establish a breach of NAFTA Article 1105 and declined an importation of non-investment law obligations into NAFTA.

However, the Tribunal did not elaborate on the importance the invoked non-NAFTA international obligations might have on the interpretation of Article 1105 through Article 31(3)(c) VCLT,⁴⁷¹ effective treaty interpretation (like in the *Shrimp/Turtles Report*) or otherwise. Under Article 31(3)(c) VCLT, ‘any relevant rules’ may mean an ‘other rule’ that may shed light on the meaning of the applicable provision.⁴⁷² Taking into account that FET standard consists of several sub-elements, other relevant rules of international law could shape an arbitral tribunal’s interpretation of FET, for instance, ‘legitimate expectations’. Hence, the *Grand Rivers v. US* Tribunal applied methodology which was contrary to what prominent scholars have suggested as the expected action by tribunals, namely, integrating external rules in arbitration through the presumption of compliance or referring to Article 31(3)(c).⁴⁷³

⁴⁷⁰ *Grand River Enterprises et al. v. United States of America*, UNCITRAL (NAFTA) Award, 12 January 2011.

⁴⁷¹ Luke Eric Peterson, ‘Analysis: Tribunal in *Grand River v. U.S.A.* arbitration declines to import non-investment law obligations into NAFTA; role of other “relevant” legal obligations in treaty interpretation under Vienna Convention is not discussed’, *Investment Arbitration Reporter*, March 6, 2011.

⁴⁷² J Pauwelyn, *Conflict of Norms in Public International Law. How WTO Law Relates to Other Rules of International Law* (Cambridge University Press, 2003), 263-264.

⁴⁷³ Christoph Schreuer, Ursula Kriebaum, ‘From Individual to Community Interest in International Investment Law’ in Ulrich Fastenrath *et al.* (eds), 1095; T Wälde, ‘Interpreting Investment Treaties: Experiences and Examples’ in Christina Binder, Ursula Kriebaum, August Reinisch, Stephan Wittich (eds) *International Investment Law for the 21st Century. Essays in Honour of Christoph Schreuer* (OUP 2009), 724, 772–5; Bruno Simma, Theodore Kill, ‘Harmonizing Investment Protection and

To conclude, the above-mentioned cases cut short the possible application of non-investment international law in investment treaty claims. However, the *Suez v. Argentina* Tribunal, by declaring (though unelaborated) a presumption of compliance between human rights to water and the BITs, acted more in compliance with the ‘guardians of law’ approach⁴⁷⁴ than, for instance, the Tribunal in *Santa Elena v. Costa Rica*, which has taken the self-contained regime approach. Thus, it is outdated and contrary to the suggested sustainable development perspective. What sustainable development context influences is the necessity to realize that conflict of norms may arise in the first place.

2.2.3. ‘Conflict of norms’ in a broad sense

The sustainable development context requires the very realization of the existence of a potential conflict in applicable law and the application of conflict avoidance techniques by tribunals, bearing in mind the difference between potential and genuine conflict of norms.⁴⁷⁵ Conflict of norms in a broad sense means situations where the application of a treaty may frustrate the goals of another treaty without there being any strict incompatibility between their provisions.⁴⁷⁶ This kind of conflict can be interpreted away.⁴⁷⁷ In contrast, a genuine conflict of norms means situations where the application of one norm excludes the application of the other.⁴⁷⁸

In a case where external sources of law are invoked as a justification for the alleged breach of investment guarantees, it creates a potential conflict of law which one may attempt to solve by treaty interpretation. Resolution methods of ‘conflict of norms’ in the broadest sense implies an interpretation with reference to non-investment law so

International Human Rights; First Steps Towards a Methodology’ in Christina Binder, Ursula Kriebaum, August Reinisch, Stephan Wittich (eds) *International Investment Law for the 21st Century. Essays in Honour of Christoph Schreuer* (OUP 2009), 678-707.

⁴⁷⁴ Christoph Schreuer, Ursula Kriebaum, ‘From Individual to Community Interest in International Investment Law’ in Ulrich Fastenrath *et al.* (eds), 1096. On the importance of self perception of international institutions see M Koskenniemi, *The Politics of International Law* (Hart Publishing 2011), 336.

⁴⁷⁵ J Pauwelyn, *Conflict of Norms in Public International Law. How WTO Law Relates to Other Rules of International Law* (Cambridge University Press, 2003), 176-178.

⁴⁷⁶ Fragmentation Report, [24]; R.Wolfrum and N.Matz define conflict in the widest sense as a situation when treaties ‘frustrate the goals of another treaty without there being any strict incompatibility between their Provisions’, see Rudiger Wolfrum, Nele Matz, *Conflicts in International Environmental Law* (2003) 6-13.

⁴⁷⁷ J Pauwelyn, *Conflict of Norms in Public International Law. How WTO Law Relates to Other Rules of Internatioanl Law* (Cambridge University Press, 2003), 165-166.

⁴⁷⁸ Wilfred Jenks, ‘Conflict of Law-Making Treaties’ (1953) 30 BYIL 401 at 426, 451.

as to inform the content of investment protection standards, presumption against conflict, and interpreting away the conflict through teleological, effective and evolutive treaty interpretation or through the systemic integration principle as established by Article 31(3)(c) of the VCLT.⁴⁷⁹ In case these interpretative methods do not solve the potential conflict in applicable law, the conflict becomes genuine, and general international law methods of conflict resolution become applicable.

2.2.4. The required interpretative relationship between external rules and investment protection law

This section highlights the required methods of solving potential conflict in applicable law and offers examples of arbitral jurisprudence, devoting significant efforts and argumentation for solving potential conflicts of norms invoked by defending states (summarized in Box 3 in the Appendix). Here, the tribunals have carefully utilized customary conflict avoidance and treaty interpretation principles for addressing the relevance of non-investment law within the interpretation process of investment guarantees.

‘Informing the content’ of investment guarantees by reference to external fields of law

The FET and indirect expropriation standard consists of various sub-elements such as ‘legitimate investment-backed expectations’. Non-investment law may inform the content and scope of these sub-elements, consequently narrowing or extending their scope. For instance, in *SPP v. Egypt*, the Tribunal limited the content of ‘legitimate expectations’ for compensation by referring to the UNESCO Convention. Contrary to *Santa Elena v. Costa Rica*, the *SPP v. Egypt* Tribunal took the moment when the 1972 UNESCO Convention became effective in Egypt into account, consequently affecting the investor’s legitimate expectations for fair compensation of the expropriated property. The Tribunal considered the effect of the application of the UNESCO Convention on the legality of the investment project and consequently decided not to

⁴⁷⁹ OECD, *Relationships between International Investment Agreements* (OECD, Paris, 2004.); Joost Pauwelyn, ‘Bridging Fragmentation and Unity: International Law as a Universe of Inter-Connected Islands’ (2004) 25 Michigan Journal of International Law at 906-907; Bruno Simma, Theodore Kill, ‘Harmonizing Investment Protection and International Human Rights; First Steps Towards a Methodology’ in Christina Binder, Ursula Kriebaum, August Reinisch, Stephan Wittich (eds) *International Investment Law for the 21st Century. Essays in Honour of Christoph Schreuer* (OUP 2009), at 704-707.

award *lucrum cessans* from the date of the inclusion of the project area in the World Heritage List.⁴⁸⁰ From that date, the investment project became illegal and, thus, the investor had lost its legitimate expectations to gain profit from his business activity. Simma and Kill also emphasize the inherent flexibility of a legitimate expectations element as a tool for the integration of non-investment law in investment guarantees. They suggest that ‘whatever expectations investor may have had, these must have included an expectation that the State would honour its international human rights obligations’.⁴⁸¹

In *Parkerings v. Lithuania*, the UNESCO Convention was taken into account to determine the content of ‘like circumstances’ under the MFN standard. The Tribunal justified the differentiation between two similar foreign investment projects in Vilnius. One of the projects was meant to operate in the area that was protected under the UNESCO Convention, thus providing justifiable grounds for different treatment.⁴⁸²

In *Maffezini v. Spain*, the investor challenged the requirement to undertake the costly environmental impact assessment as an arbitrary measure by Spain. The Tribunal took into account not only that Spanish law required an environment impact assessment of the investment project but also the EU Directives that buttressed the national law requirement.⁴⁸³ Hence, the Tribunal respected Spain’s obligations under EU law when applying the BIT provision on compliance with local laws.⁴⁸⁴

Finally, in *Chemtura v. Canada* at issue was the gradual phase-out of the agrochemical lindane. The Tribunal took into account international treaties not explicitly addressed by NAFTA Article 104. The *Chemtura* Tribunal considered the 1998 Aarhus Protocol on Persistent Organic Pollutants to the UNECE Convention on Long-Range Transboundary Air Pollution of 1979, which was adopted by both the United States and Canada, and the Stockholm Convention on Persistent Organic Pollutants, to which Canada was a member state⁴⁸⁵ but the US was merely a signatory state, to ensure a ‘broader factual context’ in assessing whether Canada had acted in

⁴⁸⁰ SPP v. Egypt [190]-[191].

⁴⁸¹ Bruno Simma, Theodore Kill, ‘Harmonizing Investment Protection and International Human Rights: First Steps Towards a Methodology’ in Christina Binder, Ursula Kriebaum, August Reinisch, Stephan Wittich (eds) *International Investment Law for the 21st Century. Essays in Honour of Christoph Schreuer* (OUP 2009), 705.

⁴⁸² *Parkerings v. Lithuania* [382], [394].

⁴⁸³ *Maffezini v. Spain* [69].

⁴⁸⁴ *Ibid*, [69]-[71].

⁴⁸⁵ *Ibid* [134]-[137].

its mandate under its international commitment. The Tribunal found that Canada had not breached the FET and expropriation standards.⁴⁸⁶

Principle of systemic integration

Article 31 (3) (c) of the VCLT instructs that in interpreting a specific treaty ‘[t]here shall be taken into account, together with the context: (...) any relevant rules of international law applicable in the relations between the parties.’ However, the reach of the systemic integration principle is limited by the requirement to apply relevant applicable rules between the parties. Thus, only those international obligations which bind both parties of the relevant IIA may be used in the interpretation process. Furthermore, the scope of ‘any relevant rules’ is subject to various interpretations – from a narrow focus on the subject matter of the rules to the inclusion of any rules of international law.⁴⁸⁷ The sustainable development context of investment protection law allows setting the content of the ‘relevant’ rules linking investment and external international obligations, and it could imply the application of non-investment international sources of law through clarifying and informing the content of the applicable norm. For instance, the ICJ in *Oil Platforms* Judgement (2003) had limited jurisdiction to examine claims under the Treaty of Amity between the United States and Iran (1955). However, while interpreting the Treaty of Amity, the ICJ referred to external sources of law and read the term ‘protection of essential security interests’ under the Treaty with reference to general international law which prohibits the use of force, invoking Article 31(3)(c) VCLT.⁴⁸⁸ Consequently, the ICJ interpreted the scope of the ‘essential security interests’ exception restrictively, excluding the use of force from its scope.

None of the investment arbitral awards known to this author has applied Article 31(3)(c) of the VCLT.⁴⁸⁹

⁴⁸⁶ Chemtura v. Canada, NAFTA, UNCITRAL, Award, August 2, 2010 [134]-[143], [266].

⁴⁸⁷ Martins Paparinskis, ‘Investment treaty interpretation and customary investment law: Preliminary remarks’, in Chester Brown, Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (CUP 2011) 71.

⁴⁸⁸ *Oil Platforms* (Islamic Republic of Iran v. United States of America), 2003 I.C.J.90 (November 6), available at http://www.icj-cij.org/icjwww/idocket/iop/iopjudgment/iop_ijudgment_20031106.PDF, [40]-[41].

⁴⁸⁹ A Van Aaken, ‘Fragmentation of International Law: The Case of International Investment Protection’ (2008) U. of St. Gallen Law & Economics Working Paper No. 2008-1. Available at SSRN: <http://ssrn.com/abstract=1893692> (accessed at 12 December 2011), 16: ‘ICSID tribunals have heavily

Teleological, effective and evolutionary treaty interpretation

Potential conflicts in applicable law may be ‘interpreted away’ through the application of teleological, effective or evolutive treaty interpretation.⁴⁹⁰ For instance, the *US-Shrimps Report* dealt with the US import ban of shrimps harvested in an unfriendly manner towards sea turtles. Sea turtles as an endangered species were protected under the CITES Convention.⁴⁹¹ While interpreting the meaning of the term ‘exhaustible natural resources’ under GATT Article XX(g), the AB used various soft law documents⁴⁹² and environmental treaties, not all of which were binding to all the disputing parties,⁴⁹³ as authoritative statements of the contemporary meaning of the term.⁴⁹⁴ As a result, the AB extended the coverage of the GATT exception to living natural resources⁴⁹⁵ and qualified the US import ban on shrimps as a measure falling under the listed exceptions.⁴⁹⁶ It is important to note that the sustainable development objective mentioned in the preambular language of the WTO Agreement gave ‘colour, texture and shading’ to the AB interpretation of the generic term ‘exhaustible natural resources’.⁴⁹⁷

A similar line of argumentation may be applicable in investment treaty arbitration. Sustainable development is a general context of investment protection law; thus, investment guarantees are to be interpreted in light of it through teleological and effective treaty interpretation principles. For instance, effective treaty interpretation

relied on the application of the VCLT, especially Art. 31 (1) of the VCLT. They have not however resorted explicitly to Art. 31 (3) (c) of the VCLT for interpreting the clauses of BITs, even if they used other special international law for interpretation.’ (footnotes omitted).

⁴⁹⁰ On evolutive interpretation see case: *Gabčíkovo-Nagymaros (Hungary/Slovakia)*, Judgment, I.C.J. Reports 1997, pp. 67-68, [112], Permanent Court of Arbitration: In the Arbitration Regarding the Iron Rhine ("IJzeren Rijn") Railway, between the Kingdom of Belgium and the Kingdom of the Netherlands (May 24, 2005). See also I. Van Damme, ‘Treaty Interpretation by the WTO Appellate Body’, Draft Article for the EJIL Seminar, 10 November 2009 (forthcoming), [103]. Treaty interpretation principles are not exclusive of each other to justify the meaning of the treaty norms; thus the effective interpretation ‘can also be instrumental in justifying an evolutionary interpretation of the treaty’, if there is a need to actualize the content of a treaty’s provisions.

⁴⁹¹ United States – Import Prohibition of Certain Shrimp and Shrimp Products (US-Shrimp/Turtle I), AB-1998-4, Report of the Appellate Body 6 November 1998, WT/DS58/AB/R, [132].

⁴⁹² UN Agenda 21- Report of the UNCTED, I (1992) UN Doc. A/conf.151/26/Rev.1, (1992), 31 ILM 874.

⁴⁹³ For instance, the Convention on Biological Diversity and the Convention on the Conservation of Migratory Species of Wild Animals were not ratified by Thailand and the US.

⁴⁹⁴ J. Pauwelyn, *Conflict of Norms in Public International Law. How WTO Law Relates to Other Rules of International Law* (Cambridge University Press, 2003), 260.

⁴⁹⁵ United States – Import Prohibition of Certain Shrimp and Shrimp Products (US-Shrimp/Turtle I), AB-1998-4, Report of the Appellate Body, WT/DS58/AB/R [129]-[131].

⁴⁹⁶ Nevertheless, the AB found a breach of the Chapeau of the GATT Article XX.

⁴⁹⁷ US-Shrimp/Turtle, [152], [154], [155].

may require a restrictive interpretation of the legitimate expectations sub-element of indirect expropriation so as to give full effect to the objective of foreign investment protection (see Chapter 4). Furthermore, Simma and Kill observe that evolutive treaty interpretation is also applicable with respect to the content of FET and indirect expropriation standards which are inherently generic.⁴⁹⁸ Hence, the sustainable development objective should give ‘colour, texture and shading’ in setting their content, especillay in the case of an application of ‘old school’ BITs that do not contain explicit references to the safeguarding of wider societal interests other than foreign investment protection.

Presumption against conflict in favour of coherence and interpreting away conflict

In the case of a potential conflict of norms situation, the initial step is to presume against conflict⁴⁹⁹ or, if possible, to interpret away the conflict as it was done in the *SPP v. Egypt* and *S.D. Myers v. Canada* awards.

In *S.D. Myers v. Canada*, the Tribunal took into account the Basel Convention as a legal context for the interpretation of the ‘like circumstances’ element under the national treatment standard (Article 1102 of the NAFTA).⁵⁰⁰ The Tribunal noted that the object and purpose of the NAFTA⁵⁰¹ and its conflict resolution clause in Article 104 required balancing both ‘its concern with the environment and the need to avoid trade distortions that are not justified by environmental concerns’ necessitating to ‘take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest’.⁵⁰²

Furthermore, Article 104 necessitated Canada to use ‘the alternative that is least inconsistent with other provisions of this Agreement’ provided that the alternative is equally effective and reasonably available. Hence, the Tribunal analyzed the Basel

⁴⁹⁸ Bruno Simma, Theodore Kill, ‘Harmonizing Investment Protection and International Human Rights; First Steps Towards a Methodology’ in Christina Binder, Ursula Kriebaum, August Reinisch, Stephan Wittich (eds) *International Investment Law for the 21st Century. Essays in Honour of Christoph Schreuer* (OUP 2009), at 704. See also *Duke Energy Electroquil Partners v Ecuador*, ICSID Case No. ARB/04/14, Award, 18 August 2008, [378]; *Pope & Talbot Inc v The Government of Canada*, UNCITRAL (NAFTA), Award on Damages, 31 May 2002, [59]–[65]. *Mondev International, Ltd v United States*, ICSID Case No. ARB(AF)/99/2, Award, 11 October 2002, [101].

⁴⁹⁹ However, the *Electrabel v. Hungary* Tribunal held that there is no general principle of harmonious interpretation of different treaties (like the ECT and EU law), see *Electrabel S.A. v. The Republic of Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable law and Liability, 30 November 2012 [4.130.]

⁵⁰⁰ *S.D. Myers v. Canada*. Partial Award [247], [250], [255], [256], [287].

⁵⁰¹ Preambular language of which refers to the promotion of sustainable development.

⁵⁰² *S.D. Myers v. Canada* Partial Award [287].

Convention in order to see if a real conflict of norms existed and whether the Basel Convention was a ‘real’ motivation for Canada’s export ban. Since Canada’s main motive for the export ban was protectionism, and there were alternative methods available to achieve the policy objectives of the Basel Convention not contravening Canada’s international commitments under the NAFTA, the Tribunal found a violation of the NAFTA Chapter 11.⁵⁰³

In *SPP v. Egypt*, the Tribunal considered the UNESCO Convention, which served as a motivation and justification for expropriating investor’s property. Egypt invoked its obligations under the UNESCO Cultural Heritage Convention as grounds for the investment project termination, claiming that the expropriation did not take place. The Tribunal approved the legitimacy of the termination of the project by Egypt. The Tribunal maintained that, as a matter of international law, Egypt was entitled to cancel a tourist development project situated in its own territory for the purpose of protecting antiquities belonging to World Heritage.⁵⁰⁴ The Tribunal carefully examined whether the government actions that breached the investment agreement were genuinely motivated by the desire to comply with these non-investment obligations.⁵⁰⁵ The Tribunal found no real conflict between the norms of the UNESCO Convention and Egypt’s requirement to pay compensation for expropriation because ‘the choice of the sites to be protected is not imposed externally, but results instead from the State’s own voluntary nomination’.⁵⁰⁶

In *Suez v. Argentina*, Argentina and *amicus curiae* invoked Argentina’s human rights obligations to water as a rationale and context for the assessment of the customary necessity defence. The necessity defence was invoked in order to avoid liability for the breach of the Concession Agreement by freezing tariffs during and after the crisis in 2001-2002.⁵⁰⁷

The *Suez v. Argentina* Tribunal interpreted Argentina’s and *amicus* arguments as suggesting ‘that Argentina’s human rights obligations [...] somehow trumps its obligations under the BITs and [...] implicitly gives Argentina the authority to take

⁵⁰³ Ibid, [287].

⁵⁰⁴ Southern Pacific Properties (SPP) (Middle East) Limited v. Arab Republic of Egypt, ICSID ARB/84/3, May 20, 1992, Egypt’s National Law No.43, [158].

⁵⁰⁵ Ibid, [153]-[154], [159].

⁵⁰⁶ Ibid, [154], but see the Dissenting Opinion by Professr Khan.

⁵⁰⁷ *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic*, Decision on Liability, 30 July 2010, ICSID Case No. ARB/03/19, France-Argentina BIT, Spain – Argentina BIT, United Kingdom – Argentina BIT, UNCITRAL Rules [249], [252], [256].

actions in disregard of its BIT obligations'. The Tribunal noted that the 'trumping' argument is unsound under the BIT and international law, and went on by stating that in the case at hand 'Argentina's human rights obligations and its investment treaty obligations are not inconsistent, contradictory, or mutually exclusive' and 'Argentina could have respected both types of obligations'.⁵⁰⁸

The Tribunal's approach to Argentina's human rights arguments needs some attention. Although Argentina did not suggest that its human rights obligations trumped the BITs, there are indeed no grounds to consider in international law that human rights considerations automatically trump international investment guarantees.⁵⁰⁹ There is no hierarchy between the sources of international law,⁵¹⁰ with the exception of Article 103 of the Charter of the UN, *jus cogens* and *erga omnes* obligations.⁵¹¹ IIAs rarely provide for 'general exceptions', as in the GATT 1994, which allows certain listed non-trade public policies to trump trade liberalization commitments.⁵¹²

It is more difficult, however, to agree with the easy dismissal by the *Suez* Tribunal of the importance of human rights argument. The Tribunal simply stated that 'Argentina's human rights obligations and its investment treaty obligations are not inconsistent', and Argentina could have respected both. On the one hand, the Tribunal presumed against conflict of norms that is one of the conflict avoidance techniques under international law.⁵¹³ Nevertheless, presumption against conflict requires further consequences, i.e. it requires addressing the arguments raised by those who considered that the conflict existed, or an employment of such interpretation of the

⁵⁰⁸ *Suez v. Argentina*, [262].

⁵⁰⁹ Nikken is suggesting that a solution to meet incompatible investment commitments with human rights obligations is to give up the investment commitments by providing an adequate compensation to the affected investor. See P Nikken, 'Balancing of Human Rights and Investment Law in the Inter-American System of Human Rights' in PM Dupuy, F Francioni, EU Petersmann (eds), *Human Rights in International Investment Law and Arbitration*, (OUP 2009), Chapter 12.

⁵¹⁰ For criticism on trumping in general, see Thomas Waelde and Abba Kolo, 'Environmental Regulations, Investment Protection and 'Regulatory Taking' in International Law' (2001) 50 ICLQ 811, 823 and Martti Koskenniemi, *The Politics of International Law* (Hart Publishing 2011) 346, 349.

⁵¹¹ Fragmentation Report, [47-49, 168, 85-87, 328]; J Pauwelyn, *Conflict of Norms in Public International Law. How WTO Law Relates to Other Rules of International Law* (Cambridge University Press, 2003), 94-109; M Koskenniemi, *The Politics of International Law* (Hart Publishing 2011), 346-349.

⁵¹² Petros C Mavroidis, George A Bermann, Mark Wu, *The Law of the World Trade Organization (WTO): documents, cases & analysis* (Thomson/West, 2010), 684.

⁵¹³ J Pauwelyn, *Conflict of Norms in Public International Law. How WTO Law Relates to Other Rules of International Law* (Cambridge University Press, 2003), 240-244.

norm that harmonizes the meaning of the two norms under debate.⁵¹⁴ This aspect was skipped entirely by the *Suez* Tribunal even if Argentina and *amicus* submissions put forward particular issues for a nuanced analysis by the Tribunal. Argentina maintained that its duty to comply with its human rights obligations needed to inform the interpretation and application of the customary necessity defence and the content of the vague FET and indirect expropriation standard.⁵¹⁵ Namely, the intention to safeguard the human rights of its population served as a proof for the legitimacy of Argentina's actions (it had a legitimate public purpose in mind). By avoiding these issues, the Tribunal ignored the real request by Argentina to apply its external international obligations so as to inform the content of indirect expropriation and other investment guarantees as it was done, for instance, in *SPP v. Egypt* and *Parkerings v. Lithuania* awards.

In sum, the above-mentioned arbitral jurisprudence indicates that investment tribunals may be flexible enough to incorporate external international law arguments within the interpretation process of investment guarantees. However, it requires a certain mindset of arbitrators in applying investment norms and the sustainable development context requires them to use their inherent powers in a way which incorporates the principle of integration and seeing the link between investment protection standards and *prima facie* external norms. Consequently, the *Santa Elena v. Costa Rica* avoiding approach to external sources of law is outdated and no longer in line with the general context of investment protection law.

2.2.5. Genuine conflict of norms

In the case of a real conflict of norms, some IIAs contain explicit conflict resolution rules for a genuine conflict of norms situation, for example, Article 104 of the NAFTA and Article 16 of the ECT.⁵¹⁶ Otherwise, general international law provides several conflict resolution methods as *lex specialis*, *lex posterior* and limited hierarchy of norms as expressed in Article 103 UN Charter.⁵¹⁷ For instance, the

⁵¹⁴ Ibid, 244.

⁵¹⁵ *Suez v. Argentina* [252], [256].

⁵¹⁶ Mosche Hirsch, 'Interactions between Investment and Non-Investment Obligations' in Peter Muchlinski, Frederico Ortino and Christoph Schreuer (eds) *The Oxford Handbook of International Investment Law* (OUP 2008) 159 – 160.

⁵¹⁷ See J Pauwelyn, *Conflict of Norms in Public International Law. How WTO Law Relates to Other Rules of International Law* (Cambridge University Press, 2003) 164-200; Rüdiger Wolfrum, Nele

Tribunal in *Roussalis v. Romania* applied *lex specialis*, and denied the application of Article 1 of the First Additional Protocol to the European Convention on Human Rights because BIT provided for a ‘higher and more specific level of protection’ (*lex specialis*) in line with the majority view.⁵¹⁸

Invocation of these conflict resolution mechanisms requires establishing again the link between the conflicting international rules. For instance, application of the *lex posterior* principle (Article 30 of the VCLT) involves the determination of whether the conflicting rules apply to the same subject matter. The integration principle of sustainable development may play a role in establishing this link on a case-by-case basis.

INTERIM CONCLUSIONS

Defendant states have often invoked non-investment international obligations as a possible excuse for an alleged breach of investment protection standard. The current arbitral jurisprudence does not have a clear and predictable attitude towards the necessity to elaborate on non-investment international law as applicable law in investment claims. There are two main trends among investment tribunals: ignorance towards non-investment sources (e.g. *Santa Elena v. Costa Rica*) and tolerance towards non-investment sources (e.g. *SD.Myers v. Canada*, *SPP v. Egypt*, *Parkerings v. Lithuania*).

Although investment tribunals are limited by narrow jurisdiction clauses, the sustainable development objective provides the necessary doctrinal foundation for incorporating *prima facie* non-investment obligations in the investment context. Sustainable development affects the understanding of what is the ‘same subject matter’. In this respect, the Fragmentation Report suggests that the characterizations of specialized legal regimes such as ‘trade law’, ‘investment law’ or ‘international environmental law’ have no normative value *per se*, since various legal regimes under

Matz, *Conflicts in International Environmental Law* (Springer, 2003), 1-12; OECD, Relationships between International Investment Agreements (OECD, Paris, 2004). On the possibility of a host state to invoke peremptory norms as a defence see Mosche Hirsch, ‘Interactions between Investment and Non-Investment Obligations’ in Peter Muchlinski, Frederico Ortino and Christoph Schreuer (eds) *The Oxford Handbook of International Investment Law* (OUP 2008), 159-160.

⁵¹⁸ Spyridon Roussalis v. Romania, ICSID Case No.ARB/06/1, Award, December 7, 2011 [117]. Cf. Ursula Kriebaum ‘Privatizing Human Rights. The Interface between International Investment Protection and Human Rights’ in A Reinisch, U Kriebaum, *The Law of International Relations, Liber Amicorum Hanspeter Neuhold* (Utrecht : Eleven International Pub., 2007).

different ‘labels’ may, and often do, deal with the ‘same subject matter’.⁵¹⁹ ‘New generation’ IIAs approve this inter-relationship by incorporating various mechanisms, such as no lowering of standards clauses or interpretative guidelines, and approving the emerging trend for ‘seeking relationships’ between various differently ‘labelled’ existing primary norms which deal with the same subject matter.

Sustainable development, thus, necessitates a ‘systemic’ thinking of international investment law implying that investment protection law is not autonomous from other legal regimes, functioning as a mechanism of ‘de-fragmentation’. Thus, arbitrators are required to recognize the existence of a conflict of norms in its widest sense and use appropriate tools for solving them in light of the integration requirement.

Most importantly, the sustainable development objective clearly excludes the approach that the economic development aspect might in any way trump other pillars of sustainable development. Hence, methods for assessing the existence of indirect expropriation that exclusively focus on the investment protection as a necessary element of economic development are contrary to the sustainable development objective. Hence, the *Santa Elena v. Costa Rica* ‘self-containing’ approach is outdated and not serving the clarified object and purpose of the IIAs regime.

⁵¹⁹ Fragmentation Report, [21].

CHAPTER 3: THE APPLICATION OF INDIRECT EXPROPRIATION STANDARD AGAINST THE BACKGROUND OF SUSTAINABLE DEVELOPMENT

INTRODUCTION

This chapter aims to assess the compatibility of the methodologies used for the interpretation of the indirect expropriation standard with the sustainable development objective/principle. In essence, sustainable development requires an integrated approach between an economic development aspect, which is traditionally linked with foreign investment protection, and social and environmental elements of investment protection. Therefore, this section analyzes these methodologies in turn, focusing on the scope of interests they allow to take into account in examining the existence of indirect expropriation and whether these methodologies would now qualify as *bona fide* and effective reading of indirect expropriations standard guided by the principle of sustainable development.

A broad spectrum of general legislative acts,⁵²⁰ administrative measures⁵²¹ and compliance measures with non-economic international obligations of host States⁵²² aimed at the facilitation of non-economic public interests has been challenged as expropriatory (see Box 1 in the Appendix). Thus, the chapter deals with the assessment of which of the methodologies or doctrines guarantee that commercial interests are not prioritized but rather are balanced and reconciled with competing non-economic interests in the interpretation process of the indirect expropriation standard.

⁵²⁰E.g., in *Methanex v United States*, UNCITRAL (NAFTA) Final Award, 3 August 2005, which involved a general legislation banning a toxic gas ingredient that polluted the environment. In *Glamis Gold, Ltd. v The United States of America*, UNCITRAL (NAFTA), Award, 8 June 2009, California imposed new restrictions on gold mining. California invoked internationally protected rights of indigenous groups among the reasons for limiting rights to gold extraction in the area of cultural property of Indian tribes.

⁵²¹E.g., *Técnicas Medioambientales Tecmed S.A. v The United Mexican States* (ICSID Case No. ARB (AF)/00/2), Award of 29 May 2003 that involved the revocation of the operation licence by the local Municipality for the alleged environmental protection purpose.

⁵²²E.g., *Chemtura v Canada*, NAFTA, UNCITRAL, Award August 2 2010, in which the gradual phase-out by Canada of the agrochemical lindane was supported by the 1998 Aarhus Protocol on Persistent Organic Pollutants and the Stockholm Convention on Persistent Organic Pollutants. Lindane was gradually eliminated because it endangered public health and the environment.

At first, the chapter provides an insight in the general rule on indirect expropriation and its three-step assessment that arbitral jurisprudence has rather coherently employed (the first step deals with the indication of whether there is a protected investment capable of being expropriated; the second step deals with the assessment of the existence of expropriation; the third step consists of legitimacy assessment of the already found expropriation).

It proceeds with examples of the host state's regulatory measures that (allegedly) deal with sustainable development matters, which foreign investors have challenged as expropriatory (summarized in Box 1 in the Appendix) and which reflect the clash between investor's claims for its property protection and legal stability, on the one hand, and the host State's interest to retain and apply its regulatory flexibility, on the other hand.

The chapter continues with a brief overview of the negative issues of the indirect expropriation standard, namely the confusion between legitimacy conditions of indirect expropriation and non-compensable regulation which causes ambiguity over the scope of the indirect expropriation standard. In particular, arbitral tribunals have interpreted the role and legal consequences of a 'public purpose' criterion discordantly, often perplexing criteria for legitimacy of a State's customary right to regulate and/or indirect expropriation with the establishment of the existence of the latter. This situation has led to uncertainty within the scope of the indirect expropriation standard.

Against this background, and taking into account the sustainable development context, the chapter proceeds with the analysis of three main doctrines used for distinguishing expropriatory measures from non-compensable regulations. The assessment of these methods or doctrines is done in light of the integration principle, outdating those approaches which allow arbitrators to limit themselves strictly to the narrow focus on foreign investment protection.

3.1. EXPROPRIATION. GENERAL RULE

The right to expropriate property is recognized in public international law. It is well established that:

[I]f alien-owned property is subject to measures of expropriation which are not arbitrary or discriminatory, and which are adopted in furtherance of the public

*interest and accompanied by genuine and realistic provisions for the payment of compensation, the state will be held not to have acted in breach of its customary international law obligations.*⁵²³

Expropriation may take place in direct and indirect forms. Direct expropriation means the taking of property by transferring its title and related property interests to the state⁵²⁴ (e.g., *Santa Elena v. Costa Rica*,⁵²⁵ where the expropriation was based on the formal decree issued by the State). In contrast, indirect expropriation, which is nowadays the dominant form of expropriation,⁵²⁶ ‘may occur when measures short of an actual taking result in the effective loss of management, use or control, or a significant depreciation of the value of the assets of a foreign investor’.⁵²⁷ In IIAs, indirect expropriations are mostly referred to as ‘measures having effect equivalent to nationalization or expropriation’ or ‘measures tantamount to nationalization or expropriation’.⁵²⁸

Indirect expropriation may take place through a single measure (e.g., regulatory expropriation through a general regulation having an expropriatory effect on foreign investment) or it may result from a series of related or unrelated measures over a period of time (the so-called ‘creeping’ expropriation).⁵²⁹ Overall, elements of indirect expropriation include a permanent taking of an investment by a government-type authority acting in its sovereign capacity,⁵³⁰ transfer of ownership is not decisive.⁵³¹

3.1.1. Assessing An Indirect Expropriation Claim. Four-Steps Test

⁵²³ Sir Robert Jennings, Sir Arthur Watts, *Oppenheims’s International Law* (9th ed Longman 1992) 917-919, 926.

⁵²⁴ August Reinisch, ‘Expropriation’ in Peter Muchlinski, Frederico Ortino and Christoph Schreuer (eds) *The Oxford Handbook of International Investment Law* (OUP 2008) 408.

⁵²⁵ *Compañía del Desarrollo de Santa Elena, S.A. v The Republic of Costa Rica* (ICSID Case No. ARB/96/1), Award of 17 February 2000, 15 ICISD REV – FILJ 169 (2000).

⁵²⁶ Also called ‘de facto expropriation’, ‘indirect expropriation’, ‘compensatory taking’ or ‘measures tantamount to expropriation or having equivalent effect’, see *Tecmed v. Mexico* [114]. See also PE Comeaux, NS Kinsella, *Protecting Foreign Investment under International Law. Legal Aspects of Political Risk* (New York, Oceana Publications Inc Dobbs Ferry, 1997), 8.

⁵²⁷ August Reinisch, ‘Expropriation’ in Peter Muchlinski, Frederico Ortino and Christoph Schreuer (eds) *The Oxford Handbook of International Investment Law* (OUP 2008) 421- 422 (footnotes omitted).

⁵²⁸ UNCTAD, *Taking of Property*, UNCTAD/ITE/IIT/15 (UN 2000) 18. The Tribunal in *Feldman* noted: ‘The Article 1110 [of the NAFTA] is of such generality as to be difficult to apply in specific cases’, see *Marvin Roy Feldman Kappa v United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award, 16 December 2002 [98].

⁵²⁹ *Fireman’s Fund v. Mexico*, [176(i)].

⁵³⁰ In contrast to contractual capacity. *Parkerings v.Lithuania* [443]. *Azurix. v. Argentina* [314]. *Waste Management II v.Mexico* [175].

⁵³¹ *Fireman’s Fund v. Mexico* [176(a)-(e)].

In contrast to direct expropriation, where the focal point lies in the examination of its legitimacy conditions, the main problem with indirect expropriation is to establish whether a state action constitutes an expropriation of a protected investment. That is to say, its existence must be distinguished from a legitimate, non-compensable exercise of State power to regulate that nevertheless affects foreign investment,⁵³² ‘and it is fair to say that no one has come up with a fully satisfactory means of drawing this line’.⁵³³ Tribunals have provided vague and incomprehensible guidelines for making this distinction, for example the *S.D.Myers v. Canada* Tribunal famously noted that ‘[e]xpropriations tend to involve the deprivation of ownership rights; regulations a lesser interference’.⁵³⁴

Thus, arbitral jurisprudence has established a theoretical four-step approach in assessing an indirect expropriation claim focusing on, first, whether there is a protected investment capable of being expropriated, second, whether that investment has in fact been expropriated, and, third, whether the expropriation is lawful⁵³⁵ or whether it is covered by customary police power exceptions. If a tribunal finds the existence of expropriation, the fourth step deals with the amount of compensation which an affected investor is entitled to receive.

However, there is no consistency and predictability with respect to the second step of establishing indirect expropriation. Arbitrators have often interchanged and perplexed the establishment of the existence of indirect expropriation with its legitimacy criteria or with the legitimacy assessment of a non-compensable exercise of a customary state’s right to regulate. Consequently, the scope of the indirect expropriation standard is unclear, and arbitral jurisprudence has used various methodologies or doctrines that emphasize differing criteria for establishing the existence of indirect expropriation, which now need to be assessed against the clarified sustainable development context.

3.1.2. Element of ‘substantial deprivation’ of investment

The dominant view states that for indirect expropriation to exist it is necessary to establish a substantial deprivation of the investment as a whole. Existence of a

⁵³² General, *bona fide* regulations are not *per se* exempt from becoming expropriatory, see Pope & Talbot v Canada [99].

⁵³³ Feldman v. Mexico [100].

⁵³⁴ *S.D.Myers, Inc. v Government of Canada*, Partial Award, November 13, 2000, NAFTA, UNCITRAL [282].

⁵³⁵ Rudolf Dolzer, Christoph Schreuer, *Principles of International Investment Law* (OUP 2008) 90, 91; *Chemtura v. Canada* [242]; *Merrill v. Canada* [139].

substantial deprivation of the (economic) use and enjoyment of property rights⁵³⁶ was emphasized by the *Pope & Talbot* Tribunal,⁵³⁷ and it is widely followed by later arbitral awards.⁵³⁸ Investors often refer to the *Metalclad v. Mexico* award,⁵³⁹ where the Tribunal reasoned that expropriation is also constituted in cases where the owner is deprived of a ‘significant part, of the use or reasonably-to-be-expected economic benefit of property’,⁵⁴⁰ but this definition is mostly considered as extremely broad.⁵⁴¹ The ‘substantial deprivation’ test consists of two main criteria, namely, the severity of the (economic) impact on property rights⁵⁴² and the duration of that impact.⁵⁴³ In *Biwater Gauff v. Tanzania*, the Tribunal declared that the ‘substantial interference’ does not even need to be economic in nature.⁵⁴⁴

Substantial deprivation of property rights as the decisive element for the existence of expropriation is accepted also outside of foreign investment law. Thus, the

⁵³⁶ *Biwater Gauff v. Tanzania* [463]; Y Fortier and SL Drymer, ‘Indirect Expropriation in the Law of International Investment: I know It When I See It, or *Caveat Investor*’ (2004) 19 ICSID Review-FILJ 293, 305: ‘an interference that renders rights so useless that they must be deemed to have been expropriated’; ‘an interference that deprives the investor of fundamental rights of ownership’; ‘an interference that makes rights practically useless’; ‘an interference sufficiently restrictive to warrant a conclusion that the property has been “taken”’; ‘an interference that makes any form of exploitation of the property disappear’; ‘an interference such that the property can no longer be put to reasonable use’. In *Glamis Gold v. US* [358]-[536] the Tribunal used nearly 200 paragraphs for the analysis on ‘substantial deprivation’ of the investor’s property.

⁵³⁷ *Pope & Talbot Inc v The Government of Canada*, Interim Award, June 26, 2000, NAFTA, UNCITRAL [102].

⁵³⁸ *S.D. Myers v. Canada* [283]; *Vivendi v. Argentina*, Resubmitted, [7.5.24]; *Merrill v. Canada* [145], *Chemtura v. Canada* [242], [245]; *Parkerings v. Lithuania* [455]. *Tecmed v. Mexico* [115]; *Biwater Gauff v. Tanzania* [463]; *Spyridon Roussalis v. Romania*, [328]; *Telenor Mobile Communications A.S. v. Republic of Hungary*, ICSID Case No. ARB/04/15, Award, September 13, 2006, [64]-[65].

⁵³⁹ For instance, *Roussalis v. Romania* [130].

⁵⁴⁰ *Metalclad v. Mexico* [103].

⁵⁴¹ *Chemtura v. Canada* [248].

⁵⁴² In *Pope & Talbot v. Canada* [100], the Tribunal provided the following non-exhaustive criteria for assessing the existence of substantial deprivation, and thus, indirect expropriation: whether the investor remained in control of its investment, whether it directed its day-to-day operations, whether its officers and employees were detained by the State, whether the State supervised the work of the investor’s officers and employees or not, whether the State had taken the proceeds of sales other than through taxation, whether the State interfered with management or shareholders’ activities, whether the State prevented the distribution of dividends to shareholders, whether the State interfered with the appointment of directors or management, and whether the State had taken any other actions ousting the investor from full ownership and control of the investment.

⁵⁴³ *Glamis Gold v. US* [356]; *Biwater Gauff v. Tanzania* [463]; The often-cited *Tippets* award from the Iran-US Claims Tribunal stated that property is taken by a regulation ‘whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral’. *Tippets, Abbott, McCarthy, Stratton v. TAMS-AFFA Consulting Engineers of Iran*, 6-Ian- U.S.C.T.R. 219 at 255.

⁵⁴⁴ *Biwater Gauff v. Tanzania* [464]-[465].

jurisprudence by the ECtHR on *de facto* expropriations⁵⁴⁵ has constantly held that a property owner must be deprived of all uses of his/her property or, in other words, the property should disappear.⁵⁴⁶ Otherwise, the interference with property rights is merely a ‘control of the use of property’ not necessitating compensation.⁵⁴⁷

As a result of the apparently high ‘substantial deprivation’ standard, many alleged expropriation claims fail under this provision⁵⁴⁸ and their substance is addressed under the FET standard justifying the interconnected analysis of both of these standards and their sub-elements.

3.2. EXAMPLES OF CHALLENGED MEASURES DEALING WITH SUSTAINABLE DEVELOPMENT RELATED MATTERS

International investment protection law covers a wide array of tangible and intangible property interests,⁵⁴⁹ for example, the enjoyment of rights under a licence,⁵⁵⁰ contractual rights,⁵⁵¹ and access to markets.⁵⁵² The State may affect and expropriate these rights through an infinite variety of measures.⁵⁵³ Accordingly, a vast array of a State’s measures directly or indirectly related to particular public interest, which goes under one of the three pillars of the term sustainable development, have been challenged as expropriatory (see Box 1 in the Appendix). Usually, respondent states

⁵⁴⁵ On indirect expropriation under international human rights see Ali Riza Coban, *Protection of Property Rights within the European Convention on Human Rights* (Ashgate, 2004), and in particular *Sporrong & Lönnroth v. Sweden*, *Eur. Ct.H.R.* No. 52 (ser.A) (1982) [62], [63]; *Fredin v. Sweden*, Judgement of 18 February 1991, *Eur. Ct.H.R.*, No. 192. (Ser. A) [42]; P Nikken, Chapter 12, ‘Balancing of Human Rights and Investment Law in the Inter-American System of Human Rights’ in PM Dupuy, F Francioni, EU Petersmann (eds), *Human Rights in International Investment Law and Arbitration*, (OUP 2009).p.270 *et seq.*

⁵⁴⁶ *Sporrong and Lonnroth v. Sweden* [62].

⁵⁴⁷ E.g., *Pine Valley Developments Ltd and Others v. Ireland* [56]; *Handyside v. United Kingdom*, 24 Eur. Ct. H.R. (ser A) at 29, 1976.

⁵⁴⁸ E.g., *Parkerings v. Lithuania* [447], *S.D.Myers v. Canada*. Partial Award [282].

⁵⁴⁹ *Fireman’s Fund Insurance Company v. Mexico*, ICSID Case No. ARB(AF)/02/01, Award, 17 July 2006, NAFTA [176(b)].

⁵⁵⁰ *Mondev International Ltd. v. United States*, ICSID Case No. ARB(AF)/99/2, Award, 11 October 2002 [98].

⁵⁵¹ *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic*, Decision on Liability, 30 July 2010, ICSID Case No. ARB/03/19 [151].

⁵⁵² *Pope & Talbot Inc v The Government of Canada*, Interim Award, June 26, 2000, NAFTA, UNCITRAL [96].

⁵⁵³ Louis B Sohn, R R Baxter, ‘Responsibility of States For Injury to the Economic Interests of Aliens’ (1961) 55 AJIL, 545, 559.

bring up the public interest aspects as its defence in the investment dispute. Rarely, claiming investors⁵⁵⁴ or *amicus curiae*⁵⁵⁵ appeal to these concerns.

One may classify the challenged measures in four broad categories: (1) National legislation of general application suppressing or/and restricting certain economic activity (the so-called regulatory takings cases) usually for the environment or health protection reasons. Suppression of specific previously allowed activity was the central issue in *Methanex v. US*⁵⁵⁶ and *Chemtura v. Canada*⁵⁵⁷ claims. These claims originated from the bans of harmful chemicals, the production of which was the claimants' investment. In *Methanex v. US*, the contested Californian ban of the toxic gasoline additive was motivated by environmental and health concerns approved by scientific research. Similarly, at the core of the *Glamis Gold v. US*⁵⁵⁸ claim was the ban and severe restrictions of the previously allowed gold mining methods. California justified its ban on the use of open-pit mining and the newly imposed back-filling requirement by the need to protect the religious and cultural property of Native American Indians. In *Metalclad v. Mexico*,⁵⁵⁹ the investor challenged the Cactus Protection Decree prohibiting any commercial activity on its property as an expropriation. In *Ethyl v. Canada*,⁵⁶⁰ the investor was complaining about the ban of inter-provincial trade in harmful chemicals, which Canada imposed for health and environmental protection reasons. In *Merrill v. Canada*,⁵⁶¹ at issue was the new Canadian regulatory regime for log exports, requiring the sale of surplus logs from private land to the province before they could be exported. This requirement was believed to be directed at the sustainable use of natural resources and the promotion of

⁵⁵⁴ As in *Biloune v. Ghana*, where the investor complained about arbitrary detention as a breach of his human rights, the tribunal rejected this part of the claim as having no jurisdiction over the issue. In *Grand River Enterprises et al. v. United States of America*, UNCITRAL (NAFTA) Award, 12 January 2011, the investors unsuccessfully attempted to incorporate indigenous peoples' rights under various human rights instruments in NAFTA Article 1105 on international minimum standard.

⁵⁵⁵ In *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania*, ICSID Case No ARB/05/22, Award, 24 July 2008 *amicus curiae* referred to the right to water of the local population as the core of the issue.

⁵⁵⁶ *Methanex v. United States*, UNCITRAL (NAFTA) Final Award, 3 August 2005.

⁵⁵⁷ *Chemtura v. Canada*, NAFTA, UNCITRAL, Award August 2 2010.

⁵⁵⁸ *Glamis Gold, Ltd. v. The United States of America*, UNCITRAL (NAFTA), Award, 8 June 2009.

⁵⁵⁹ *Metalclad Corporation v. The United Mexican States*, ICSID Case No.ARB(AF)/97/1, Award August 30, 2000, NAFTA.

⁵⁶⁰ *Ethyl Corporation v. Canada*, UNCITRAL (NAFTA), Decision on Jurisdiction, 24 June 1998.

⁵⁶¹ *Merrill & Ring Forestry L.P. v. Canada*, UNCITRAL, ICSID Administered Case (NAFTA) Award, 31 March 2010.

the local processing of timber. In *Piero Foresti v. South Africa*,⁵⁶² investors complained about South Africa's Black Economic Empowerment programme. The programme required the introduction of compulsory equity divestiture as an attempt to encourage greater ownership of mining industry assets by historically disadvantaged South Africans. Costa Rica's measures establishing a preserve park for breeding sites of endangered leatherback turtles⁵⁶³ were also challenged as expropriatory measures.

(2) Another category of challenged State acts involves administrative measures, in particular, non-issuance or termination of licence or other authorization. For instance, termination or non-issuance of an operation licence for allegedly social or environmental concerns was at issue in *Tecmed v. Mexico*,⁵⁶⁴ *Metalclad v. Mexico* and *Vattenfall v. Germany*.⁵⁶⁵ The State's rejection of a proposed investment activity as a result of environmental and social impact assessment was at the core of *Glamis Gold v. US*,⁵⁶⁶ *Pac Rim v. El Salvador*,⁵⁶⁷ *San Sebastian v. El Salvador*⁵⁶⁸ and *Maffezini v. Spain*.⁵⁶⁹ For instance, in *Pac Rim v. El Salvador* and *San Sebastian v. El Salvador*, the indirect expropriation claims arose out of the Government's revocations of investors' environmental permits and non-renewal of their gold and silver exploration licenses. The State claimed these measures were necessary for the protection of drinking water resources.

(3) Another group of challenged measures stems from the general treatment of investors, especially public utility companies, through legislative, executive and

⁵⁶² Piero Foresti, Laura de Carli and ors v Republic of South Africa ICSID Case No ARB(AF)/07/1, Award, 4 August 2010.

⁵⁶³ Reinhard Hans Unglaube v. Costa Rica (ICSID Case No. ARB/09/20); Marion Unglaube v. Costa Rica (ICSID Case No. ARB/08/01).

⁵⁶⁴ Técnicas Medioambientales Tecmed S.A. v. The United Mexican States (ICSID Case No. ARB(AF)/00/2), Award of 29 May 2003 (Spain/Mexico BIT).

⁵⁶⁵ The *Vattenfall v. Germany* arbitration evolved from various administrative delays and new ecological measures imposed upon the coal-fired power plant project by the water use and discharge permit in Elba. The claim was settled through the Agreement between the Parties that required issuing a modified water use permit for the project.; see *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany*, ICSID Case No. ARB/09/6, Award March 11, 2011.

⁵⁶⁶ The investor complained about a prohibition to use open-pit mining in an area of religious and cultural importance for Native American Indians.

⁵⁶⁷ *Pac Rim Cayman LLC v. The Republic of El Salvador*, CAFTA, ICSID Case No. ARB/09/12, Award on Merits Pending (Decision on the Respondent's Preliminary Objections Under CAFTA Articles 10.20.4 and 10.20.5, 2 August 2010).

⁵⁶⁸ The Government revoked the Claimants' environmental permits and did not renew their exploration licenses, allegedly protecting drinking water resources.

⁵⁶⁹ The investor complained about the additional costs imposed by the environment impact assessment, which was necessitated by Spanish national laws.

judiciary branches of the host State. For instance, in *Vivendi v. Argentina (Resubmitted)*,⁵⁷⁰ Argentina claimed that its treatment of the investor by terminating the concession agreement and supporting customers not to pay bills for contaminated water fell within its regulatory activity to provide vital water and sewage services. Similarly, in *Biwater Gauff v. Tanzania*,⁵⁷¹ Tanzania argued that the termination of the concession contract in water and sanitation services and the occupation of the investor's premises were measures aimed at safeguarding the local population's vital rights to water, since the investor was not performing its obligations and had created a threat to public health and welfare.⁵⁷²

(4) Last but not least, investors have challenged several measures relating to host State's attempts to comply with its non-investment international obligations. For instance, in *Chemtura v. Canada*, the investor complained about the gradual phase-out of the agro-chemical lindane due to its effects on health. The phase-out was buttressed by the 1998 Aarhus Protocol on Persistent Organic Pollutants and the Stockholm Convention on Persistent Organic Pollutants. In *S.D.Myers v. Canada*, Canada justified its temporary export ban of the chemical waste PBC by its obligations under the Basel Convention, which, *inter alia*, required reducing to the minimum the transboundary movement of hazardous wastes.⁵⁷³ Finally, the UNESCO Cultural Heritage Convention was considered in *SPP v. Egypt* award⁵⁷⁴ dealing with the claim arising out of the termination of the previously approved project to develop a tourist complex at the Pyramids near Cairo. Egypt invoked its obligations under the UNESCO Cultural Heritage Convention as a justification of the termination of the project.

⁵⁷⁰ 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, Resubmitted.

⁵⁷¹ *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania*, ICSID Case No ARB/05/22, Award, 24 July 2008.

⁵⁷² *Ibid.*, [434], [436].

⁵⁷³ *S.D.Myers v Canada*. Partial Award [105]-[107].

⁵⁷⁴ *Southern Pacific Properties (SPP) (Middle East) Limited v. Arab Republic of Egypt*, ICSID ARB/84/3, May 20, 1992, Egypt's National Law No.43.

3.3. LEGITIMACY CONDITIONS FOR NON-COMPENSABLE REGULATION AND REGULATORY EXPROPRIATION

To begin with, the right to expropriate property is recognized in public international law, if it is subject to certain conditions and consequences,⁵⁷⁵ namely if it is non-discriminatory and non-arbitrary, adopted in furtherance of the public purpose and against the payment of fair compensation.⁵⁷⁶

Apart from the compensation requirement, the same legitimacy conditions apply equally to such non-compensable regulations affecting foreign investment as national legislations and administrative measures without expropriatory effect. Because of that there is frequently confusion between the second and third step of the assessment of an indirect expropriation claim, namely, the establishment of the very existence of indirect expropriation (proving the existence of substantial deprivation of property and thus, its separation from non-compensable regulations without such an effect on the property) and the legitimacy assessment of challenged regulatory measures or the already established expropriation. Therefore, these legitimacy criteria are addressed before the doctrines of establishing the very existence of expropriation.

3.3.1. Non-discrimination and non-arbitrariness

Any kind of host State's measures that detrimentally affect investors lose their legitimacy if they are applied in an arbitrary and discriminatory manner.⁵⁷⁷

Existence of a genuine public purpose of the measure helps to prove that it is non-discriminatory and non-arbitrary.⁵⁷⁸ Nonetheless, even non-discriminatory regulation

⁵⁷⁵ Sir Robert Jennings, Sir Arthur Watts, *Oppenheims's International Law* (9th ed Longman 1992) 917-919; Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (OUP 2008) 89.

⁵⁷⁶ Jennings, Watts, *Oppenheims's International Law* (9th ed Longman 1992), 926.

⁵⁷⁷ Restatement Third [200-201]. *Biloune and Marine Drive Complex Ltd. v. Ghana Investments Centre and the Government of Ghana*, Award on Jurisdiction and Liability, 27 October 1989, 95 ILR 183, where the government stopped the work, partially demolished the work in progress, and arbitrarily arrested, detained and deported Mr. Biloune. Similarly, in the *Tecmed* and *Metalclad* awards expropriation was found due to the arbitrary conduct by the governments, unjustifiably interfering in previously approved investment projects.

⁵⁷⁸ *Methanex v. US* Part IV - Chapter D - Page 4, para.7. Cf. The American Law Institute, Restatement of the Law Third. The Foreign Relations Law of the United States (Vol 2, The American Law Institute 1987) [712] 211 *et seq*; T M Frank, *Fairness in International Law and Institutions* (OUP 2002) 470.

for public interest might add up to indirect expropriation (regulatory taking)⁵⁷⁹ if it results in a ‘substantial deprivation’ of property rights and is not justified under police powers exceptions.⁵⁸⁰ Thus, the Tribunal in *Pope & Talbots* rejected Canada’s argument that non-discriminatory regulations for public good cannot be expropriatory, holding that ‘a blanket exception for regulatory measures would create a gaping loophole in international protections against expropriation’.⁵⁸¹

With regard to non-arbitrariness/due process requirement, indirect expropriation may be comprised of too-far-reaching regulatory measures (regulatory takings) and also by substantial interference with investment that takes place in breach of due process or regulatory mistreatment of investors (creeping or disguised takings)⁵⁸² for instance, acting in breach of prior promises like it was done in *Suez v. Argentina*,⁵⁸³ where Argentina refused to revise tariffs in line with the legal framework established by the Concession Contract. Compliance with legitimate investment-backed expectations of investors as a substantial element of non-arbitrariness is dealt with in detail in the following chapters.

Failure in obeying due process bars a State the possibility to rely on exercising otherwise legitimate regulatory powers. For instance, in *Middle East Cement v. Egypt*, Egypt took the investor’s ship, which was subject to an administrative seizure, without due notification contrary to the due process of law requirement.⁵⁸⁴ As a consequence, the State could not rely on its exercise of non-compensable police powers exceptions.⁵⁸⁵ Jennings and Watts consider non-arbitrariness as ‘[p]erhaps the

⁵⁷⁹ *Pope & Talbot v. Canada* [99]; See also *S.D. Myers v Canada* [281], observing that regulatory action by public authorities is unlikely to be the subject of legitimate complaint under Article 1110 of the NAFTA, although the possibility cannot be ruled out.

⁵⁸⁰ A Newcombe, ‘The Boundaries of Regulatory Expropriation in International Law’ (2007) 4 TDM 4, available at transnational-dispute-management.com, Introduction. ‘Exceptions’ in this case are an internationally accepted subset of State measures that despite their deprivatory effect are non-compensable.

⁵⁸¹ *Pope & Talbot v. Canada*, [99]; See also *S.D. Myers v Canada*, [281], observing that regulatory action by public authorities is unlikely to be the subject of legitimate complaint under Article 1110 of the NAFTA, although the possibility cannot be ruled out.

⁵⁸² *Fireman’s Fund v. Mexico*, [176(i)]. N. Rubins, N.S. Kinsella, *International Investment, Political Risk and Dispute Resolution. A Practitioner’s Guide*, (Oxford: Oceana Publications, 2005), 5-17.

⁵⁸³ *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic, Decision on Liability*, 30 July 2010, ICSID Case No. ARB/03/19.

⁵⁸⁴ *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/99/6 (Greece/Egypt BIT) Award, 12 April 2002 [139]-[144].

⁵⁸⁵ *Ibid* [139].

most clearly established condition' of the legitimacy of expropriation.⁵⁸⁶ In the *ELSI* case, the ICJ defined arbitrariness as 'a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety',⁵⁸⁷ setting a rather high threshold for finding a violation of the due process requirement.

Concerning regulatory takings claims, such elements as a reliance on a scientific research, a compliance with international guidelines and a response to overall trends in other legal systems will serve as arguments to prove the non-arbitrariness of the challenged regulatory measures.

For instance, in *Glamis Gold v. US*, the Tribunal analysed reasonableness of the newly imposed legislative measure requiring a cultural review of the investment project. The measure was deemed to be reasonable since it was based on the guidelines and studies of qualified professional archaeologists and researchers.⁵⁸⁸ Similarly, in *Methanex v. US*, the Tribunal found that the peer-reviewed University of California Report provided a serious, objective and scientific justification for the legislative ban of the chemical gasoline ingredient.⁵⁸⁹ Hence, *bona fide* scientific opinion serves as an important element in reasonability and non-arbitrariness assessment of governmental measures banning or restricting investor's activity for public interest. Even more, in line with *Glamis Gold* and *Methanex* awards, the scientific opinion needs not to be the majority opinion, it is also not required that it is based on international standards, thus, there is a leeway for the exercise of precautionary actions by State. In comparison, under the WTO law, Article 5.7 of the SPS Agreement sets rather high standards for the exercise of precautionary actions – they need to be substantiated with well established scientific justification and risk assessment.⁵⁹⁰

Compliance with international guidelines and the response to overall trends in other legal systems by the challenged regulatory measure leaves less room to manoeuvre for tribunals within the reasonableness assessment. For instance, in *Chemtura v. Canada* the gradual legislative phase-out of the agro-chemical lindane was buttressed by

⁵⁸⁶ Jennings, Watts, *Oppenheims's International Law* (9th ed Longman 1992), 919-920. See also ECHR- Article 1 Protocol 1- deprivation of property shall occur only "subject to the conditions provided by the law."

⁵⁸⁷ Case Concerning Elettronica Sicula S.p.A. (ELSI), ICJ Reports (1989)[128].

⁵⁸⁸ *Glamis Gold v. US* [781], [783], [828], [826].

⁵⁸⁹ *Methanex v. US*, Part III - Chapter A – 51[101].

⁵⁹⁰ EC-Measures Concerning Meat and Meat Products (Hormones), AB Report, WT/DS26,48/AB/R, 13 February 1998, DSR 1998:I, 135, [172], [186]. See also Korea-Measures Affecting Imports of Fresh, Chilled and Frozen Beef, AB Report, WT/DS161, 169/AB/R/DSR 2001:I, 5, [178].

international treaties (1998 Aarhus Protocol on Persistent Organic Pollutants and the Stockholm Convention on Persistent Organic Pollutants) and supported by the comparative analysis of lindane regulations in other countries. Lindane as a potential carcinogen was gradually banned in numerous countries.⁵⁹¹ The Tribunal took into account these factors when asked to rule on the reasonableness and legitimacy of the lindane ban in Canada. As a result, the Tribunal concluded that Canada had acted *bona fide* within its police powers and in line with genuine concerns for the environment and health protection.⁵⁹²

3.3.2. Compensation Requirement

Expropriation is legal only if it is accompanied by prompt and just compensation. A standard of compensation established by the network of IIAs requires the payment of the full market value of the expropriated investment.

In essence, indirect expropriations are *per se* illegal, since they are not compensated unless the affected investor undertakes litigation against a host state asserting the existence of expropriation and claiming compensation. Thus, in case where indirect expropriation is found, in addition to full market value compensation the investor may also rely on customary law requirement to get redress, which ‘as far as possible [will] wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed’.⁵⁹³

The requirement to pay compensation has raised tensions between developed and developing States. During the decolonization process in the 1950s and 1960s, developing states insisted on expropriation without compensation of property belonging to nationals of former colonial powers. In these countries extracting industries were in control of foreigners who operated on long-term concession agreements negotiated by the former colonial states.⁵⁹⁴ Developing countries saw those contracts as a threat to their sovereignty, economic self-determination and development, and, therefore, they attempted to push forward for a new system of

⁵⁹¹ Chemtura v. Canada, [134]-[137].

⁵⁹² Ibid, [135-138].

⁵⁹³ *Case concerning Certain German Interests in Polish Upper Silesia (Germany v. Poland)*, 1928, PCIJ, Series A No. 17, p. 47.

⁵⁹⁴ R. Higgins, ‘The Taking of Property by the State: Recent Developments in International Law’ (1982) 176 *Recueil des Cours* 259.

justice within the UN.⁵⁹⁵ However, developing states failed to establish a custom that expropriation of investment in the field of a state's natural resources is not compensable.⁵⁹⁶ Compensation requirement was approved in the UN GA Resolution 1803 on Permanent Sovereignty over Natural Resources⁵⁹⁷ and now enjoys the status of customary international law, since the Resolution was accepted both by developed and developing States.⁵⁹⁸

Moreover, even those BITs concluded between developed and developing states provide for fair market value in the case of expropriation, and, thus, excludes the proposition that 'developing countries which might not be able to pay for large-scale expropriation following decolonization should be entitled to argue that just compensation would be less than full market value'.⁵⁹⁹ Likewise, the Explanatory note to Harvard Draft rejects the approach 'that adverse economic circumstances or a strong national policy may in international law justify the taking of property without compensation'.⁶⁰⁰

So, once the expropriation is established (irrespective of its direct or indirect nature), it needs to be accompanied by full market value compensation.

3.3.3. Public Purpose and its perplexed understanding

Last, but not least, in order to be legitimate the taking of property must serve a public purpose as must also a non-compensable regulatory measure by a State.⁶⁰¹ The existence of a genuine 'public' purpose usually indicates non-discrimination and non-arbitrariness of the challenged measure.

⁵⁹⁵ N.J. Schrijver, *Sovereignty over Natural Resources: Balancing Rights and Duties*, (Cambridge: Cambridge University Press, 2008), 83. See also Declaration on the Establishment of a New International Economic Order, UN Doc. A/RES/S-6/3201 (1974), reprinted 13 ILM 715; Charter of Economic Rights and Duties of States; UN GA 1986 Declaration on the Right to Development.

⁵⁹⁶ T.M. Frank, *Fairness in International Law and Institutions* (OUP 2002), 465.

⁵⁹⁷ UN General Assembly Res.1803, Permanent Sovereignty Over Natural Resources, 14 Dec.1962, reprinted in (1963) 2 ILM 223, [4].

⁵⁹⁸ Customary status of this provision is affirmed by sole Arbitrator J.P.Dupuy in *Texaco Over Seas Petroleum Company (TOPCO) v.Libya* (1974) 53 ILR 389, [81]-[86].

⁵⁹⁹ J Waincymer, 'Balancing Property Rights and Human Rights in Expropriation' in PM Dupuy, F Francioni, EU Petersmann (eds), *Human Rights in International Investment Law and Arbitration*, (OUP 2009), 285; O Schacher, *International Law in Theory and Practice* (1991) 324.

⁶⁰⁰ LB Sohn, RR Baxter, 'Responsibility of States for Injury to the Economic Interests of Aliens' (1961) 55 AJIL, 545, 557.

⁶⁰¹ Jennings, Watts, *Oppenheims's International Law* (9th ed Longman 1992), 911. *Marvin Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1, AWARD, December 16, 2002, NAFTA, [98].

However, the term ‘public purpose’ is often used in various meanings, and arbitral tribunals dealing with indirect expropriation claims do not always keep in mind these various uses of the term ‘public purpose’ and their differing legal consequences.

One may distinguish three main usages of the term ‘public purpose’, each of which may lead to different legal consequences that are often perplexed by arbitral tribunals.

The first and logical meaning in which ‘public purpose’ is understood is a State’s motivation for expropriation (or regulation), which is required to serve a public good and not a private interest.⁶⁰² In this sense, the existence of a public purpose serves as a

legitimacy criterion for both non-compensable regulatory measures and expropriation.

If a public purpose of a regulation is missing, the State may be found to act in *mala fide*⁶⁰³ resulting in international responsibility; however, if an expropriatory measure

serves a real public purpose it does not exempt a state from the compensation

requirement. For instance, the Tribunal in *SPP v. Egypt* concluded that ‘[t]he obligation to pay fair compensation in the event of expropriation applies equally where antiquities are involved’,⁶⁰⁴ previously accepting the cancellation of the

investor’s tourism development project due to the inclusion of its territory in the World Heritage List as a clearly legitimate measure.⁶⁰⁵

Very rarely do international tribunals deny the existence of a public purpose of the challenged regulation,⁶⁰⁶ thus respecting the wide discretion of States to consider what is necessary for the public good;⁶⁰⁷ international law is indifferent in this respect.⁶⁰⁸

⁶⁰² For instance, this tenet is established in Article 1(4) of the 1962 UN Declaration on Permanent Sovereignty over Natural Resources, stating that expropriation is to be based on reasons of ‘public utility, security or the national interest, which are recognized as overriding purely individual or private interests, both domestic and foreign’.

⁶⁰³ Andrew Newcombe, ‘The Boundaries of Regulatory Expropriation in International Law’ in Philippe Kahn, Thomas W Waelde (eds), *New Aspects of International Investment Law*, (Martinus Nijhoff, 2007) 417.

⁶⁰⁴ *Southern Pacific Properties (SPP) (Middle East) Limited v. Arab Republic of Egypt*, ICSID ARB/84/3, May 20, 1992, Egypt’s National Law No.43, (*SPP v Egypt*) [159].

⁶⁰⁵ *Ibid* [158].

⁶⁰⁶ One of the few awards where the lack of public purpose was found is *S.D. Myers v Canada* [162], [258] where the Tribunal held that the real intention of the temporary export ban of the chemical was protectionism and not environmental protection. See also *ADC v. Hungary*, ICSID Case No.ARB/03/16, Award, October 2, 2006 [429]. The ADC Tribunal in paragraph 429 notably concluded: ‘In the Tribunal’s opinion, a treaty requirement for „public interest” requires some genuine interest of the public. If mere reference to „public interest” can magically put such interest into existence and therefore satisfy this requirement, then this requirement would be rendered meaningless since the Tribunal can imagine no situation where this requirement would not have been met.’

⁶⁰⁷ *Glamis Gold v.US* [624]-[625], [762], [779]; *Saluka v. Czech Republic*. Partial Award [272]; *S.D. Myers*, Partial Award, [263]. See also *James and Others*, Judgment of February 21, 1986, ECHR 50, [46]; A.R. Çoban., *Protection of property rights within the European Convention on Human Rights*, (Aldershot, Hants, England; Burlington, VT: Ashgate, 2004), 200.

For instance, the arbitral Tribunal in *Saluka v. Czech Republic* has pointed out that there is ‘the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders’⁶⁰⁹ leaving the margin of appreciation open for host States.⁶¹⁰ Similarly, the ECtHR in *James and Others v. UK* noted that in its judicial review of a governmental act it ‘will respect the legislature’s judgment as to what is “in the public interest” unless that judgment be manifestly without reasonable foundation’.⁶¹¹

Secondly, in the case of indirect expropriation, ‘public purpose’ is often confused with the ‘intent to expropriate’, which is rarely present in indirect expropriation cases or even explicitly denied by a State, and it is indeed irrelevant in establishing indirect expropriation.⁶¹²

Thirdly, the existence of ‘public purpose’ as a legitimacy criterion of regulation or expropriation may also be confused with a defending State’s invocation of the customary police powers doctrine that is meant to exclude the application of the expropriation standard in case *bona fide* regulation for public purpose is taken. Nevertheless, application of this doctrine is still unclear as noted by the Tribunal in *Saluka v. Czech Republic*:

*[I]nternational law has yet to identify in a comprehensive and definitive fashion precisely what regulations are considered “permissible” and “commonly accepted” as falling within the police or regulatory power of States and, thus, noncompensable.*⁶¹³

Application and interpretation of the indirect expropriation standard allows integrating customary doctrine of ‘police power’ in a case where no specific treaty provision addresses the limitations of the expropriation clause.⁶¹⁴ This is so since the network of IIAs codifies the indirect expropriation standard that has its origins in the

⁶⁰⁸ S Friedman, *Expropriation in International Law* (Stevens&Sons, 1953), 141 – 144; Restatement Third [712] comment (g) at 200.

⁶⁰⁹ *Saluka Investments BV (The Netherlands) v. The Czech Republic*, UNCITRAL, (Dutch/Czech BIT), Partial Award, 17 March 2006 [305], relying on *S.D. Myers v. Canada*, [263].

⁶¹⁰ Shany, *Towards a General Margin of Appreciation Doctrine in International Law*, 16 *European Journal of International Law*, 2005, 907- 926.

⁶¹¹ *James and Others*, Judgment of February 21, 1986, ECHR 50, [41],[42], [45].

⁶¹² G.C. Christie, ‘What Constitutes a Taking of Property Under International Law’ [1962] 38 *BYIL* 307, 309; *Fireman’s Fund v. Mexico* [176(f)]; *German Interests in Polish Upper Silesia*, Judgement No.7, PCIJ, pp.510, 541 (merits); *National Grid P.L.C. v. Argentine Republic*, UNCITRAL, Award, November 3, 2008 [147].

⁶¹³ *Saluka v. Czech Republic*. Partial Award [263].

⁶¹⁴ *Saluka v. Czech Republic*. Partial award [254].

customary law of expropriation.⁶¹⁵ Some arbitral awards have explicitly followed this stance, e.g., the *SD Myers v. Canada* Tribunal noted that indirect expropriation clause in NAFTA Article 1110 ‘must be interpreted in light of the whole body of state practice, treaties and judicial interpretations of that term in international law cases’.⁶¹⁶ Similarly, the *Saluka v. Czech Republic* Tribunal employed Article 31(3)(c) of the VCLT for integrating the customary police powers in the interpretation of the expropriation clause under the Czech-Netherlands BIT⁶¹⁷ and held that the State is ‘not liable to pay compensation to a dispossessed alien investor when it adopts general regulations that is “commonly accepted as within the police power of States” ’.⁶¹⁸ One may understand the police powers doctrine in both a wider and narrower sense (police powers exceptions).⁶¹⁹

In a broad meaning, police powers of the State encompass non-discriminatory and reasonable regulations by a State that may constitute far-reaching interference with private property but without an expropriatory effect. Christie has formulated police powers regulations in the following way:

*The conclusion that a particular interference is an expropriation might also be avoided if the State whose actions are the subject of complaint had a purpose in mind which is recognized in international law as justifying even severe, although by no means complete, restrictions on the use of property.*⁶²⁰

For instance, shifts in taxation policy, public health regulations, and administration of public utilities and planning of urban and rural development are traditionally accepted as falling within the exercise of police powers in a wider sense.⁶²¹

⁶¹⁵ S Friedman, *Expropriation in International Law* (London, Stevens&Sons Limited, 1953). *Saluka v. Czech Republic* [254].

⁶¹⁶ *S.D.Myers v. Canada*. Partial Award [280]. See also *Saluka v. Czech Republic*. Partial Award [254].

⁶¹⁷ *Saluka v. Czech Republic*. Partial Award [254], Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of The Netherlands and the Czech and Slovak Federal Republic, signed on 29 April 1991.

⁶¹⁸ *Saluka v. Czech Republic* [262]-[263]. See Martins Paparinskis, ‘Investment treaty interpretation and customary investment law: Preliminary remarks’, in Chester Brown, Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (CUP 2011) 89-90. He is criticizing the *Saluka* award for not making a clear distinction between the application of Article 31(3)(c) and Article 31(1) or 31(4) of the VCLT while integrating the customary rules in the interpretation of treaty rules.

⁶¹⁹ A Newcombe, ‘The Boundaries of Regulatory Expropriation in International Law’ in Philippe Kahn, Thomas W Waelde (eds), *New Aspects of International Investment Law* (Martinus Nijhoff 2007), 417, 418, 420-421; see also *EDF (Services) Limited v. Romania*, ICSID Case No. ARB/05/13 (UK/Romania BIT), Award and Dissenting Opinion, 8 October 2009 [308, 311].

⁶²⁰ Christie (1962) 38 BYIL 307, 331.

⁶²¹ R. Jennings, A. Watts, *Oppenheims’s International Law* (9th ed Longman 1992), 911.

3.3.3.1. Police powers exceptions

Under international law, a narrow meaning of customary police powers or police powers exceptions refers to a host State's measures that justify a state's substantial interference with property rights that would otherwise amount to a compensable deprivation of property (also subject to non-discrimination, due process and reasonableness criteria).⁶²² However, application of this doctrine in practice is unclear; for example, the *Pope & Talbots* award held that the expropriation provision of NAFTA Article 1110 'does cover non-discriminatory regulation that might be said to fall within an exercise of a state's so-called police powers'⁶²³ in case a 'substantial deprivation' is found.⁶²⁴

Despite the fact that its application is unclear, state practice and arbitral jurisprudence⁶²⁵ have clarified certain categories of non-compensable exercise of state's police powers in a narrower sense.

The first category is a destruction of property in emergency cases to protect public safety, public health, morals and/or the environment.⁶²⁶ For instance, back in 1894, Brazil destroyed several lots of watermelons belonging to US citizens due to a cholera epidemic. The US did not take up a diplomatic challenge to that action since it held that the measure was justified and non-compensable under the police powers of Brazil.⁶²⁷

A more recent attempt to invoke this police powers exception was undertaken by Tanzania in its defence in *Biwater Gauff v. Tanzania*, where the investor contributed to the crisis by its poor performance of the water and sewage concession. Tanzania argued it had acted within its police powers by expropriating the concession without

⁶²² Newcombe, 'The Boundaries of Regulatory Expropriation', in Kahn, Waelde (2007), 428-429; G.C.Christie G.C., 'What Constitutes a Taking of Property under International Law', 33 BYIL 307 (1962), 335; M Paparinskis, 'Regulatory Expropriation and Sustainable Development', 300. Restatement Third, 211.

⁶²³ *Pope & Talbot v. Canada* [96].

⁶²⁴ *Ibid* [102].

⁶²⁵ For the jurisprudence up to the 1950s see S Friedman, *Expropriation in International Law*, (London, Stevens&Sons Limited, 1953); Sohn and Baxter, 'Responsibility of States for Injury to the Economic Interests of Aliens' (1961) 55 AJIL, 545, at 559- 562. For more recent jurisprudence on police powers see Newcombe, 'The Boundaries of Regulatory Expropriation', in Kahn, Waelde (2007).

⁶²⁶ Bin Cheng, *General Principles of Law as applied by International Courts and Tribunals* (Grotius Publications, 1987) 52-55; Newcombe, 'The Boundaries of Regulatory Expropriation' Newcombe, 'The Boundaries of Regulatory Expropriation', in Kahn, Waelde (2007), 425, referring to Moore, *International Law Digest*, Vol. VI, Section 1003.

⁶²⁷ *Ibid* (Newcombe).

compensation in order to respond to ‘a real threat to public health and welfare’.⁶²⁸ The Tribunal did not directly address this line of argumentation. Nevertheless, it concluded that Tanzania had acted in *mala fide*,⁶²⁹ thus the possible police powers defence lost its legitimacy.

The next category of a well recognized police powers exception is a taking or deprivation of property which is ‘otherwise incidental to the normal operation of the laws of the State’ such as carrying out the judgement of a court in a civil case or a fine or penalty in criminal proceedings’.⁶³⁰ For instance, in *Saluka v. Czech Republic*, the investor was substantially deprived of its investment due to the forced administration of its bank by Czech authorities. The Tribunal justified this interference in the investor’s property as a permissible regulatory action under Czech law.⁶³¹ In this respect the Tribunal stated that:

*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.*⁶³²

Similarly, the ECtHR has classified normal operation of the laws of the State resulting in substantial interference with property rights as a non-compensable ‘control of use of property’. Article 1 of the First Protocol of the European Convention on Human Rights contains the ‘control of use of property’ principle, implying that enjoyment of property rights is necessarily limited ‘with 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’.⁶³³ Thus, in *Agosi v United Kingdom*, that involved a confiscation of illegally imported coins, the ECtHR held that:

⁶²⁸ *Biwater Gauff v. Tanzania*, [436].

⁶²⁹ *Ibid.*, [814].

⁶³⁰ Sohn, Baxter, ‘Responsibility of States for Injury to the Economic Interests of Aliens’ (1961) 55 *AJIL*, 545, at 561; Friedman, *Expropriation in International Law*, (1953), 917; *Middle East Cement v. Egypt* [139]; See also *ADC v. Hungary* [423]; *EDF v. Romania* [311].

⁶³¹ *Saluka Investments BV (The Netherlands) v. The Czech Republic*, UNCITRAL, (Dutch/Czech BIT), Partial Award, 17 March 2006 [258], [262], [267], [276].

⁶³² *Ibid.*, [255].

⁶³³ Article 1 paragraph 2, European Convention for the Protection of Human Rights and Fundamental Freedoms Protocol 1, 1952, 312 UNTS 262; J A Frowein, ‘The Protection of Property’ in R Macdonald, F Matscher and H Petzold (eds) *The European System for the Protection of Human Rights*, (Martinus Nijhoff Publishers, 1993), 516, 520, 525; Ali Riza Coban, *Protection of Property Rights within the European Convention on Human Rights* (ASHGATE, 2004), 137, 171; *Sporrong & Lönnroth v. Sweden*, *Eur. Ct.H.R.* No. 52 (ser.A) (1982), [61]; *Fredin v. Sweden*, Judgement of 18 February 1991, *Eur. Ct.H.R.* No. 192. (Ser. A), [41]; *Matos e Silva, Lda., and Others v. Portugal*,

*The forfeiture of the coins did, of course, involve a deprivation of property, but in the circumstances the deprivation formed a constituent element of the procedure for the control of the use in the United Kingdom of gold coins such as Kruegerrands. It is therefore the second paragraph of Article 1 (P1-1) which is applicable in the present case.*⁶³⁴

The third category of police powers exceptions relates to general taxation that is not intended to be confiscatory, devaluation of the currency and ‘other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory’.⁶³⁵

Lastly, and most importantly for the topic of the thesis, scholars and a limited amount of international jurisprudence distinguish between a customary police powers exception and suppression of previously allowed activity like the prohibition of trade in harmful substances⁶³⁶ that results in driving an investor out of a business.⁶³⁷ For instance, no compensation was paid to those affected by the U.S. alcoholic liquor ban in 1926, since the prohibition was considered to be within ‘police powers’ of the State.⁶³⁸

However, there is no such clarity of the application of this category of police powers for exempting a State from compensation in case substantial deprivation of an investment takes place.

One of the proponents of this category of police powers is the Tribunal in *Feldman v. Mexico*. In *Feldman*, the investor was driven out of its tobacco resale business due to various changes in domestic law that were aimed at fighting the grey market economy. The Tribunal found these shifts in national laws were legitimate and stated:

*Governments in their exercise of regulatory power, frequently change their laws and regulations in response to changing economic circumstances or changing political, economic or social considerations. Those changes may well make certain activities less profitable or even uneconomic to continue.*⁶³⁹

judgment of September 16, 1996, 85, [81]; *Agosi v United Kingdom*, [1986] ECHR 13 (24 October 1986), [48].

⁶³⁴ *Agosi v United Kingdom*, [1986] ECHR 13 (24 October 1986) [48].

⁶³⁵ Restatement Third, Section 712, comment g.

⁶³⁶ Christie (1962), 335; Friedman (1953), 51.

⁶³⁷ Christie (1962) 334-335; Oscar Chinn, PCIJ, 1934, Series A/B, No.63, at p.88, 55. *Feldman v. Mexico* [103].

⁶³⁸ Friedman (1953), 51. See also Christie (1962), 335.

⁶³⁹ *Feldman v. Mexico*, [112].

However, the Tribunal did not find a substantial deprivation of the investor's property since other branches of the investor's business were not affected, therefore the police powers exception was approved in a merely theoretical manner.

On a national level, a similar police powers exception was raised by Australia with respect to its plain packaging law that was challenged by tobacco producers in the Australian High Court.⁶⁴⁰ Australia proposed that the law was aimed at public health protection and, therefore, it was not subject to takings clause in its Constitution. The Court remarked that it was a large proposition, but it was not necessary to consider it further since it found no expropriatory effect of the plain packaging law, and thus the expropriation case was dropped at an early stage.⁶⁴¹

In this study it is argued that the sustainable development objective has the capacity to bring a considerable clarity to the application of this category of police powers exceptions. Namely, in situations where regulatory change takes place after the investment was established in the host country, suppressing previously allowed activity, e.g., responding to changes in scientific knowledge or public expectations.⁶⁴² The necessity to balance economic and non-economic interests provides precise guidelines for filling the expropriation standard with content. In particular, sustainable development considerations have a role to play in establishing the content of the legitimate investment-backed expectations element, which participates in drawing the line between legitimate application of police powers and compensable indirect expropriation (analyzed in detail in Chapter 4).

3.4. METHODOLOGIES DEVELOPED BY ARBITRAL JURISPRUDENCE TO ASSESS WHEN THE REGULATION BECOMES COMPENSATORY (SECOND STEP OF INDIRECT EXPROPRIATION ASSESSMENT)

Using their wide discretion in filling the loose indirect expropriation standard with content in specific cases,⁶⁴³ arbitral tribunals have established several methodologies

⁶⁴⁰ High Court of Australia, *JT International SA v Commonwealth of Australia British American Tobacco Australasia Limited v The Commonwealth* [2012] HCA 43, 15 August 2012, S409/2011 & S 389/2011.

⁶⁴¹ *Ibid.*, p. 97.

⁶⁴² Cf. T.W. Waelde, A.Kolo, 'Environmental Regulations, Investment Protection and 'Regulatory Taking' in International Law,' (2001) 50 ICLQ 811, 839.

⁶⁴³ On arbitral jurisprudence as the main developer of the particular content of the vague investment guarantees see SW Schill, *The Multilateralization of International Investment Law* (CUP 2009) 321-357. See also Ole K Fauchald, 'The Legal Reasoning of ICSID Tribunals – An Empirical Analysis', 19 EJIL (2008) 301.

on how to distinguish non-compensable regulation from indirect expropriation (see Box 1 in the Appendix). These methodologies frequently suffer from confusing the second step (whether there is an expropriation) and the third step (whether the expropriation is legitimate) of indirect expropriation analysis contributing to the obscurity on the content of indirect expropriation and, consequently, often overlooking the variations in the use of the term ‘public purpose’. Further, these methodologies either focus on the context and public interest of the interference in foreign investment or limit themselves to the exclusive focus of the protection of the property rights of foreign investors while disregarding other interests involved.⁶⁴⁴ Thus, they raise uncertainty over the regulatory capacity left for host States.

In essence, sustainable development requires an integrated approach between the economic development aspect, which is traditionally linked with foreign investment protection, and social and environmental elements of investment protection. Therefore, the aim of the section is to assess the compatibility of the methodologies used for the interpretation of the indirect expropriation standard with the sustainable development objective and principle. The analysis focuses on the scope of interests the methodologies allow to take into account in examining the existence of indirect expropriation and whether these methodologies would now qualify as *bona fide* and effective reading of the indirect expropriations standard guided by the principle of sustainable development.

The section will analyse in turn the ‘sole effects’, ‘proportionality’ and ‘context’ doctrines.

3.4.1. ‘Sole effects’ doctrine for the assessment of the existence of indirect expropriation

‘Sole effect’ doctrine⁶⁴⁵ focuses exclusively on the degree to which the governmental measure deprives the investor of its investment in order to establish the existence of

⁶⁴⁴ Continental Casualty v. Argentina, Decision on Jurisdiction, ICSID Case No.ARB/03/9, February 22, 2006, [277].

⁶⁴⁵ The phrase was invented by Rudolf Dolzer, ‘Indirect Expropriations: New Developments?’ (2002) 11 New York University Environmental Law Journal 64, 79–80.

indirect expropriation⁶⁴⁶ and to distinguish non-compensable regulation from indirect expropriation.⁶⁴⁷

As Paparinskis has remarkably mentioned, ‘if indirect expropriation is viewed through the lens of direct expropriation, it is natural to look at the effect of State’s conduct’,⁶⁴⁸ since ‘substantial deprivation’ of foreign investment by a regulation is an essential requirement to qualify a state’s act as expropriatory.⁶⁴⁹ However, the sole focus on the detrimental effect on a foreign investment allows overly broad interpretation of the prohibition of indirect expropriation disproportionately limiting the State’s capacity to safeguard people and the environment.

Thus, for instance, the textbook example of ‘sole effects’ award is *Metalclad v. Mexico*.⁶⁵⁰ The dispute emerged from the rejection by Mexico to grant an operation permit for the previously approved hazardous waste landfill project, which met severe local resistance. The Tribunal evaluated, *inter alia*, the Ecological Decree issued by the local municipality establishing a rare cactus protection area on the investor’s property. The Tribunal held that the analysis of the Ecological Decree was not strictly necessary or essential but it served ‘as a further ground for a finding of expropriation’. In this respect, the Tribunal found expropriatory effect of the Decree since it prohibited any commercial activity on the investor’s property and pronounced that it need ‘not decide or consider the motivation or intent of the adoption of the Ecological Decree’⁶⁵¹ in order to establish indirect expropriation.

⁶⁴⁶ Rosalyn Higgins, ‘The Taking of Property by the State: Recent Development in International Law’ (1982) 3 *Recueil des Cours* 176, 331.

⁶⁴⁷ LY Fortier and SL Drymer ‘Indirect Expropriation in the Law of International Investment: I Know It When I See It, or *Caveat Investor*’ (2004) 19 *ICSID Rev – Foreign Investment L J* 293 at 300: ‘From this perspective, a valid police power regulation is a measure that does not have a sufficiently restrictive effect on property rights to constitute expropriation. Conversely, an expropriation will be found to have occurred where a regulatory measure, or series of measures, is sufficiently restrictive.’

⁶⁴⁸ M Paparinskis, ‘Regulatory Expropriation and Sustainable Development’ in Marie-Claire Cordonier Segger, Markus W Gehring, Andrew Newcombe (eds), *Sustainable Development in World Investment Law* (Kluwer 2011) 300.

⁶⁴⁹ Y Fortier and SL Drymer, ‘Indirect Expropriation in the Law of International Investment: I know It When I See It, or *Caveat Investor*’ (2004) 19 *ICSID Review-FILJ* 293, 305; W Michael Reisman, Robert D Sloane, ‘Indirect Expropriation and its Valuation in the BIT Generation’, 74 *BYIL* (2004) 115-150.

⁶⁵⁰ *Metalclad Corporation v The United Mexican States*, ICSID Case No.ARB(AF)/97/1, Award August 30, 2000, NAFTA.

⁶⁵¹ *ibid* [111]. For a criticism of the Metalclad approach see The Supreme Court of Columbia, judgment of 2 May 2001 [99] <<http://ita.law.uvic.ca/documents/Metalclad-BCSCReview.pdf>> accessed on 20 November 2012. See also M Sornarajah, ‘A Coming Crisis: Expansionary Trends in Investment Treaty Arbitration’ in Karl P Sauvant (ed), *Appeals Mechanisms in International Investment Disputes* (OUP 2008), 39-45.

The Tribunal did not reflect on any qualifying elements for finding indirect expropriation. It did not consider the possible application of customary police powers exceptions, albeit the facts of the case suggest the Decree would not be justified as a police powers exception due to the lack of *bona fide*. The Tribunal also did not analyze the scope of the legitimate expectations of the investor, e.g., whether it was reasonably foreseeable that such a measure might be issued by the Municipality.

Coupled with the unlimited indirect expropriation definition established earlier in the award,⁶⁵² which was criticized as overly broad by the judge of the Supreme Court of British Columbia,⁶⁵³ and the later *Fireman Funds v. Mexico* award,⁶⁵⁴ the reasoning of the *Metalclad* Tribunal allows classifying as expropriatory almost every environmental and social regulation detrimentally affecting foreign investors. Such an interpretation of the indirect expropriation standard generates room for a conflict between the State's investment protection obligations and the State's regulatory responsibilities by permitting a suggestion that the interest of protecting foreign investment might trump the interest of protecting competing non-economic public interest.

Another exemplary 'sole effects' award is *Vivendi v. Argentina* (Resubmitted).⁶⁵⁵ In *Vivendi*, the claim arose out of the troubled relationship between the parties to a concession agreement that privatized the water and sewage services of the Province of Tucumán in Argentina. The problems arose out of complex factual issues such as the increase of the tariffs by the investor and two incidents of water turbidity. Argentina claimed that its treatment of the investor, i.e. terminating the concession and supporting the customers not to pay the bills for contaminated water, fell within its regulatory activity 'and that this is even more so the case when the service provided is as vital as the provision of water and sewage services'.⁶⁵⁶

⁶⁵² Ibid [103], where the Tribunal declared that 'expropriation under NAFTA includes [...] 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'.

⁶⁵³ The Supreme Court of Columbia, judgment of 2 May 2001, *United Mexican States v. Metalclad Corporation*, 2001 BCSC 664 [99], available at: <http://ita.law.uvic.ca/documents/Metalclad-BCSCReview.pdf>.

⁶⁵⁴ *Fireman's Fund Insurance Company v. Mexico*, Award, NAFTA, ICSID Case No.ARB(AF)/02/01, 17 July 2006 [177] footnote 164.

⁶⁵⁵ *Compañía de Aguas del Aconquija S.A and Vivendi Universal v Argentine Republic*, ICSID Case No.ARB/97/3, Award 20 August 2007, Resubmitted.

⁶⁵⁶ Ibid [3.3.3]- [3.3.5].

The Tribunal took a different approach and focused merely on the effects of the governmental measures, stating:

*There is extensive authority for the proposition that the state's intent, or its subjective motives are at most a secondary consideration (...) While intent will weigh in favour of showing a measure to be expropriatory, it is not a requirement, because the effect of the measure on the investor, not the state's intent, is the critical factor.*⁶⁵⁷

Even if it is true that there is no need to establish the intent to expropriate, which is rarely present in indirect expropriation cases or even explicitly denied by a State,⁶⁵⁸ the *Metalclad* and *Vivendi* awards have unduly diminished the public purpose element and the general context of the interference in foreign investment to the intent to expropriate. In addition, the *Vivendi* award went on by stating that '[i]f public purpose automatically immunises the measure from being found to be expropriatory, then there would never be a compensable taking for a public purpose'.⁶⁵⁹

This reasoning is problematic for the following reasons. Even if it is true that 'substantial deprivation' of foreign investment is an essential requirement to qualify a state's act as expropriatory, there are certain limitations to this stance. These limitations are the customary police powers exceptions ('exceptions' in this case is meant understanding not a legal instrument that allows to shift a burden of proof from one party to another but a commonly accepted subset of State measures that despite their deprivatory effect are non-compensable⁶⁶⁰) and the inner flexibility of the sub-elements of the indirect expropriation standard like legitimate investment-backed expectations, allowing a limit to the scope of indirect expropriation. These are essential elements for taking into account the sustainable development objective of investment protection law.

Within the limits of the particular cases, both the *Metalclad* and *Vivendi* awards overlook the application of the possible customary police powers exceptions and

⁶⁵⁷ Ibid [7.5.20] (footnote omitted), see also [7.5.34].

⁶⁵⁸ GC Christie, 'What Constitutes a Taking of Property under International Law' 38 BYIL 307 (1962) 307, 309.

⁶⁵⁹ *Vivendi v Argentina* (Resubmitted) [7.5.21].

⁶⁶⁰ A.Newcombe, 'The Boundaries of Regulatory Expropriation in International Law' (2007) 4 TDM 4, available at transnational-dispute-management.com.

seemingly confuse legitimacy criteria for the already established expropriation with the very establishment of the existence of indirect expropriation.⁶⁶¹

Defending States (like Mexico and Argentina in the above-mentioned awards) usually emphasize the existence of ‘public purpose’ as an indicative element of the application of customary police powers⁶⁶² that is subject to a legitimacy assessment by tribunals and may exempt the governmental measure from being classified as expropriation.

Notwithstanding uncertainty as to its application, it is a general principle that a State bears no responsibility for economic injury done to an alien within the commonly accepted police powers of the State.⁶⁶³ In a general or wider sense, police powers encompass all non-discriminatory and reasonable regulations for public purpose under the State’s sovereign powers without the effect of substantial deprivation of foreign investment.⁶⁶⁴ A narrower formulation of police powers (police powers exceptions) covers those internationally recognized measures that justify a state’s substantial interference with property rights, which would otherwise amount to a compensable deprivation of property,⁶⁶⁵ as far as these measures are non-discriminatory, reasonable and follow the due process of law.⁶⁶⁶

⁶⁶¹ This confusion of the second and third step of the assessment of the indirect expropriation claim is reflected in *Vivendi v Argentina* (Resubmitted) [7.5.21]: ‘If we conclude that the challenged measures are expropriatory, there will be violation of Article 5(2) of the Treaty, even if the measures might be for a public purpose and non-discriminatory, because no compensation has been paid’.

⁶⁶² On customary police powers, see Andrew Newcombe, ‘The Boundaries of Regulatory Expropriation in International Law’ in Philippe Kahn, Thomas W Waelde (eds), *New Aspects of International Investment Law* (Martinus Nijhoff 2007) 417, 420-421; Sir Robert Jennings, Sir Arthur Watts, *Oppenheims’s International Law* (9th ed Longman 1992) 911.

⁶⁶³ *Saluka Investments BV (The Netherlands) v. The Czech Republic*, UNCITRAL, (Dutch/Czech BIT), Partial Award, 17 March 2006 [302]. See also *Methanex v. United States*, UNCITRAL (NAFTA) Final Award, 3 August 2005, Part IV - Chapter D - Page 4 [7]; *S.D.Myers, Inc. v Government of Canada*, Partial Award, November 13, 2000, NAFTA, UNCITRAL [281]; *Técnicas Medioambientales Tecmed S.A. v The United Mexican States* (ICSID Case No. ARB (AF)/00/2), Award of 29 May 2003 (Spain/Mexico BIT) [119]; GC Christie, ‘What Constitutes a Taking of Property under International Law’ (1962) 38 BYIL 307 at 309, 331.

⁶⁶⁴ Andrew Newcombe, ‘The Boundaries of Regulatory Expropriation in International Law’ in Philippe Kahn, Thomas W Waelde (eds), *New Aspects of International Investment Law* (Martinus Nijhoff 2007) 417-418.

⁶⁶⁵ *ibid* 418.

⁶⁶⁶ These categories are (1) destruction of property in emergency cases to protect public safety, public health, morals and/or environment; (2) a taking or deprivation of property which is otherwise incidental to the normal operation of the laws (3) general taxation, which is not confiscatory, or currency devaluation; and (4) suppression of activities (e.g. driving out of business) like the prohibition of harmful substances or activities. See S Friedman, *Expropriation in International Law* (Stevens&Sons 1953), LB Sohn, RR Baxter, ‘Responsibility of States For Injury to the Economic Interests of Aliens’ (1961) 55 AJIL 545, 559- 562; GC Christie, ‘What Constitutes a Taking of Property under International Law’ (1962) 38 BYIL 307 at 334-338; Andrew Newcombe, ‘The

Thus, the exclusive focus on the detrimental effect permits an overly broad interpretation of the indirect expropriation standard, disproportionally limiting the State's capacity to safeguard non-economic public interests, or it can even suggest that the interest of protecting foreign investment trumps the responsibilities of the host State to safeguard non-economic public interests. Consequently, some 'new generation' IIAs clearly integrate the need to move away from the 'sole effects' approach.⁶⁶⁷ Thus, some new generation IIAs declare that 'although the fact that an action or series of actions by a Member State has an adverse effect on the economic values of an investment, standing alone, does not establish that such an expropriation has occurred',⁶⁶⁸ requiring a determination of other relevant factors like the character of the governmental action and legitimate expectations.

Similarly, several 'new generation' IIAs supplement the indirect expropriation clause with an explanation that 'non-discriminatory regulatory measures of a Member State that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations'.⁶⁶⁹ One may consider these explanatory sentences as a codification of customary police powers in 'new generation' IIAs. However, some IIAs supplement this kind of clause with a phrase that 'except in rare circumstances' these measures will not be considered as expropriatory,⁶⁷⁰ adding some confusion to the clarity of drawing the line between non-compensable regulation and indirect expropriation.⁶⁷¹ Only Canada Model BIT contains an explanation that 'except in rare circumstances' relates to the existence of an 'individual and excessive burden' on foreign investor'.⁶⁷²

Boundaries of Regulatory Expropriation in International Law' in Philippe Kahn, Thomas W Waelde (eds), *New Aspects of International Investment Law* (Martinus Nijhoff 2007) 425-429.

⁶⁶⁷ UNCTAD, *World Investment Report 2010. Investing in A Low-Carbon Economy* (New York and Geneva, UN, 2010) 85-87; Suzanne A Spears, 'The Quest for Policy Space in a New Generation of International Investment Agreements' (2010) 13 JIEL 4, at 1037, 1051.

⁶⁶⁸ For instance, ASEAN Comprehensive Investment Agreement in its Annex 2, paragraph 3(a) <[http://www.aseansec.org/documents/ASEAN%20Comprehensive%20Investment%20Agreement%20\(ACIA\)%202012.pdf](http://www.aseansec.org/documents/ASEAN%20Comprehensive%20Investment%20Agreement%20(ACIA)%202012.pdf)> accessed on 20 November 2012; US-Colombia FET, Annex 10-B, paragraph 3(a)(i).

⁶⁶⁹ ASEAN Comprehensive Investment Agreement Annex 2, paragraph 4.

⁶⁷⁰ COMESA Common Investment Area Agreement (CIAA) 2007, Article 20(8) (explicitly referring to the customary police powers doctrine); US Model BIT, Annex B. 4(b), Canada Model BIT, Annex B.13(1)(c) (specifying 'rare circumstances' as individual and excessive burden on an affected investor); US-Colombia FET Annex 10-B 3(b).

⁶⁷¹ For a criticism of these clauses see M Paparinskis, 'Regulatory Expropriation and Sustainable Development' in Marie-Claire Cordonier Segger, Markus W Gehring, Andrew Newcombe (eds), *Sustainable Development in World Investment Law* (Kluwer 2011), 321-323.

⁶⁷² Canada Model BIT, Annex B.13(1)(c) (specifying 'rare circumstances' as an individual and excessive burden on an affected investor).

Few other ‘new generation’ IIAs explicitly indicate that a public purpose as a legitimacy criterion of indirect expropriation refers to a concept in customary international law and shall be interpreted in accordance with international law.⁶⁷³

There is not yet an interpretation of these kinds of clauses in arbitral jurisprudence; however, they are apparently aimed at codifying customary police powers doctrine and indicating the necessity to move away from the sole effect approach.

To conclude, the pure ‘sole effects doctrine’ leaves no room for non-economic public interest concerns entering into the legal process of deciding whether or not the taking of an investment has occurred. Thus, without disagreeing with the outcome of the awards, the sole effects approach that the *Metalclad* and *Vivendi* Tribunals applied in reaching their conclusions contradicts the sustainable development principle requiring integration of economic, social and environmental matters.

Instead of a careful balance between the contradicting interests of States and investors, the sole effects doctrine leaves the impression that foreign investment protection might trump the protection of other societal interests,⁶⁷⁴ contributing to the concerns of fragmentation of international investment law and regulatory chill in the host countries.⁶⁷⁵ These tensions in their turn have contributed to the hostility against investment treaty arbitration being made material by, for instance, Bolivia, Venezuela, Ecuador and Australia.⁶⁷⁶

Therefore, the ‘sole effects’ approach is no longer a suitable methodology for establishing the existence of indirect expropriation. In its place, sustainable development context of investment protection necessitates methodologies that integrate the surrounding circumstances of the interference in the investor’s property and other qualifying elements, like the exercise of customary police powers, the

⁶⁷³ US-Colombia FET, Article 10.7.(1)(a) footnote 5; Canada –Colombia FET, Article 811(7).

⁶⁷⁴ See Howard Mann, ‘Private Rights, Public Problems: A Guide to NAFTA’s Controversial Chapter on Investor Rights’ at 32-33, IISD Website <http://www.iisd.org/pdf/trade_citizensguide.pdf> accessed 20 November 2012.

⁶⁷⁵ M Sornarajah, ‘A Coming Crisis: Expansionary Trends in Investment Treaty Arbitration’ in Karl P Sauvant (ed), *Appeals Mechanisms in International Investment Disputes* (OUP 2008) 39-45.

⁶⁷⁶ TDM News, Issue 1, Week 05, 31 January 2012, <<http://www.transnational-dispute-management.com/news/tdmnewsdigest.htm>> accessed 20 November 2012; J Kurtz, ‘The Australian Trade Policy Statement on Investor-State Dispute Settlement, ASIL Insights, August 2, 2011, Volume 15, Issue 22 <<http://www.asil.org/insights110802.cfm>> accessed 3 August 2012; ICSID News Release, Bolivia Submits a Notice Under Article 71 of the ICSID Convention, May 16, 2007, available at <http://www.worldbank.org/icsid/highlights/05-16-07.htm>, ICSID News Release, Ecuador’s notification Under Article 25 (4) of the ICSID Convention, Dec.5, 2007, available at <http://www.worldbank.org/ICSID/Index.jsp>.

character of the governmental action and the scope of investor's legitimate expectations,⁶⁷⁷ in the assessment of the existence of indirect expropriation.

3.4.2. Proportionality doctrine

One may call the second method that is developed by arbitral jurisprudence for establishing the existence of indirect expropriation a proportionality doctrine since it argues for proportionality (or balancing) between the importance of the public purpose and the effects on the investor by the measure.

In investor-state arbitration, the proportionality approach in the assessment of indirect expropriation was first developed by the Tribunal in *Tecmed v. Mexico*.⁶⁷⁸ The *Tecmed* case dealt with the non-renewal of the investor's operation licence of a hazardous waste facility. Mexico classified the non-renewal as a legitimate regulatory measure within the highly regulated and extremely sensitive framework of environmental protection and public health.⁶⁷⁹

Similar to *Metalclad v. Mexico*, the Tribunal stressed the paramount importance of the effect of the state's regulation to decide whether indirect expropriation took place.⁶⁸⁰ The Tribunal found a significant deprivation of the investment by the Municipality's non-renewal of the licence, since it made the investor's assets and rights impossible to exploit, depriving them of any economic value.

However, in contrast to *Metalclad v. Mexico*, the Tribunal proceeded with the analysis of the alleged expropriatory character of the governmental action (as it was required under the applicable BIT between Spain and Mexico⁶⁸¹) and analyzed the Municipality's motives for the non-renewal of the licence that Mexico claimed to be an environment protection and social emergency.⁶⁸²

⁶⁷⁷ US-Colombia FET, Annex 10-B, paragraph 3(a). See also Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic, Decision on Liability, 30 July 2010, ICSID Case No. ARB/03/19, UNCITRAL Rules [134].

⁶⁷⁸ Técnicas Medioambientales Tecmed S.A. v. The United Mexican States (ICSID Case No. ARB (AF)/00/2), Award of 29 May 2003 (Spain/Mexico BIT), [122].

⁶⁷⁹ Técnicas Medioambientales Tecmed S.A. v The United Mexican States (ICSID Case No. ARB (AF)/00/2), Award of 29 May 2003 (Spain/Mexico BIT) [97].

⁶⁸⁰ *ibid* [115].

⁶⁸¹ *Ibid* [115]. The Agreement on the Reciprocal Promotion and Protection of Investments signed by the Kingdom of Spain and the United Mexican States (December 18, 1996) Section 5(1): 'any other measure with similar characteristics or effects'.

⁶⁸² *ibid* [97], [121], [122], [125].

Tecmed's argumentation on the character of the non-renewal of the licence may be divided into two parts.

First, in the context of the social emergency argument, the Tribunal approved as undisputable the principle that 'the State's exercise of its sovereign powers within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling them to any compensation'.⁶⁸³ Since the Tribunal found no evidence supporting allegations by Mexico that the claimant's actions had raised a real social crisis in the municipality, the application of the non-compensable police powers exception was rejected,⁶⁸⁴ as noted in the paragraph 147 of the Award:

The actions undertaken by the authorities to face these socio-political difficulties, where these difficulties do not have serious emergency or public hardship connotations, or wide-ranging and serious consequences, may not be considered from the standpoint of the Agreement or international law to be sufficient justification to deprive the foreign investor of its investment with no compensation [...].

So, the *Tecmed* Tribunal approved the existence of police powers in the narrower sense, namely, the conditions under which even the substantial deprivation of the investor's property is non-compensable. However, the *Tecmed* Tribunal did not consider the alleged environmental emergency as falling under the exercise of police powers in a narrower sense.

Second, as regards the environmental protection motivation for the termination of the licence, the Tribunal stated that the exercise of the State's regulatory powers is subject to legitimacy review under international law,⁶⁸⁵ since:

*[W]e find no principle stating that regulatory administrative actions are per se excluded from the scope of the Agreement, even if they are beneficial to society as a whole —such as environmental protection—, particularly if the negative economic impact of such actions on the financial position of the investor is sufficient to neutralize in full the value, or economic or commercial use of its investment without receiving any compensation whatsoever.*⁶⁸⁶

⁶⁸³ *ibid* [119]. In paragraph 139, the Tribunal explained that under international law expropriation would not be found in a case where the substantial interference in property was done because of a serious urgent situation, crisis, need or social emergency.

⁶⁸⁴ *Tecmed v Mexico* [144], [146], referring to *Case Elettronica Sicula S.p.A (ELSI) (United States of America v. Italy)*, July 20, 1989, ICJ Reports, 1989 and [147].

⁶⁸⁵ *ibid* [120].

⁶⁸⁶ *ibid* [121] referring to *Compañía del Desarrollo de Santa Elena, S.A. v Republic of Costa Rica*, ICSID case No. ARB/96/1 [72], which represents the 'sole effects' approach.

As a next step, the Tribunal famously held that for a domestic measure to be legitimate under international law ‘[t]here 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’.⁶⁸⁷ The Tribunal continued:

*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.*⁶⁸⁸

For this reason, the Tribunal examined whether the investor had to bear ‘an individual and excessive burden’⁶⁸⁹ holding that it actually had since the termination of the licence did not serve the stated environmental protection purpose but was rather a politically motivated action,⁶⁹⁰ the investor was deprived of its property and no compensation was received by the investor.⁶⁹¹ Even more, the Tribunal took into account that previously, when the investor was found to violate the licence, the responsible authorities applied a fine that was deemed to be reasonable and appropriate to the importance of the violation.⁶⁹² Therefore, the investor was found to bear ‘an individual and excessive burden’ and the expropriation was considered to be illegal.

In essence, the *Tecmed* Tribunal used proportionality analysis as a legitimacy criterion of the exercise of the State’s regulatory powers, suggesting that in case there is a substantial deprivation of foreign investment, payment of compensation is a necessary element of the achievement of proportionality. Thus, the Tribunal linked proportionality balancing with the level of interference in foreign investment and whether the interference is compensated or not.

It is argued here that there is a methodological problem with the *Tecmed*’s employment of the proportionality analysis. First of all, the *Tecmed* Tribunal provided no argumentation as to why the Tribunal deemed it appropriate to refer to the jurisprudence of the ECtHR and its proportionality analysis, and why such a reference

⁶⁸⁷ *Tecmed v Mexico* [122].

⁶⁸⁸ *ibid.*

⁶⁸⁹ *ibid* [122], footnote 143.

⁶⁹⁰ *ibid* [127]. To compare, the Tribunal in *AES Summit Generation Limited v. The Republic of Hungary*, ICSID Case No. ARB/07/22, Award, September 23, 2010 [10.3.24], where in the assessment of the reasonableness of the governmental action the arbitrators noted, ‘it is normal and common that a public policy matter becomes a political issue; that is the arena where such matters are discussed and made public’.

⁶⁹¹ *ibid* [149].

⁶⁹² *Ibid* [124]. See also [149].

was justified under the applicable BIT.⁶⁹³ Thus, for instance, the Tribunal in *Fireman's Fund Insurance Company v. Mexico* has referred to the *Tecmed* award and has challenged the applicability of proportionality analysis under NAFTA in interpreting the indirect expropriation standard:

*The factor [proportionality analysis] is used by the European Court of Human Rights [...] and it may be questioned whether it is a viable source of interpreting Article 1110 of the NAFTA.*⁶⁹⁴

Hence, one may suggest the *Tecmed* proportionality analysis was an autonomous interpretation of the applicable treaty provision. Nevertheless, the *Tecmed* approach of introducing the language of proportionality in the indirect expropriation standard has been adopted by several later arbitral awards.⁶⁹⁵

Thus, the Tribunal in *Azurix v. Argentina* case,⁶⁹⁶ which developed from various governmental activities related to the concession agreement of water and sewage systems, addressed the question of whether a measure that is legitimate and serving a public purpose can amount to a compensation claim under the expropriation standard.⁶⁹⁷ The *Azurix* Tribunal was confused with the principle that states 'are not liable for economic injury that is the consequence of bona fide regulation within the accepted police powers of the State'.⁶⁹⁸ The Tribunal did not see the difference between the second and the third step of indirect expropriation assessment, as one may see in the following quote:

⁶⁹³ S R Ratner, 'Regulatory Takings in Institutional Context: Beyond the Fear of Fragmented International Law' (2008) 102 AJIL 3, 475, at 527. Erlend M. Leonhardsen, on his part, suggests that the Tribunal could have explained whether it considered the proportionality analysis as a general principle of international law or as an outcome of systemic integration (Article 31(3)(c)), see Erlend M. Leonhardsen, 'Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration' (2012) 3 Journal of International Dispute Settlement 1, 95-136, at 123.

⁶⁹⁴ *Fireman's Fund Insurance Company v. Mexico*, Award, NAFTA, ICSID Case No.ARB(AF)/02/01, 17 July 2006, para.174(j), footnote 161.

⁶⁹⁵ The most recent, and also most controversial, approval of it is *Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award 5 October 2012 [404], [406] – [408]. The Tribunal incorporated the proportionality assessment in FET standard referring to the wide use of proportionality analysis in human rights, European law, WTO law and in a growing body of arbitral law [402]-[404]. The Tribunal stated that it 'has no doubt that the principle of proportionality is applicable as a matter of general international law, and has been applied in many ICSID arbitrations in the past'[427]. For criticism see L E Peterson, 'Liability ruling in Oxy v. Ecuador arbitration puts spotlight on need for states to mete out treatment that is proportionate', Investment Arbitration Report, October 9, 2012 indicating insufficient reasoning on the allegation that proportionality analysis is a customary norm.

⁶⁹⁶ *Azurix Corp. v. the Argentine Republic*, ICSID Case No.ARB/01/12, Award, July 14, 2006.

⁶⁹⁷ *Ibid* [301].

⁶⁹⁸ *Ibid* [310]-[311].

*The argument made by the S.D. Myers tribunal is somehow contradictory. According to it, the BIT would require that investments not be expropriated except for a public purpose and that there be compensation if such expropriation takes place and, at the same time, regulatory measures that may be tantamount to expropriation would not give rise to a claim for compensation if taken for a public purpose.*⁶⁹⁹

Since the Tribunal did not see the difference between the establishment of the very existence of indirect expropriation and the assessment of legitimacy of regulatory measures or expropriation, it decided to complement the public purpose criterion with the proportionality test requiring to ‘bear a reasonable relationship of proportionality between the means employed and the aim sought to be realized’.⁷⁰⁰ The Tribunal stated that ‘these additional elements provide useful guidance for purposes of determining whether regulatory actions would be expropriatory and give rise to compensation’.⁷⁰¹ The expropriation claim was rejected because the investor did not lose the attributes of ownership⁷⁰² and, thus, there was no expropriatory effect. Therefore, the Tribunal did not apply the proportionality analysis in practice.

In *LG&E Energy v. Argentina*, which developed from Argentina’s crisis management measures that affected the privatized natural-gas transport and distribution service, the Tribunal stated ‘that there must be a balance in the analysis both of the causes and the effects of a measure in order that one may qualify a measure as being of an expropriatory nature’.⁷⁰³ The Tribunal referred to the *Tecmed* balancing requirement between two competing interests – ‘the degree of the measure’s interference with the right of ownership and the power of the State to adopt its policies’⁷⁰⁴ – in order to draw the line between expropriation and legitimate regulation. The *LG&E* Tribunal noted:

With respect to the power of the State to adopt its policies, it can generally be said that the State has the right to adopt measures having a social or general welfare purpose. In such a case, the measure must be accepted without any imposition of

⁶⁹⁹ Ibid[311].

⁷⁰⁰ Ibid [311] footnote 257 referring to *James and Others*, sentence of February 21, 1986 [50], [63], and *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States* (ICSID Case No. ARB(AF)/00/2) [121]-[122].

⁷⁰¹ Ibid [312].

⁷⁰² Ibid [322].

⁷⁰³ Ibid [194].

⁷⁰⁴ *LG&E v. Argentina*, Decision on Liability, 3 October 2006, ICSID Case No. ARB/02/1, Argentina – US BIT 1991, [189].

*liability, except in cases where the State's action is obviously disproportionate to the need being addressed.*⁷⁰⁵

It continued by reference to paragraph 122 of the *Tecmed v. Mexico* award and stated that the degree of interference in the foreign investment ‘has a key role upon deciding the proportionality’.⁷⁰⁶

Since the Tribunal did not find a substantial deprivation of LG&E’s investment,⁷⁰⁷ it did not elaborate more on the characteristics of Argentina’s measures, namely, the context and the host State’s purpose and their proportionality to the interference in foreign investment.

Similarly, in *Continental Casualty v. Argentina*, which arose out of the pesification of financial assets and devaluation of the peso as tools for fighting the social and economic crisis in Argentina in 2001-2002, the Tribunal proposed proportionality analysis as a legitimacy criterion of the exercise of the State’s regulatory powers.

The *Continental* Tribunal considered doctrinal approaches for drawing the line between expropriation and non-compensable legitimate regulatory interference in property rights.⁷⁰⁸ The Tribunal stated that governmental regulations do not rise to State liability provided that they do not affect property in an intolerable, discriminatory or disproportionate manner,⁷⁰⁹ namely, in cases where ‘these restrictions do not impede the basic, typical use of a given asset and do not impose an unreasonable burden on the owner as compared with other similarly situated property owners’.⁷¹⁰

As a result, and since these governmental actions did not amount to expropriatory effect,⁷¹¹ the Tribunal held that the pesification of the investor’s deposits fell under the monetary sovereignty of Argentina as ‘typical government regulations of property entailing mostly inevitable limitations imposed in order to ensure the rights of others or of the general public’.⁷¹²

⁷⁰⁵ Ibid [195], referring to *Tecmed v. Mexico* [122].

⁷⁰⁶ Ibid.

⁷⁰⁷ Ibid [194], [195].

⁷⁰⁸ *Continental Casualty v. Argentina*, [276].

⁷⁰⁹ Ibid, [276], footnote 406 referring to Art. 1, First Protocol to the ECHR; US Model BIT 2004, Annex B [Expropriation]; Restatement Third comment (g) at 200; OECD, *International Investment Law, A Changing Landscape* (2005), Chapter 2 “Indirect Expropriation” and the “Right to Regulate” in *International Investment Law*’ 43-72.

⁷¹⁰ Ibid, [276].

⁷¹¹ Ibid [284].

⁷¹² *Continental Casualty v. Argentina*, [276], [278].

In *EDF v. Romania*,⁷¹³ which dealt with the anti-corruption regulation abolishing duty-free activities within airports, the Tribunal admitted that the measure was falling within police powers of the State taken in the legitimate public interest since the measure was directed at fighting corruption.⁷¹⁴ Nevertheless, for the exercise of police powers to be legitimate, the Tribunal added:

*[I]n addition to a legitimate aim in the public interest there must be “a reasonable relationship of proportionality between the means employed and the aim sought to be realized”; that proportionality would be lacking if the person involved “bears an individual and excessive burden.”*⁷¹⁵

The Tribunal held that the proportionality requirement was met and there was no individual and excessive burden on the investor because the prohibition of the duty-free operations affected only a limited part of the investor’s business activity.⁷¹⁶

Finally, the very recent *Occidental v. Ecuador* award,⁷¹⁷ dealing with Ecuador’s termination of a participation contract because of the investor’s improper transfer of a share without governmental authorization for the transfer of rights, required that:

*[A]ny such administrative goal must be balanced against the Claimants’ own interests and against the true nature and effect of the conduct being censured. The Tribunal finds that the price paid by the Claimants – total loss of an investment worth many hundreds of millions of dollars – was out of proportion to the wrongdoing alleged against OEPC, and similarly out of proportion to the importance and effectiveness of the “deterrence message” which the Respondent might have wished to send to the wider oil and gas community.*⁷¹⁸

Accordingly, the Tribunal found violations of both the FET standard and the indirect expropriation standard.⁷¹⁹

3.4.2.1. Critical Assessment of the Tecmed’s proportionality analysis

⁷¹³ *EDF (Services) Limited v. Romania*, ICSID Case No. ARB/05/13, Award, October 8, 2009.

⁷¹⁴ *Ibid* [311].

⁷¹⁵ *Ibid* [293]. Here the Tribunal referred to *Azurix Corp. v. The Argentina Republic*, Award of July 14, 2006 [311] quoting *James v. United Kingdom* [50] and [63].

⁷¹⁶ *EDF v. Romania* [293] referring to *Azurix Corp. v. The Argentina Republic*, Award of July 14, 2006, [293], [311].

⁷¹⁷ *Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award 5 October 2012.

⁷¹⁸ *Ibid* [450].

⁷¹⁹ *Ibid* [455].

On the whole, the *Tecmed* award can be praised for introducing the language of balancing between the interests of the State and those of the investor within the indirect expropriation standard⁷²⁰ that was adopted in several later arbitral awards.

Nevertheless, the practical application of the *Tecmed* proportionality analysis does not help to bring clarity for distinguishing between a non-compensable regulation and a compensable expropriation, by taking into account a broader context other than the economic one, in order to avoid regulatory chill detrimentally affecting local and international community.

This is so since the Tribunal had established that the key aspect of its proportionality assessment and its ‘individual and excessive burden’ element is the level of interference in the foreign investment and whether the interference was compensated or not.

To be exact, the way the ‘individual and excessive burden’ test was applied by *Tecmed* (and its approving awards) indicates that the proportionality criterion would not be met in the case of an investor who did not receive compensation for a substantial deprivation of its investment. Even if the compliance with the public interest requirement was met (which was not the case at hand), the failure to pay compensation for the substantial interference with property rights would render the deprivation non-proportional.⁷²¹ Thus, the *Tecmed* Tribunal had used proportionality analysis as a legitimacy criterion of expropriation, suggesting that in case there is a substantial deprivation of foreign investment, the payment of compensation is a necessary element for the achievement of proportionality and, thus, legitimacy.

That is a circular argument going back to the ‘sole effects’ approach: the proportionality assessment is minimized to the legitimacy evaluation of the governmental action, which is set as a supplementary element to the paramount effects criterion, namely, in case there is a substantial deprivation of a foreign investment that is not compensated, the *Tecmed* approach suggests the measure is disproportional and hence, illegal. Therefore, *Tecmed* proportionality assessment also

⁷²⁰ However, the Tribunal did not justify the employment of proportionality assessment inspired by international human rights law, see *Fireman’s Fund Insurance Company v Mexico*, Award, NAFTA, ICSID Case No.ARB(AF)/02/01, 17 July 2006, [174(j)] footnote 161.

⁷²¹ *Tecmed v Mexico* [122], in particular footnote 142.

mixes the second and third step of the assessment of an indirect expropriation claim.⁷²²

Form the methodological point of view, *Tecmed v. Mexico* did not justify its employment of the ECtHR inspired proportionality assessment, unlike what was done by the arbitral tribunal in *Continental v. Argentina*, where the reference to the weighing and balancing method in WTO law was justified by the textual similarities between the norms.

Although the similarities between investment protection against uncompensated expropriation and property rights under Article 1 of the First Protocol to the European Convention on Human Rights are undeniable,⁷²³ there is a sharp difference between the two legal regimes which lies in the influence of the proportionality analysis on the compensation of expropriated property (see *infra*⁷²⁴). Under European human rights law proportionality analysis and its element of ‘individual and excessive burden’ is allowed to influence the amount of compensation due to the affected individual. It is not possible under the network of IIAs, since they explicitly provide for full market value compensation in cases where the existence of expropriation is found.

Tecmed’s application of the proportionality analysis within the evaluation of the expropriatory effect is also against the logic of the balancing of interests as it is used in constitutional courts with respect to property rights. Thus, for instance, tobacco producers asked the Australian High Court to assess whether the recently enacted plain packaging law is expropriatory in its character as it goes against the Constitution of Australia.⁷²⁵ In this matter, the Court started its assessment with the base question – whether the plain packaging law is to be characterized as one for the acquisition of trade marks of tobacco companies, and noted that this question ‘is not answered by a

⁷²² See in particular the above analyzed *Azurix v. Argentina* [311].

⁷²³ Both legal regimes function so as to govern relationships between States and individuals (often called the common paradigm of global administrative law, see S.W. Schill, *The Multilateralization of International Investment Law* (CUP 2009), 377). Both legal regimes safeguard reasonable expectations, provide remedies to individuals against the arbitrariness of a State, and value transparency and foreseeability of government actions, see *Generation Ukraine, Inc. v. Ukraine*, ICSID Case No. ARB/00/9, Award, 16 September 2003, [93]; *Parkerings v. Lithuania*, [315-319]; Cf. Krommendijk J., Morijn J., “‘Proportional’ by What Measure(s)? Balancing Investor Interests and Human Rights by Way of Applying the Proportionality Principle in Investor-State Arbitration”, in *Human Rights in International Investment Law and Arbitration*, P.M.Dupuy, F.Francioni, E.U.Petersmann (eds.), (Oxford: Oxford University Press, 2009), 424 et seq.

⁷²⁴ See below [4.7.1. Proposed human rights approach in assessing compensation for expropriation].

⁷²⁵ High Court of Australia, *JT International SA v Commonwealth of Australia British American Tobacco Australasia Limited v The Commonwealth* [2012] HCA 43, 15 August 2012, S409/2011 & S 389/2011.

test of proportionality'.⁷²⁶ The Court found that the law did not have an effect of acquiring trade marks; they remained with the plaintiffs, albeit subject to severe restrictions on use. Therefore, the proportionality assessment was not necessary.

Finally, the *Tecmed*'s proportionality assessment does not integrate non-economic interests in the judgement of whether expropriation has taken place. That judgement is exclusively dependant on the detrimental effect on foreign investment, which in the *Tecmed* case was found to be non proportional because it was uncompensated. Moreover, *Tecmed*'s proportionality assessment has no influence on the amount of compensation for expropriation which is in contrast to the proportionality assessment under the European human rights system.⁷²⁷ *Tecmed*'s proportionality analysis does not propose an application of weighing and balancing in case an effect of substantial deprivation is found so as to possibly exempt the compensation requirement or to minimize the compensation for the interference in the investor's investment. Argentina has proposed this stance inspired by human rights law⁷²⁸ in *Vivendi v. Argentina* (Resubmitted),⁷²⁹ and *Siemens v. Argentina*⁷³⁰ but this approach has not been taken up by the investment tribunals (dealt *infra*⁷³¹).

Nevertheless, *Tecmed*'s proportionality assessment has inspired the drafting of 'new generation' IIAs that reflect the necessity to shift away from the narrow focus on economic interests in foreign investment protection. Thus, for instance, ASEAN Comprehensive Investment Agreement (CIA) states that the determination of whether

⁷²⁶ Ibid, p. 96.

⁷²⁷ On the comparison between the human rights approach of balancing in expropriation cases and *Tecmed*, see Ursula Kriebaum, 'Regulatory Takings: Balancing the Interests of the Investor and the State', (2007) 8 J. of World Investment and Trade 717, at 727-729. See also *Siemens A.G. v The Argentine Republic*, ICSID case No.ARB/02/8, Award, February 6, 2007 [354]: 'Argentina has pleaded that, when a State expropriates for social or economic reasons, fair market value does not apply because otherwise this would limit the sovereignty of a country to introduce reforms in particular of poor countries. [...] Argentina in its allegations has relied on *Tecmed* as an example to follow in terms of considering the purpose and proportionality of the measures taken. The Tribunal observes that these considerations were part of that tribunal's determination of whether an expropriation had occurred and not of its determination of compensation. The Tribunal further observes that Article I of the First Protocol to the European Convention on Human Rights permits a margin of appreciation not found in customary international law or the Treaty.'

⁷²⁸ Ali Riza Çoban, *Protection of Property Rights within the European Convention on Human Rights* (ASHGATE, 2004), 93; *James and Others v. UK*, [46].

⁷²⁹ *Vivendi v. Argentina* (Resubmitted), [8.4.1]. Argentina objected to the full compensation requirement of the breach of the BIT relying on its economic conditions and the fact that Argentina acted in the public interests.

⁷³⁰ *Siemens A.G. v. The Argentine Republic*, ICSID case No.ARB/02/8, Award, February 6, 2007, [348]-[357]. The *Siemens* Tribunal observed that the Germany- Argentina BIT nor customary IL permitted a margin of appreciation as found in Article 1 Protocol 1 ECHR.

⁷³¹ See below [4.7.1. Proposed human rights approach in assessing compensation for expropriation].

an indirect expropriation has taken place (second step of the assessment of an indirect expropriation claim) requires a case-by-case, fact-based inquiry that considers, among other factors, the economic impact of the challenged governmental measure, prior commitments given by a host State towards a foreign investor and ‘the character of the government action, including, its objective and whether the action is disproportionate to the public purpose’.⁷³² In contrast to the *Tecmed v. Mexico* proportionality assessment, ASEAN CIA approach is welcome from the sustainable development perspective because it separates proportionality assessment from the economic impact assessment and indicates that the proportionality assessment must be taken in light of the public purpose, and not in light of the economic impact of the measure. Consequently, it means paying attention to more than the economic context in the establishment of indirect expropriation.

To conclude, the *Tecmed v. Mexico* and its approving awards have linked the individual and excessive burden test with the level of interference in the foreign investment generally holding that non-compensated substantial deprivation of foreign investment is unproportional. This logic unjustifiably limits the criteria that could be taken into account in assessing whether an individual investor suffers an excessive burden that needs to be redressed.

The option discussed later in the thesis is to provide balancing analysis within the legitimate expectations sub-element of the FET or indirect expropriation standards as a more appropriate place for balancing between the private interests of the investor and the interests of the state that are covered by the sustainable development objective of the network of IIAs.

3.4.3. Context doctrine

A string of arbitral rulings take a much more cautious approach with regard to the paramount ‘effects’ requirement than the sole effects doctrine and complements it with other equally important considerations. In contrast to the ‘sole effects’ awards, ‘context doctrine’ awards lay particular stress on the circumstances in which the indirect expropriation claim arises and they have referred to a ‘public purpose’ as an

⁷³² Annex 2, paragraph 3 of the ASEAN Comprehensive Investment Agreement, available at <[http://www.aseansec.org/documents/ASEAN%20Comprehensive%20Investment%20Agreement%20\(ACIA\)%202012.pdf](http://www.aseansec.org/documents/ASEAN%20Comprehensive%20Investment%20Agreement%20(ACIA)%202012.pdf)> accessed on 20 November 2012.

indication of the exercise of a state's non-compensable customary rights to regulate.⁷³³

Thus, in a moderate version of 'context doctrine, the Tribunal in *S.D. Myers v. Canada*⁷³⁴ acknowledged 'that international law makes it appropriate for tribunals to examine the purpose and effect of governmental measures' and that '[i]t must look at the real interests involved and the purpose and effect of the government measure'.⁷³⁵ In *Total v. Argentina*, the Tribunal shared a similar approach and took into account the purpose and the causes of the measures taken by the State together with their adverse effects on the foreign investment.⁷³⁶ In this particular case, the Total Tribunal justified the Argentina crisis management measures under the indirect expropriation standard and declared:

*The Tribunal shares the dominant approach followed by international tribunals, that is to take into account also the purpose and the causes of the measures taken by a State (together with their adverse effects on the foreign investment).*⁷³⁷

The same method is represented in another Argentina crisis award – *Suez v. Argentina*,⁷³⁸ which arose out of the treatment by Argentina of the water services concession during and after the crisis.⁷³⁹ In its assessment of the existence of indirect expropriation, the Tribunal characterized the effects criterion 'as an important element in determining if the measure constitutes an expropriation requiring compensation',⁷⁴⁰ but not as the sole element. In contrast to *Metalclad v. Mexico* and *Vivendi v.*

⁷³³ *Methanex v United States*, UNCITRAL (NAFTA) Final Award, 3 August 2005, Part IV - Chapter D - Page 4 [7]; *Marvin Roy Feldman Kappa v United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award, 16 December 2002 [103]; *Técnicas Medioambientales Tecmed S.A. v The United Mexican States* (ICSID Case No. ARB (AF)/00/2), Award of 29 May 2003 [119]; *SD Myers, Inc v Canada*, UNCITRAL (NAFTA), First Partial Award, 13 November 2000 [281]; *Saluka Investments BV (The Netherlands) v. The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006 [262].

⁷³⁴ *SD Myers, Inc v Canada*, UNCITRAL (NAFTA), First Partial Award, 13 November 2000.

⁷³⁵ *Ibid* [281], [285].

⁷³⁶ *Total S.A. v. Argentina*, ICSID Case No. ARB/04/1, Decision on liability (December 27, 2010), footnote 232.

⁷³⁷ *Ibid* [197], footnote 232 referring to the opinion Fortier, Drymer, *Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor*, 19 ICSID Review-Foreign Investment Law Journal 293 (2004)) and the *Oscar Chinn Case* and *Sea-Land Service Inc. v. Iran*, 6 Iran-US Cl. Trib. Rep. 149, 166 (1984).

⁷³⁸ *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic*, Decision on Liability, 30 July 2010, ICSID Case No. ARB/03/19, France-Arentina BIT, Spain – Argentina BIT, United Kingdom – Argentina BIT, UNCITRAL Rules.

⁷³⁹ Argentina required the fulfilment of the obligations under the Concession but refused a revision of the tariffs, even if the costs of the concession increased. In addition, Argentina alleged the existence of high levels of nitrates in the water being distributed by the investor and later transferred the concession to the company owned by Argentina.

⁷⁴⁰ *Suez v. Argentina*, [134].

Argentina (Resubmitted), the *Suez v. Argentina* Tribunal commenced its argumentation with ‘general considerations’ and indicated that the Concession was meant to balance two interests, namely, to attract foreign capital and know how assuring private investors the opportunity to earn a reasonable profit, on the one hand, and to assure the efficient provision of water and sewage service at low costs preserving a certain degree of regulatory discretion for the authorities on the other.⁷⁴¹ Against this initial deliberation on the balancing of interests, the Tribunal acknowledged the necessity to distinguish between regulatory measures having an effect of expropriation⁷⁴² and a valid exercise of a customary non-compensable State’s regulatory powers⁷⁴³ concluding that Argentina’s crisis management measures were within the general police powers and did not constitute a permanent and substantial deprivation of the investment. As regards the termination of the Concession, the Tribunal noted it was contractual in nature, thus, the investor’s claim under the indirect expropriation standard failed.⁷⁴⁴

As regards investment claims that involve restrictions of previously allowed activity or a termination of a foreign investor’s business, ‘context doctrine’ awards start their analysis of an indirect expropriation claim by paying due respect to ‘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”’,⁷⁴⁵ even if ‘that makes it uneconomical to continue a particular business’.⁷⁴⁶

This emphasis of the exercise of a State’s regulatory powers has sometimes been mistakenly understood as supporting an automatic and general exemption from compensation to all *bona fide*, reasonable and non-discriminatory general regulations.⁷⁴⁷ Therefore, ‘context doctrine’ is often criticized as an extreme *pro* state approach unnecessarily limiting a foreign investor’s rights.⁷⁴⁸

⁷⁴¹ Ibid [124]-[126].

⁷⁴² Ibid [133]-[134], [145], [155].

⁷⁴³ Ibid [139], [132].

⁷⁴⁴ Ibid, [140], [157].

⁷⁴⁵ *Saluka v Czech Republic*, Partial Award [302]. See also *Methanex v US* Part IV - Chapter D - Page 4 [7]; *S.D.Myers, Inc. v Government of Canada*, Partial Award, November 13, 2000, NAFTA, UNCITRAL [281]; GC Christie, ‘What Constitutes a Taking of Property under International Law’ 38 BYIL 307 (1962) 309, 331.

⁷⁴⁶ *Marvin Roy Feldman Kappa v United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award, 16 December 2002 [112].

⁷⁴⁷ As suggested by Charles H Brower II, ‘Obstacles and Pathways to Consideration of the Public Interest in Investment Treaty Disputes’ in Karl P Sauvant (ed), *Yearbook on International Investment*

One may reject this criticism as ungrounded by paying scrupulous attention to the leading awards representing the ‘context doctrine’ – they have not found substantial deprivation of foreign investments.⁷⁴⁹

For instance, the Tribunal in *Feldman v Mexico* started its analysis on indirect expropriation by emphasizing the general rule providing that such traditional types of property rights restrictions as reasonable regulation for public purpose, could be harmful but do not carry consequences under international law.⁷⁵⁰

The tribunal stated:

*[G]overnments must be free to act in the broader public interest through protection of the environment (...), imposition of zoning restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this (...).*⁷⁵¹

Further, the Tribunal concluded that ‘not all government regulatory activity that makes it difficult or impossible for an investor to carry out a particular business, change in the law or change in the application of existing laws that makes it uneconomical to continue a particular business, is an expropriation under Article 1110’.⁷⁵² However, the Tribunal checked whether there is an expropriatory effect of the investor’s property and found that the investment was not substantially deprived.⁷⁵³

Similarly to *Feldman*, and in sharp contrast to the *Metalclad v. Mexico* award, the *Methanex v. US* Tribunal famously declared:

[A]s a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which

Law & Policy 2008-2009, (OUP 2009) 363-364; Ursula Kriebaum ‘Privatizing Human Rights. The Interface between International Investment Protection and Human Rights’ in A Reinisch, U Kriebaum, *The Law of International Relations, Liber Amicorum Hanspeter Neuhold* (Eleven International Pub. 2007) 182-183.

⁷⁴⁸ Markus Perkams, ‘*Methanex — Erroneous on Expropriation?*’ (2005) 2 Transnational Dispute Management. See also *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, Resubmitted, France-Argentina BIT1991 [7.5.21].

⁷⁴⁹ *Feldman v Mexico* [119]; *Methanex v US*, Part IV - Chapter D [16]; *Glamis Gold, Ltd. v The United States of America*, UNCITRAL (NAFTA), Award, 8 June 2009 [356]-[357], [536]; *Chemtura v Canada* [263]-[266].

⁷⁵⁰ *Tecmed v. Mexico* [119]; *S.D. Myers v. Canada*, [281]; *Saluka v Czech Republic*, [262]; G. Christie, ‘What Constitutes taking of Property under International Law’, 38 B.Y.I.L. (1962), 309, 331.

⁷⁵¹ *Feldman v. Mexico* [103].

⁷⁵² *Ibid*, [112].

⁷⁵³ *Ibid*, [119].

*affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.*⁷⁵⁴

This dictum has been criticized as too ‘radical’, exaggerating the importance of a state’s exercise of its regulatory powers. Critics insist that the *Methanex* Tribunal failed to consider the economic impact of the Californian regulation on the investor in deciding whether expropriation took place. Critics also maintain that the decision did not pay attention to the burden of costs – whether the investor should have to bear the full costs of these regulations or whether it would be more appropriate to shift these costs, at least in part, to society.⁷⁵⁵

This view cannot be supported, since the *Methanex* Tribunal did consider the economic impact of the regulation and whether that effect could be reasonably foreseen by the investor.

In a largely overlooked paragraph of the *Methanex* award, the Tribunal found no substantial deprivation of the investor’s property by the Californian ban.⁷⁵⁶ Accordingly, the *Methanex* award does not propose a general exemption from compensation of all reasonable, non-discriminatory general regulations. It merely approves the application of police powers in a wider sense where there is no substantial deprivation of foreign investment.⁷⁵⁷

Another arbitral award dealing with a restriction of a previously allowed commercial activity is *Glamis Gold v. US*,⁷⁵⁸ where California imposed new measures for gold mining, demanding a complex environmental and cultural impact assessment, and requiring complete backfilling and restoration of the mining site in order to protect the Quechan Indians religious and cultural heritage and historic sites in the investment area. These measures resulted in greater operation costs of the goldmine and thereby

⁷⁵⁴ *Methanex v. US*, Part IV - Chapter D - Page 4, para.7.

⁷⁵⁵ See Charles H Brower II, ‘Obstacles and Pathways to Consideration of the Public Interest in Investment Treaty Disputes’ in Karl P Sauvant (ed), *Yearbook on International Investment Law & Policy 2008-2009*, (OUP 2009), p.363-364; Ursula Kriebaum ‘Privatizing Human Rights. The Interface between International Investment Protection and Human Rights’ in A Reinisch, U Kriebaum, *The Law of International Relations, Liber Amicorum Hanspeter Neuhold* (Utrecht : Eleven International Pub., 2007), 182-183; S.A. Spears, ‘The Quest for Policy Space in a New Generation of International Investment Agreements’ (2010) 13 JIEL 4, 1050-1051.

⁷⁵⁶ *Ibid*, Part IV - Chapter D - Page 4, para.16.

⁷⁵⁷ For support of this approach, see M. Paparinskis, ‘Regulatory Expropriation and Sustainable Development’ in Segger, Gehring, Newcombe (2011), 300-305; Jan Paulsson, ‘Indirect Expropriation: Is the Right to Regulate at risk?’ (April 2006) 3 Transnational Dispute Management 2.

⁷⁵⁸ *Glamis Gold, Ltd. v. The United States of America*, UNCITRAL (NAFTA), Award, 8 June 2009.

diminished the amount of the expected profits. For these reasons, Glamis alleged indirect expropriation of its mining rights but the Tribunal noted that ‘a State is not responsible, however, for loss of property or for other economic disadvantage resulting from *bona fide* [...] regulation [...] if it is not discriminatory’.⁷⁵⁹ As in *Methanex v. US*, there was no existence of ‘substantial deprivation’ of the investor’s property, since the investor’s losses were not significant enough to establish expropriation.⁷⁶⁰

In sum, the above-mentioned arbitral jurisprudence reflects the application of non-compensable police powers in a wider sense, namely, without substantial deprivation of the investor’s investment.

With regard to a suppression of a previously legal activity as an action covered by police powers exceptions, there are two important aspects. First, the *Restatement Third* suggests that comparison of practices of major legal systems and international guidelines may serve as a justification of the challenged regulation⁷⁶¹ which because of its harshness would not otherwise be justifiable.⁷⁶² Applying similar logic and comparing legal systems, the Tribunal in *Telenor v. Hungary*, the case which involved the reorganization of the Hungarian public telephone service, dismissed the expropriation claim, *inter alia*, because ‘the type of arrangement set up by the Hungarian Government for universal service provision was not dissimilar to those established in a number of other jurisdictions, both within and outside Europe’.⁷⁶³

Secondly, one may argue police powers exception for the suppression of activity was theoretically approved in the *Chemtura v. Canada* award dealing with Canada’s regulatory phase-out of the controversial agro-chemical lindane.

Even if the Tribunal did not find a substantial deprivation of the investor’s investment, since ‘the sales from lindane products were a relatively small part of the overall sales of Chemtura’,⁷⁶⁴ it did pay particular attention to the general circumstances of the interference in foreign investment.⁷⁶⁵ The Tribunal took into account the fact that the ban was non-discriminatory, in compliance with due process

⁷⁵⁹ Ibid [354], referring to Restatement (Third) of Foreign Relations, paragraph 712, Comment (g) (1986).

⁷⁶⁰ Glamis Gold v. US [356]-[357], [536].

⁷⁶¹ Restatement Third, 211.

⁷⁶² Christie (1962), 332.

⁷⁶³ Telenor Mobile Communications A.S. v. The Republic of Hungary, ICSID No. ARB/04/15, Award September 13, 2006 [78].

⁷⁶⁴ Chemtura v. Canada, NAFTA, UNCITRAL, Award August 2 2010 [263]-[266].

⁷⁶⁵ Chemtura v Canada [266].

and based on widely accepted scientific data recognizing lindane as a dangerous chemical that over the years many countries had taken steps to ban the use of lindane, and that the ban was necessitated by Canada's international environmental obligations.⁷⁶⁶

For these reasons the Tribunal stated that '[i]rrespective of the existence of a contractual deprivation, [...] 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'.⁷⁶⁷

Thus, the *Chemtura* award supports the position that legitimate suppression of previously legal activity which destroy an investor's business may exempt a host state from the obligation to pay compensation.⁷⁶⁸ Nevertheless, the Tribunal recognized a limitation to this stance – compliance with the investor's legitimate expectations. The Tribunal held that the exercise of a state's police powers would be non-compensable 'unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation'.⁷⁶⁹

To conclude, the 'context doctrine' (unlike the 'sole effects' doctrine) explicitly recognizes customary limitations on the indirect expropriation standard, namely, the application of police powers in both a broader and narrower sense, thus respecting a host State's responsibilities to safeguarding non-economic public interests. Hence, the 'context doctrine' is the most compatible with sustainable development as a 'conceptual framework' of investment law because it allows the incorporation of wider societal concerns other than merely the investor's protection to the application and interpretation of the indirect expropriation standard.

It also needs to be kept in mind that the application of the 'context doctrine' on its own does not provide a clear answer on the legal consequences in case substantial deprivation is found. Nevertheless, the doctrine lays particular emphasis on the investor's legitimate expectations element, which functions as a limitation or extension to which the State may exercise its non-compensable regulatory powers. It is argued later in the thesis that exactly this element has the inherent flexibility that

⁷⁶⁶ Ibid [128], [131], [134]-[137], [139], [147].

⁷⁶⁷ Ibid [266], referring to *Saluka v Czech Republic* [262].

⁷⁶⁸ See also *Continental Casualty v. Argentina* [277], footnote 408.

⁷⁶⁹ *Methanex v. US*, Part IV - Chapter D - Page 4, para.7.

not only has a potential to embrace the balancing between investor's and State's interests, but it also has a capacity to make more scrupulous adjustment of the legal consequences in cases where an expropriatory effect is found, e.g., whether lost profits are available.⁷⁷⁰

3.4.4. Interim conclusions on the methods for assessing an indirect expropriation claim

Arbitral jurisprudence has developed various methodologies for the assessment of the existence of indirect expropriation. A common problem that these methodologies have is that they often perplex legitimacy criteria for already established expropriation, the very establishment of indirect expropriation and legitimacy assessment of non-compensable state's powers to regulate in the public interest. Consequently, this situation has created uncertainty with respect to the scope of the indirect expropriation standard and has minimized the trust in these methodologies to address the existing tension between investment protection standards and regulatory space left for the host States to regulate in the public interest. Nevertheless, the sustainable development objective provides guidelines for screening these methodologies with regard to their compatibility with the clarified object and purpose of the investment protection regime.

Thus, the 'sole effects' doctrine appears to be the least compatible methodology for the achievement of the overall sustainable (economic) development objective. Sustainable development as the objective of investment protection regime implies that the regime 'must benefit all'⁷⁷¹ not merely foreign investors, especially in case of application of 'old school' BITs that do not contain explicit references to safeguarding wider societal interests other than foreign investment protection. Consequently, the sustainable development objective extends the scope of the criteria to be taken into account for the assessment of the content of an indirect expropriation standard and its

⁷⁷⁰ Southern Pacific Properties (SPP) (Middle East) Limited v Arab Republic of Egypt, ICSID ARB/84/3, May 20, 1992, Egypt's National Law No.43. [190]-[191]; MTD Equity Sdn. Bhd. And MTD Chile S.A. v Republic of Chile, ICSID Case No ARB/01/7, Award May 25, 2004, the 1992 Malaysia – Chile BIT [178]. See also COMESA Common Investment Area Agreement 2007, article 20(2) and Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania, ICSID Case No ARB/05/22, Award, 24 July 2004, [775], [789]-[792], [798].

⁷⁷¹ Lemire v. Ukraine, [273]. On maximization of development as the overall object of IIAs see Alex Mills, 'Antinomies of Public and Private at the Foundations of International Investment Law and Arbitration' (2011)14 Journal of International Economic Law 2, 469, at 493.

sub-elements. For instance, public purpose as a legitimacy criterion of expropriation, legitimate expectations, non-investment obligations of the host state, a comparative approach of other states experience and investor's own conduct together are the criteria that must be taken into account when deciding on the existence of expropriation or, in case of its existence, for the causation of the necessary compensation (*SPP v. Egypt* and *Biwater Gauff v. Tanzania* approach).

In sharp contrast, some notable 'sole effects' doctrine awards attempt to limit the scope of the above-mentioned criteria by focusing solely on the 'substantial deprivation' element. Thus, the *Metalclad v. Mexico*, *Santa Elena v. Costa Rica* and *Vivendi v. Argentina (Resubmitted)* interpretations of 'public purpose' are overly restrictive. They ignore the theoretical existence of customary police powers exceptions, i.e., non-compensable regulations, despite their deprivatory effect, which is in sharp contrast to the 'context doctrine' awards like *Methanex v. US*, *Saluka v. Czech Republic* and *Chemtura v. Canada*, awards that have referred to a 'public purpose' as an indication of the exercise of a state's non-compensable customary rights to regulate.

Secondly, the 'sole effect' doctrine overlooks the role the existence of 'public purpose' can have on the scope of legitimate expectations of the affected investor, quite the opposite to the *SPP v. Egypt* Tribunal which has referred to the existence of a 'public purpose' as part of the legitimacy assessment of expropriation as having a consequential impact on the expectations of the compensation due for the expropriated property.

Finally, from the broader perspective, 'sole effects' doctrine appears to ignore the public dimension of investment arbitration that implies a necessity to provide a process that gives space for weighing competing factors, such as investment protection and public interests, which cannot be achieved by an exclusive focus on the property interests of foreign investors. Thus, the sole effects doctrine is outdated and not serving the clarified object and purpose of the IIAs regime.

Further, *Tecmed's* inspired proportionality doctrine in its current way of application does not integrate non-economic interests in the judgement of whether expropriation has taken place. That judgement is exclusively dependant upon the detrimental effect on foreign investment as the key aspect of *Tecmed's* 'individual and excessive burden' element. This logic limits, without a justification, the criteria that could be

taken into account in assessing whether an individual investor suffers an excessive burden that needs to be redressed.

Finally, the ‘context doctrine’ is the most open method for integrating various conflicting considerations in the assessment of the very existence of indirect expropriation that integrates the balance between the host State’s responsibilities to safeguard non-economic public interests and its limiting element – investor’s legitimate expectations.

CHAPTER 4. INHERENT FLEXIBILITY OF THE INDIRECT EXPROPRIATION STANDARD - LEGITIMATE INVESTMENT-BACKED EXPECTATIONS

INTRODUCTION

The ‘conceptual framework’ of sustainable development promotion within the interpretation of investment protection guarantees requires the incorporation of wider societal concerns than purely economic ones. Arbitral jurisprudence is diverse regarding the incorporation of wider societal concern. Therefore, it is argued that sustainable development perspective allows excluding as inappropriate that line of arbitral jurisprudence which concentrates narrowly on foreign investment protection. The chapter is designed to prove that methodologically the most appropriate way to incorporate wider societal concerns in setting the scope of the indirect expropriation standard is through the effective interpretation of its legitimate expectations element. Similarly, it is argued that the effective treaty interpretation principle, implying interpretation of a treaty as a whole whilst paying particular respect to its context,⁷⁷² requires deliberate consideration of sustainable development as an aim to be achieved. The sustainable development objective entails certain guidelines and a direction to be followed – the integration of economic interests and non-economic interests. Consequently, it implies certain ‘pushing and pulling’ of the scope of substantive provisions of the treaty, for instance, allowing an argument for a broader or narrower interpretation of a treaty term⁷⁷³ in order to fulfil the objective of sustainable development.

Legitimate expectations for legal stability element embeds the conflict between the host state’s regulatory autonomy and investor interests for a predictable and stable legal framework. While filling legitimate expectations with content in specific cases, numerous arbitral awards have seen it as containing an inherent flexibility that allows integrating nuanced factual circumstances in the decision of whether the host State has violated investment protection guarantees.

This chapter is structured in the following way: it begins with establishing the link between legitimate expectations and the indirect expropriation standard. The following section explains the particular focus on legitimate expectations for legal

⁷⁷² R Gardiner, *Treaty Interpretation* (OUP 2008) 148, 161, 199-200.

⁷⁷³ On the possible outcomes of effective treaty interpretation, see R Gardiner, *Treaty Interpretation* (OUP 2008) 187.

stability and indicates the two prerequisites for the existence of legitimate expectations – specific assurances towards the investor to induce an investment and the existence of a protected right. Then it proceeds to analyze sub-elements of legitimate expectations for legal stability, which have been gradually identified by arbitral jurisprudence. These elements are factual circumstances surrounding investment (general knowledge about business and the legal framework in the host State), competent businessman criterion and the investor's own conduct. Further, the chapter analyzes the ways in which a handful of arbitral tribunals have used these sub-elements for integrating a certain balancing analysis between the rights of investors and the duties of States in the assessment of the existence of the investor's legitimate expectations for legal stability. Finally, special attention will be paid to the balancing exercise that tribunals have used in order to justify substantial regulatory changes that are in formal violation of prior commitments. The chapter concludes that filling the legitimate expectations for stability element contains an intrinsic balancing mechanism, which may and must be used for bringing the indirect expropriation standard in line with the objective of sustainable development.

4.1.Link between legitimate expectations and indirect expropriation

Several investment treaty tribunals, analyzed in turn below, use legitimate expectations as an important tool for drawing the line between commercial risk that has to be borne by a foreign investor and political risk which should be shifted to the host State.⁷⁷⁴

The instrument of legitimate expectations forms part of the FET standard. The landmark *Waste Management II* award⁷⁷⁵ notes that FET standard is expressed through the evaluation of its elements – arbitrariness, unfairness, unjustness, discrimination, lack of due process, complete lack of transparency⁷⁷⁶ and whether a State has acted 'in breach of representations made by the host State which were reasonably relied on by the claimant'.⁷⁷⁷

⁷⁷⁴ *Saluka v Czech Republic* [304].

⁷⁷⁵ *Waste Management II v Mexico*, ICSID Case No. ARB(AF)/00/3, Award, 30 April 2004 [99].

⁷⁷⁶ *Ibid* [98].

⁷⁷⁷ *Ibid*. Subsequent *Continental Casualty v. Argentina* award has supplemented these criteria, including also 'relevance of the public interest pursued by the State' and 'accompanying measures aimed at reducing the negative impact' in the assessment of a FET claim, see *Continental Casualty v. Argentina*, Decision on Jurisdiction, ICSID Case No. ARB/03/9, February 22, 2006 [261(iv)].

The legitimate expectations element may play a significant role in the determination of whether indirect expropriation has taken place; its importance for this purpose is indicated by the *National Grid v. Argentina* award.⁷⁷⁸

*[T]he prohibition against indirect expropriation should protect legitimate expectations of the investor based on specific undertakings or representations by the Host State upon which the investor has reasonably relied. This is by no means an exclusive test to be applied to all types of alleged indirect expropriations in isolation of other relevant factors. It is, nonetheless, a useful guiding principle that appears to cover many of the situations that have come before the modern investment treaty tribunals.*⁷⁷⁹

In line with *Methanex v. US*⁷⁸⁰ and *Merrill v. Canada*,⁷⁸¹ the content of legitimate expectations is interchangeable for both indirect expropriation and FET standards; hence, it is analyzed under both investment protection guarantees.

The respect for investor's legitimate investment-backed expectations also participates in the appraisal of whether an application of the host State's police powers in a broad and narrow sense is done in a legitimate manner – in good faith⁷⁸² and in a non-arbitrary way.⁷⁸³

Last but not least, the legitimate expectations standard has a capacity to serve for the adjustment of the amount of compensation in a case of indirect expropriation or a

⁷⁷⁸ *National Grid P.L.C. v. Argentine Republic*, UNCITRAL, Award, November 3, 2008, the UK, North Ireland –Argentine BIT 1990.

⁷⁷⁹ Ibid [152] referring to Jan Paulsson and Zachary Douglas, 'Indirect Expropriation in Investment Treaty Arbitrations' in N Horn and S Kröll (eds), *Arbitrating Foreign Investment Disputes*, 2004. See also [151].

⁷⁸⁰ *Methanex v. US*, Part IV - Chapter D - Page 4 [8].

⁷⁸¹ *Merrill & Ring Forestry L.P. Canada*, UNCITRAL, ICSID Administered Case (NAFTA) Award, 31 March 2010 [153]. See also *Fireman's Fund Insurance Company v. Mexico*, ICSID Case No. ARB(AF)/02/01, Award, 17 July 2006, NAFTA [176(k)]; I Paulsson, Z Douglas, 'Indirect Expropriation in Investment Treaty Arbitration' in N Horn, S Kroll (eds), *Arbitrating Foreign Investment Disputes: Procedural and Substantive Legal Aspects* (2004) 146.

⁷⁸² Legitimate expectations element is derived from the good faith, fairness and non-arbitrariness principles, see Arbitrator Waelde Separate Opinion in *International Thunderbird Gaming Corporation v The United Mexican States*, Award, January 26, 2006, NAFTA, UNCITRAL [25]; C Brown, 'The Protection of Legitimate Expectations as A "General Principle of Law": Some Preliminary Thoughts', *Transnational Dispute Management* March 2009 <www.transnational-dispute-management.com> accessed 31 March 2012.

⁷⁸³ The police powers doctrine is usually analyzed under the indirect expropriation standard but its legitimacy may also be assessed under the FET standard. See *EDF (Services) Limited v. Romania*, ICSID Case No. ARB/05/13 (UK/Romania BIT), Award and Dissenting Opinion, 8 October 2009, [217]. See also *Total S.A. v. Argentina*, ICSID Case No. ARB/04/1, Decision on liability (December 27, 2010) [111]; Arbitrator Waelde Separate Opinion in *International Thunderbird Gaming Corporation v. The United Mexican States*, Award, January 26, 2006, NAFTA, UNCITRAL [25]; *Glamis Gold v. US* [542]. *Waste Management Inc. v. Mexico (No. 2)*, Final Award Apr. 30, 2004 [98], *Biwater Gauff v. Tanzania* [602].

violation of the FET standard,⁷⁸⁴ for instance, whether lost profits are available. Thus, an investor's legitimate expectations introduce some flexibility with respect to compensation despite the full market value compensation requirement in the current network of IIAs.

Because of these multiple functions, the content of legitimate expectations has an influence on various stages of an assessment of whether potential violation of a foreign investor's rights has occurred. All the more important, several arbitral tribunals have used legitimate expectations element in a way that allows for a nuanced analysis and integration of non-investment considerations into investment protection law by balancing the interests of the investor and those of the State.⁷⁸⁵ Thus, it will be analyzed further in the chapter with an insistence that balancing has become a requirement that is justified by, and stems from, the sustainable development objective and principle and, hence, its application needs to be deliberate and effective with respect to the integration of economic and non-economic concerns. The most popular frame of balancing between competing public and private interests is the proportionality principle; however, there is no agreement on the justification of the application of proportionality analysis within investment treaty law. That said, it is argued here that the sustainable development objective provides for a clear and predictable justification of balancing analysis within the indirect expropriation standard that is missing from those who are proponents of adopting variations of proportionality analysis in investment arbitration which is dealt with in detail in the following chapter.

4.2. Stability and predictability of a business and legal regime as part of legitimate expectations

For the present study the most important aspect of legitimate investment-backed expectations relates to an investor's legitimate expectations for stability of a legal and business framework in a host country. On the one hand, expectations for a legal

⁷⁸⁴ Southern Pacific Properties (SPP) (Middle East) Limited v Arab Republic of Egypt, ICSID ARB/84/3, May 20, 1992, Egypt's National Law No.43. [190]-[191]; MTD Equity Sdn. Bhd. And MTD Chile S.A. v Republic of Chile, ICSID Case No ARB/01/7, Award May 25, 2004, the 1992 Malaysia – Chile BIT [178]. See also COMESA Common Investment Area Agreement 2007, article 20(2) and Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania, ICSID Case No ARB/05/22, Award, 24 July 2004, [775], [789]-[792], [798].

⁷⁸⁵ Lemire v. Ukraine, [273].

stability element reflects the underlying clash between an investor's interest in a predictable legal framework of its long-term business activity in a State.⁷⁸⁶ On the other hand, it encompasses respect for a host State's interest to retain its regulatory flexibility.⁷⁸⁷

Arbitral tribunals have varied significantly in their interpretation of this element. On one end of the spectrum there is the *Tecmed* Tribunal. Through its interpretation it limited most the scope of manoeuvre of the host State to regulate matters in public interests. The Tribunal has stated:

*[T]he 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.*⁷⁸⁸

In other words, the *Tecmed* dictum requires a regulatory and administrative perfection from the host State; the legal effect of such a stringent interpretation might amount to *de facto* freezing of a legal regime at *status quo* when the investment was made. Therefore, this pronouncement is much criticized and not supported in most of the subsequent awards. Already in the *Oscar Chinn* case the PCIJ noted:

*[f]avourable business conditions and good-will are transient circumstances, subject to inevitable changes; [...] No enterprise [...] can escape from the chances and hazards resulting from general economic conditions.*⁷⁸⁹

In contrast to the *Tecmed* approach, some other tribunals have emphasized that the expectations for legal stability embrace the idea that the State will use its regulatory powers when needed.⁷⁹⁰ For instance, the Tribunal in *Impregillo v. Argentina* award noted that the FET standard and its legitimate expectations criterion 'cannot be designed to ensure the immutability of the legal order, the economic world and the social universe'.⁷⁹¹ This idea is supplemented by the *AES v. Hungary* award, which established that any reasonably informed business person or investor should recognize

⁷⁸⁶ TW Waelde and A Kolo, 'Environmental Regulations, Investment Protection and 'Regulatory Taking' in International Law' (2001) 50 ICLQ 811, 819.

⁷⁸⁷ *Saluka v. Czech Republic*, Partial Award [305]; *S.D. Myers v. Canada*, Partial Award [263].

⁷⁸⁸ *Tecmed v. Mexico* [154].

⁷⁸⁹ The *Oscar Chinn* Case (*United Kingdom v Belgium*), Judgement 12 December 1934, PCIJ Rep Series A/B No 63, at 27.

⁷⁹⁰ *Saluka v. Czech Republic* [307].

⁷⁹¹ *Impregillo v. Argentina* [290]. Cf. *EDF v. Romania* [217].

that ‘laws can evolve in accordance with the perceived political or policy dictates of the times’.⁷⁹²

Thus, one may consider the *Tecmed* dictum to be an autonomous interpretation of the FET standard in the particular BIT. The more traditional interpretations of legitimate expectations state that ‘[n]o investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged’,⁷⁹³ and ‘any businessman or investor knows that laws will evolve over time’,⁷⁹⁴ and they might detrimentally affect the investor.⁷⁹⁵ Even more, in *AES v. Hungary*, arbitrators ruled that the Energy Charter Treaty, which unlike most of the IIAs contains a reference to legal stability in its preamble, did not require regulatory and administrative ‘perfection’ by the host State. Quite the contrary, the Tribunal established that the State’s acts or omissions need to be ‘manifestly unfair or unreasonable’ in order to violate the FET standard and its legitimate expectations for the legal stability element.⁷⁹⁶

In view of the above, one may conclude that the *Tecmed* stringent approach to the content of legitimate expectations is rejected by the later arbitral jurisprudence as not reflecting *lex lata*. Even more, the post-*Tecmed* Tribunals appear to support even dramatic changes in the regulatory environment affecting a foreign investor in case no specific assurances to the contrary effects are given to the investor and if a regulation is *bona fide* and non-discriminatory.

To conclude, legitimate expectations of legal stability do not function as a stabilization clause and reliance on them intrinsically entails the probability that the host State will adopt measures within its sovereign powers.

4.3. Prerequisites: specific assurances and existence of a protected right

The standard of legitimate expectations does not cover ‘every hope’ by an investor.⁷⁹⁷ There are two prerequisites of the existence of legitimate expectations: the existence

⁷⁹² AES Summit Generation Limited, AES-Tisza Erőmű KFT v. The Republic of Hungary, ICSID Case No. ARB/07/22, Award September 23, 2010 [9.3.34].

⁷⁹³ Saluka v. Czech Republic, Partial Award [305], Feldman v. Mexico [112].

⁷⁹⁴ Parkerings v. Lithuania [332].

⁷⁹⁵ See also Impregillo v. Argentina [291].

⁷⁹⁶ AES Summit Generation Limited, AES-Tisza Erőmű KFT v. The Republic of Hungary, ICSID Case No. ARB/07/22, Award September 23, 2010 [9.3.40].

⁷⁹⁷ Impregillo v. Argentina, [292]; Parkerings v. Lithuania [344].

of specific assurances by a State towards an investor to induce an investment and the existence of a protected right.

The dominant base for an investor's expectations is specific assurances given to an investor by a State. Arbitral jurisprudence has constantly emphasized the existence of specific representations or 'promises' given to an investor in order to induce an investment that are later violated by the State.⁷⁹⁸ Thus, in its assessment of the suppression of the investor's business, the *Methanex* Tribunal stated, 'it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied upon by the claimant'.⁷⁹⁹

If a foreign investor acquires specific rights to pursue investment activity like a concession contract (contractual commitments),⁸⁰⁰ licence (authorizations) or other specific assurances by a host State,⁸⁰¹ these assurances create the strongest evidence on what the investor could reasonably rely upon. Their unilateral violation by the host State will lead to the conclusion of a violation of the investor's legitimate expectations and, accordingly, to a violation of the FET and/or indirect expropriation standard.

In exceptional circumstances, a host State may also create limited expectations for legal stability through laws or regulations of a general character that are not specifically addressed to a particular investor.⁸⁰² In the same vein, the *Total v. Argentina* Tribunal specified that this could occur in case of regimes, which are applicable to long-term investments, and the protection of legitimate expectations would stem from 'legitimate fairness' and 'regulatory certainty' principles.⁸⁰³ Otherwise legitimate expectations for legal stability are not protected if general legislation is modified, unless there is an individual and excessive burden on the

⁷⁹⁸ *Tecmed v. Mexico* [154]; *MTD Equity Sdn. Bhd. And MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Decision on Annulment, 21 March 2007, [67]; *Metalclad v. Mexico* [28]-[41], *Feldman v. Mexico* [148], [149]; *Glamis Gold v. US* [620]. *National Grid v. Argentina* [173]; *Total v. Argentina* [117].

⁷⁹⁹ *Methanex v. US*, Part IV - Chapter D - Page 4 [8].

⁸⁰⁰ As it was in *Vivendi v. Argentina* (Resubmitted) [7.5.10]; *Suez v. Argentina*, Decision on Liability, 30 July 2010, ICSID Case No. ARB/03/19 [231]; *Waste Management v. Mexico* (No. 2), Final Award [98].

⁸⁰¹ *Continental Casualty v. Argentina* [279].

⁸⁰² *LG&E*, Decision on Liability [130]; *Continental Casualty v. Argentina* [279]; *Suez v. Argentina* ICSID Case No. ARB/03/19 [223]-[225].

⁸⁰³ *Total S.A. v. Argentina*, ICSID Case No. ARB/04/1, Decision on liability, December 27, 2010 [122] (footnotes omitted).

individual ('unusual damage') that goes beyond the inherent risk of a given economic activity.⁸⁰⁴

In arbitral jurisprudence it is further clarified that if regulatory fairness is not compromised, an investor's sole reliance on general domestic regulations at the time of making its investment is not enough to establish legitimate expectations for legal stability.⁸⁰⁵ In this respect, the Tribunal in *Continental Casualty v. Argentina* has held that 'general legislative statements engender reduced expectations, especially with competent major international investors in a context where the political risk is high', since '[t]heir enactment is by nature subject to subsequent modification'.⁸⁰⁶ In *Continental*, the claim arose out of the investor's complaint about the freezing of bank deposits and their pesification during the crisis⁸⁰⁷ as a breach of the investor's legitimate expectations for 'a stable legal and business environment'.⁸⁰⁸ The investor founded its claim on a series of acts and pronouncements by Argentina's officials that the convertibility regime of Argentina would not change. The Tribunal rejected this part of the claim⁸⁰⁹ and also added that 'political statements have the least legal value, regrettably but notoriously so'.⁸¹⁰

Other criterion that an investor must establish in order to reasonably rely on the expectations for legal stability is the existence of a protected right. Legitimate expectations may only exist to protect a certain right that an investor has acquired.⁸¹¹ For instance, in *Suez v. Argentina*,⁸¹² the investor had a legitimate right to expect tariff adjustments; this right was established in the Concession agreement, namely 'a document which certainly embodies the Claimants' legitimate expectations, as well as those of Argentina'.⁸¹³ Since Argentina did not attempt to adjust tariffs during and

⁸⁰⁴ Ibid [130] footnote 142 referring to Di Lenardo Adriano Srl, Dilexport Srl and Ministerio del Comercio con l'Estero, Case C-37/02 and C-38/02, Judgment, 15 July 2004, [63], [82]; Dorsch Consult Ingenieurgesellschaft mbH v. Council of the European Union and Commission of the European Communities, Case T-184/95, Judgment, 28 April 1998 [80].

⁸⁰⁵ *Continental Casualty v. Argentina*, Decision on Jurisdiction, ICSID Case No.ARB/03/9, February 22, 2006 [261].

⁸⁰⁶ *Continental Casualty v. Argentina* [261].

⁸⁰⁷ *Continental Casualty v. Argentina* [246], [249], [250]-[252].

⁸⁰⁸ *Continental Casualty v. Argentina* [249].

⁸⁰⁹ Ibid, [304]. Albeit the Tribunal excused pesification under „non-precluded” measures defence, it went on by analyzing the legal stability claim.

⁸¹⁰ Ibid.

⁸¹¹ *Merrill v. Canada* [149]-[150].

⁸¹² *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic*, Decision on Liability, 30 July 2010, ICSID Case No. ARB/03/19, France-Argentina BIT, Spain – Argentina BIT, United Kingdom – Argentina BIT, UNCITRAL Rules.

⁸¹³ *Suez v. Argentina* [231]-[234]. See also *Total v. Argentina* [168].

after the financial and social crisis in 2001-2002, the majority Tribunal found a breach of FET through the violation of the investor's legitimate expectations⁸¹⁴ (rejecting Argentina's necessity defence under customary international law⁸¹⁵).

In contrast, in *Feldman v. Mexico*, the investor was driven out of his business as a result of the elimination of a tax rebate on the export resale of cigarettes. The Tribunal held that:

*[T]he facts [...] appear to support a finding of an indirect or creeping expropriation. The Claimant [...] is no longer able to engage in his business [...] and has thus been deprived completely and permanently of any potential economic benefits from that particular activity.*⁸¹⁶

Nonetheless, the Tribunal did not find expropriation in the present case since the export of cigarettes was not a right of the investor protected by law for which the investor could have legitimate expectations.⁸¹⁷ Consequently, the Tribunal classified the situation merely as a business problem and not as a compensable expropriation.⁸¹⁸

To conclude, initial criteria that must be fulfilled for establishing the existence of legitimate expectations are the following: the existence of specific assurances towards the investor to induce investment, like licences or concession agreements, and the existence of a protected right.⁸¹⁹ If a host State induces investment by promising a stable legal regime, State limits its regulatory powers in case of changing circumstances,⁸²⁰ and unilateral violation of these expectations creates legal consequences under international law. Therefore, a host State takes responsibility for the extent to which it contracts away its police powers.

4.4. Balancing an investor's expectations for legal stability and a State's right to regulate

Arbitral jurisprudence has rather clearly established that investor's legitimate expectations for legal stability do not imply freezing of the regulatory environment in the host State, however, they function as a limitation of the State's discretion to change

⁸¹⁴ *Suez v. Argentina* [213], [231]-[234].

⁸¹⁵ The applicable BITs did not contain the 'non-precluded measures' clause present in US-Argentina BIT applicable in, e.g., *Continental Casualty v. Argentina* case.

⁸¹⁶ *Feldman v. Mexico* [109].

⁸¹⁷ *Ibid* [114].

⁸¹⁸ *Ibid* [111], [112].

⁸¹⁹ *Vivendi v. Argentina*, (Resubmitted) [7.4.42] footnote 355, and [7.4.18]-[7.4.19], [7.4.36]-[7.4.46].

⁸²⁰ *Biwater Gauff v. Tanzania* [530].

the regulatory environment of an investor's business area.⁸²¹ Thus, in *Continental Casualty v. Argentina*, the Tribunal was asked to evaluate if abrupt and fundamental changes made by Argentina to the exchange and currency regime, because of the 2001-2002 economic crisis, by blocking bank accounts, pesifying deposits and restructuring financial instruments resulted in the breach of the investor's legitimate expectations for legal stability under the FET standard.⁸²² The Tribunal ruled that even though the preamble of the BIT contained the reference to the respect for legal stability, it would be against the effective treaty interpretation principle to interpret that clause in a way that would bar Argentina from changing domestic regulations in case of a crisis.⁸²³

Customary international law grants a right to States to issue regulations for public purpose. In this respect a State enjoys a significant margin of appreciation. The existence of a margin of appreciation, in essence, means that national authorities due to their democratic legitimacy, institutional competence and expertise are better placed than international ones in judging what is in the public interest.⁸²⁴ Thus, the *S.D. Myers v. Canada* Tribunal has famously established that the determination of the breach of FET standard under the NAFTA 'must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders'.⁸²⁵

This right of the State to regulate for public interest is, therefore, a necessary element to be taken into account and weighed for the assessment of whether an investor's expectations for legal stability are reasonable and legitimate. The *Suez v. Argentina*⁸²⁶ Tribunal has remarkably noted that this weighing means the inclusion within the investor's expectations that also 'the expectation that the Argentine government would exercise its legitimate regulatory interests with respect to the AASA

⁸²¹ *Methanex v US* (n 520) Part IV-Chapter D [7]-[8].

⁸²² *Continental v. Argentina* [246]-[258].

⁸²³ *Ibid* [258].

⁸²⁴ See Yutaka Arai-Takahashi, *The Margin of Appreciation Doctrine and the Principle of Proportionality in the Jurisprudence of the ECHR*, (Antwerpen: Intersentia, 2002) 154.

⁸²⁵ *S.D. Myers v. Canada* [263], see Article 104 of the NAFTA – it requires a State to choose regulations which are least inconsistent with NAFTA. See also *ADF v. US*, Award [190]; *Mondev v. US*, Award, [136]; *Azinian v. US*, Final Award [99]; *Chemtura v. Canada* [123]; *Saluka v. Czech Republic*, Partial Award, [305].

⁸²⁶ *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic*, Decision on Liability, 30 July 2010, ICSID Case No. ARB/03/19.

Concession (of water distribution) throughout the period of thirty years and in response to unpredictable circumstances that might arise during that time’.⁸²⁷

To conclude, the existence and scope of an investor’s legitimate expectations does not exclude a State’s customary right to regulate – it merely limits it. The tools for determining the fair and balanced extent of the limitations imposed by legitimate expectations is analyzed in the following section.

4.5. Inherent flexibility of legitimate expectations for legal stability through its sub-elements

The aim of this section is to indicate those sub-elements of legitimate expectations, the interpretation of which, in light of the sustainable development context, allows room for the integration of economic and non-economic aspects and through which ‘pushing and pulling’ of the scope of the indirect expropriation standard may take place.

It is true that arbitral tribunals have interpreted the legitimate expectations element discordantly with respect to its strictness on the ability of host States to change regulations or to adapt to changing factual circumstances, with a detrimental effect on foreign investors.⁸²⁸ At the same time, they have gradually clarified and necessitated several key qualifying sub-elements of the content of legitimate expectations. Understanding what the content of these sub-elements is helps to assess if future changes in fact and law which diminish the value of foreign investment become compensable.

The section starts by indicating the mentioned elements claiming they contain the inherent flexibility for taking into account wider interests than merely economic ones. The following elements will be addressed here in turn: general knowledge about the business and legal framework in the host State⁸²⁹ including the State’s level of development,⁸³⁰ the fact that investment is made in a previously highly regulated area, and the investor’s own conduct and competence.⁸³¹

⁸²⁷ Ibid [236].

⁸²⁸ For instance, the *pro investore* approach taken in *Tecmed v Mexico* [154] is questioned indirectly in the later *Saluka v Czech Republic* [305] or *Parkerings-Comagniet AS v Republic of Lithuania*, ICSID, Award, Case No. ARB/05/8, September 11, 2007 [332].

⁸²⁹ *Glamis Gold, Ltd. v The United States of America*, UNCITRAL (NAFTA), Award, 8 June 2009 [813].

⁸³⁰ *Generation Ukraine Inc v Ukraine*, ICSID Case No. ARB/00/9, Award, 16 September 2003 [20.37] – [20.38]; *Parkerings-Comagniet AS v Republic of Lithuania*, ICSID, Award, Case No.

The chapter proceeds with the analysis of the methods of balancing between the interests of the investors and the States, as applied by various arbitral tribunals within consideration of these sub-elements of legitimate expectations.

4.5.1. Factual circumstances surrounding investment: general knowledge about business and the legal framework in the host State as the investor's risk

The first of the sub-elements – general knowledge about business and the legal environment in the country at the time the investment was made, allows for distinguishing between the commercial risk, that is on the investor, from the compensable political risk.

For instance, in *Generation Ukraine v. Ukraine*, the Tribunal took into account that Ukraine was a developing country and, thus, rejected the indirect expropriation claim based on the bureaucrat conduct of the Ukraine authorities. It emphasized that:

*The Claimant was attracted to the Ukraine because of the possibility of earning a rate of return on its capital in significant excess to the other investment opportunities in more developed economies. The Claimant thus invested in the Ukraine on notice of both the prospects and the potential pitfalls. Its investment was speculative.*⁸³²

In *Parkerings v. Lithuania*, the Tribunal focused on Lithuania's transition from the Soviet regime to European Union membership, implying the probability of legal change of which the investor was supposed to know,⁸³³ hence rejecting the investor's legal stability claim.

Similarly, in *Genin v. Estonia*, the Tribunal set the context in which the dispute arose:

[N]amely, that of a renascent independent state, coming rapidly to grips with the reality of modern financial, commercial and banking practices and the emergence of state institutions responsible for overseeing and regulating areas of activity

ARB/05/8, September 11, 2007 [329], [331], [335]-[336], [342]; *Genin v Estonia Award*, 25 June 2001, 6 ICSID Reports 241, 17 ICSID Reports 240 [348], [362]; *Continental Casualty v Argentina*, Decision on Jurisdiction, ICSID Case No. ARB/03/9, February 22, 2006 [261]; *Total S.A. v Argentina*, ICSID Case No. ARB/04/1, decision on liability (December 27, 2010) [151], [158], [160], [167].

⁸³¹ *Continental Casualty v Argentina* [261]; *Genin v Estonia* [362]; *Total S.A. v Argentina*, ICSID Case No. ARB/04/1, decision on liability (December 27, 2010) [151], [158], [160], [167].

⁸³² *Generation Ukraine, Inc. v. Ukraine*, ICSID Case No. ARB/00/9 (United States/Ukraine BIT), Award, 16 September 2003, [20.37] – [20.38].

⁸³³ *Parkerings v. Lithuania* [329], [331], [335]-[336], [342].

*perhaps previously unknown. This is the context in which Claimants knowingly chose to invest in an Estonian financial institution.*⁸³⁴

In general, the assessment of the reasonableness of an investor's legitimate expectations for legal stability is not isolated from the country's prevailing political, socio-economic, cultural and historical conditions.⁸³⁵

As regards the sustainable development context, it is suggested that the knowledge of the pre-existing regulatory environment is not necessarily limited by the national regulatory environment; it may also extend to the international regulatory environment of the investor's business activity. In this respect the *Chemtura v. Canada* award sheds some light on how the comparative approach may be taken into account. The *Chemtura* award took into account the practice of other states and the existence of various international conventions on banning lindane, even if it did not analyze the scope of the legitimate expectations of the investor, namely, the effect of various national and international restrictions or bans of lindane going back to the 1970.s and alerting investors of the risk to pursue lindane business. This served as proof for widely accepted scientific data on the harmful effect on health of lindane, and hence, it was a part of the legitimacy assessment of Canada's regulatory measure. Thus, in cases where the investor's business activity has been highly regulated internationally or in other legal systems but not yet in a host State, and if the host State changes its regulatory environment in line with the international values, a 'competent' investor should not consider it as a sudden and unexpected change⁸³⁶ unless the host State has given specific assurances for that kind of legal stability. What results from the above-mentioned arbitral jurisprudence imposes a significant burden on the investor as a 'competent businessman' to know the environment in which the investor chooses to invest, and realize and face the inherent risks of the investor's intended investment. Therefore, one may conclude that the 'competent businessman' criterion requires an investor to embrace not only domestic but also international regulation of the relevant investment area.

⁸³⁴ Genin v. Estonia Award, 25 June 2001, 6 ICSID Reports 241, 17 ICSID Reports 240, [348].

⁸³⁵ Duke Energy Electroquil Partners and Electroquil S.A. v. Republic of Ecuador, ICSID Case No.ARB/04/19, Award, 18 August 2008 [340]. See also Glamis Gold v.US [615].

⁸³⁶ Rudolf Dolzer, 'Indirect Expropriations: New Developments?', (2002-2003) 11 N.Y.U. Envtl. L. J. 64, 79.

4.5.2. Competent businessman criterion and an investor's own conduct

IAs 'are not insurance policies against bad business judgements'.⁸³⁷ Hence, arbitrators often focus on the investor's own conduct and on what may be reasonably expected from a competent investor in order to determine the reasonability of the investor's legitimate expectations for stability.

Thus, for example, in the above-mentioned *Genin v. Estonia*, the crux of the claim was the revocation of the investor's banking licence. The revocation was fuelled by the credibility gap, which the investor had created by not disclosing to the relevant authorities the necessary information about the ownership of its investment.⁸³⁸ The Tribunal took this aspect into account when denying a violation of the FET standard.

Other tribunals have focused on what a 'competent businessman' is supposed to do in order to transfer a business risk into a compensable political risk. Thus, in *Continental Casualty v. Argentina*, the Tribunal rejected the investor's reliance on political and general legislative statements as non-reasonable. The Tribunal emphasized that the investor was a 'competent major international investor', implying it was assumed to know that its investment involved a probability of political risk.⁸³⁹ Therefore, the investor's reliance merely on a general regulation without securing any specific assurances by the State was not reasonable.

Likewise, the Tribunal in *Total v. Argentina* focused on the timing of Total's investment as a barring factor for reasonable legal stability expectations for regular tariffs adjustments in the gas sector.⁸⁴⁰ The investor invested in Argentina at the beginning of the crisis in 2001, when various limitations to tariff adjustments were already in place.⁸⁴¹ This aspect, coupled with the existence of no specific promises for legal stability,⁸⁴² led the Tribunal to conclude that Argentina did not violate the investor's legitimate expectations and acted reasonably within its police powers during the peak of the crisis by pesifying and freezing the gas tariffs.⁸⁴³

In comparison, under the European human rights law, legitimate expectations of the affected individual play a significant role in the 'excessive and individual burden'

⁸³⁷ Maffezini v. Spain [64].

⁸³⁸ Genin v. Estonia, [362].

⁸³⁹ Continental Casualty v. Argentina [261].

⁸⁴⁰ Total v. Argentina [151].

⁸⁴¹ Ibid, [158].

⁸⁴² Ibid, [160],[167].

⁸⁴³ Ibid, [163].

assessment, and the ECtHR will not find an individual and excessive burden if the applicant could expect an element of commercial risk that has materialized. For instance, in *Pine Valley Developments Ltd and Others v. Ireland*, the claim originated from the invalidation of the planning permission for the development of the applicant's property by the State's Supreme Court. The ECHR considered that:

*The applicants were engaged on a commercial venture which, by its very nature, involved an element of risk [...] and they were aware not only of the zoning plan but also of the opposition of the local authority... to any departure from it. This being so, the Court does not consider that the annulment of the permission without any remedial action being taken in their favour can be regarded as a disproportionate measure.*⁸⁴⁴

Similarly, the general knowledge of the legal framework of a particular business area was taken into account in rejecting the expropriation claim in *Fredin v. Sweden*. The ECtHR held that the amendments to the laws regulating revocation of gravel exploitation permits that had been in force for more than ten years were a justified non-compensable control of use of property. The ECtHR gave emphasis to the fact that it was general knowledge that over the years, the exploitation of gravel had become more and more restricted.⁸⁴⁵

Several investment tribunals have applied a similar analysis of legitimate expectations even though not within the framework of proportionality analysis and its 'individual and excessive burden' element. Thus, the *Methanex v. US* and *Glamis Gold v. US* Tribunals rejected the investors' expectations for legal stability due to the well known fact that environmental regulations in California were gradually becoming more stringent, as analysed below.

In sum, one may conclude that the foreign investor as a 'competent businessman' bears a significant burden to show that the alleged legitimate expectations for legal stability are actually legitimate, and that the investor's own conduct does not deter it from relying on the expectations.

In this respect the clarified sustainable development objective allows shaping the content of the 'competent investor' criterion and arguably permits the extension of the meaning of what actions may be considered as bad business judgements.

⁸⁴⁴ *Pine Valley Developments Ltd and Others v. Ireland*, ECtHR, Judgement of 29 November, 1991, Series A No. 222, [59].

⁸⁴⁵ *Fredin v. Sweden*, Judgement of 18 February 1991, *Eur. Ct.H.R.*, No. 192. (Ser. A), [47].

Firstly, a ‘competent businessman’ would not expect that a host State would act contrary to the object and purpose of the investment protection regime, including its sustainable development objective. Since attention is also paid to the investor’s own conduct, the investor is supposed to act in compliance with the objective of sustainable development, for which the very investment protection is granted. Thus, ‘competent investors’ are required to know and rely on their expectations not only on the economic aspects of their business activity but also on its social and environmental context. This context may be domestic or international, taking into account general tendencies with regard to the particular investment activity. For instance, extensive administrative procedures and impact assessments might be necessary as an inherent element of the particular investment activity in cases where the investment relates to the extraction or use of natural resources or affects other significant public interests.

Secondly, the ‘competent businessman’ test must allow the internalizing of risks of a particular investment activity. This means that if post-investment changes of the legal environment deals with inherent risks of the particular investment activity, then the changes should not bear any consequences on the host State, unless specific assurances to the contrary effect are given by the State. For instance, in cases where the international best practice standard or a common practice of many states requires social or environmental impact assessments that is later adopted in a host State affecting the performance of foreign investment or even prohibiting it, such changes may qualify as something a competent investor could and should predict and take into account. For instance and hypothetically, the compensation for expropriation in the *Santa Elena v Costa Rica*⁸⁴⁶ award might have been adjusted differently if the Tribunal had taken into account the general knowledge about the factual circumstances, namely the fact that Costa Rica had longstanding commitments and efforts to expand an international reserve park by including the investment area.⁸⁴⁷

4.5.3. Investment in a previously highly regulated area

⁸⁴⁶ *Compañía del Desarrollo de Santa Elena, S.A. v The Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award of 17 February 2000, 15 ICISD REV – FILJ 169 (2000).

⁸⁴⁷ Charles N. Brower, Jarrod Wong, ‘General Valuation Principles: The Case of Santa Elena’ in Todd Weiler (ed), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (Cameron May 2005), Chapter 20, 747, 763-764, referring to the Counter-Memorial of Costa Rica [on file with authors].

Several arbitral awards have emphasized that there is no ground for an investor's expectations for legal stability in cases where the investor has invested in a highly regulated business area without securing any stability assurances by the host State.

For instance, in *Methanex v. US*, dealing with California's suppression of trade in a controversial gasoline additive, production of which was a foreign investor's investment, the Tribunal accentuated that Methanex 'entered a political economy in which it was widely known, if not notorious, that governmental environmental and health protection institutions (...) 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'.⁸⁴⁸

Since there were no commitments for legal stability given by California to induce the *Methanex* investment, the Tribunal denied the existence of legitimate expectations for legal stability in its assessment of the indirect expropriation claim.⁸⁴⁹

Similarly, the Tribunal in *Glamis Gold v. US* rejected the investor's legal predictability claim under the FET standard because of the lack of any specific assurances for legal stability, and furthermore, because of the general knowledge that 'California is a particularly highly regulated environment with respect to environmental measures in general, and mineral exploration in particular'.⁸⁵⁰

4.5.4. Interim conclusions

Arbitrators have extracted several sub-elements of the legitimate expectations principle focusing on general knowledge about the business and the legal framework in the host State, a pre-existing knowledge of the regulatory environment of the investment area and the investor's own conduct and competence. Some legal commentators have suggested that a progressive interpretation of some of these sub-elements may function as an effective tool for incorporating the interests of all those who are affected by the foreign investment in the scope of the relevant investment guarantees.⁸⁵¹

⁸⁴⁸ *Methanex v US*, Part IV - Chapter D - Page 4 [7]-[8].

⁸⁴⁹ *Ibid* Part IV - Chapter D - Page 5 [9].

⁸⁵⁰ *Glamis Gold v. US* [800].

⁸⁵¹ Francioni sees effective interpretation of the sub-elements of the FET standard as a tool to safeguard the interests of the local population in investment arbitrations, see Francesco Francioni, 'Access to Justice, Denial of Justice, and International Investment Law', (2009) 20 *European Journal of International Law* 729, 739. Simma has highlighted precisely these above-mentioned aspects of

Extending the idea of a progressive interpretation of these elements, the study suggests that effective treaty interpretation principle, namely the principle which requires such an interpretation of a treaty term that secures the effectiveness of the aim of the treaty,⁸⁵² is now specifically guided by the integration element of sustainable development. This proposition has two main consequences. Firstly, it is now an obligation and not a choice to integrate in the interpretation process of investment guarantees the interests of both the local and international communities in the field of human rights, the environment, cultural heritage and health protection. Secondly, since the sustainable development objective rejects the ‘self-contained’ approach to investment law, considerations of international and comparative law elements are justified and even necessary in setting the scope of legitimate expectations for legal stability.

4.6. Use of various methods of balancing in the assessment of whether legitimate expectations for legal stability are protected

Legitimate expectations for the legal stability element do not contract away a host State’s right to exercise its police powers (unless specific commitment to that particular effect is given to the investor); however, it functions as a limitation of the State’s discretion to change the regulatory environment of the investor’s business area.⁸⁵³ Therefore, filling the legitimate expectations element with content in a specific case necessarily leads to a certain balancing exercise between these two interests.

As a logical consequence, within the assessment of the potential violation of the FET standard some arbitral tribunals have noted that there needs to be ‘a weighing of the Claimant’s legitimate and reasonable expectations on the one hand and the Respondent’s legitimate regulatory interests on the other’.⁸⁵⁴ This balancing has taken place in determining whether an exercise of a right of a State to regulate the general

‘legitimate expectations’ as an ‘entry point’ for human-rights objectives in investment protection law, see Bruno Simma, ‘Foreign Investment Arbitration: A Place for Human Rights?’ (2011) 60 ICLQ 3, 573, at 592-593.

⁸⁵² R Gardiner, *Treaty Interpretation* (OUP 2008) 148, 161, 199-200.

⁸⁵³ *Methanex v US* (n 520) Part IV-Chapter D [7]-[8].

⁸⁵⁴ *Saluka v. Czech Republic* [306]; *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic, Decision on Liability*, 30 July 2010, ICSID Case No. ARB/03/19, [236]. For detailed analysis on proportionality analysis in applying FET standard, see A Stone Sweet, ‘Investor-State Arbitration: Proportionality’s New Frontier’ (2010) 1 *Law & Ethics of Human Rights* 4, Article 4, 61-76.

welfare through enacting, modifying or cancelling a law at its own discretion⁸⁵⁵ is limited by the need to safeguard the investor's reliance that nothing will change in the regulatory regime of its investment. Thus, it has played the key role for drawing the line between the commercial risk that has to be borne by a foreign investor and the political risk which should be shifted to the host State.

In view of the above, the aim of this particular section is to analyse possibilities of the integration of economic and non-economic interests through the balancing techniques that are applied by some arbitral tribunals in relation to legitimate expectations for the legal stability element under FET and indirect expropriation standards. Even more, it is claimed that these balancing techniques should be applied intentionally in other similar factual situations, and their application must be guided by the integration principle of economic and non-economic interests.

The section is structured in the following way – it starts with an overview of balancing analysis and proceeds with the analysis of the application of various methods of balancing within the legitimate expectations element by investment treaty tribunals. The section concludes with a claim that the integration element of sustainable development requires and justifies a balancing of interests of the state and the investor in setting the scope of indirect expropriation as an inherent element, instead of being an outside methodology that needs to be justified as a custom or general principle of law in order to be applicable in investment arbitration.

4.6.1. Overview: prerequisites and variations of balancing analysis

The most accurate mode of balancing is proportionality analysis as developed by national constitutional courts. In a modified way it is adopted by several international courts and tribunals. The proportionality test is generally understood as a best-practice method or framework of legal interpretation and decision-making in case of a conflict of two principles or public policy objectives of equal normative value.⁸⁵⁶ It functions as a judicial review mechanism of governmental measures.

Robert Alexy, who has constituted the basic conceptual foundations of proportionality analysis, defines it as an optimization requirement instead of 'all-or-nothing' way of

⁸⁵⁵ *Parkerings v. Lithuania* [332].

⁸⁵⁶ A. Stone Sweet A, J. Mathews, 'Proportionality Balancing and Global Constitutionalism' (2008-2009) 47 *Colum.J.Transnat'l L.* 73-74; Stone Sweet, 'Investor-State Arbitration: Proportionality's New Frontier' (2010) 1 *Law & Ethics of Human Rights* 4, Article 4, 76.

solving normative conflicts. That is to say, in cases of a collision or a competition of principles it is required that both of them are realized to the greatest extent possible given the legal and factual possibilities.⁸⁵⁷ Traditionally, proportionality consists of three sub-principles – suitability, necessity or the requirement not to go further than is needed for achieving the stated aim, and proportionality in the narrower sense. In cases where all of these three elements are applied in the proportionality analysis, it is called a three-tier proportionality test. Within the ‘proportionality in the narrower sense’, Alexy distinguishes the ‘law of balancing’ or in other words, the principle that ‘[t]he greater the degree of nonsatisfaction of, or detriment to, one principle, the greater must be the importance of satisfying the other.’⁸⁵⁸ ‘Law of balancing’, thus, implies taking into account several relevant aspects like the importance of the right affected and the right protected, the degree and length of interference and the availability of alternative measures that might achieve the same end with less restrictive means.⁸⁵⁹

In practice, international courts and tribunals have applied various modifications of proportionality analysis in comparison to the one analyzed by Alexy and which have traditionally been employed by domestic constitutional courts. For instance, the ECtHR applies proportionality analysis within the ‘margin of appreciation’ doctrine to determine whether a State has abused its scope of discretion when imposing limitations on human right guarantees.⁸⁶⁰ The WTO Dispute settlement bodies apply modified proportionality analysis in relation to general exceptions from trade rules under GATT Article XX, focusing on two-tiers – suitability and necessity, and in particular on the ‘available less restrictive alternative’ element within the necessity analysis.⁸⁶¹ The ECJ applies proportionality analysis for analysing the legitimacy of limitations that EU Member States impose on EU fundamental freedoms⁸⁶² and the

⁸⁵⁷ Robert Alexy, *A Theory of Constitutional Rights* (OUP 2002) 47.

⁸⁵⁸ Ibid 102.

⁸⁵⁹ Ibid.

⁸⁶⁰ Y Arai-Takahashi, *The Margin of Appreciation Doctrine and the Principle of Proportionality in the Jurisprudence of the ECHR* (2002).

⁸⁶¹ P Van den Bossche, ‘Looking for Proportionality in WTO Law’ (2008) 35 *Legal Issues of Economic Integration* 3, 283-294.

⁸⁶² Benedict Kingsbury and Stephan W Schill ‘Public Law Concepts to Balance Investors’ Right with State Regulatory Actions in the Public Interest – the Concept of Proportionality’ in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010), 82.

ICJ uses proportionality analysis for the assessment of the legitimacy of use of force and countermeasures.⁸⁶³

4.6.2. Proportionality analysis in investment law: pros and cons

A number of investment arbitral tribunals have incorporated the idea of balancing or even referred to the proportionality test as a method of reasoning in the application of various investment protection standards.⁸⁶⁴

With respect to proportionality analysis in international investment protection law, there are two basic lines of thought dividing the investment expert circles. There are those who are against proportionality analysis and those who see the proportionality test as a rational argumentation method employable in investment arbitration.

Those who are against proportionality balancing in investment treaty arbitration see proportionality analysis as a legal tool that is appropriate only for legal systems of high judicialization, and thus not available for institutionally different *ad hoc* arbitrators limited by the consent of the disputing parties.⁸⁶⁵ They disagree in particular with the application of the ‘law of balancing’ in Alexy’s sense, since arbitral tribunals are too far removed from the reality of host States in order to undertake an assessment of proportionality *stricto sensu* that necessarily implies making policy choices;⁸⁶⁶ it is the function for which investment arbitrators do not have a democratic legitimacy. Further, it is noted that there are significant differences in the treaty texts that are subject to proportionality assessment; therefore it is not appropriate to directly transfer argumentation methods used by one dispute settlement body under a specific treaty to another.⁸⁶⁷ Nevertheless, some scholars see limited use of proportionality analysis consisting of first two tiers of suitability and necessity fit for investment arbitrations, since it would provide a predictable framework of

⁸⁶³ Roger O’Keefe, ‘Proportionality’ in J. Crawford, A. Pellet, S. Olleson (eds), *The Law of International Responsibility* (OUP 2010), 1157-1168.

⁸⁶⁴ Alex Stone Sweet, ‘Investor-State Arbitration: Proportionality’s New Frontier’ (2010) 1 *Law & Ethics of Human Rights* 4, Article 4.

⁸⁶⁵ William Burke-White and Andreas von Staden, ‘The Need for Public Law Standards of Review in Investor-State Arbitrations’ in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010) 717.

⁸⁶⁶ *Ibid.*

⁸⁶⁷ B Kingsbury, S W Schill, ‘Public Law Concepts to Balance Investors’ Right with State Regulatory Actions in the Public Interest – the Concept of Proportionality’ in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010) 80.

legitimacy assessment of state's measures and, by not going into the proportionality *stricto sensu*, the principle of deference would be tolerated.⁸⁶⁸

Those who argue for adopting proportionality analysis in investment treaty arbitration insist that the role of arbitrators has changed from merely serving the claiming parties to serving as agents of the community of States participating in the network of IIAs.⁸⁶⁹ It is indicated that a gradual judicialization process of investment treaty arbitration has taken place,⁸⁷⁰ allowing and even requiring adopting legal argumentation methods that are usually used in legal systems of high judicialization.⁸⁷¹ Furthermore, investment treaty arbitrators are already accommodating variations of balancing analysis in the interpretation process of some investment guarantees, what Stone Sweet calls 'flirtation with proportionality balancing'.⁸⁷² For instance, arbitrators in *Tecmed v. Mexico* got inspiration from the ECtHR proportionality and applied it in the indirect expropriation analysis; the *National Grid v. Argentina* and *Total v. Argentina* awards used proportionality language for determining the scope of legitimate investment backed expectations under FET, and *Continental Casualty v. Argentina* referred to the two-tiered

⁸⁶⁸ Schill Stephan W, 'Deference in Investment Treaty Arbitration: Reconceptualizing the Standard of Review through Comparative Public Law', SIEL, Working Paper No. 2012/33, available <<http://www.ssrn.com/link/SIEL-2012-Singapore-Conference.html>> (accessed on 15 August 2012).

⁸⁶⁹ Alec Stone Sweet, 'Investor-State Arbitration: Proportionality's New Frontier', Law & Ethics of Human Rights, Volume 4, Issue 1, 2010, Article 4; Andreas Kulick, *Global Public Interest in International Investment Law*, (CUP 2012); Caroline Henckels, 'Proportionality and the Standard of Review in Fair and Equitable Treatment Claims: Balancing Stability and Consistency with the Public Interest', SIEL Working Paper No.2012/27, available at <http://www.ssrn.com/link/SIEL-2012-Singapore-Conference.html>, accessed on 31 March 2013. For instance, Henckels argues that proportionality analysis may be the most appropriate methodological approach for determining disputes that engage the competing interests of investors and host states in the context of fair and equitable treatment claims arising from a host states' exercise of regulatory or administrative power. She argues that the employment of proportionality analysis that would be inspired by the ECJ, ECtHR or WTO approaches would provide greater autonomy to host states to take measures in the public interest, yet would provide sufficient scrutiny to control misuse of public power through the identification of a host state's actions taken with impermissible purposes or by ineffective or overboard measures.

⁸⁷⁰ Alec Stone Sweet, 'Investor-State Arbitration: Proportionality's New Frontier', Law & Ethics of Human Rights, Volume 4, Issue 1, 2010, Article 4, 54-59; Stone Sweet conceptualizes judicialization in investment treaty adjudication on four criteria: precedent system, the adoption of balancing techniques, admission of amicus briefs as an indicator of diffusion of interests affected by investment treaty arbitration and indicating the public law aspect, and the push for appellate supervision. See also E-U. Petersmann, 'Multilevel Trade Governance Requires Multilevel Constitutionalism', in *Constitutionalism, Multilevel Trade Governance and Social Regulations*, C.Joerges, E-U.Petersmann (eds.), 2006, 5; E-U. Petersmann, 'Future of International Economic Law: A Research Agenda', EUI Working Papers, Law 2010/06, available at <http://ssrn.com>, 19-28.

⁸⁷¹ A.Stone Sweet, J.Mathews, 'Proportionality Balancing and Global Constitutionalism' (2008-2009) 47 Colum.J.Transnat'l L, 72, 162, A Stone Sweet, 'Investor State Arbitration: Proportionality's New Frontier', 67-76.

⁸⁷² Alec Stone Sweet, 'Investor-State Arbitration: Proportionality's New Frontier', Law & Ethics of Human Rights, Volume 4, Issue 1, 2010, Article 4.

proportionality as it is applied by the WTO AB in the assessment of application of ‘non-precluded measures’ clauses. Finally, advocates of proportionality analysis note that the proportionality test as a rational legal argumentation method provides structure and more predictability in the application of the vague investment standards, and it allows minimising ‘losses to looser’ in balancing the conflicting rights.⁸⁷³ Therefore, it is suggested that its employment in investment treaty arbitration would improve the legitimacy of the international investment protection regime, which has suffered from such arbitral awards as *Santa Elena v. Costa Rica* and *Metalclad v. Mexico*, and would allow more careful analysis of the content of abstract investment guarantees.

Notwithstanding the above, there is no agreement on the justification of the application of proportionality or other balancing analysis within the investment guarantees – those investment arbitral tribunals that employ balancing are often challenged as lacking a clear justification of the employment of balancing from the sources of law point of view, e.g., whether balancing is introduced as an outer method stemming from customary law or general principles of law or it is an intrinsic part of investment treaty standards.⁸⁷⁴

It is argued that balancing between the interests of an investor and those of a host State is induced by the sustainable development objective that requires a process by which economic and non-economic aspects of investment protection are mitigated and, thus, private-property oriented interests of foreign investors and other public interests are put into balance. It is argued here that the sustainable development objective has implications for justifying the balancing analysis within the indirect expropriation standard that is missing from those who are proponents of adopting variations of proportionality analysis in investment arbitration. Let us take an illustrative example, the earlier cited award highlighted by Stone Sweet with reference to proportionality analysis that is now applicable in investment arbitration is

⁸⁷³ ‘2-against-1 problem’ see A.Stone Sweet, J.Mathews, ‘Proportionality Balancing and Global Constitutionalism’ (2008-2009) 47 Colum.J.Transnat’l L, 72, 81-97.

⁸⁷⁴ Kingsbury and Schill refer to Article 31(3)(c) of the VCLT so as to integrate proportionality analysis as a general principle of law in investment arbitration, see Benedict Kingsbury and Stephan W. Schill, ‘Public Law Concepts to Balance Investors’ Right with State Regulatory Actions in the Public Interest – the Concept of Proportionality’ in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010) 88.

Continental v. Argentina.⁸⁷⁵ Here, ‘flirtation with proportionality’ was justified, since Article XI of the US-Argentina BIT under consideration resembled Article XX of the GATT. Hence, the imitation of the two-tiered weighing and balancing under GATT Article XX was justified but it cannot be directly transmitted in the indirect expropriation standard.

As regards the interpretation of the indirect expropriation standard, none of the proportionality proponents go beyond the criticized *Tecmed* proportionality analysis and its approving awards. Therefore, doubts remain whether it is an appropriate tool to be employed for this particular standard,⁸⁷⁶ and at which stage of indirect expropriation analysis it would be appropriate. That said, it needs to be kept in mind that the indirect expropriation standard functions as a rule and not as a principle. It is so because the determination of whether expropriation has taken place implies an ‘all or nothing’ approach, namely, whether the property is taken away or not, considerably limiting the space for a balancing analysis. Therefore, in case expropriation is found, there is no explicit place for proportionality balancing with respect to the amount of compensation unlike in the European human rights system under the right of property.⁸⁷⁷

Therefore, the next section is designed to demonstrate the approach to balancing that is claimed to be appropriate for the indirect expropriation standard and that is inherently justified by the effective interpretation of the standard in light of the

⁸⁷⁵ A Stone Sweet, ‘Investor-State Arbitration: Proportionality’s New Frontier’ (2010) 4(I) Law and Ethics of Human Rights, 47, at 64.

⁸⁷⁶ Benedict Kingsbury and Stephen W Schill, ‘Public Law Concepts to Balance Investors’ Right with State Regulatory Actions in the Public Interest – the Concept of Proportionality’ in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010), 89-96; A Stone Sweet, ‘Investor-State Arbitration: Proportionality’s New Frontier’ (2010) 4(I) Law and Ethics of Human Rights, 47, at 64. See, for instance, *Fireman Funds on Tecmed* ECtHR inspired proportionality balancing, *Fireman’s Fund Insurance Company v. Mexico*, Award, NAFTA, ICSID Case No.ARB(AF)/02/01, 17 July 2006, para.174(j), footnote 161.

⁸⁷⁷ *James and ors v UK* Judgement, 21 February 1986, ECHR Series A, No. 98 [37], [54]. See also below ‘4.7.1. Proposed human rights approach in assessing compensation for expropriation’. In essence, Alexy assesses proportionality balancing of two equal legal norms as a requirement of ‘optimization’:

‘The basic idea of optimization relative to the legal possibilities at hand can be expressed by a rule that might be called the “Law of Balancing.” A statement of this rule runs as follows: “The greater the degree of non-satisfaction of, or detriment to, one principle, the greater must be the importance of satisfying the other.” (R. Alexy, ‘The Construction of Constitutional Rights’ (2010) 1 Law & Ethics of Human Rights 4, Article 2, 28.)

That is to say, once the expropriation is found, the optimization requirement by diminishing fair market value of expropriated property is not explicitly possible in cases where the expropriation is done for highly important public purposes. The situation is different with the right to property under European human rights, where the ECtHR can minimize the compensation in a case of a significant public purpose, for which the property is expropriated.

sustainable development objective. It is argued that the balancing element is suitable and necessary within the interpretation process of the content of the investor's legitimate investment-backed expectations that allows for the most nuanced way of integrating economic and non-economic considerations in the indirect expropriation standard.

4.6.3. Case studies: balancing within the legitimate expectations for legal stability

Balancing as an inherent constituent of legitimate expectations for legal stability is mainly brought to attention by several arbitral awards dealing with the crisis of Argentina in 2001-2002 and the consequent dramatic and unexpected changes in the business and legal environment. Investment tribunals have exercised a balancing analysis for setting the scope of legitimate expectations for legal stability in two situations – in the first scenario, significant changes to the legal framework of the investment were done without violating specific commitments given to an investor (as in *Total v. Argentina*,⁸⁷⁸ *Continental v. Argentina*⁸⁷⁹). In the other scenario, the State's legal environment was changed in violation of prior commitments to the foreign investor (*National Grid v. Argentina*,⁸⁸⁰ *Suez v. Argentina*⁸⁸¹).

These Tribunals have employed various modifications of (proportionality) balancing between the investor's expectations for legal stability and the State's reasonable right to regulate for public interest in order to arrive at their conclusions about the scope of this standard. These balancing methods are analyzed in the subsequent sections, suggesting that one may adopt similar logic and methodology to integrate not only the context of an extreme financial crisis but also elements covered by the concept of sustainable development within the scope of legitimate expectations.

4.6.3.1. Balancing in a case of no violation of prior commitments

⁸⁷⁸ *Total S.A. v. Argentina*, ICSID Case No. ARB/04/1, Decision on liability, December 27, 2010.

⁸⁷⁹ *Continental Casualty Company v. The Argentine Republic*, Annulment Proceeding, ICSID Case No. ARB/03/9, September 16, 2011 [262].

⁸⁸⁰ *National Grid P.L.C. v. Argentine Republic*, UNCITRAL, Award, November 3, 2008, where the violation of prior commitments was justified in part.

⁸⁸¹ *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic*, Decision on Liability, 30 July 2010, ICSID Case No. ARB/03/19. Unlike other awards analyzed in the section, the Suez award is not related to the crisis in Argentina. It serves as an example of unjustified deviations from prior commitments.

In the recent *Total v. Argentina* award,⁸⁸² the Tribunal used (proportionality) analysis as a general principle of law⁸⁸³ in assessing the scope of legitimate expectations and, thus, alleged violations of the FET and the indirect expropriation standard.

The investor challenged the pesification of the gas tariffs based on the Emergency Law and the freezing of the gas tariffs during and after the social and economic crisis in Argentina in 2001-2002 as acts tantamount to expropriation and in violation of the FET standard.

The Tribunal highlighted several legal principles that it applied to the facts of the case so as to evaluate Total's claims.

Firstly, the Tribunal engaged in the balancing exercise in order to assess whether the FET standard (legitimate expectations for legal stability) was breached by the changes to the Gas Regulatory Framework in the context of the severe economic emergency. The Tribunal noted that balancing 'requires an assessment of the existence of a breach of the fair and equitable treatment standard taking into account the purposes, nature and objectives of the measures challenged, and an evaluation of whether they are proportional, reasonable and not discriminatory'.⁸⁸⁴

As to the nature of the challenged measures, the Tribunal paid due respect to the importance of the context of regulatory change and the public interest pursued by the regulatory measure, which, in the case at hand, was Argentina's unique social and economic crisis.⁸⁸⁵ The Tribunal took into account that the pesification of the tariffs was a non-discriminatory measure of general application to all sectors of the economy and justified it as being taken in good faith within the monetary sovereignty of the State 'in a situation of recognized economic emergency of an exceptional, even catastrophic, nature'.⁸⁸⁶ Therefore, The Tribunal justified pesification and the freezing of tariffs during the peak of the crisis as a non-discriminatory, good faith

⁸⁸² *Total S.A. v. Argentina*, ICSID Case No. ARB/04/1, Decision on liability, December 27, 2010.

⁸⁸³ The Tribunal justified the balancing analysis within the legitimate expectations element by using a comparative analysis of the interpretation of legitimate expectations in a non-BIT context using as a guidance its interpretation by other courts and Tribunals. The Tribunal interpreted the content of legitimate expectation under the FET standard in a non-BIT context, using a comparative approach to national administrative law, EU law, human rights law and public international law.[126]-[127]. A comparative approach was justified, since the concept of reasonable and legitimate expectations stems from good faith that is a general principle of law in the meaning of Article 38(1) of the Statute of the ICJ.[124] [126].

⁸⁸⁴ *Ibid* [162].

⁸⁸⁵ *Ibid*, [159], [162].

⁸⁸⁶ *Ibid* [163].

exercise of the State's regulatory power⁸⁸⁷ which did not violate the investor's legitimate expectations for legal stability,⁸⁸⁸ albeit these measures changed dramatically the regulatory environment of the investor's business activity.

Beforehand, the Tribunal analyzed the existence of Total's legitimate expectations for legal stability, indicating that for legitimate expectations to exist, governmental 'promises' made to a foreign investor need to be specific.⁸⁸⁹ In the case at hand, no promises were given to the investor not to pesify the gas tariffs,⁸⁹⁰ and even though the Convertibility Law was in force at the time of making the investment, there were no specific assurances sought by Total for its stability.⁸⁹¹

Secondly, and most importantly for the present study, the Tribunal noted that in the assessment of the fairness of the governmental action, the overall context and 'the host State's right to regulate domestic matters in the public interest has to be taken into consideration as well',⁸⁹² especially when a fundamental change of factual circumstances takes place. In this particular respect, the Tribunal invoked reasonableness and proportionality as relevant applicable standards⁸⁹³ that require 'a weighing of the Claimant's reasonable and legitimate expectations on the one hand and the Respondent's legitimate regulatory interest on the other',⁸⁹⁴ also taking into account the conduct of the investor. Here, the Tribunal declared that:

*Besides such an objective comparison of the competing interests in context, the conduct of the investor in relation to any undertaking of stability is also, so to speak "subjectively", relevant. Tribunals have evaluated the investor's conduct in this respect, highlighting that BITs "are not insurance policies against bad business judgements".*⁸⁹⁵

In the end, the investor's conduct barred it from the legitimate reliance on legal stability because at the time of the making of Total's investment in Argentina, there

⁸⁸⁷Total v. Argentina [160]-[165], [175]. In contrast to most of the previous awards on Argentina's crisis, see [176]-[181].

⁸⁸⁸Ibid, [164].

⁸⁸⁹Ibid [144].

⁸⁹⁰Ibid [145], [148].

⁸⁹¹Ibid [149].

⁸⁹²Ibid [123].

⁸⁹³Total v. Argentina [126]-[127].

⁸⁹⁴Ibid [123] footnote 127 referring to the *Saluka Investments BV v. The Czech Republic* [305]-[306].

⁸⁹⁵Ibid [124] (footnotes omitted).

were several restrictions on the convertibility regime already in place.⁸⁹⁶ Therefore, the Tribunal held that the investor's conduct was not reasonable:

*From a business point of view, an experienced international investor such as Total could not have considered these developments as irrelevant to the future stability of the PPI-adjusted US dollar gas tariffs. An objective risk analysis of the situation should have alerted Total that the stability of the gas regime was being undermined in practice from various directions.*⁸⁹⁷

Since there were no 'specific stabilization promises to the foreign investor' and the investor's own conduct barred it from relying on any stability expectations through laws or regulations of a general character, the Tribunal concluded that the pesification of tariffs was fair 'in the circumstances' and 'considering the inherent flexibility' of the FET standard.⁸⁹⁸

The same measures that Total challenged under the FET standard were also challenged under the indirect expropriation standard. Although Total failed to prove the substantial deprivation of its investment by pesification and Argentina's failure to readjust gas tariffs after the peak of the crisis,⁸⁹⁹ the Tribunal once again noted that 'in the absence of specific stabilization promises' to the investor pesification was 'a bona fide regulatory measure of general application, which was reasonable in light of Argentina's economic and monetary emergency and proportionate to the aim of facing such an emergency',⁹⁰⁰ and, thus, it did not amount to a measure equivalent to expropriation.⁹⁰¹

The Tribunal did not apply the three tier-proportionality assessment in Alexy's sense, the balancing was less precise. Nevertheless, it established a link between the relevance of the context and nature (e.g., non-discrimination) of the measure and exemption of State liability. The *Total* Tribunal allocated balancing in the place where

⁸⁹⁶ Ibid [151].

⁸⁹⁷ Ibid [156].

⁸⁹⁸ Ibid [164].

⁸⁹⁹ Ibid [196]-[198].

⁹⁰⁰ Ibid [197]: '[A] tribunal must take into account their [regulatory measures'] features and object so as to assess their proportionality and reasonableness in respect of the purpose which is legitimately pursued by the host State. These regulatory measures, when judged as legitimate, proportionate, reasonable and non-discriminatory, do not give rise to compensation in favour of foreign investors.' In footnote 232 the Tribunal refers to Fortier and Drymer who express the proportionality balancing in the following words: 'The higher the purpose of a measure and the greater its practical benefit to the public welfare, the greater is the level of investment interference that must be demonstrated in order to tip the scales towards a characterization of the measures as an expropriation.', see L Yves Fortier, Stephen L Drymer, 'Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor' (2004) 19 ICSID Review-Foreign Investment Law Journal 2, 293, 300.

⁹⁰¹ Ibid [197].

real balancing of interests may take place, considering wider interests and circumstances than the private property interests of the investor.

The same measures were also considered to be proportional and justified by the *Continental v. Argentina* award. Even if most of Argentina's crisis management measures were covered by the 'non-precluded measures' clause under the applicable BIT,⁹⁰² the Tribunal proceeded to distinguish those measures adopted by Argentina that were legitimate under the BIT, from those which were carved out because of the application of exceptions clause.⁹⁰³ Eventually the Tribunal concluded that the fixing of an exchange rate was a legitimate limitation to the use of property in the public interest not imposing 'an unreasonable burden on the owner as compared with other similarly situated property owners'.⁹⁰⁴ The measure was not imposing an unreasonable burden on the investor because it was non-discriminatory, it was not in violation of prior commitments – the investor had no legitimate expectations for freezing the convertibility law in US dollars⁹⁰⁵ – and there was no substantial deprivation of the investor's property.⁹⁰⁶

In sum, the *Total* and *Continental* Tribunals noted that balancing requires taking into account the nature and objectives of the measures challenged. Argentina's measures were justified since they were taken in the context of severe economic crisis and no stabilization promises were ever given to the investors. As a result, both Tribunals have indicated that in cases of a dramatic change in the regulatory environment the existence of specific prior commitments, non-discrimination and the general context of the measure are elements participating in the balancing process in order to see if the investor's expectations for legal stability are violated (within the context of FET and the indirect expropriation standards).

A comparable approach is adopted in the 'new generation' ASEAN Comprehensive Investment Agreement (ASEAN CIA⁹⁰⁷). It states that the determination of whether an indirect expropriation has taken place requires a case-by-case, fact-based inquiry that considers, among other factors, the economic impact of the challenged governmental measure, prior commitments given by a host State towards a foreign

⁹⁰² *Continental v. Argentina* [262], [266] [275].

⁹⁰³ *Continental v. Argentina* [276].

⁹⁰⁴ *Continental v. Casualty* [276]-[278].

⁹⁰⁵ *Ibid* [279].

⁹⁰⁶ *Ibid* [284].

⁹⁰⁷ ASEAN Comprehensive Investment Agreement 2009, available at <http://www.aseansec.org/22218.htm> (accessed on 31 March 2011), Annex 2, paragraph 3.

investor, and, ‘the character of the government action, including, its objective and whether the action is disproportionate to the public purpose’.

These elements are supplemented by the high standard of behaviour and awareness of the surrounding circumstances that is expected from a competent investor. Competent investor’s criterion also implies an investor’s proactive conduct so as to secure its interests by specific commitments from the host State.

It is argued that these balancing elements leave room for the potential integration of sustainable development related aspects within the scope of legitimate expectations and, thus, the indirect expropriation standard extending the scope of non-compensable commercial risk. Thus, the sustainable development objective and its integration element may effectively function as an interpretative tool to distinguish between compensable political and non-compensable commercial risk by ‘pushing and pulling’ the boundaries of these elements.

For instance, it is already acknowledged that ‘the political, socioeconomic, cultural and historical conditions prevailing in the host State’ are important for the determination of the business context that the investor needs to be aware of.⁹⁰⁸ The integration element of sustainable development arguably allows interpreting the necessary knowledge of the relevant context also in light of domestic or international social and environmental aspects of the particular investment activity, e.g., the knowledge that it is restricted or prohibited in some countries or global best practice standards requires impact assessments of it.

4.6.3.2. Balancing of the investor’s and the State’s interests in the case where a formal violation of prior commitments has happened

Generally, there would be a presumption of compensable ‘individual and excessive burden’ (using the terminology of the ECtHR⁹⁰⁹), ‘unusual damage’ (using the phrase from *Total v. Argentina*⁹¹⁰) or ‘unreasonable burden’ (as mentioned in *Continental v.*

⁹⁰⁸ *Duke Energy v. Ecuador* [340].

⁹⁰⁹ Under European human rights law, legitimate expectations of the affected individual play a significant role in the ‘excessive and individual burden’ assessment, and the ECtHR will not find an individual and excessive burden if the applicant could expect an element of commercial risk, which has materialised.

⁹¹⁰ *Total S.A. v. Argentina*, ICSID Case No. ARB/04/1, Decision on liability, December 27, 2010 [130] footnote 142.

*Argentina*⁹¹¹) on the part of the investor in case amendments in regulatory environment contradict the State's prior commitments towards the investor. In other words, the above-mentioned balance between the interests of the investor and those of the State would not be reached if the State would deviate from its specific commitments, on which the investor had relied for making the investment in the country.

Deviation from prior commitments may be excused by invoking general exception clauses in a case where the applicable IIA contains one. However, recent arbitral jurisprudence confirms that even without an invocation of a general exceptions clause, balancing between the relevance of the circumstances, the investor's own conduct and the importance of the public interest pursued by the regulatory change may allow for a deviation from the prior commitments (*National Grid v. Argentina*, analyzed below).

Balancing within a general exceptions clause

Certain IIAs contains various general exceptions or 'non-precluded measures' clauses, allowing measures of safeguarding certain pressing public interest to trump the investor's private interests and leading to a non-applicability of various substantive obligations of IIAs.

These clauses came to attention in particular after the Argentina crisis in 2001-2002. In several investment arbitrations, Argentina has invoked a customary necessity defence and treaty specific 'non-precluded measures' clause as its defence for justifying its crisis management measures.

The *Continental v. Argentina* award, which is one of many awards interpreting the 'non-precluded measures' clause under Article XI of the Argentina-US BIT,⁹¹² has become popular among proportionality proponents in investment arbitration. The *Continental* award drew the attention of legal commentators by linking the scope of the treaty-specific 'non-precluded measures' clause with the balancing under GATT

⁹¹¹ *Continental v. Casualty* [276]-[278]. As regards the expropriation claim, the *Continental* Tribunal decided that fixing of an exchange rate as a crisis management measure was not imposing an unreasonable burden on the investor because it was non-discriminatory, not in violation of prior commitments and there was no substantial deprivation of the investor's property.

⁹¹² It states: 'This Treaty shall not preclude the application by either party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.'

Article XX.⁹¹³ It was possible because the ‘non-precluded measures’ clause reflected the formulation of Article XX GATT.⁹¹⁴ This comparative law approach was upheld by the *ad hoc* Annulment Committee as a welcome trend.⁹¹⁵

Although there were no violations of prior commitments given to the investor, the Tribunal agreed with Argentina that most of the crisis management measures (the freezing of bank deposits, devaluation of the peso, pesification of dollar-denominated deposits, suspension of payments) were covered by the necessity defence under Article XI, and the investor’s claims of breach of FET and indirect expropriation were rejected save for the restructuring of certain financial instruments.⁹¹⁶

However, *Continental’s* balancing approach may be used as an inspiration only for comparable norms, namely, necessity exceptions and future application of autonomous interpretation of Article XI of the Argentina–US BIT. It is not directly transferrable to the indirect expropriation standard, which bears no similarity with GATT Article XX and has a different structure.

Balancing as part of the inner flexibility of the legitimate expectations element

The balancing exercise that may bear direct consequences for the indirect expropriation standard through its legitimate expectations element is represented by another Argentina crisis award – *National Grid v. Argentina*.⁹¹⁷

Traditionally, violation of prior commitments given to an investor would lead to a conclusion that the host State has acted in bad faith, arbitrarily or unfairly like in *Suez v. Argentina*.⁹¹⁸ There, the Tribunal found violation of FET by Argentina because the State was not cooperating with the investors in the crisis management⁹¹⁹ and rigidly and persistently refused to revise the tariffs for water distribution, thus acting contrary

⁹¹³ In contrast to earlier *CMS v. Argentina*, *Enron v. Argentina*, and *Sempra v. Argentina* awards, *LG&E v. Argentina* and *Continental v. Argentina* treated Article XI of the US–Argentina BIT as an autonomous norm, separate from customary necessity defence.

⁹¹⁴ *Ibid* [192].

⁹¹⁵ *Continental Casualty Company v. The Argentine Republic*, Annulment Proceeding, ICSID Case No. ARB/03/9, September 16, 2011, [132]–[133].

⁹¹⁶ *Continental v. Argentina* [262], [266] [275].

⁹¹⁷ *National Grid P.L.C. v. Argentine Republic*, UNCITRAL, Award, November 3, 2008, the UK, North Ireland –Argentina BIT 1990.

⁹¹⁸ *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic*, Decision on Liability, 30 July 2010, ICSID Case No. ARB/03/19, UNCITRAL Rules.

⁹¹⁹ *Suez v. Argentina* [233], [244].

to Argentina's prior commitments expressed in the Concession Agreement.⁹²⁰ The Tribunal used the proportionality-like language and noted that Argentina could have employed a 'less restrictive alternative' in dealing with the crisis,⁹²¹ namely, the alternative that would imply prior consultations with the investors as required by the Concession Agreement⁹²² in order to ensure the interests of both the State and the investors are protected.

Nevertheless, in line with *National Grid v. Argentina*, protection of the investor's reliance on prior commitments may also be subject to balancing between the general interests of the host State's population and the investor's private interests, and, exceptionally, violation of legitimate expectations induced by prior commitments may be justified under the relevant IIA, even without an invocation of general exceptions.

In *National Grid v. Argentina*⁹²³ the investor complained about the devaluation of the Argentine Peso and the abolishment of the calculation of utility tariffs in US Dollars. These measures dramatically affected its investment in a privatized electric power company. In contrast to the situation of *Total v. Argentina*, here the crisis management measures dismantled the former regulatory framework that the State had promised to the investor at the time of the privatization and on which *National Grid* had relied in making its investment.⁹²⁴

Nevertheless, the Tribunal held that Argentina did not violate the FET standard and the investor's legitimate expectations for legal stability by the adoption of the emergency measures for several months at the peak of the crisis, although they formally violated prior commitments given to the investor.⁹²⁵ The Tribunal came to

⁹²⁰ Ibid [237].

⁹²¹ Arbitrator Nikken, in his separate opinion, disagreed on the employment of the 'less restrictive alternative' test by stating that it was unreasonable for the majority Tribunal 'to determine the alternative measures that could have been adopted, because it cannot ex post facto substitute itself for the Argentine Government when it had to address the serious crisis that hit the country.' See Arbitrator Nikken, Separate Opinion in *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic*, Decision on Liability, 30 July 2010, ICSID Case No. ARB/03/19, [37].

⁹²² *Suez v. Argentina* [235]. Since the Tribunal did not propose a particular outcome of the alternative solution, but merely indicated that Argentina needed to cooperate with investors in order not to breach FET (leaving the potential outcome in the hands of the Parties), the Tribunal did not participate in an actual balancing of conflicting interests; it merely came to the conclusion that Argentina's actions were arbitrary and inequitable.

⁹²³ *National Grid P.L.C. v. Argentine Republic*, UNCITRAL, Award, November 3, 2008, the UK, North Ireland –Argentina BIT 1990.

⁹²⁴ Ibid, [178].

⁹²⁵ Ibid [179]. The Tribunal found a violation of the FET standard for other governmental actions - Argentina's unfair conditions for renegotiating the terms of operation of the Concession after the peak of the crisis.

this conclusion by ‘qualifying in time’ the determination of the violation of the FET standard.⁹²⁶ Arbitrators ruled that they could not ‘ignore the context in which the Measures were taken’:

*The determination of the Tribunal must take into account all the circumstances and in so doing cannot be oblivious to the crisis that the Argentine Republic endured at that time.*⁹²⁷

In this regard the Tribunal noted that ‘[w]hat is fair and equitable is not an absolute parameter’:

*What would be unfair and inequitable in normal circumstances may not be so in a situation of an economic and social crisis. The investor may not be totally insulated from situations such as the ones the Argentine Republic underwent in December 2001 and the months that followed.*⁹²⁸

The Tribunal rejected Argentina’s necessity defence under customary international law (in this case, the applicable BIT did not contain a comparable article to the non-precluded measures clause in Article XI of the US-Argentina BIT).⁹²⁹ Therefore, the above determination fell clearly within the inner flexibility and limits of the legitimate expectations element.

In sum, the Tribunal noted that Argentina’s attempts to cope with an exceptionally severe crisis affected the scope of the legitimate expectations element and permitted a formal violation of prior commitments during the peak of the crisis due to the more pressing public interest. Although the Tribunal did not use the proportionality language, it was a balancing exercise between the investor’s legitimate expectations and the state’s duty to cope with an exceptionally severe situation, requiring a certain level of solidarity from foreign investors, bearing in mind that international investment protection regime is not ‘designed to ensure the immutability of the legal order, the economic world and the social universe’.⁹³⁰

Thus, on the one hand, legitimate expectations of legal stability are to be honoured, on the other hand, their scope does not go as far as to exempt a foreign investor from the

⁹²⁶ See also *Total v. Argentina* [123]: ‘[A]n evaluation of the fairness of the conduct of the host country towards an investor cannot be made in isolation, considering only their bilateral relations. The context of the evolution of the host economy, the reasonableness of the normative changes challenged and their appropriateness in the light of a criterion of proportionality also have to be taken into account.’

⁹²⁷ *Ibid* [180].

⁹²⁸ *Ibid* [180].

⁹²⁹ *Ibid* [250]-[262].

⁹³⁰ *Impregillo v. Argentina* [290]. See also *EDF v. Romania* [217].

real situation in the host country, providing a place for balancing the investor's legitimate expectations for legal stability and the context of the interference in foreign investment.

Comparing the balancing analysis applied in *Tecmed v. Mexico*, that linked the 'individual and excessive' burden to the effect of the measure on the foreign investment and whether it was compensated or not, *Total/National Grid* balancing allows integrating within the second step of the assessment of an indirect expropriation claim several elements that imply the integration of the investor's interests with wider non-economic interests. These elements are as follows: (1) the importance of the public purpose, for which the challenged regulatory measure is taken. Although the *National Grid* award dealt with a unique social and economic crisis in Argentina, one may suggest a similar logic should be employed beyond crisis situations⁹³¹ and its content may be determined by the integration principle of sustainable development. For instance, in case new scientific information of a particular business activity is available finding it harmful to human or animal health, a departure from the principles of stability and predictability could be justified. (2) The integration element of sustainable development requires such an interpretation of legitimate expectations for legal stability, induced by specific commitments, that does not allow them to prevail over legitimate non-economic interests of the local and international communities.

4.6.4. Interim conclusions of 'inherent flexibility' of legitimate expectations sub-element

Sustainable development context prohibits modes of reasoning that would allow economic interests to trump other public interests. It requires an incorporation of wider societal concerns other than an investor's private interests when interpreting such investment guarantees as the indirect expropriation standard.

It can be effectively done through the legitimate expectations sub-element of the indirect expropriation standard. Legitimate expectations for legal stability inherently

⁹³¹ See Caroline Henckels, 'Proportionality and the Standard of Review in Fair and Equitable Treatment Claims: Balancing Stability and Consistency with the Public Interest', SIEL Working paper No. 2012/27, available at <<http://www.ssrn.com/link/SIEL-2012-Singapore-Conference.html>>, accessed on 20 November 2012, p.6.

imply balancing between the investor's interest in predictability and the state's interest in retaining its regulatory flexibility.

First of all, legitimate expectations for legal stability element is rather consistently interpreted in a way that tolerates the host State's customary right in a non-discriminatory and *bona fide* manner to enact, modify or cancel laws at its own discretion. The host State principally enjoys wide discretion to change the regulatory environment of the investor's business area in cases where there no specific commitments were given to the investor to the contrary effect. So, the dynamism that the sustainable development objective brings in the interpretation process of this element is an integration of the State's response to the evolutionary character of economic and social life, so as to pursue broader societal values like the protection of the environment, health and cultural heritage, to the arbitration process.

This study alleges that the deliberate application of sub-elements of the legitimate expectations element and expanding their scope may ensure compliance with the clarified context of investment protection law. Thus, the knowledge of the pre-existing regulatory environment is not necessarily limited by the national regulatory environment, but also extends to the international regulatory environment. For instance, in the case where the investor's activity has been highly regulated internationally or in other legal systems but not yet in a host State, and if the host State changes its regulatory environment in line with international values, a 'competent' investor may not consider it as a sudden and unexpected change. Thus, one may conclude that a 'competent businessman' criterion requires an investor to embrace not only the domestic but also the international regulatory environment, and it allows internalizing the risks of a particular investment activity, namely, if the later changes of the legal environment address the inherent risks of the particular investment activity, then the changes will bear no consequences on the host State.

In addition, since the sustainable development context of the investment protection regime requires the rejection of the 'self-contained' regime approach, considerations of international and comparative law elements are justified and even necessary in setting the scope of legitimate expectations for legal stability.

4.7. Compensation requirement in cases where expropriation is found: the role of legitimate expectations

The final (the fourth) step of assessing an indirect expropriation claim is to allocate compensation due in cases where the fact of expropriation is established. If there is a ‘substantial interference’ with an investor’s property rights, and if the interference is not justified under customary police powers exception or a specific treaty exemption like ‘non-precluded measures’ under Article XI of the US-Argentina BIT, then investment protection law imposes a duty of the expropriating state to pay ‘full compensation of the fair market value for the expropriated property, i.e., what a willing buyer would pay to a willing seller’⁹³² calculated by reference to the ‘highest and best use’ of the property.⁹³³

Sometimes it is suggested that certain breaches of investment guarantees based on environmental or human rights reasons should not be subject to the requirement of compensation. This stance is supported by reference to such ‘context doctrine’ awards as *Saluka v. Czech Republic* and *Chemtura v. Canada*.⁹³⁴ This opinion is not entirely correct since the ‘context doctrine’ awards refer to the application of police powers that may exempt the governmental measure from being classified as expropriatory. ‘Context doctrine’ awards do not propose a hierarchy of public purposes claiming that certain purposes may prevail over foreign investment protection, and that their invocation would automatically exempt certain substantial deprivations as non-compensable. Instead, the existence of expropriation may be rebutted by the application of recognized police powers of States. Hence, in case of a substantial interference in the investor’s property, even if it is done for human rights protection, cultural heritage or environmental protection reasons, an expropriating State is not *per se* exempt from the duty to compensate.⁹³⁵

The aim of the section is not to study thoroughly the methods for allocating the full market value, like the discounted cash flow method, but rather to indicate those

⁹³² *Compañía del Desarrollo de Santa Elena, S.A. v Republic of Costa Rica*, ICSID case No. ARB/96/1 [73]. The Tribunal in para [69] indicates: ‘The vocabulary describing the amount of compensation properly payable in respect of a lawful taking has varied considerably from time to time. It comprises such words as “full”, “adequate”, “appropriate”, “fair” and “reasonable”. Sometimes, the descriptive adjective is elaborated by the additional mention of “market value”.’ See also *Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award, 5 October 2012, US-Ecuador BIT (1997) [458].

⁹³³ *Ibid*, *Santa Elena v Costa Rica* [70].

⁹³⁴ For three different approaches in this respect among investment lawyers, see Jorge E. Viñuales, *Foreign Investment and the Environment in International Law* (CUP 2012) 123-128.

⁹³⁵ Contra: L. Liberti, ‘The Relevance of Non-Investment Treaty Obligations in the Assessment of Compensation’ in PM Dupuy, F Francioni, EU Petersmann (eds), *Human Rights in International Investment Law and Arbitration*, (OUP 2009), Chapter 23.

factors that, despite the rigid full fair market value compensation requirement, have the capacity to serve as adjustments of the appropriate compensation taking into account broader interests and circumstances than the narrow focus on the integrity of property rights.

In order to do that, the section is structured into three parts. The first part deals with the unsuccessful attempts to adopt a human rights approach to the compensation requirement of an expropriated property. The second part addresses the investor's own conduct (contributory negligence) that is a factor relevant for quantifying losses. The third part analyzes the role of non-investment or external legal considerations in informing the content of the investor's expectations for appropriate compensation. It is claimed that the legally relevant wider context in the allocation of compensation is determined by the sustainable development objective and its integration element.

4.7.1. Proposed human rights approach in assessing compensation for expropriation

Argentina has put forward an argument in some investment treaty arbitrations that a State's human rights obligations and a country's economic conditions allow excluding or significantly diminishing the amount of compensation due for expropriation.

In *Vivendi v. Argentina* (Resubmitted)⁹³⁶ and *Siemens v. Argentina*,⁹³⁷ Argentina has argued that in cases of expropriation for social or economic reasons, fair market value compensation is too burdensome on the expropriating State, limiting its sovereignty and, in general, disadvantaging poor states.

In *Siemens v. Argentina*, Argentina substantiated its argument⁹³⁸ by reference to the *Tecmed* balancing analysis and the ECtHR case *James v. UK*. There, the ECtHR held that Article 1 of the First Protocol does not 'guarantee a right to full compensation in all circumstances' because '[l]egitimate objectives of "public interest" such as pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of full market value,'⁹³⁹ and what

⁹³⁶ *Vivendi v. Argentina*, Resubmitted, [8.4.1]. Argentina objected to the full compensation requirement of the breach of the BIT, relying on its economic conditions to the fact that Argentina acted in the public interest.

⁹³⁷ *Siemens A.G. v. The Argentine Republic*, ICSID case No.ARB/02/8, Award, February 6, 2007, [348]-[357]. The Siemens Tribunal decided that neither the Germany- Argentina BIT nor customary international law permitted a margin of appreciation as found in Article 1 Protocol 1 ECHR.

⁹³⁸ *Siemens v. Argentina*, [346].

⁹³⁹ *Ibid*, [346] referring to *James v. UK*, *European Court of Human Rights*, 1986, 8, EHRR 123, [48].

is needed is proportionality analysis with respect to the amount of compensation. In *Siemens v. Argentina*, the Tribunal found these contentions incompatible with the customary international law on foreign investment protection and the applicable German-Argentina BIT requiring full market value compensation.⁹⁴⁰ Thus, it rejected the request for balancing conflicting interests when setting the amount of compensation.

On the one hand, the Tribunal was correct in rejecting Argentina's proposal for less than full market value since the direct transfer of human rights methodology in assessing compensation in investment law would go contrary to the full market value requirement explicitly established by the current network of IIAs.

In European human rights law, the compensation requirement is not explicitly included in Article 1 Protocol 1 of the European Convention on Human Rights on property rights; nevertheless, it is a 'material consideration' of Article 1 which implicitly requires compensation in case of a deprivation of property.⁹⁴¹ In contrast to the current network of IIAs, the ECtHR treats the compensation requirement as an element of the fair balance test.⁹⁴² Determination of the appropriate amount of compensation is part of the proportionality assessment;⁹⁴³ it contributes to the assessment of whether there is a disproportionate burden on the individual.⁹⁴⁴ Thus, in exceptional circumstances, the ECtHR may find it proportional not to award compensation or to reimburse less than the full market value due to the legitimate objectives of public interest like a country's economic reform or measures designed to achieve greater social justice that does not impose an individual and excessive burden on the individual.⁹⁴⁵

The compensation requirement in investment law is more rigid – the reimbursement of the full market value is an exact requirement of the network of IIAs.⁹⁴⁶ Accordingly, Argentina's proposition of adopting the ECtHR methodology under the

⁹⁴⁰ Ibid, [354].

⁹⁴¹ James and Others, Judgment of February 21, 1986, ECHR 50, [54].

⁹⁴² A.R.Çoban, *Protection of property rights within the European Convention on Human Rights*, (Aldershot, Hants, England; Burlington, VT: Ashgate, 2004), 93.

⁹⁴³ U. Kriebaum, 'Regulatory Takings: Balancing the Interests of the Investor and the State', (2007) 8 J. of World Investment and Trade 717, at 731, 739.

⁹⁴⁴ Sporrong & Lönnroth v. Sweden, *Eur. Ct.H.R.* No. 52 (ser.A) (1982), [69], [73].

⁹⁴⁵ James v. UK, European Court of Human Rights, 1986, 8, EHRR 123, [46], [48], [54].

⁹⁴⁶ Rudolf Dolzer and Christoph H. Schreuer, *Principles of International Investment Law* (OUP, 2012), 100.

relevant BIT was correctly rejected as going against the very wording of the applicable BIT.

On the other hand, the Tribunal, as examined below, may have an ability to adjust and diminish fair market compensation in a case where Argentina would have formulated its request differently.

4.7.2. The impact of the investor's own conduct on the expectations for compensation

Several investment treaty tribunals, at their own discretion, have taken into account the investor's own conduct (contributory negligence) as a relevant factor for quantifying losses and assessing the reasonableness of compensation expected by the investor.⁹⁴⁷ The investor's own conduct has served as an element for reducing compensation to ensure it is fair in the given circumstances. Thus, the compensation requirement for expropriated property (or violation of the FET standard) is flexible enough to be adjusted in line with the equity principle.

For example, in *MTD v. Chile*,⁹⁴⁸ the Tribunal diminished compensation for the breach of FET by 50 per cent because the investor's own actions, by disregarding the national law requirements, increased the risks and losses of the investment. In these circumstances, the Tribunal decided that investors 'should bear the consequences of their own actions as experienced businessmen'.⁹⁴⁹ Also, in *Occidental v. Ecuador*⁹⁵⁰ the Tribunal diminished the fair market value compensation of expropriated property by 25 per cent since the investor acted illegally under Ecuadorian law. Similarly, in *Biwater Gauff v. Tanzania*, the Tribunal did not award any compensation despite establishing the existence of an expropriation of the investor's contractual rights.⁹⁵¹

⁹⁴⁷ I Knoll-Tudor, 'The Fair and Equitable Standard and Human Rights Norms' in PM Dupuy, F Francioni, EU Petersmann (eds), *Human Rights in International Investment Law and Arbitration*, (OUP 2009), 342.

⁹⁴⁸ *MTD Equity Sdn. Bhd. And MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award May 25, 2004, the 1992 Malaysia – Chile BIT.

⁹⁴⁹ *Ibid*, [178]. The *ad hoc* Annulment Committee upheld the award: *MTD Equity Sdn. Bhd. And MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Decision on Annulment, 21 March 2007 [101], [107].

⁹⁵⁰ *Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award, 5 October 2012, US-Ecuador BIT (1997) [670]-[687].

⁹⁵¹ *Biwater Gauff v. Tanzania* [778].

In this case the investor's own conduct made the expropriated concession contract valueless.⁹⁵²

The investors own conduct as a barring factor for expectations for full fair market compensation is also integrated in some 'new generation' IIAs. For instance, the COMESA Common Investment Area Agreement 2007,⁹⁵³ Article 20(2) states that 'compensation [for expropriation] may be adjusted to reflect the aggravating conduct by a COMESA investor or such conduct that does not seek to mitigate damages'.

To conclude, despite a rigid full market value compensation requirement, the amount of compensation may be subject to adjustments in line with the customary rule of contributory negligence (Article 39 of the International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts).

4.7.3. Influence of the circumstances of the host State on the amount of compensation. *SPP v. Egypt* versus *Santa Elena v. Costa Rica*

This section analyzes the possible role of the knowledge of the surrounding circumstances of the host State in informing the content of an investor's expectations for appropriate compensation in cases where the existence of expropriation is found.

The section juxtaposes two arbitral awards – *SPP v. Egypt*⁹⁵⁴ and *Santa Elena v. Costa Rica*,⁹⁵⁵ which represent contradicting approaches in this regard. It will be argued that the *Santa Elena* methodology is outdated because the integration element of the sustainable development objective requires paying more scrupulous attention to non-investment law and policy arguments by host States.

The ability of arbitrators to take into account circumstances of the host State when establishing the amount of compensation for expropriation is demonstrated in *SPP v. Egypt*. In the *SPP* case, the Tribunal took into account the legal effect of the investor's knowledge of non-investment obligations of Egypt in awarding compensation for indirect expropriation. The claim emerged from the termination of the Pyramids Oasis Project for developing a tourist resort near the Pyramids. Egypt

⁹⁵² *Biwater Gauff v. Tanzania*, [789]-[792], [798].

⁹⁵³ Common Market for Eastern and Southern Africa (COMESA) Common Investment Area Agreement (CIAA) (2007) <[http://www.comesa.int/investment/regimes/investment area/Folder.2007-11-06.4315/Multi-language content.2007-11-07.1013/en](http://www.comesa.int/investment/regimes/investment%20area/Folder.2007-11-06.4315/Multi-language%20content.2007-11-07.1013/en)> accessed on 20 November 2012.

⁹⁵⁴ *Southern Pacific Properties (SPP) (Middle East) Limited v Arab Republic of Egypt*, ICSID ARB/84/3, May 20, 1992.

⁹⁵⁵ *Compañía del Desarrollo de Santa Elena, S.A. v Republic of Costa Rica*, ICSID case No. ARB/96/1.

terminated the Project after its approval because it had included an area in the World Cultural Heritage List. The Tribunal found the termination of the Project expropriatory.⁹⁵⁶ However, while deciding on the appropriate amount of compensation due, the Tribunal considered the effect of the application of the UNESCO Convention on Cultural Heritage Protection on the legality of the investment project. It consequently decided not to award *lucrum cessans* calculated as off the date of inclusion of the project area in the Word Heritage List as this is when the investment project became illegal.⁹⁵⁷

In contrast, the *Santa Elena v. Costa Rica* award showed no responsiveness to non-investment aspects in the determination of compensation for expropriation. Costa Rica had longstanding commitments and efforts to add the investment area ‘Santa Elena’, which was home to a variety of flora and fauna indigenous to the region, to a national reserve park and to the World Heritage List.⁹⁵⁸ Therefore, the State asked to take into account ‘the existing environmental legislation that would significantly restrict, if not prohibit outright, the commercial development of Santa Elena’ in the assessment of fair market value compensation for the expropriated property.⁹⁵⁹ In response, the *Santa Elena* Tribunal correctly concluded that expropriation, even if it is done for a public purpose (thus, being lawful), requires compensation;⁹⁶⁰ however, it missed the main point raised by Costa Rica – to take into account the circumstances of the investment field previously known to the investor in assessing the proper amount of compensation. The *Santa Elena* Tribunal remained ignorant to the possible effect the UNESCO Convention could have on the amount of compensation.

As it is established that sustainable development context requires the integration of an investment protection aspect and surrounding non-investment interests, the *Santa Elena* approach goes contrary to the sustainable development context by focusing merely on the interests of the foreign investor. One may even suggest that by not taking into account the pre-existing knowledge of Costa Rica’s national and international environmental protection efforts as a line of argument, the investor’s

⁹⁵⁶ SPP v. Egypt [159], [164].

⁹⁵⁷ Ibid [190]-[191]. See also *Amoco International Finance Corp. v. Iran*, 15 Iran-US.C.T.R 189; *Biwater Gauff v. Tanzania*, [775].

⁹⁵⁸ Charles N. Brower, Jarrod Wong, ‘General Valuation Principles: The Case of Santa Elena’ in Todd Weiler (ed), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (Cameron May 2005), Chapter 20, 747, 763-764, referring to Counter-Memorial of Costa Rica [on file with authors].

⁹⁵⁹ *Santa Elena v. Costa Rica* [35].

⁹⁶⁰ Ibid [72].

responsibility to be a competent investor and to know the regulatory field is neglected. Therefore, the Santa Elena Tribunal's argumentative approach is outdated.

4.7.4. Interim conclusions

This study suggests that a legitimate expectations analysis may serve as a tool in the assessment of compensation, in particular where non-arbitrary and non-discriminatory indirect expropriation takes place (*SPP v. Egypt* approach). This stance is justified because the object and purpose of international investment protection law necessitates establishing clearer limits on legitimate expectations of investors, and requires the compensation requirement not to be contrary to the inherent object and purpose of the IIAs regime by diminishing the prospects of a host State's development.

However, balancing requirement as such cannot be deducted from the concept of 'fair market value', since in essence it means a value that is calculated taking into account the highest and best use of the property. Thus, the concept itself is not functioning as a principle leaving room for optimization of its fulfilment. Nevertheless, it may be read as a sum of several variables instead of reading the full market value compensation requirement in an 'all or nothing' manner – such elements as legality or illegality of the purpose for expropriation, legitimate investment-backed expectations and the investor's own conduct must all affect the amount of compensation, for instance, whether lost profits are available. It is claimed these elements are an efficient enough place for integrating non-economic interests within the otherwise rather rigid full market value requirement.

CONCLUSIONS

This study takes a fresh look at the interpretation of the indirect expropriation standard through the lens of the sustainable development objective, which necessitates an extension of the protected interests in investment law in comparison to the more traditional sole focus on foreign investment protection.

It is usually the case that investment treaty arbitration involves a legitimacy review of the State's general legislation or administrative acts aimed at protecting various public interests. The reviewing process of the governmental measures being challenged subsequently impacts upon the clash between the investor's claims for its property protection and legal stability, on the one hand, and the interest of the host State to use its regulatory flexibility in order to respond to changing circumstances, on the other hand. Furthermore, the host State in its actions has a duty to take not only the interest of foreign investor into account, but also must ensure that the interests of its local population are protected and that it complies with its international obligations. These wider considerations are often put forward in investment arbitrations as defences by host States or invoked by *amicus curiae*. As some tribunals have ignored these wider considerations or have failed to address them properly, it is difficult to predict whether the interpretation of investment standards will unreasonably restrain the fulfilment of the State's duties and interests in safeguarding the welfare of its citizens or the values of the global community.

The narrow focus on foreign investment protection in interpreting the scope of indirect expropriation has been reached by applying customary treaty interpretation principles. It has led to the impression that economic interests may trump other societal interests, and that host States may safeguard non-economic societal interests only as far as they do not interfere with foreign investment. Accordingly, several States have taken various radical steps, including the withdrawal from IIAs and investor-state arbitration mechanisms, in order to safeguard their ability to formulate and execute efficient policy in this area. These radical developments have emphasized the need to find a fair balance between the regulatory interests of States and an investor's expectations for stability, predictability and protection which cannot be achieved merely by reference to enhanced application of customary treaty interpretation principles without a precise guideline aiming at a goal to be achieved. Otherwise, a differing understanding of what is the aim to be achieved causes the

situation that the same treaty interpretation principles are applied in a manner that often reaches radically conflicting conclusions.

For this reason, this thesis views the concept of sustainable development as an interpretative tool that guides the use of treaty interpretation principles towards certain aims – the integration of economic and non-economic aspects of foreign investment protection in order to ensure that, firstly, the interpretation of the indirect expropriation standard always takes into account the needs and interests of both the investor and the host State. Secondly, it argues that the pro-investor biased modes of reasoning within the interpretation of investment guarantees are excluded. Since changes in treaty drafting are slow and not always possible, the proposed reinterpretation of indirect expropriation standard in light of the objective of sustainable development is an alternative to redrafting treaties and it is capable of functioning within the network of IIAs as it stands.⁹⁶¹

First of all, it is claimed that sustainable development is the object and purpose of the network of IIAs. Its principle of integration is exact enough to guide the application and interpretation of investment guarantees in individual IIAs.

The foreign direct investment protection regime, as part of the phenomenon of economic globalization, is inherently a related field of development law, and numerous investment protection treaties refer to economic development as their object and purpose. Economic development, thus, is the initial and inherent motivation for states to enter the network of IIAs that consists of bilateral and regional agreements gradually concluded over the last sixty years. However, over the last four decades it has become clear that the narrow focus on economic development is insufficient and, in the long run, harmful to the global community. As a result, in three global conferences the international community has committed to replace the focus on economic development with a broader term of sustainable development, which embraces economic development and its limiting aspects of social and environmental protection. Thus, by sustainable development one understands the achievement of an equal balance between economic development, social progress and environmental protection at every level of decision-making. Since FDI protection was intended as a

⁹⁶¹ Unlike UNCTAD's *Investment Policy Framework for Sustainable Development* that deals with proposals for future treaty and investment policy making.

tool for achieving economic development, it is necessarily affected by the current global commitment to promote sustainable development.

A number of ‘new generation’ IIAs, in their preambular language and operative parts, already include various acknowledgements of mutual support for investment protection and *prima facie* external issues to investment protection like protection of the environment, human rights and labour rights. Older IIAs, logically, are silent on the integration of economic and non-economic aspects of FDI protection. Nevertheless, it is argued that sustainable development is the current meaning of the intrinsic and evolutive object and purpose of the very network of IIAs. Thus, it has the capacity to participate in contextual and effective interpretation of specific treaty terms in individual IIAs irrespective of the existence of a specific reference to sustainable development.

Consequently, the sustainable development objective of the foreign investment protection regime requires a change in mindset for adjudicators applying and interpreting investment standards.

Accordingly, it has two main consequences. Firstly, the requirement to integrate places investment protection in the field of public litigation affecting the way in which arbitrators view themselves. The sustainable development perspective adds to a realization that investor–state arbitration is not exclusively about the protection of a foreign investor’s interests. It may considerably exceed the interests of pleading parties, adding to a public dimension of investment protection law, which accordingly requires arbitrators to adopt the role of ‘guardians of law’ instead of ‘service providers’. It is especially so because investment treaty arbitration as an impartial venue is meant to replace national and international courts, so as to ensure a careful and objective balance between the interests of investors and host States. The public dimension of investment protection subsequently means that investment treaty arbitration as an institution, dealing with a development-related field of law, must provide for a process which gives space for the consideration of competing factors such as investment protection and public interests targeted at achieving development goals. Secondly, the sustainable development context and its integration principle guides the inherent powers and the discretion of arbitrators, which they enjoy with respect to the interpretation of loosely drafted investment protection standards like indirect expropriation. To a certain extent, this leads to integrating all three pillars of

sustainable development irrespective of the limitations of jurisdiction and applicable law.

So, adjudicators are required to act in a manner that expresses the values and goals of the legal regime, namely, the general commitment to promote sustainable development. The sustainable development context affects the ‘background theory’ of adjudicators in setting the content of the open-textured indirect expropriation standard, namely, the idea of values and goals that adjudicators are supposed to safeguard in solving the legal dispute. It explicitly requires that commercial interests are not prioritized but balanced and reconciled with competing public interests by choosing appropriate language and argumentation methods, which gives space for the consideration of these conflicting factors.

Thus, the interpretation of investment guarantees, in light of the sustainable development objective, requires the incorporation of wider societal concerns other than those traditionally associated with investment protection law. That is to say, interpretation of such investment guarantees as indirect expropriation requires adjudicators to adopt a point of view that is not limited to the sole focus on safeguarding the private interests of investors.

The extension of protected interests may effectively be taken into account through contextual and effective treaty interpretation and, if applied in a *bona fide* manner, those modes of reasoning that focus narrowly on the interests of a foreign investor will be outdated. This is especially so in a case of the application of ‘old school’ BITs that do not contain explicit references to safeguarding wider societal interests other than foreign investment protection. It is so because interpretation of common-form ‘old generation’ BITs has led to the conclusion of the existence of two levels of object and purpose of investment protection regime. Namely, there is the ‘immediate’ one of investment protection, which is explicitly mentioned in BITs, and the ‘overall’ one of economic development. The latter is not always mentioned in IIAs but it stems from the very logic of the existence of the network of IIAs, and it also participates in the effective interpretation of ‘old school’ BITs. Since it is argued that economic development is intrinsically a generic legal term, the current meaning of which is sustainable development, it requires an evolutive interpretation of ‘old school’ BITs, resulting in the extended understanding of tolerated interests by the investment regime.

Second, although limited with narrow jurisdiction clauses, the sustainable development objective provides the necessary doctrinal foundation for incorporating *prima facie* non-investment obligations in the investment context by affecting the understanding of what is the ‘same subject matter’. Thus, arbitrators are required to recognize the potential existence of a conflict of norms in its widest sense and use appropriate tools for solving them.

Even though arbitral tribunals have a wide range of customary conflict avoidance tools available, they differ significantly regarding their understanding of the need to use them when faced with arguments grounded in non-investment law or policies. Currently, arbitrators have showed two opposing attitudes towards the degree of relevance of non-investment law invoked by defending States. Defendant States have often invoked non-investment international obligations as a possible excuse for an alleged breach of investment protection standards. They refer to potential conflict in applicable law or indicate that a non-investment obligation is an element that allows setting the scope of investment guarantees. Taking into account that a state relying on external norms to the investment regime has the burden of proving the existence of norm conflict and their relevance to the settlement of the investment dispute, on the one side of the spectrum lies the *Santa Elena* award with its rejection of any relevance of non-investment law for informing the content of investment guarantees (Costa Rica argued its environmental obligations influenced the scope of the fair market value determination for the expropriated property). On the other side of the spectrum stands the *Chemtura v. Canada* award that used Canada’s international commitments as a ‘broader factual context’ for informing the content of the bad faith standard and *Parkerings v. Lithuania* which took into account the UNESCO Convention so as to inform the content of the ‘like circumstances’ sub-element of the MFN standard. Thus, the current arbitral jurisprudence does not have a clear and predictable attitude towards the necessity to elaborate on non-investment international law as applicable law in investment claims or solving potential conflicts in applicable law through the customary law mechanisms available like the principle of integration enshrined in the Article 31(3)(c) of the VCLT.⁹⁶²

⁹⁶² It seems none of the investment treaty tribunals have invoked Article 31(3)(c) of the VCLT, see A Van Aaken, ‘Fragmentation of International Law: The Case of International Investment Protection’

Investment treaty limitations with respect to jurisdiction and applicable law may explain the current reluctance of some investment tribunals to embark upon non-investment international obligations in investment law context. This situation might also be explained by the lack of a clear link between foreign investment protection norms and the protection of non-economic goals such as the environment or public health. Therefore, it is argued that the sustainable development context automatically changes the perception of what issues might actually be ‘at the heart of the matter’. The sustainable development context thus provides the necessary link or a solid ‘connection’ between various *prima facie* separate fields of law that go under the notion of sustainable development. It allows for their categorization as ‘relevant’ applicable law for informing the content of investment guarantees through interpretation. Sustainable development, thus, necessitates a ‘systemic’ thinking of international investment law implying that investment protection law is not autonomous from other legal regimes, functioning as a mechanism of ‘de-fragmentation’.

Thus, investment tribunals are now asked to realize that external or, in other words, non-investment norms may cause a conflict of norms situation and play a significant role in the interpretation of investment guarantees, e.g., by informing the content of indirect expropriation or its sub-elements as was done in *SPP v. Egypt* with respect to the investor’s legitimate expectations for fair compensation.

Third, the integration element of sustainable development outdates the ‘sole effects’ doctrine and favours the ‘context doctrine’ of the interpretation of indirect expropriation standard because the latter allows for the adoption of a wider spectrum of elements than the integrity of an investor’s property in deciding whether indirect expropriation has taken place.

Violation of the indirect expropriation standard, together with the FET standard, is often invoked in relation to a host State’s regulatory measures or administrative actions for public interest, e.g., in the case of a failure to issue a mining licence to protect the cultural heritage of an indigenous community or in the case of general changes to domestic regulatory frameworks like a phase out of nuclear energy. Thus,

(2008) U. of St. Gallen Law & Economics Working Paper No. 2008-1. Available at SSRN: <http://ssrn.com/abstract=1893692> (accessed at 12 December 2011), 16.

the core issue of the application of indirect expropriation standard is to distinguish compensable indirect expropriation from a legitimate, non-compensable exercise of a State's power to regulate for public interest that has a detrimental effect on foreign investment. Arbitrators have applied three main methodologies for the assessment of the existence of indirect expropriation that differ significantly in their responsiveness to the public interest involved – the 'sole effects' doctrine, the 'proportionality doctrine' and the 'context doctrine'.

As investment treaty arbitration must provide for a process which gives space for the consideration of competing factors, such as investment protection and public interest. The 'sole effects' doctrine, focusing exclusively on the substantial deprivation of investment for establishing the existence of indirect expropriation, may not be anymore a result of an effective interpretation in light of the sustainable development objective. It is so because it limits the criteria that must be taken into account when deciding on the existence of expropriation. Furthermore, its application does not allow for the consideration of non-investment law or policies in informing the content of the indirect expropriation standard or its sub-elements.

Regarding the 'proportionality doctrine' as applied by the *Tecmed* Tribunal and its approving awards, it is inspired by the ECtHR balancing but, unlike in the human rights system, it links the individual and excessive burden test exclusively with the level of interference in the foreign investment. Thus, the *Tecmed* proportionality analysis suggests that non-compensated substantial deprivation of foreign investment is non-proportional. This logic is circular and goes back to the 'sole effect' approach, limiting the criteria that could be taken into account in the assessment of whether an individual investor suffers an excessive burden that needs to be redressed.

In contrast, the 'context doctrine' awards like *Methanex v. US* and *Chemtura v. Canada*, focusing on the general context and public interest of the interference in foreign investment, permits the integration of a more nuanced assessment of non-economic considerations when deciding whether indirect expropriation has taken place.

Fourth, employment of the 'context doctrine' needs to be accompanied by the inherent balancing between the interests of the investor and the State that most effectively takes place within the sub-element of legitimate expectations for legal stability. Legitimate expectations sub-elements provide a platform for the

nuanced integration of factual and legal circumstances in the appraisal of the existence of indirect expropriation. Furthermore, legitimate expectations sub-element provides room for flexibility in setting the amount of fair market value compensation in the case that expropriation standard is violated.

As the interpretation of investment guarantees, in light of the sustainable development objective, requires the incorporation of wider societal concerns than traditionally associated with investment protection law, legitimate expectations (for legal stability) sub-elements as an argumentative tool has the capacity to integrate a broad spectrum of factual and legal considerations in the expropriation analysis and provides room for a balanced way of distinguishing commercial risk from compensable political risk.

Arbitral jurisprudence has gradually split the legitimate expectations element into various sub-elements that participate in the determination of what is a compensable political risk. These elements are general knowledge about business and the legal framework in the host State and in the chosen investment area; and competent businessman criterion and the investor's own conduct. These elements have the capacity to function as entry-points for environmental, human rights and other considerations when setting the content of legitimate expectations. If applied in light of the integration principle of sustainable development, they set a higher threshold in the assessment of the reasonableness of the investor's expectations and provide a broader framework for internalizing risks of a particular investment activity as a non-compensable commercial risk.

Thus, these elements provide a framework for balancing the investor's interest in stability and predictability in the host State, on the one hand, and the State's interest and duty to safeguard other societal purposes on the other. This balancing must reflect the contextual and effective treaty interpretation principles and requires the interpretation of indirect expropriation and its sub-elements so as to give full effect to the objective of sustainable development that requires concrete outcomes – the integration of economic and non-economic concerns.

Balancing at this stage is appropriate because an investor's legitimate expectations for legal stability stems from the good faith principle, and it limits the State's right to exercise its regulatory autonomy.

In sum, the deliberate application of sub-elements of legitimate expectations in light of the sustainable development objective may ensure that:

- (1) Arbitrators do not limit themselves to the narrow focus of the investment protection and promotion but also take into account the wider context leading to interference in foreign investment;
- (2) Scrupulous analysis of the inherent flexibility of these sub-elements implies the required balancing, not as an external technique but as an internal element of the indirect expropriation standard;
- (3) Risks of a particular investment activity are internalized in the assessment of whether indirect expropriation has taken place (the second step of indirect expropriation assessment). The assessment of an alleged violation of an investor's legitimate expectations usually plays a role in determining the very existence of indirect expropriation, therefore the study argues it is a proper place where consideration and balancing between investor and State interests should take place.
- (4) This balancing adds the necessary dynamism and flexibility in the application of the standard. For instance, rigorous analysis of the above-mentioned elements might significantly affect the amount of compensation due for the expropriated property despite the rigid fair market value requirement in the network of IIAs (such as was done in *SPP v. Egypt*). Even in the case of the existence of specific commitments, unexpected circumstances and pressing public need may justify deviations from the commitments.

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APPENDIX

BOX 1. INTERPRETATION OF THE INDIRECT EXPROPRIATION STANDARD CONCERNING PUBLIC INTEREST MEASURES BY THE HOST STATE

[...] - Relevant paragraph of an award.
Awards are listed in chronological order.

Arbitral award and alleged public interest act by the host State (general regulation, administrative measure or general treatment) which is challenged by a foreign investor as an expropriatory measure	Defence by the host State	Response by the Tribunal	Comments
SUSTAINABLE DEVELOPMENT ASPECT: ENVIRONMENTAL/PUBLIC HEALTH ISSUES			
<i>Ethyl Corporation v. Canada</i> ⁹⁶³ Investor, a producer of the gasoline additive, claimed that the Canadian trade ban of the gasoline additive for human health and environmental protection reasons constituted indirect expropriation of its investment in Canada.	[9] Canada claimed that its trade ban was a law of general application and represented a legitimate regulation for environmental and health protection reasons.	Disputing parties reached amicable settlement after the Tribunal rejected Canada's objections to jurisdiction.	Amicable settlement included the revocation of the trade ban and a substantial compensation to the investor. ⁹⁶⁴ The dispute left open the question of whether precautionary actions for the environment and health protection reasons banning an investor's activity may be considered as a non-compensable police powers exception.
<i>Santa Elena, S.A. v The Republic of Costa Rica</i> ⁹⁶⁵ The award emerged from the disagreement between the foreign investor and the State on the amount of	Costa Rica had longstanding commitments and efforts to add to the area of the national reserve park and to the World Heritage List. ⁹⁶⁶ [35] Hence, the State	The Tribunal declared that: [71] 'While an expropriation or taking for environmental reasons may be classified as a taking for a public purpose,	In sharp contrast to the <i>SPP v. Egypt</i> award (see below and Box 3), the <i>Santa Elena</i> Tribunal reduced Costa Rica's contentions of environmental laws affecting the value of

⁹⁶³ Ethyl Corporation v. Canada, UNCITRAL (NAFTA), Decision on Jurisdiction, 24 June 1998.

⁹⁶⁴ J. Soloway, 'Environmental Regulations as Expropriation: The Case of NAFTA's Chapter 11', (2000) 33 Canadian Business Law Journal 92, at 116.

⁹⁶⁵ Compañía del Desarrollo de Santa Elena, S.A. v The Republic of Costa Rica, ICSID Case No. ARB/96/1, Award of 17 February 2000, 15 ICISD REV – FILJ 169 (2000).

⁹⁶⁶ Charles N. Brower, Jarrod Wong, 'General Valuation Principles: The Case of Santa Elena' in Todd Weiler (ed), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (Cameron May 2005), Chapter 20, 747, 763-764, referring to Counter-Memorial of Costa Rica [on file with authors].

<p>compensation to be paid for direct expropriation of investor's property for environmental conservation reasons. The State's right to expropriate the property was not in dispute since the property was home to a variety of flora and fauna indigenous to the region.</p>	<p>argued for such valuation of the property's fair market value that would have taken into account 'the existing environmental legislation that would significantly restrict, if not prohibit outright, the commercial development of Santa Elena'. 'Respondent also submitted that, in the event that interest is applicable to the Award, international law supports an award of simple interest only, at a nominal rate.'</p>	<p>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.'</p> <p>[72] '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.'</p>	<p>the expropriated property to the mere declaration that even a lawful expropriation for environmental protection reasons raises the duty for the expropriating state to pay compensation. However, Costa Rica's duty to compensate was never at question. The question was about the effect that Costa Rica's international and national efforts of protecting the site had on the fair market value. However, the Tribunal declined to address that issue. Instead, the Tribunal focused merely on the integrity of the investor's property interests.</p>
<p><i>Metalclad v. US</i>⁹⁶⁷</p> <p>The claim arose from the rejection by Mexico of the operation permit for the previously approved hazardous waste landfill project which met severe local resistance.</p>	<p>[92], [106] The local municipality denied the permit for reasons which included the ecological concerns regarding the environmental effect and impact on the site and surrounding communities. One of the reasons for denying</p>	<p>The Tribunal provided the widest indirect expropriation definition:</p> <p>[103] '[E]xpropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory</p>	<p>Keeping in mind the difference between the prime focus on the 'effect' of the interference, and the sole focus on the interference, the <i>Metalclad</i> award is a textbook example of the 'sole effects' doctrine which focuses only on the effect of</p>

⁹⁶⁷ *Metalclad Corporation v. The United Mexican States*, ICSID Case No.ARB(AF)/97/1, Award August 30, 2000, NAFTA.

	the permit was the Cactus Protection Decree which was applicable to the territory of the investment.	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.’ Regarding the Cactus Protection Decree: [111] ‘The Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree. [...] However, the Tribunal considers that the implementation of the Ecological Decree would, in and of itself, constitute an act tantamount to expropriation.’	the measure by State which is challenged by the investor. The ‘sole effects’ doctrine leaves the wider circumstances and the alleged ‘public purpose’ defence outside consideration in the assessment of indirect expropriation. Such an interpretation of the standard generates room for a conflict between investment protection obligations other than regulatory responsibilities by the host State.
<i>S.D. Myers v. Canada</i> ⁹⁶⁸ The investor claimed that the Temporary export ban of hazardous chemicals between Canada and the US constituted, among others, a breach of the indirect expropriation standard and violated the national treatment standard.	[99] - [107] Canada imposed the Export Ban of the hazardous chemical in line with its international commitments to minimise the risk to human health and the environment by the chemical. In particular, Canada argued the Export Ban was designed to fulfil the goals set by the Basel Convention that required managing hazardous waste in an environmentally sound manner reducing the transboundary movement of them to a minimum.	The Tribunal did not find a violation of the indirect expropriation standard because no substantial deprivation of the investment was found. However, the Tribunal ruled that: [281] ‘The general body of precedent usually does not treat regulatory action as amounting to expropriation. Regulatory conduct by public authorities is unlikely to be the subject of legitimate complaint under Article 1110 of the NAFTA, although the Tribunal does not rule out that possibility.’ [282] ‘Expropriations	The expropriation claim failed as there was no lasting removal of the investor’s property rights. Therefore, the Tribunal did not address the influence of the Basel Convention under Article 1110 NAFTA. Nevertheless, the Tribunal acknowledged the necessity to draw the distinction between a non-compensable regulations and a measures that amounts to expropriation because of a ‘substantial deprivation’ of the investment.

⁹⁶⁸ S.D.Myers, Inc. v Government of Canada, Partial Award, November 13, 2000, NAFTA, UNCITRAL.

		<p>tend to involve the deprivation of ownership rights; regulations a lesser interference. The distinction between expropriation and regulation screens out most potential cases of complaints concerning economic intervention by a state and reduces the risk that governments will be subject to claims as they go about their business of managing public affairs.’</p> <p>[283] ‘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.’</p>	
<p><i>Tecmed v. Mexico</i>⁹⁶⁹</p> <p>The dispute emerged from the revocation of the operation licence of the investor’s hazardous waste landfill.</p>	<p>[97] Mexico claimed that the non-renewal of the licence was a legitimate regulatory measure issued due to the environmental protection.</p>	<p>[116] The Tribunal stressed the paramount importance of the effect of the state’s regulation to decide whether indirect expropriation took place. The Tribunal found a significant deprivation of the investment and, thus, the expropriatory effect generated by the non-renewal of the operation licence. However, in contrast to <i>Metalclad</i>, the Tribunal proceeded with the analysis of the alleged expropriatory character of the governmental action (as it was</p>	<p>The <i>Tecmed</i> award introduced the language of balancing within the indirect expropriation standard (the so-called ‘proportionality doctrine’). <i>Tecmed</i>’s balancing analysis was later approved in <i>LG&E Energy v. Argentina</i>,⁹⁷² <i>Continental Casualty v. Argentina</i>⁹⁷³ and <i>Azurix v. Argentina</i>⁹⁷⁴ awards. <i>Tecmed v. Mexico</i> supplements the paramount ‘effects’ criterion with an assessment whether the character of the governmental measure</p>

⁹⁶⁹ Técnicas Medioambientales Tecmed S.A. v. The United Mexican States (ICSID Case No. ARB (AF)/00/2), Award of 29 May 2003 (Spain/Mexico BIT), ILM 43 (2004) 133.

		<p>required by the applicable BIT⁹⁷⁰) and analyzed the Municipality's motives for the non-renewal of the licence. Here the Tribunal noted that [122] for a domestic measure to be legitimate under international law '[t]here 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.'⁹⁷¹ The Tribunal found that the rejection of the licence was not supported by any real reason of public interest; therefore, the investor was found to bear 'an individual and excessive burden', and the expropriation was considered to be illegal.</p>	<p>is expropriatory. In order to do that, the Tribunal has focused on whether there is a balance between the importance of the public purpose and the effect on the investor by the measure. It declared that there would not be a proportional relationship between these two elements in cases of substantial interference in the foreign investment is not compensated.</p>
<p><i>Methanex v. US</i>⁹⁷⁵</p> <p>The dispute emerged from the ban by California of the controversial gasoline additive (MTBE) which endangered human health and the environment. The investor – a company producing the chemical, claimed that a substantial portion of</p>	<p>California substantiated its ban with research done by the University of California on the effects of MTBE on human health and the environment. The research suggested the imposition of the ban. The <i>amicus curiae</i> brief emphasized 'the immense public importance of the case</p>	<p>[Part III - Chapter A – 51 [101]] 'The Tribunal accepts the UC Report as reflecting a serious, objective and scientific approach to a complex problem in California since it was subjected to public hearings, testimony and peer-review.' [Part IV - Chapter D - Page 4, [7]]</p>	<p>In contrast to the 'sole effects' doctrine represented by <i>Metalclad</i>, the so-called 'context doctrine' represented by <i>Methanex</i> especially emphasizes the respect for wider circumstances for which an interference in a foreign investment occurs. <i>Methanex</i> gave</p>

⁹⁷² LG&E v. Argentina, Decision on Liability, 3 October 2006, ICSID Case No. ARB/02/1, Argentina – US BIT 1991, [194-195].

⁹⁷³ Continental Casualty v. Argentina, [208, 276].

⁹⁷⁴ Azurix Corp. v. the Argentine Republic, ICSID Case No. ARB/01/12, Award, July 14, 2006.

⁹⁷⁰ Ibid [115]. The Agreement on the Reciprocal Promotion and Protection of Investments signed by the Kingdom of Spain and the United Mexican States (December 18, 1996) Section 5(1): "any other measure with similar characteristics or effects".

⁹⁷¹ Ibid [122]. The Tribunal referred to European Court of Human Rights, In the case of Mellacher and Others v. Austria, judgment of December 19, 1989, 48, p.24; In the case of Pressos Compañía Naviera and Others v. Belgium, judgment of November 20, 1995, 38, p. 19.

⁹⁷⁵ Methanex v. United States, UNCITRAL (NAFTA) Final Award, 3 August 2005.

its investments, including its share of the California and wider US oxygenate markets, was taken by the measure that was arbitrary in nature.	and the critical impact that the Tribunal's decision will have on environmental and public welfare law-making.' It was also contended that the interpretation of the Chapter 11 of the NAFTA should reflect legal principles underlying the concept of sustainable development. ⁹⁷⁶	Tribunal famously declared: '[A]s 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 contemplating investment that the government would refrain from such regulation.' ⁹⁷⁷ [9] No such commitments were given to Methanex.	emphasis to the public interest protection by explicitly recognizing the customary right of a State to regulate for the public interest as far as the regulation affecting the foreign investment is performed in good faith. However, the <i>Methanex</i> award does not propose a general exemption from compensation of all reasonable, non-discriminatory general regulations since in the case at hand, there was no substantial deprivation of the investor's property by the Californian ban. ⁹⁷⁸ Accordingly, the <i>Methanex</i> award does not provide a clear answer in a case of substantial deprivation would have been found.
<i>Chemtura v. Canada</i> ⁹⁷⁹ Chemtura, a company producing lindane, filed the claim under the NAFTA Chapter 11 due to the gradual phase-out of the agrochemical lindane by Canada. The investor alleged that the ban was lacking a rigorous scientific risk assessment, hence was being enforced in bad faith. The investor claimed violations of the FET, MFN, and indirect expropriation standards.	[131], [134]-[137] Canada argued that its gradual ban was based on the legitimate human health and environmental protection considerations in accordance with international undertakings by Canada.	[128], [131], [134-7], [139], [147] The Tribunal found that the ban was non-discriminatory, in compliance with due process and based on widely accepted scientific data recognizing lindane as a dangerous chemical. Legitimacy of the ban was supported by the fact that many countries had taken steps to ban the use of lindane, and that the ban was necessitated by Canada's international environmental obligations. [266] The Tribunal stated that	Like the <i>Methanex</i> award, the <i>Chemtura</i> Tribunal approved the 'context doctrine' approach. However, the Tribunal found no 'substantial deprivation' of the <i>Chemtura</i> 's investment ([263]-[266]). Nevertheless, [266] the award arguably supports the position that a legitimate suppression of a previously legal activity through recognized police powers of state destroying the investor's business may exempt the host state from the obligation to pay compensation

⁹⁷⁶ *Methanex v. United States (NAFTA)*, Decision on Amici Curiae, 15 January 2001 [5].

⁹⁷⁷ See also *Saluka v. Czech Republic* [262]-[263].

⁹⁷⁸ *Methanex v. US, Part, Part IV - Chapter D* [16].

⁹⁷⁹ *Chemtura v. Canada, NAFTA, UNCITRAL, Award August 2 2010*.

		‘[i]rrespective of the existence of a contractual deprivation, (...) 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’. ⁹⁸⁰	under international law.
<p><i>Pac Rim v. El Salvador</i>⁹⁸¹</p> <p>El Salvador delayed and ultimately declined to issue certain environmental permits for gold mining in Ecuador. The investor, a United States mining company, complained that a revocation of permits for its exploration and exploitation projects had amounted, among others, to indirect expropriation of the investor’s investment in certain mining areas.</p>	<p>The government protested the claim by stating it was concerned about the underwater pollution caused by industrial gold mining.⁹⁸² Therefore, El Salvador responded that Pacific Rim failed to complete domestic requirements for obtaining necessary permits including the environmental impact assessment.</p>	<p>Merits of the case are pending under the domestic investment statute.</p>	<p><i>Pac Rim v. El Salvador</i> and <i>San Sebastian v. El Salvador</i> disputes represent a potential clash between the ability of the host State to shift towards a more environmentally-friendly policy and its international investment protection obligations that might significantly limit that ability.</p>
<p><i>San Sebastian v. El Salvador</i>⁹⁸³</p> <p>El Salvador revoked the investors’ environmental permits and did not renew their exploration licenses for gold mining in Ecuador. Commerce Group and San Sebastian alleged that these governmental actions violated several investment guarantees of the CAFTA, including the protection against indirect expropriation</p>	<p>Similar as for <i>Pac Rim</i> arbitration (above).</p>	<p>[140] ‘The Tribunal rejected its jurisdiction and competence pursuant to CAFTA primarily on the ground that the claimants had failed to discontinue local litigation in El Salvador before turning to international arbitration.’</p>	<p>See above (<i>Pac Rim</i>).</p>

⁹⁸⁰ referring to *Saluka v. Czech Republic*, Partial Award, [262].

⁹⁸¹ *Pac Rim Cayman LLC v. The Republic of El Salvador*, CAFTA, ICSID Case No. ARB/09/12, Award on Merits Pending (Decision on the Respondent’s Preliminary Objections Under CAFTA Articles 10.20.4 and 10.20.5, 2 August 2010).

⁹⁸² Gus Van Harten, ‘Thinking twice about a gold rush: *Pacific Rim v El Salvador*,’ *Columbia FDI Perspectives*, No. 23, May 24, 2010.

⁹⁸³ *San Sebastian v El Salvador*, CAFTA, ICSID Case No. ARB/09/17, Award 14 March 2011.

of their interests in the gold mining venture.			
<p>Marion and Reinhard Unglaube v. Costa Rica⁹⁸⁴</p> <p>Investors having an investment in the ecotourism sector of Costa Rica brought a claim to arbitration for several alleged violations of the Costa Rica-Germany BIT. In 1991, Costa Rica issued a decree creating a new national park for the protection of leatherback turtles. The creation of the park implied expropriation of part of the investors' land. Investors claimed that effective expropriation of their land inside and outside the Park territory took place. Other claims involved alleged FET violations, failure to grant full protection and security and arbitrary and discriminatory treatment ([168]).</p>	<p>Overall, Costa Rica emphasized its important responsibilities to protect the seriously endangered leatherback turtles. These obligations were stemming from the Constitution of Costa Rica and the Inter-American Convention for the Protection and Conservation of Sea Turtles ([101]-[103], [140]). Regarding Costa Rica's actions that did not relate to the direct expropriation of the investors' land strip within the Park territory, the country insisted it had exercised its <i>bona fide</i> regulatory autonomy for clear and important public interest that did not amount to expropriation ([144]). Concerning the direct expropriation of the investors' land strip within the Park territory, Costa Rica alleged that the expropriation was legal and the claim was premature ([156]-[158]), since the issue on the precise amount of compensation for the expropriation was pending before domestic courts.</p>	<p>The Tribunal approved the importance of the public purpose at issue ([163]) and customary right of the State to take property for such a purpose ([166]-[167]). However, the Tribunal held: ([167]) 'While the subject of the protection of endangered species is an important one, the Tribunal finds that the crucial elements of this dispute involve more mundane issues of fact and law as they relate to the legality of the [expropriation].' Thus, the only claim that survived was the one of the illegal expropriation of the land strip inside the Park territory. Even if the land was meant to be directly expropriated, the expropriation process was not complete. Until the day of the Award, the Investors and the country had on-going domestic disputes over the legality of the expropriation and the amount of due compensation constituting significant delay in the intended taking. Therefore, the Tribunal held that Costa Rica did not make timely arrangements to determine and make payment to the Investor ([209]-[210]) constituting a breach of the expropriation standard. Since the expropriation was</p>	<p>The <i>Unglaube</i> Tribunal referred to the <i>Santa Elena</i> award as an authority, and it did limit the notorious parts of the <i>Santa Elena</i> ruling on expropriation. First, while dealing with the argument by Costa Rica that expropriation was lawful since the compensation issue was to be resolved in the future, the Tribunal highlighted the similarity with the <i>Santa Elena</i> case, where equally intense domestic legal proceedings resulted in delay of timely compensation. The Tribunal stated: [216] 'Then, as now, Costa Rican law included provisions which required, <i>inter alia</i>, that property expropriated for a public purpose must be dedicated to that purpose within 10 years [...]' Since the time limit was exceeded, the <i>Unglaube</i> Tribunal referred to the <i>Santa Elena</i> award as an authority for constituting the fact of unlawful expropriation of the Investors land in the Park territory ([218]-[221]). Second, the <i>Unglaube</i> Tribunal held that lack of a timely arrangement of compensation was not justified because the expropriation was intended for <i>bona fide</i></p>

⁹⁸⁴ Marion Unglaube and Reinhard Hans Unglaube v. Republic of Costa Rica, ICSID Case No. ARB/08/1 and ICSID Case No. ARB/09/20, Award, May 16, 2012.

		<p>found to be unlawful due to the overly long time-period for paying prompt compensation, the Tribunal undertook to decide the proper compensation for the expropriation. Both parties agreed principally on the fair market value as the applicable standard of compensation ([309], [203]).</p>	<p>public purpose ([213] - [214]). In this context, the <i>Unglaube</i> Tribunal cited the notorious paragraph 72 of <i>Santa Elena</i> : [217] ‘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.’ Hence, the <i>Unglaube</i> Tribunal is noteworthy for limiting the reading of that paragraph to merely prove the point that already established expropriation must meet its legitimacy criteria under international law including timely compensation.</p>
<p><i>Vattenfall v. Germany</i>⁹⁸⁵</p> <p>Swedish energy company Vattenfall claims compensation for alleged losses resulting from the recent decision by Germany to phase-out nuclear power. Vattenfall bases its claim on the Energy Charter Treaty.⁹⁸⁶</p>	<p>Country’s precaution within its energy policy, shifting the policy after the Fukushima tragedy in Japan.</p>	<p>Pending.</p>	
<p><i>Bilcon/Clayton v. Canada</i>⁹⁸⁷</p> <p>The dispute arose from the environmental impact assessment process of the unpopular Nova Scotia basalt quarry site and</p>	<p>Canada argues that differences in regulatory goals and in various projects allow different treatments for different projects. Canada argues that the complex and thorough environmental</p>	<p>Pending.</p>	

⁹⁸⁵ Vattenfall AB and others v. Federal Republic of Germany (ICSID Case No. ARB/12/12), The case registered at ICSID on May 31, 2012, pending.

⁹⁸⁶ Investment Arbitration Reporter, ‘Germany is Sued at ICSID by Swedish Energy Company in Bid for Compensation for Losses Arising out of Nuclear Phase-out’, June 1, 2012.

⁹⁸⁷ William Richard Clayton, Douglas Clayton and Daniel Clayton and Bilcon of Delaware Inc. v. Government of Canada, available at www.italaw.org (accessed at 1 April 2012), Pending.

<p>its associated marine terminal. The investor brought Canada to arbitration after the rejection of its quarry terminal project due to the conclusions of the impact assessment. The investor claims various mistreatments by Canadian authorities including an overly excessive environment impact assessment, and hence, a violation of the investor's expectations for a stable legal and business environment. The investor also insists the application of the precautionary principle was discriminatory, as it was not applied to other comparable projects.</p>	<p>assessment was necessitated because of 'the modern concept of the "environment" encompassing both biophysical components like the air, land, water, flora and fauna, and human components such as socio-economic conditions, environmental health and the physical and cultural heritage of a place'.⁹⁸⁸ Since all of these elements were potentially affected by the investment project, Canada has analyzed them in the environmental assessment resulting in the rejection of the project.</p>		
<p><i>Philip Morris v. Australia</i>⁹⁸⁹ / <i>Philip Morris v. Uruguay</i>⁹⁹⁰</p> <p>The cases developed from the recently-enacted laws by Australia and Uruguay mandating the plain packaging of tobacco products. Investors claim the existence of expropriation and violations of the FET standard and, in particular, the violation of legitimate expectations for legal stability.</p>	<p>States argue that the plain packaging laws are necessary for public health protection reasons. These laws are said to be supported by a broad range of studies, and not amounting to expropriation since they do not raise a substantial deprivation of the investments. Furthermore, Australia claims the investor was able to expect such regulatory changes within the country since the regulations challenged are the consequential outcome</p>	<p>Pending.</p>	

⁹⁸⁸ Government of Canada, Counter-Memorial, Public Version, December 9, 2011, in the Matter of an Arbitration Under Chapter Eleven of the North American Free Trade Agreement and the UNCITRAL Arbitration Rules between William Ralph Clayton, William Richard Clayton, Douglas Clayton and Daniel Clayton and Bilcon of Delaware Inc. v. Government of Canada [22].

⁹⁸⁹ Investment Arbitration Reporter, 'Philip Morris puts Australia on notice of treaty claim, but both parties decline to release documents; claim over tobacco regulations would be third treaty-based investor-state claim filed by Philip Morris since 2010', June 30, 2011. Hong Kong – Australia BIT.

⁹⁹⁰ Philip Morris Brand Sarl (Switzerland), Philip Morris Products S.A. (Switzerland) and Abal Hermanos S.A. (Uruguay) v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7. Switzerland-Uruguay BIT.

	of the long term policy by the government. Australia also refers to its compliance with the practices of other member states of the World Health Organization and to the requirements of the Framework Convention on Tobacco Control.		
SUSTAINABLE DEVELOPMENT ASPECT: SOCIAL DEVELOPMENT/CULTURAL HERITAGE PROTECTION/HUMAN RIGHTS ISSUES LIKE ACCESS TO WATER AND SANITATION SERVICES AND INDIGENOUS RIGHTS			
<p><i>SPP v. Egypt</i>⁹⁹¹</p> <p>The claim emerged from the termination of the Pyramids Oasis Project for developing a tourist resort near the Pyramids. The project was rejected because Egypt had included the area in the World Cultural Heritage List after the investment was accepted in the country.</p>	<p>[156], [158], [160]-[164] Egypt invoked its obligations under the UNESCO Cultural Heritage Convention as grounds for the termination of the project, claiming that the compensable expropriation did not take place.</p>	<p>[158] The Tribunal maintained that, as a matter of international law, Egypt acted legitimately by cancelling a tourist development project situated on its own territory for the purpose of protecting antiquities belonging to the World Heritage. However, [159] the Tribunal noted that both Egyptian and international law required to pay fair compensation in the event of expropriation including for the purpose of safeguarding antiquities. Nevertheless, [190-191] the Tribunal limited the content of 'legitimate expectations' for the amount of expropriation and consequently decided not to award <i>lucrum cessans</i> from the date of the inclusion of the project area in the Word Heritage List. Starting from that date the investor had lost its legitimate expectations to gain profit of such</p>	<p>Similarly as in <i>Santa Elena v. Costa Rica</i>, the <i>SPP</i> Tribunal approved the general rule that any expropriation is compensable. However, contrary to <i>Santa Elena</i>, the <i>SPP v. Egypt</i> Tribunal took into account the UNESCO Convention for informing the content of 'legitimate expectations' for fair compensation of the expropriated property (sub-element of indirect expropriation standard). This last aspect indicates a careful balance between the protection of public interest and the investor's private interest.</p>

⁹⁹¹ Southern Pacific Properties (SPP) (Middle East) Limited v. Arab Republic of Egypt, ICSID ARB/84/3, May 20, 1992, Egypt's National Law No.43.

		an activity.	
<p>Vivendi v. Argentina (Resubmitted)⁹⁹²</p> <p>The dispute arose out of the troubled relationship between the parties to a concession agreement that privatized the water and sewage services of the Province of Tucumán in Argentina. The problems occurred out of the complex factual issues like the increase by the investor of the tariffs, corresponding reaction by the governmental authorities, two incidents of water turbidity and an overreacted response by the authorities to it.</p>	<p>[3.3.3.]- [3.3.5] Argentina claimed that its treatment of the investor by terminating the concession and supporting the customers not to pay the bills for contaminated water fell within its regulatory activity ‘and that this is even more so the case when the service provided is as vital as the provision of water and sewage services.’</p>	<p>[7.5.20], [7.5.34] The Tribunal took a different approach and focused merely on the effects of the governmental measures, stating ‘There is extensive authority for the proposition that the state’s intent, or its subjective motives are at most a secondary consideration [...] While intent will weigh in favour of showing a measure to be expropriatory, it is not a requirement, because the effect of the measure on the investor, not the state’s intent, is the critical factor.’</p> <p>[7.5.21] Further, the Tribunal held: ‘If public purpose automatically immunises the measure from being found to be expropriatory, then there would never be a compensable taking for a public purpose.’</p>	<p>Overall, this award is another ‘sole effects’ doctrine award. It is apparent that Argentina and the Tribunal focused on different issues: Argentina allegedly referred to the police powers exceptions under customary international law but the Tribunal reduced the issue to the intent to expropriate, which, indeed, is not a decisive factor in the establishment of indirect expropriation. Similarly to the <i>Metalclad</i> award, the <i>Vivendi</i> Tribunal did not acknowledge the necessity to distinguish between regulatory measures amounting to expropriation and non-compensable police powers exceptions, confusing two separate steps - the establishment of the existence of expropriation and the legitimacy assessment of the already established expropriation.</p>
<p>Biwater Gauff v. Tanzania⁹⁹³</p> <p>Biwater, an investor in water and sanitation services in Dar es Salaam, Tanzania, had underestimated the difficulty of the project and had failed to allocate sufficient managerial and financial resources to it. The investor’s provision of water and</p>	<p>[419] Tanzania rejected the existence of the expropriation since the very conduct of the investor had led to the mismanagement of the water and sanitation services and the investor had financially failed and, therefore, there was nothing to be expropriated. Furthermore, the Republic noted that:</p>	<p>The tribunal held that some aspects of Tanzania’s conduct amounted to expropriation (substantial deprivation) of the investor’s contractual rights to operate water and sewerage services ([489]-[510], [518]-[519]) and breached FET. The conduct in</p>	<p>Although the Tribunal focused solely on the effects of the State’s conduct, it nevertheless took into account the circumstances of the case, namely the investor’s own failures in managing the company. Consequently no damages were awarded to the investor for the violations of the</p>

⁹⁹²COMPANHIA DE AGUAS DEL ACONQUIJA S.A. and VIVENDI UNIVERSAL S.A. v. Argentine Republic, ICSID, Case No. ARB/97/3, Award 20 August 2007, Resubmitted, France-Argentina BIT1991.

⁹⁹³ Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania, ICSID Case No ARB/05/22, Award, 24 July 2008.

<p>sanitation services caused protests by local residents, objecting to the quality of the services. Since Biwater experienced serious financial problems, it requested an increase in tariffs. The raise in tariffs was rejected by the government. Later, the governmental authorities terminated the contract with Biwater, occupied investor's facilities, took over the management of the company, and deported senior managers of the investor's local company. Biwater brought a claim under the UK-Tanzania BIT claiming that the combined effect of the Republic's conduct amounted to <i>de facto</i> expropriation and other violations of the BIT ([393], [418]).</p>	<p>'Water and sanitation services are vitally important, and the Republic has more than a right to protect such services in case of a crisis: it has a moral and perhaps even a legal obligation to do so.'</p> <p>[436] 'In short, City Water had created a real threat to public health and welfare. DAWASA and the Government judged quite reasonably that the system had to be freed of City Water's control. Considering the importance of the issue at hand, the fact that City Water was entitled to remain in control for three weeks at most, and City Water's own responsibility for creating the crisis, the Government acted well within the Republic's margin of appreciation under international law.'</p>	<p>violation of the BIT was the seizing of the assets of the Company, the usurpation of the management control, and the deportation of the company's management. However, the Tribunal did not award damages to the investor because of lack of economic damages done.</p>	<p>investment protection guarantees.</p>
<p><i>Glamis Gold v. US</i>⁹⁹⁴</p> <p>The claim arose from the non approval of the investor's, a Canadian mining company, new mining project and from the limitations imposed on its existing mining rights by new California legislations requiring a complex environmental and cultural impact assessment and full back-filling of open-pits in order to protect the Quechan Indians religious, cultural and historic sites in the investment area. The investor asserted that</p>	<p>[107]-[110], [153] In its defence, the US Government had insisted that the new regulations were designed to promote important public interests – including public safety and the protection of Native American cultural sites. Any other alleged procedural mistreatments were caused by the fact that Canada was dealing with a mining project with particularly notable environmental and cultural implications.</p>	<p>[536] The Tribunal rejected the expropriation claim because 'the first factor in any expropriation analysis is not met', namely there was no substantial deprivation of the investor's investment.</p> <p>[354] Nevertheless, the Tribunal approved that 'a State is not responsible, however, "for loss of property or for other economic disadvantage resulting from bona fide ... regulation ... if it is not discriminatory."⁹⁹⁵ As a result, all investor's claims were</p>	<p><i>Glamis Gold</i> is a good example of regulatory expropriation, where the protection of such non-investment interests as indigenous rights, cultural heritage and environmental protection has caused allegations of regulatory expropriation of the investor's property. The Tribunal (in contrast to <i>Methanex v. US</i>) started its analysis with the assessment of the existence of 'substantial deprivation' of the investor's property and rejected the existence</p>

⁹⁹⁴ *Glamis Gold, Ltd. v. The United States of America*, UNCITRAL (NAFTA), Award, 8 June 2009.

⁹⁹⁵ Restatement Third, comment (g) at 200.

<p>these new requirements amounted to regulatory expropriation of its mining rights making the project economically unfeasible [356]. Further, Glamis claimed violation of FET under the NAFTA Article 1105. The FET claim was based on the same factual circumstances, and the investor regarded the situation as arbitrary and in breach of its reasonable expectations for legal stability.</p>		<p>rejected, and the company was ordered to pay 2/3 of the arbitration costs and their own legal expenses.</p>	<p>of indirect expropriation since the investor's losses were not significant enough. However, like <i>Methanex</i>, the <i>Glamis</i> award reflects the approval of non-compensable police powers in a wider sense, namely without a substantial deprivation of the investor's investment.</p>
<p><i>Merrill v. Canada</i>⁹⁹⁶</p> <p>The case lodged by a U.S. forestry company arose from the restrictions imposed by Canada on the export of logs from Canada to the United States. The restriction was the surplus testing procedure requiring that logs from both private and public land had to be deemed surplus to provincial needs before they could be exported ([28]). The investor argued that the Log Export Control Regime resulted in indirect expropriation since it controlled the processing and selling of its logs ([120]-[129]). Further, the investor claimed these restrictions were arbitrary and discriminatory, since their real aim was to provide low cost raw material for domestic sawmills in British</p>	<p>[134] Canada insisted that there was no substantial deprivation of any of investors investment, and [235] that the Log Export Control Regime reflected a legitimate industrial public policy objective – to promote local processing of its timber through the creation of domestic employment and retention in Canada of part of the timber value chain (which applied both to nationals and foreigner).</p>	<p>The Tribunal dismissed the expropriation claim on the basis of lack of the substantial deprivation. There cannot be an expropriation of potential future income like expectations of getting a certain price level at the international market . ([150], [215]). Further, the Tribunal accepted Canada's Log Export Control Regime as a legitimate public policy that did not constitute an abrupt change of the legal environment ([236]). However, in reaching that conclusion, the Tribunal analyzed in detail the purposes and objectives of the Regulation so as to see if they were issued genuinely for public interest([223] –[224]). The Tribunal dealt with the legitimacy of the Log Export Control Regime under the wider FET standard.</p>	<p>The Merrill award indicates a balanced approach between the interests of an investor and a State by paying detailed analysis to the sub-elements of the FET standard.</p>

⁹⁹⁶ Merrill & Ring Forestry L.P. v. Canada, *UNCITRAL, ICSID Administered Case (NAFTA)* Award, 31 March 2010.

Columbia at the expense of private log producers ([217]).		Under FET, the Tribunal approved the legitimacy of Canada's measure ([153], [217]-[246]), among others, because the investor did not have legitimate expectations to the contrary effect and there were no actual damages that the investor had suffered, even if some of the motives of the Regulation were hardly serving genuine public interest.	
<p>Suez v. Argentina⁹⁹⁷</p> <p>The case was related to the Argentina crisis management measures, and concerned the concession for water distribution and treatment services in Buenos Aires. During and after the crisis, Argentina refused a revision of the tariffs, even if the costs of the concession increased. Nevertheless, Argentina required full compliance of the obligations under the Concession. In addition, Argentina alleged the existence of high levels of nitrates in the water being distributed by the investor, commencing formal investigation. In the end, Argentina terminated the Concession, and transferred it to the company owned by Argentina. Investors brought a claim against Argentina asserting violations of guarantees against indirect expropriation</p>	Argentina argued that none of its actions violated the BITs and that the measures were aimed at fighting the crisis and providing access to water services in the country.	<p>The Tribunal affirmed the importance of the 'effect' of the measure as a decisive criterion for finding expropriation. ([133]-[134]).</p> <p>However, the Tribunal went on by stating (referring to the <i>Methanex</i> and <i>Saluka</i> awards):</p> <p>[139] 'As numerous cases have pointed out, in evaluating a claim of expropriation it is important to recognize a State's legitimate right to regulate and to exercise its police power in the interests of public welfare and not to confuse measures of that nature with expropriation.' Hence, the Tribunal concluded that the Argentina crisis management measures were within the general police powers of Argentina, and they did not constitute a permanent and substantial deprivation of the investment ([140]).</p> <p>Further, no substantial</p>	<p>In contrast to <i>Metalclad v. Mexico</i> and <i>Vivendi v. Argentina</i> (Resubmitted), the <i>Suez v. Argentina</i> Tribunal acknowledged the necessity to distinguish between regulatory measures having the effect of expropriation and a valid exercise of a customary non-compensable State's regulatory powers (police powers in both a wide and narrow sense).</p> <p>[134] Hence, the Tribunal took a much more cautious approach with regard to the effects of the requirement as the 'sole effects' doctrine awards do. The Tribunal characterized the criterion of the effect on the investment 'as an important element in determining if the measure constitutes an expropriation requiring compensation' but not as the sole element.</p>

⁹⁹⁷ Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic, Decision on Liability, 30 July 2010, ICSID Case No. ARB/03/19, France-Argentina BIT, Spain – Argentina BIT, United Kingdom – Argentina BIT, UNCITRAL Rules.

<p>of their investments and breaches of FPS and FET. The investors alleged these measures amounted to expropriation: 1) acts of a general legal or regulatory nature, enacted to cope with the financial crisis and its aftermath; 2) the failure of the Argentine government to revise the tariffs in line with the legal framework established by the Concession Contract and 3) the actions taken by the Argentine government at the time of the termination of the Concession.</p>		<p>deprivation was found by Argentina's refusal to revise the tariffs ([145]). Finally, regarding the termination of the Concession, the Tribunal noted it was contractual in nature ([147]). Thus, the investor's claim under the indirect expropriation standard failed.</p>	
<p><i>Piero Foresti v. South Africa</i>⁹⁹⁸</p> <p>The investors complained about South Africa's Black Economic Empowerment programme requiring the introduction of compulsory equity divestiture benefiting the historically disadvantaged South Africans. Italian investors claimed that these South African attempts to deal with the consequences of apartheid amounted to expropriation of Italian investment in the granite sector.</p>	<p>South Africa claimed its measures were within its regulatory autonomy as an attempt to deal with the consequences of apartheid.</p>	<p>Amicable settlement was reached between the parties after the Tribunal found jurisdiction over the claim. The investors discontinued the claim as they agreed with the State on the individual Black Economic Empowerment arrangements.</p>	<p>Initiation of this arbitration raised politically sensitive questions, since it touched upon the interrelation between South Africa's constitutional, human rights law and international investment law obligations. [79] This situation has fuelled concerns about the overly broad reach of the indirect expropriation standard on the host State's ability to safeguard legitimate public welfare objectives unduly limiting its administrative, legislative, or judicial powers.</p>

⁹⁹⁸ Piero Foresti, Laura de Carli and Others v Republic of South Africa ICSID Case No ARB(AF)/07/1, Award, 4 August 2010.

BOX 2. UNSUCCESSFUL ATTEMPTS TO INVOKE NON-INVESTMENT OBLIGATIONS

[..] - Relevant paragraph of an award.
Awards are listed in chronological order.

Arbitral award Facts of the case	Public interest defence by a host State (and/or <i>amici</i> arguments) invoking non-investment international commitments	Response by a tribunal on the necessity to address non-investment international obligations	Comments
SUSTAINABLE DEVELOPMENT ASPECT: THE ENVIRONMENT PROTECTION			
<p><i>Santa Elena, S.A. v The Republic of Costa Rica</i>⁹⁹⁹</p> <p>The award emerged from the disagreement between the foreign investor and Costa Rica on the amount of compensation to be paid for the direct expropriation of the investor's property which was supposed to be included in the nature protection park.</p>	<p>Costa Rica noted that: [18] 'The lands [...] contain flora and fauna of great scientific, recreational, educational, and tourism value, as well as beaches that are especially important as spawning grounds for sea turtles.' Furthermore, Costa Rica had longstanding commitments and efforts to add the area of the investor's property to the World Heritage List under the World Heritage Convention. Costa Rica's conservationist objectives for unique flora and fauna were buttressed by numerous treaties to which it was party like the Western Hemisphere Convention, the Convention Concerning the Protection of the World Cultural and Natural Heritage, the Convention on Wetlands, the 1992 Convention on Biological Diversity and the Central</p>	<p>[71] '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.'</p> <p>[72] '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</p>	<p>The <i>Santa Elena</i> award is notable for skipping entirely the identification of the existence of a potential conflict in applicable law in contrast to <i>SPP v. Egypt</i>. Moreover, <i>Santa Elena</i> did not address the potential effect non-investment obligations invoked by Costa Rica could have on the valuation of the expropriated property (contrary to the approach taken in, e.g., <i>SPP v. Egypt</i>, where the Tribunal had considered the effect of the World Heritage Convention on the valuation of expropriated property ([156]) and on the amount of compensation due). The <i>Santa Elena</i> Tribunal unduly reduced the issue of the effect that non-investment international law might have on the amount of compensation to the</p>

⁹⁹⁹ Compañía del Desarrollo de Santa Elena, S.A. v The Republic of Costa Rica, ICSID Case No. ARB/96/1, Award of 17 February 2000, 15 ICISD REV – FILJ 169 (2000).

	American Regional Convention for the Management and Conservation of the Natural Forest Ecosystems. ¹⁰⁰⁰ For these reasons, [35] the State argued for such valuation of the property's fair market value that would have taken into account 'the existing environmental legislation that would significantly restrict, if not prohibit outright, the commercial development of Santa Elena'.	is expropriated, even for environmental purposes, whether domestic or international, the state's obligation to pay compensation remains. ⁷	mere statement that '[t]he international source of the obligation to protect the environment makes no difference' and that expropriation for whatever purpose needs to be compensated (the fact that was never questioned by Costa Rica).
SUSTAINABLE DEVELOPMENT ASPECT: SOCIAL AND ECONOMIC DEVELOPMENT RELATED TO CRISIS MANAGEMENT MEASURES AND HUMAN RIGHTS ISSUES LIKE ACCESS TO WATER AND SANITATION SERVICES			
<i>Azurix v. Argentina</i> , ¹⁰⁰¹ The investor was seeking compensation for the termination of a water and sewage concession in Buenos Aires.	[254] Argentina had attempted to invoke as applicable law human rights that protect consumers' rights and had pointed to the potential conflict between the relevant BITs and Argentina's human rights obligations. Argentina had stated that a conflict had to be resolved in favour of human rights.	[261]The Tribunal rejected Argentina's arguments on the potential conflict of norms in applicable law as not fully elaborated, since Argentina failed to establish the incompatibility in the specifics of the instant case.	It was Argentina's first attempt to invoke the existence of the conflict between the BIT and its human rights obligations. Anyhow, Argentina's claim that human rights should 'trump' investment law would be difficult to substantiate, unless the human rights invoked are covered by <i>jus cogens</i> norms and Article 103 of the UN Charter. ¹⁰⁰²
<i>Siemens v. Argentina</i> ¹⁰⁰³ Investors claimed that Argentina had expropriated Siemens' contractual rights and had denied the firm FET when it	[75] 'Argentina contended its human rights obligations would be disregarded by recognizing the allegedly expropriated contractual property rights asserted by	[79] 'In this respect, the Tribunal notes the reference made by Argentina to international human rights law ranking at the level of the Constitution after the 1994	It was Argentina's burden to prove credibility of the existence of the conflict between human rights and the BIT. Since the network of

¹⁰⁰⁰ Charles N. Brower, Jarrod Wong, 'General Valuation Principles: The Case of Santa Elena' in Todd Weiler (ed), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (Cameron May 2005), Chapter 20, 747, 763-764, referring to Counter-Memorial of Costa Rica [on file with authors].

¹⁰⁰¹ *Azurix Corp. v. the Argentine Republic*, ICSID Case No.ARB/01/12, Award, July 14, 2006 [261].

¹⁰⁰² See JHH Weiler, Andreas L Paulus, 'The Structure of Change in International Law or Is There a Hierarchy of Norms in International Law?', (1997) 8 EJIL 545, 558-65.

¹⁰⁰³ *Siemens A.G. v. The Argentine Republic*, ICSID case No.ARB/02/8, Award, February 6, 2007 [75, 312].

<p>terminated its controversial concession contract for the delivery of national identity cards.</p>	<p>Siemens given the social and economic conditions of Argentina. Argentina claimed that the measures it took were in defence of vital security of the State, to keep the data on its inhabitants secure since otherwise it would violate rights enshrined in international treaties on the protection of human rights.’ [346] ‘Argentina argues that the fair market value of an expropriated property as the measure of compensation for an expropriated investment is not always applicable when an expropriation becomes necessary for social policy reasons. If this would not be the case, it would be a serious limitation on State sovereignty, and no social or economic reforms could be accomplished by poorer nations. Argentina maintains that it had effectively become bankrupt, and that to maintain that an expropriation is only lawful if full market compensation is payable is incompatible with the principle of self-determination. Argentina also refers to the statement of the European Court of Human Rights in <i>James v. UK</i>, which held that Article 1 of the First Protocol does not “guarantee a right to full compensation in all circumstances. Legitimate objectives of ‘public interest’ such as pursued in measures of economic reform or measures designed to</p>	<p>constitutional reform and implying that property rights claimed in this arbitration, if upheld, would constitute a breach of international human rights law. This argument has not been developed by Argentina. The Tribunal considers that, without the benefit of further elaboration and substantiation by the parties, it is not an argument that, <i>prima facie</i>, bears any relationship to the merits of this case.’ [354] ‘Argentina has pleaded that, when a State expropriates for social or economic reasons, fair market value does not apply because otherwise this would limit the sovereignty of a country to introduce reforms in particular of poor countries. Argentina has not developed this argument, nor justified on what basis Argentina would be considered a poor country, nor specified the reforms it sought to carry out at the time. Argentina in its allegations has relied on <i>Tecmed</i> as an example to follow in terms of considering the purpose and proportionality of the measures taken. The Tribunal observes that these considerations were part of that tribunal’s determination of whether an expropriation had occurred and not of its determination of compensation. The Tribunal further observes that Article I of the First Protocol to the European Convention on Human Rights permits a margin of appreciation not found in customary</p>	<p>IIAs requires full market value compensation for expropriation, Argentina’s argument in [346] meant the deviation from the very wording of the applicable BIT. Argentina could argue that the determination of fair market value was affected by Argentina’s non-investment international obligations and their effect on the content of the investor’s legitimate expectations for what fair market value would be (as it was successfully done in <i>SPP v. Egypt</i>).</p>
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	achieve greater social justice, may call for less than reimbursement of full market value.’	international law or the Treaty.’	
<p><i>Biwater Gauff v. Tanzania</i>¹⁰⁰⁴</p> <p>Biwater, an investor in water and sanitation services in Tanzania, had underestimated the difficulty of the project and had failed to allocate sufficient managerial and financial resources to it. The investor’s provision of water and sanitation services caused protests by local residents objecting to the quality and price of the services. Since Biwater experienced serious financial problems, it requested an increase in tariffs which was rejected by the government. Later, governmental authorities terminated the contract with Biwater, occupied the investor’s facilities, took over the management of the company, and deported senior managers of the investor’s local company. Biwater brought a claim under the UK-Tanzania BIT claiming that the combined effect of the Republic’s conduct amounted to <i>de facto</i> expropriation and other violations of the BIT ([393], [418]).</p>	<p>[380] Since Biwater’s investment was in water and sewage systems that are ‘intimately related to human rights and the capacity to achieve sustainable development’ and also carrying with it ‘very serious risks to the population at large’, <i>Amici</i> noted: ‘[H]uman rights and sustainable development issues are factors that condition the nature and extent of the investor’s responsibilities, and the balance of rights and obligations as between the investor and the host State’.</p> <p>[434, 436] Tanzania maintained that its actions were in order to safeguard its local population’s vital rights to water, since the investor was not performing its obligations and had created a real threat to public health and welfare. Tanzania further argued that: ‘[w]ater and sanitation services are vitally important, and the Republic has more than a right to protect such services in case of a crisis: it has a moral and perhaps even a legal obligation to do so.’</p> <p>Regarding the takeover of the control of the investor’s company, Tanzania asserted:</p>	<p>[814] The Tribunal found <i>amici</i>’s observations useful, but did find it necessary to elaborate on the investor’s responsibility, sustainable development and human rights, and decided the case strictly in accordance with the BITs terms. Similarly, the Tribunal did not enter into a discussion as to the margin of appreciation that might be owed to Tanzania.</p> <p>The tribunal held that Tanzania had committed the expropriation of the investor’s contractual rights to operate water and sewerage services in Dar es Salaam and had breached FET but did not award any compensation to the investor.</p>	<p>The <i>Biwater</i> award is remarkable in twofold ways. First, it did not recognize and, therefore, did not deal with the potential conflict in applicable law as it was invoked by <i>amici</i> and by Tanzania’s reference to the margin of appreciation doctrine for deciding, which measures are necessary in providing the right to water. Nevertheless, despite sticking strictly to the rules of the relevant BIT, the Tribunal provided a noteworthy outcome of the case by not allocating any damage compensation to the investor for Tanzania’s violations of the expropriation standard and FET.</p>

¹⁰⁰⁴ *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania*, ICSID Case No ARB/05/22, Award, 24 July 2008.

	[436] ‘Considering the importance of the issue at hand, the fact that City Water [Investor’s Company] was entitled to remain in control for three weeks at most, and City Water’s own responsibility for creating the crisis, the Government acted well within the Republic’s margin of appreciation under international law.’		
<p><i>Suez v. Argentina</i>¹⁰⁰⁵</p> <p>The case emerged from the crisis management measures of Argentina affecting the Concession for water distribution and treatment services in Buenos Aires. The investors which held the Concession complained about the crisis management measures – freezing of the tariffs during and after the crisis in 2001-2002 and contractual termination of the Concession. Argentina had been found liable for denying FET to the foreign investors for parts of the challenged acts.</p>	<p>[249]-[250],[252],[256]</p> <p>Argentina and <i>amicus curiae</i> submissions invoked Argentina’s human rights to water obligations as a rationale and context for the challenged actions by Argentina during and after the crisis. Hence, human rights to water obligations needed to inform the content of both Argentina’s necessity defence and the potential violation of investment protection guarantees. Remarkably: [252] ‘Argentina states that water cannot be treated as an ordinary commodity. Because of the fundamental role of water in sustaining life and health and the consequent human right to water, it maintains that in judging the conformity of governmental actions with treaty obligations this Tribunal must grant Argentina a broader margin of discretion in the present cases than in cases involving other</p>	<p>[262] The Tribunal interpreted Argentina’s and <i>amicus</i> arguments as suggesting ‘that Argentina’s human rights obligations [...] somehow trumps its obligations under the BITs and [...] implicitly gives Argentina the authority to take actions in disregard of its BIT obligations’. The Tribunal noted that the ‘trumping’ argument was unsound under the BIT and international law, and went on by stating that in the case at hand ‘Argentina’s human rights obligations and its investment treaty obligations are not inconsistent, contradictory, or mutually exclusive’ and ‘Argentina could have respected both types of obligations.’</p>	<p>There are three remarkable aspects of this award relating to the non-investment law arguments: First, like in <i>Biwater v. Tanzania</i> ([436]), the Tribunal did not address Argentina’s argument of wide margin of appreciation for safeguarding human rights. Second, the Tribunal shaped the arguments raised by Argentina and <i>amici</i> to potential conflict in applicable law, which it solved by presuming against the existence of a conflict between human rights and investment protection. In contrast, the Respondent required applying its human rights obligations as a context that informs the content of investment guarantees; nevertheless, it was done without much precision. It may be guessed that Argentina intended the Tribunal to take human rights</p>

¹⁰⁰⁵ Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic, Decision on Liability, 30 July 2010, ICSID Case No. ARB/03/19, France-Argentina BIT, Spain – Argentina BIT, United Kingdom – Argentina BIT, UNCITRAL Rules.

	<p>commodities and services.’</p> <p>Argentina went on by stating that:</p> <p>‘In order to judge whether a treaty provision has been violated, for example the provision on fair and equitable treatment, Argentina argues that this Tribunal must take account of the context in which Argentina acted and that the human right to water informs that context.’</p> <p>[256] <i>Amici</i> ‘pointed out that human rights law recognizes the right to water and its close linkages with other human rights, including the right to life, health, housing, and an adequate standard of living. Human rights law[...] required that Argentina adopt measures to ensure access to water by the population, including physical and economic access, and that its actions in confronting the crisis fully conformed to human rights law. Since human rights law provides a rationale for the crisis measures, they argue that this Tribunal should consider that rationale in interpreting and applying the provisions of the BITs in question.’</p>		<p>obligations into account in a way that resembles <i>SPP v. Egypt</i> (in relation to compensation) and <i>Parkerings v. Lithuania</i> awards (relating to ‘like circumstances’ under MFN).</p> <p>Third, since the Tribunal applied one of the conflict avoidance techniques under international law, namely the presumption against conflict, it significantly differs from the earlier <i>Santa Elena</i> award that took the ‘self-contained’ regime approach by ignoring entirely the possibility of a conflicts in applicable law.</p>
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BOX 3. SUCCESSFUL EXAMPLES OF TAKING NON-INVESTMENT LAW INTO ACCOUNT IN THE INTERPRETATION AND APPLICATION PROCESS OF INVESTMENT GUARANTEES

[..] - Relevant paragraph of an award.
Awards are listed in chronological order.

Arbitral award Facts of the case	Public interest defence by a host State (and/or <i>amici</i> arguments) invoking non-investment international commitments	Response by a tribunal addressing the potential relevance of non-investment international obligations on the merits by (1) presuming against conflict and interpreting away conflict, (2) informing the content of investment guarantees by reference to external fields of law, or (3) addressing non-investment international obligations through teleological, effective or evolutionary treaty interpretation of the content of an investment guarantee.	Comments
SUSTAINABLE DEVELOPMENT ASPECT: THE ENVIRONMENT AND/OR PUBLIC HEALTH PROTECTION			
<i>Maffezini v. Spain</i> ¹⁰⁰⁶ The investor decided to embark on the production of various chemical products in Galicia, Spain. The investor established a corporation and began construction works of the plant before the environmental impact assessment (EIA) was obtained. The company began to experience financial difficulties. The investor, among others, claimed responsibility by Spain	[66] Spain noted that the investor ‘was specifically informed of the applicable legal requirements in Spain and under the European Economic Community, particularly as the project involved the highly toxic chemical industry’. Hence, the EIA requirement was not arbitrary and could not <i>per se</i> lead to the discontinuance of the project. Spain insisted the financial difficulties were raised by bad business decisions entirely	[67] ‘The Tribunal has carefully examined these contentions, since the Environmental Impact Assessment procedure is basic for the adequate protection of the environment and the application of appropriate preventive measures. This is true, not only under Spanish and EEC law, but also increasingly so under international law.’ [69] ‘Strict procedures in this respect are provided in EEC Directive 85/337 of June 27, 1985 ²³ and in	The Tribunal took into account that not only Spanish law required an environment impact assessment of the investment project. The EU Directives buttressed the national law requirement. Hence, the Tribunal informed the content of the BIT provision on compliance with local laws by taking into account Spain’s obligations under EU law.

¹⁰⁰⁶ Emilio Augustin Maffezini v. Kingdom of Spain, ICSID Case No.ARB/97/7, Award, 13 November 2000.

for EIA as an arbitrary requirement imposing additional costs on the Project.	unrelated to the EIA.	<p>Spain's Royal Legislative Decree No. 1302/1986 of June 28, 1986.</p> <p>Chemical industries are specifically required under both measures to undertake an EIA. Public information, consultation with pertinent authorities, licensing and other procedures are also a part thereof. The EEC Directive, like the one that later came to amend it, requires "that an EIA is undertaken before consent is given to certain public and private projects considered to have significant environmental implications."</p> <p>Suspension of projects can be ordered under Spanish law, particularly if work thereon is begun before the EIA is approved.¹⁰⁰⁷</p> <p>[71] The Kingdom of Spain and SODIGA have done no more in this respect than insist on the strict observance of the EEC and Spanish law applicable to the industry in question. It follows that Spain cannot be held responsible for the decisions taken by the Claimant with regard to the EIA. Furthermore, the Kingdom of Spain's action is fully consistent with Article 2(1) of the Argentine-Spain Bilateral Investment Treaty, which calls for the promotion of investment in compliance with national legislation. The Tribunal accordingly also dismisses this contention by the Claimant.'</p>	
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¹⁰⁰⁷ Footnotes omitted.

<p><i>S.D. Myers v. Canada</i>¹⁰⁰⁸</p> <p>The investor claimed that the temporary export ban of hazardous chemicals between Canada and the US constituted a breach of NAFTA Chapter 11, including Article 1102 on national treatment and Article 1110 on indirect expropriation.</p>	<p>[150] ‘CANADA’s position is that [Investor’s] construction of Chapter 11 is inconsistent with Canada’s other international obligations, including the Basel Convention and Transboundary Agreement and that these prevail over Chapter 11 obligations in the circumstances to the extent of the inconsistency.’</p> <p>[99] - [107] Canada argued that its export ban of the hazardous chemical was in line with its international commitments to minimise the risk to human health and the environment by the chemical. In particular, Canada argued the export ban was designed to fulfil the goals set by the Basel Convention that required managing hazardous wastes in an environmentally sound manner reducing the transboundary movement of them to a minimum.</p>	<p>The Tribunal addressed the Basel Convention argument under Article 1102 NAFTA.</p> <p>[247] ‘The Tribunal considers that the legal context of Article 1102 includes the various provisions of the NAFTA, its companion agreement the NAAEC and principles that are affirmed by the NAAEC (including those of the Rio declaration).’</p> <p>[250] ‘The Tribunal considers that the interpretation of the phrase “like circumstances” in Article 1102 must take into account the general principles that emerge from the legal context of the NAFTA, including both its concern with the environment and the need to avoid trade distortions that are not justified by environmental concerns. The assessment of “like circumstances” must also take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest.’</p> <p>[255] ‘Canada was concerned to ensure the economic strength of the Canadian industry, in part, because it wanted to maintain the ability to process PCBs within Canada in the future. This was a legitimate goal, consistent with the policy objectives of the Basel Convention. There were a number of legitimate ways by which Canada could have achieved it, but</p>	<p>The <i>S.D. Myers</i> Tribunal analyzed the Basel Convention so as to see if a real conflict of norms existed and whether the compliance with the Basel Convention was a ‘real’ motivation for Canada’s export ban. In contrast to <i>Biwater Gauff</i> and <i>Suez v. Argentina</i> skipping the margin of appreciation arguments raised by States, <i>S.D. Myers</i> Tribunal dealt with the limits on the margin of appreciation imposed by Article 104 NAFTA on Canada to choose the alternative that is least inconsistent with NAFTA for fulfilling its international commitments under the Basel Convention ‘provided that the alternative is equally effective and reasonably available’. Since there were alternative methods available to Canada for achieving the policy objectives of the Basel Convention not contravening Canada’s international commitments under the NAFTA, the Tribunal found a violation of the NAFTA Chapter 11. In sum, the Tribunal presumed against conflict and interpreted away conflict of norms with the NAFTA and the Basel Convention in order to establish a</p>
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¹⁰⁰⁸ *S.D. Myers, Inc. v Government of Canada*, Partial Award, November 13, 2000, NAFTA, UNCITRAL.

		preventing SDMI from exporting PCBs for processing in the USA by the use of the Interim Order and the Final Order was not one of them.[...] Canada's right to source all government requirements and to grant subsidies to the Canadian industry are but two examples of legitimate alternative measures.'	breach of investment guarantee.
<p><i>Chemtura v. Canada</i>¹⁰⁰⁹</p> <p>Chemtura filed the claim under the NAFTA Chapter 11 due to the gradual phase-out of the agrochemical lindane. The investor claimed that the ban was lacking a rigorous scientific risk assessment, hence being enforced in bad faith. The investor claimed violations of FET, MFN, and indirect expropriation standards.</p>	<p>[131], [134]-[137] Canada argued that the scientific review of lindane and its gradual ban was based on legitimate considerations in accordance with Canada's international undertakings like the Aarhus Protocol on Persistent Organic Pollutants to the UNECE Convention on Long-Range Transboundary Air Pollution of 1979, which was adopted by both the United States and Canada, and the Stockholm Convention on Persistent Organic Pollutants, including lindane in the list of chemicals designed for elimination.</p>	<p>[134]-[143] The Tribunal took into account the international agreements invoked by Canada as a 'broader factual context' to assess whether Canada had acted in its mandate under its international commitments. This broader factual context was relevant in assessing the point raised by the Claimant that Canadian agencies acted in bad faith.</p> <p>International treaties and experience of other states were a significant argument used by the tribunal for rebutting the investor's claim that the public purpose of environment and health protection was a hidden motive, and State agencies actually acted in bad faith to irritate trade.</p>	<p>The Tribunal indirectly presumed against potential conflict in applicable law and used Canada's international commitments that were not explicitly addressed by NAFTA Article 104 as a 'broader factual context' for informing the content of the bad faith standard.</p>
SUSTAINABLE DEVELOPMENT ASPECT: CULTURAL HERITAGE PROTECTION			
<p><i>SPP v. Egypt</i>¹⁰¹⁰</p> <p>The claim emerged from the termination of The Pyramids Oasis Project for developing a tourist resort near the Pyramids. The project was terminated after its approval since Egypt had included the area in the World Cultural</p>	<p>[156], [158] Egypt invoked its obligations under the UNESCO Cultural Heritage Convention as grounds for the termination of the investment project, claiming the compensable expropriation did not take place.</p>	<p>[153]-[154], [159] The Tribunal found no real conflict between the norms of the UNESCO Convention and Egypt's requirement to pay compensation for expropriation because 'the choice of the sites to be protected is not imposed externally, but</p>	<p>Contrary to <i>Santa Elena v. Costa Rica</i>, the <i>SPP v. Egypt</i> Tribunal took into account the UNESCO Convention, which served as a motivation and justification for expropriating the investor's property. First, the Tribunal</p>

¹⁰⁰⁹ Chemtura v. Canada, NAFTA, UNCITRAL, Award August 2 2010.

¹⁰¹⁰ Southern Pacific Properties (SPP) (Middle East) Limited v. Arab Republic of Egypt, ICSID ARB/84/3, May 20, 1992, Egypt's National Law No.43.

Heritage List.		<p>results instead from the State's own voluntary nomination'.¹⁰¹¹</p> <p>[158] The Tribunal maintained that, as a matter of international law, Egypt acted legitimately by cancelling a tourist development project situated on its own territory for the purpose of protecting antiquities belonging to the World Heritage.</p> <p>Therefore, [190-191] the Tribunal limited the content of 'legitimate expectations' and consequently decided not to award <i>lucrum cessans</i> from the date of the inclusion of the project area in the World Heritage List because from that date the investor had lost its legitimate expectations to gain profit of such an activity.</p>	<p>recognized and solved potential conflicts in applicable law.</p> <p>Second, the Tribunal used the date of the Convention's coming into effect for informing the content of 'legitimate expectations' for fair compensation for the expropriated property.</p>
<p>Parkerings v. Lithuania¹⁰¹²</p> <p>Norwegian investor Parkings was involved in the business of construction and management of parking garages. The investor submitted the claim against Lithuania for alleged breaches of FET, MFN and expropriation standard. The investor claimed, <i>inter alia</i>, that another investor, Dutch company Pinus Proprius, was granted a right to make a car parking lot in the Old Town of Vilnius but the Parkerings was rejected this right.</p>	<p>[371]-[389]</p> <p>For its defence, Lithuania invoked its international obligations under the Convention of the Protection of the Architectural heritage of Europe and the European Convention on the Protection of the Archaeological heritage. Lithuania explained that the area where Parkerings intended to make a parking lot was listed in the UNESCO List of World Heritage. Due to these obligations, the local authorities feared that the construction of the parking lot in that specific area would have a significant</p>	<p>[382], [394]</p> <p>The Tribunal took into account the UNESCO Convention for the determination of the content of 'like circumstances' under the MFN standard. The Tribunal justified the differentiation between the two similar foreign investment projects in Vilnius, since one of the projects was meant to operate in the area that was protected under the UNESCO Convention, providing justifiable grounds for a different treatment.</p>	<p>The Tribunal took into account the UNESCO Convention so as to inform the content of 'like circumstances' sub-element of the MFN standard.</p>

¹⁰¹¹ The Dissenting Opinion by Professor Khan disagrees on this statement.

¹⁰¹² Parkerings-Compagniet AS v Lithuania, Award on jurisdiction and merits, ICSID Case No ARB/05/8, award 14 August 2007.

Thus, Lithuania had violated the MNF standard.	impact on internationally protected cultural properties. Thus, the relevant authorities rejected the project by Parkerings.		
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