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The Relationship Between International Investment Arbitration and Environmental Protection: Charting the Inherent Shortcomings

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Contents

Summary

Approximately 3000 international investment agreements (IIAs), mostly bilateral investment treaties, have been designed since the 1960's to promote and protect foreign investment across the world. In case of a dispute, the agreements provide for investor-state dispute settlement (ISDS) in an arbitration tribunal. Investors have, however, been successful in extending arbitration to issues concerning public policy, including environmental policy. Drawing on vague and broad investment protection provisions, investors have challenged host states' environmental protection measures by claiming that the measures constitute compensable indirect expropriation or a breach of the fair and equitable standard. Some of the environmental protection measures challenged are bans on harmful chemicals and mining, measurements to provide hazardous waste, phase-out of nuclear power, and stricter measurements to protect ground water. As a result, state measures aimed to protect the environment, including regulations in line with goals set in international environmental law, are increasingly challenged at ad hoc arbitration tribunals, within the framework of international investment law.

The thesis investigates the potential procedural shortcomings of the ISDS mechanism in relation to environmental protection. In connection to this, the thesis makes three main conclusions. The first is that the inconsistent interpretational practices of investment tribunals have created a legal environment of uncertainty in respect to the host states' obligations. As a result, states cannot take regulatory actions to protect the environment without facing the risk of arbitration. The second conclusion is that the tribunals extensive jurisdiction and the possibilities of third party funding significantly increases the host states' exposure to investor claims. A single environmental protection measure, only affecting one investment, could therefore give rise to multiple claim, potentially under different IIAs. The third conclusion, is that the asymmetries inherent of the investment regime between investors' interests and host states' interests, might invite investors to submit claims to challenge environmental protection measures, even in the absence of a strong legal basis.

The thesis also asks whether the ongoing reform efforts of IIAs to include environmental language are adequate to combat the issues identified. It concludes that the ongoing efforts are inadequate in two aspects. First, they do not address the most crucial systematic shortcomings identified. Second, they might arguably be ignored or overruled through several mechanisms identified in this thesis, namely the most favored nation standard, the use of third-party IIAs as an interpretative aid, the possibility of multiple claims and the practice of "BIT-shopping".

Sammanfattning

Cirka 3000 internationella investeringsavtal har ingåtts sedan 1960-talet för att främja och skydda gränsöverskridande investeringar över hela världen. Avtalen innehåller vanligtvis tvistlösningsmekanismen Investor-State Dispute Settlement (ISDS), som innebär att utländska investerare ges rätt att stämma värdstater inför en internationell skiljedomstol för åtgärder som potentiellt påverkar investeringar negativt. Flera skiljeförfaranden har dock även berört frågor och åtgärder som rör viktiga allmänna intressen, så som miljöskydd. Genom att åberopa vaga och breda bestämmelser i investeringsavtalen har investerare yrkat att värdstaters miljöskyddsåtgärder utgör olovlig indirekt expropriation eller ett åsidosättande av Fair and Equitable Treatment standarden. Exempel på miljöskyddsåtgärder som prövats inför skiljedomstol inom ramen för investeringsavtal är förbud mot skadliga kemikalier, åtgärder mot farliga avfall, utfasning av kärnkraftverk och restriktioner för att skydda grundvatten.

Uppsatsen undersöker potentiella processuella brister i ISDS-förfarandet i förhållande till miljöskyddsintressen i värdstater. Tre slutsatser dras. Den första slutsatsen är att skiljedomstolarnas skilda tolkningar och metoder har skapat ett oklart rättsläge vad gäller värdstaternas skyldigheter enligt avtalen och gränsdragningen för legitima statliga åtgärder. Stater kan därför inte vidta miljöskyddsåtgärder utan att undgå den kostsamma risken att stämmas inför skiljedomstol. Den andra slutsatsen är att skiljedomstolarnas omfattande jurisdiktion och möjligheterna till finansiering av investerares talan från tredje part avsevärt ökar risken för skiljeföranden. En enda miljöskyddsåtgärd, som endast påverkar en investering, kan därför ge upphov till flera parallella yrkanden, eventuellt under olika investeringsavtal. Den tredje slutsatsen är att asymmetrin inom ISDS-mekanismen mellan investerares intressen och värdstaters intressen kan ge investerare ett incitament att lämna in en stämningsansökan på grund av en statlig miljöskyddsåtgärd som påverkar investeringen negativt, även i avsaknad av en stark rättslig grund.

Uppsatsen utreder även om det pågående reformarbetet för att inkludera miljöhänsyn i investeringsavtal är lämpligt för att motverka de identifierade bristerna. Slutsatsen är att det pågående reformarbetet är otillräckligt i två hänseenden. För det första åtgärdas inte de mest väsentliga systematiska bristerna. För det andra kan reformerna möjligen bortses ifrån eller åsidosättas genom flera mekanismer som identifierats i uppsatsen, så som Most Favoured Nation standarden, användningen av andra investeringsavtal som tolkningshjälpmedel, parallella stämningsansökningar och så kallad ”BIT-shopping”.

Preface

I would first like to thank my excellent supervisor Valentin Jeutner, for his guidance and valuable insights throughout the work with this thesis.

Thank you, Louis, for being by my side throughout this semester.

Slutligen, tack till mamma och pappa, för allt ert stöd under hela juristprogrammets gång.

Porto Vecchio, May 2020

Tina Asgharian

Abbreviations

BIT	Bilateral Investment Treaty
ECT	Energy Charter Treaty
EU	European Union
FET	Fair and Equitable Treatment
FCN	Friendship, Commerce and Navigation Treaty
FTA	Free Trade Agreement
ICSID	International Centre for Settlement of Investment Disputes
ICSID Convention	Convention on the Settlement of Investment Disputes between States and Nationals of Other States 1965
IIA	International Investment Agreement
ISDS	Investor-State Dispute Settlement
ITO	International Trade Organization
MFN	Most-Favoured-Nation
NAFTA	North American Free Trade Agreement
NGO	Non-Governmental Organisation
OECD	Organisation for Economic Co-operation and Development
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCITRAL Arbitration Rules	United Nations Commission on International Trade Law Arbitration Rules 2010
UNCTAD	United Nations Conference on Trade and Development
USMCA	United-States-Mexico-Canada Agreement
VCLT	Vienna Convention on the Law of Treaties 1996
WTO	World Trade Organisation

1 Introduction

1.1 Background

Over the past four decades, growing awareness and attention to issues of climate change and hazardous human activity have prompted several international legal instruments. Binding environmental agreements, as well as soft-law mechanisms, increasingly requires or encourages states to take action to prevent environmental harm, protect biodiversity and mitigate climate change. In addition, in the absence of an international environmental court, human right bodies across the globe have acknowledged that there is a clear link between environmental protection and human rights protection, thus enabling human rights claims arising from environmental impacts. Yet, since the Paris Agreement on climate change in 2016, global investments in fossil fuel industry have increased, expanding in coal, oil and gas projects.[1]

At the same time, numerous international investment agreements have been designed since the 1960's to promote foreign investment across the world and to protect investors from discriminatory and protectionist policies. In case of a dispute, the investment agreements provide for investor-state dispute settlement (ISDS) in an arbitration tribunal. Investors have, however, been successful in extending arbitration on to issues within the public policy sphere, including health and environmental policies. Drawing on vague and broad investment protection provisions, foreign investors can argue that an environmental policy constitutes compensable indirect expropriation or that it violates the obligation to treat the investor fairly and equitable. As a result, state measures aimed to protect the environment, including regulations in line with goals set in international environmental law, are increasingly challenged at ad hoc arbitration tribunals, within the framework of international investment law.

The issue is best illustrated by two recent examples. In December 2019, the Dutch Senate passed a law to ban burning coal for electricity generation by 2030, timely following a court order from the Supreme Court of the Netherlands to drastically reduce the nation's greenhouse gas emissions.[2] The ban inevitably affects the German energy company Uniper, who newly constructed a coal-fired power plant in the Netherlands with a projected life expectancy of over 40 years. Uniper claims that it had been encouraged by a previous administration to build the plant to reduce Netherlands reliance on

1. Greenfield, P. 'Top investment banks provide billions to expand fossil fuel industry', The Guardian (Oct 13, 2019).

2. Kaminski, I. 'Dutch supreme court upholds landmark ruling demanding climate action', The Guardian (Dec 20, 2019).

gas.[3] Consequently, already prior to the final Senate vote on the ban, Uniper threatened to bring a claim against the Dutch government for expected damages to their investment, reported to amount to 850 million euros.[4] The legal base of the claim would be the investment protection rules of the Energy Charter Treaty (ECT), to which both Germany and the Netherlands are parties.

While no claim has been filed by Uniper as to yet, the situation is by no means unique. In 2015, the Obama administration rejected TransCanada's construction permit to build the Keystone XL Pipeline in the United States, arguing that it would undercut the nation's leadership on reducing carbon emissions.[5] In response, TransCanada claimed USD 15 billion under the North American Free Trade Agreement (NAFTA) for alleged lost profits and damages. The suit was later suspended due to an executive order by Trump that allowed for TransCanada to reapply for a permit.[6]

Other examples include investor claims brought against states due to bans on harmful chemicals and mining, requirements for environmental impact assessments, measures prohibiting hazardous waste, stricter standards to protect ground water, or cancellations of projects based on policy changes or human rights obligations. As of October 2016, there were more than 114 publicly known cases on environmental issues, including pending cases.[7]

These cases, as well as other cases related to public policy issues, have caused lively debates among scholars, activists and states on the legitimacy and future of international investment law. One of the most notable and controversial debates is on whether the fear of ISDS claims discourages governments to adopt appropriate health and environmental policies, creating a so called regulatory chill.[8] Skeptics of the theory maintain that investment treaties do not obstruct or chill legitimate regulation, as long as the state measures are non-discriminatory, proportionate and conform to due process.[9]

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3. Keating, D. 'Dutch Lawmakers Under Pressure Over Coal Phase-Out, Forbes, (Dec 2, 2019).
4. Van Der Schoot, E. 'Claim om kolenverbod voor Staat', De Telegraaf, (Sep 5, 2019); Niemelä, P., van Asselt, H., Kulovesi, K., Rajavouri, M. 'Risky business: Uniper's potential investor-state dispute against the Dutch coal ban', Blog of the European Journal of International Law (March 18, 2020).
5. Vaughan, A. 'How Keystone XL, the pipeline rejected by Obama, went ahead under Trump', The Guardian (Mar 24, 2017).
6. Lou, E. 'TransCanada's $15 billion U.S. Keystone XL NAFTA suit suspended, Reuters', (Feb 28, 2917).
7. Viñuales (2016), this data-set also includes cases where the claimant is challenging the state due to failure to protect the environment that causes harm to the investment.
8. See chapter 5.
9. See Schill (2007); see also Wälde and Kolo (2001), who concludes that legitimate environmental regulation is unlikely to be challenged under the investment rules of modern multilateral trade and investment treaties.

However, this stance presumes that the rules are clear and that it is fairly easy to distinguish between a legitimate or illegitimate environmental regulation within the investment regime. As will be unfolded throughout the thesis, the tribunals have applied significantly different standards in an inconsistent manner.

Similar assumptions, rejecting the regulatory chill theory, are often reached when focusing on a few single cases.[10] In light of this, this thesis aims to apply a broader view that can focus on systematic shortcomings of international investment law, rather than assessing specific cases, in order to discuss the potential implications of the ISDS mechanism on environmental protection measures in host states.

Further, as a response to the escalating criticism, the last several years has seen a change in states' treaty drafting practice. Several states have included sustainable development considerations and general exception clauses in different parts of newly concluded treaties. Changes can also be noticed in investment tribunals' practices and in the level of deference given to public interests in some subsequent investment awards. Thus, the question rises whether these changes are effective to deal with the potential restrains on environmental protection.

1.2 Purpose and Research Questions

The thesis aims at both presenting the conflicting relationship between international investment law and environmental protection measures, as well as examining whether the ongoing reform efforts are adequate to deal with the most prominent issues of this relationship. In order to reach the purpose, the thesis will attempt to answer the following research questions:

- What are the potential procedural shortcomings of the ISDS mechanism in relation to environmental protection?
- Are the ongoing reforms of IIAs to include environmental language adequate to combat the issues identified?

Environmental protection in this thesis refers to any government activity that seeks to maintain or restore the quality of the natural environment. This concept as well as the normative aspects related to the questions, such as how the thesis aims to impact the measure on environmental protection and what is meant by "adequate" to combat the issues, are clarified in the analytic chapter.

10. See Lavranos, N. 'After Philip Morris II: states maintain their regulatory powers to control the plain packaging of cigarettes', Reuters Arbitration Blog, (Aug 15, 2016).

1.3 Method and material

In order to answer the research questions, the thesis uses a traditional legal method, which means that the first part of the thesis is rather descriptive in nature to present the issue at hand, in order to later analyze the problems identified. The method is particularly important for the purpose of this thesis, as the focus is on the implications (if any) of the investment regime on host states' environmental protection, rather than the impact of the outcomes of certain cases. A mere case study or comparative study of one aspect would therefore not serve the purpose well.

The material applied in the thesis is essentially the traditional sources of international law. The analysis is based on examinations of provisions in several investment treaties and free trade agreements. The preparatory works have not been deemed as necessary to include. However, a contextual and historical background is provided in the second chapter in order to give the reader a valuable perspective on the foundations of this field of law and the purpose behind the ISDS mechanism.

Quite a few arbitral awards are also examined throughout the thesis, in order to understand how the different investment provisions have been interpreted in practice. Some of the cases, but not all, are related to environmental measures in host states. Important to note, arbitration awards are usually only public if the parties agree and the arbitration institution provides for a public record. Therefore, some extra caution must be asserted when drawing general conclusions from the case law.

This thesis also benefits largely from incorporating interpretations, findings and commentaries from legal scholars, because of the broad focus of the thesis, the approximately 3000 existing international investment agreements and the many fragmented tribunal awards. This is helpful in identifying the historical background, the substantive rights of investors and, especially, the procedural shortcomings. Findings drawn from empirical analysis or case studies conducted by legal scholars have in the largest degree possible been put in contrast to other findings or been problematized in some aspect, in order to provide the reader with a balanced understanding of the regime. Lastly, several reports and surveys from international organizations on investment law are included, in order to incorporate current trends and areas of improvement.

1.4 Current Research

In the last couple of years there has been a surge in literature that covers the relationship between investment protection and environmental protection.

They cover a broad range of different issues and have different perspectives. However, to the knowledge of the author, no study has yet been focusing primarily on the impact of procedural aspects of investment arbitration on environmental protection.

Early work in the field focuses on potential conflicts between investor rights and environmental regulation under the NAFTA,[11] or on whether investment rules can shrink the policy space for sustainable development in the electricity sector.[12] In 2015, this theory was elaborated throughout all sectors, when Romson investigated whether environmental law is allowed sufficient "policy space" in relation to the investment protection provisions fair and equitable treatment standard, national treatment standard and the expropriation standard.[13]

Several scholars discuss how environmental considerations can be better incorporated in investment arbitration and investment law.[14] Some scholars have further focused the interactions between international investment law and international environmental law, potentially as a means to bring larger environmental considerations to tribunals. Viñuales provides a great in-depth analysis on the interaction between the two fields of law in his book.[15] A few have also highlighted the potential negative impact of the ISDS mechanism on developing countries in particular.[16]

The most recent work related to the subject was published as late as January 2020. It explores the interactions between investment law and environmental law in arbitration cases, provides an excellent overview of environmental principles invoked in arbitration and suggests on legal tools and interpretation doctrines available to protect environmental interest in arbitration.[17]

Further, other recent publications have, inter alia, focused on the legal implications of novel concepts such as soft law standards of investors, including Environmental Impact Assessments and Corporate Social Responsibility provisions.[18] The interaction between international investment law and climate change have also gained some attention recently. Most have focused on the potential conflicts between the investment regime and mechanisms in the United Nations Framework Convention on Climate Change and its Kyoto Protocol.[19] Others have also pointed out the potential positive impacts of environmental issues in investment arbitration, in light of

11. Gantz (2000-2001).
12. Cho and Dubash (2003).
13. Romson (2015).
14. Boisson de Chazournes (2017).
15. Viñuales (2012).
16. See e.g. Tienhaara (2009).
17. Marisi (2020).
18. See Vadi (2010); see also Levashova (2018).
19. See Miles (2008); see also Elborough (2017).

several cases within the renewable energy sector.[20] Lastly, several scholars have also discussed the regulatory chill theory in relation to some of their findings. The theory is outlined in greater detail in the analysis in chapter 5.

1.5 Delimitations

First and foremost, this thesis is a study on international investment law and not environmental law. Several previous researches conducted has examined the relationship between the two fields of law, on both domestic and international level. In this context, it will also be emphasized that the thesis does not examine issues related to international trade. Further, while many environmental protection issues also relate to human rights infringements, the relationship between the fields of law will not be further explored here.

Issues relating exclusively to foreign investment contracts will be left out of the analysis. This means that for example stabilization clauses are excluded from the scope. The reason is mainly that general conclusions are more difficult to draw from contracts, as these are unilateral. Further, many of the contract-based arbitration awards are not publicly available.

The most important limitation relates to the broad nature of the thesis. When investigating a field of law and a range of different issues within it on limited number of pages, it becomes impossible to carefully examine each aspect in detail and elaborate on all questions arising. Every one of the provisions and issues mentioned can be subject to their own lengthy thesis. Recalling the purpose, the point here is to give an overview and provide the reader with “the bigger picture”, in order to analyze the impact of the ISDS mechanism. Yet, this limitation has led to the exclusion of several procedural matters, in order to provide for more rigorous examinations of other aspects. Some of these are mentioned in the beginning of chapter 4.

1.6 Outline

The thesis consists of six chapters. In order to introduce the unfamiliar reader to international investment law, arbitration and foreign direct investment, chapter 2 provides a historical and contextual background of the investment treaty regime and foreign direct investment. This will allow the reader to put the ISDS in a context and understand the purposes and reasons for developing such a mechanism.

In chapter 3, selected key substantive provisions in IIAs will be introduced. Each of the investment protection provisions outlined, as well their potential

20. See e.g. Boute (2009).

impact on states' environmental protection measures, have been subject to much attention in the investment law literature. Chapter 3 does not aim to contribute to that discussion. It rather provides an overview of the current legal regime and the main limitations imposed in respect to environmental protection, as well as gives the reader a sense of how some of these provisions have been interpreted by investment tribunals. The chapter also gives an overview and examination of some of the most common environmental languages included in recent investment agreements.

Chapter 4 provides an examination of four procedural issues. Like chapter 3, it is more descriptive in nature. The issues examined are jurisdiction in investment arbitration, costs, the practice of treaty interpretation, and transparency and public engagement.

Chapter 5 is the analytic part of the thesis. It aims to answer the two research questions by drawing on the findings in chapter 3 and 4.

Chapter 6 provides a brief last remark by the author.

2 Setting the Context: The development of international investment law & abitration

In order to introduce the unfamiliar reader with international investment law and investment arbitration, this chapter will provide a historical and contextual background. This will provide a valuable perspective throughout the thesis. It does not aim to give a comprehensive analysis, but rather outline the general trends and highlight the political and economic context and driving forces that helped shape the current legal regime. It also briefly mentions some of the main ongoing reforms of international investment agreements. Lastly, the final section before the conclusion aims to provide a better understanding of the concept of foreign direct investment and its potential impacts on development and environmental issues.

2.1 The origin of international investment law

Foreign investment in the eighteenth and nineteenth centuries was mostly done in the context of colonial expansion. Cross-border activity in areas that remained uncolonized was regulated through the exercise of diplomatic protection accompanied by use of force, often referred to as "gunboat diplomacy", and the European countries therefore never felt the need for commercial and investment treaties.[21] As a result, the applicable international law in the early twentieth century mainly consisted of customs and general principles of law, which offered vague protection and no effective enforcement mechanisms.[22] Further, failed attempts to conclude a Convention on the Treatment of Foreigners in 1929 and to codify international law on Responsibilities of States for Damages to the Person or Property of Foreigners in the 1930's, revealed that there were significant differences of opinion between capital-exporting and importing states on the treatment of foreign investors, particularly on the principle of equality and the standard of compensation for expropriation.[23]

The capital-exporters held the view that customary international law granted an international minimum standard on the treatment of foreign investment, and that investors had the right to be compensated by the host state if their

21. Newcombe and Paradell (2009), at 10-11.
22. Salacuse (2015), at 85-86.
23. Newcombe and Paradell (2009), at 15-17.

property was expropriated, the so called Hull Formula.[24] Over time, this stance was challenged by capital-importing states. Already in the nineteenth century, the Latin American host states persistently opposed these principles and instead adopted a position called the Calvo Doctrine, named after the Argentinean lawyer and scholar Carlos Calvo. The doctrine proposed that state sovereignty prohibited states from intervening in the affairs of other states, diplomatically or by force, and that investment disputes had to be settled in national court. Further, it concluded that foreign investors only were entitled to the same treatment as the host states' own nationals.[25] This notion was incorporated in several constitutions of Latin American states during the 1900's, and further led to the adoption of the Calvo Clause, a provision incorporated in numerous investor-state contracts under which foreign investors agree to restrict themselves to the local remedies to settle a dispute.[26]

The end of World War II and the emergence of new states in the international community prompted the need for a system of protection of foreign investment. Western corporations, particularly from the United States, established production facilities abroad.[27] At the same time, newly independent states and communist states adopted socialist economic policies and nationalizations of major industries. This led to an increase of disputes over the treatment of foreign investment, on whether natural resource concessions, granted by colonial powers, had to be respected, and on the standard of compensation for the expropriation of those acquired rights.[28]

The economic and political climate of the postwar period thus simulated several initiatives to establish a multilateral legal framework for investment.[29] The earliest effort was the Havana Charter of 1948.[30] The Charter provided the establishment of an International Trade Organization (ITO) and initially included investment provisions on national treatment, most favoured nation treatment and just compensation for expropriation. Yet, given the lasting disagreement on these standards[31], the final draft of the Charter only provided a prohibition on "unreasonable or unjustifiable action" regarding international

24. See Newcome and Paradell (2009), at 18, explaining that the obligation to compensate investors for expropriation was referred to as the "Hull Formula" after a statement by the US Secretary of State, Cordell Hull. In his diplomatic note of 21 July 1938, Hull stated that "the taking of a property without compensation is not expropriation. It is confiscation".

25. Mourra (2008), at 8-9.

26. Miles (2013), at 50-52; see also Garcia-Mora (1950).

27. Salacuse (2015), at 85-86.

28. Newcombe and Paradell (2009), at 18-19.

29. Ibid, at 29.

30. The Havana Charter for an International Trade Organization (Havana Charter) opened for signature 24 March 1948. UN Doc E/Conf 2/78.

31. Newcombe and Paradell (2009), at 19-20.

investment.[32] As western business communities considered these provisions to be vague and ineffective, the treaty never entered into force.[33] In the absence of ITO, the General Agreement on Trade and Tariffs (GATT),[34] which had been negotiated in 1947 on a provisional basis, became the only multilateral instrument governing international trade, up until the World Trade Organization (WTO) was established in 1995. The scope of the GATT, however, did not include investment.

A few of the initiatives for a multilateral investment agreement were non-governmental. A particularly influential one was the 1959 Draft International Convention on Investments Abroad (the Abs-Shawcross Draft Convention).[35] It included an international minimum standard of treatment, defined as "fair and equitable treatment", "just and effective" compensation for expropriation and protected against "unreasonable or discriminatory measures".[36] It was also the first instrument that explicitly provided for investor-state arbitration.[37] The Draft Convention was never endorsed by the states[38], however, its content largely mirrors most of today's European investment treaties.[39]

Since the Havana Charter failed to come into being, states sought to instead protect their interests by entering bilateral and regional investment agreements. Prior to World War I, the United States had a large number of bilateral agreements regarding international economic activity, known as treaties of friendship, commerce and navigation (FCN), which were primarily concerned with trade and shipping rights of individuals. The first FCN treaty was signed with France in 1778, followed by several other such treaties, mostly directed at establishing US relations with Europe.[40] In order to enable United States corporations' activity abroad in the immediate postwar period, the United States signed twenty-two bilateral FCN treaties from 1946 to 1966, primarily designed to facilitate trade, but with significant investment protection provisions, including the most favored nation treatment standard.[41] However, due to growing skepticism from newly independent countries

32. Art. 11(1)(b) of the Havana Charter provides: "No Member shall take unreasonable or unjustifiable action within its territory injurious to the rights or interests of nationals of other Members in the enterprise, skills, capital, arts or technology which they have supplied."

33. Salacuse (2015), at 98.

34. General Agreement on Tariffs and Trade, 30 Oct. 1947, 55 UNTS 814 (applied provisionally as from 1 Jan. 1948 pursuant to the Protocol of Provisional Application).

35. Abs and Shawcross (1960); for a history and commentary, see Schwarzenberger (1960).

36. Abs-Shawcross Draft Convention, Article I, II.

37. Ibid, Article VII (2).

38. For a discussion on the disagreements on the draft, see Seidl-Hohenveldern (1960).

39. Houde and Yannaca-Small (2004), at 4.

40. Vandevelde (2017), at 57-58.

41. Salacuse (1985), at 970. 1

regarding the advantages of foreign investment and the guarantees provided to United States companies, the expansion of the FCN treaties was halted in the late 1960's.[42]

At the same time, European countries started negotiating treaties with newly independent developing countries, that exclusively dealt with foreign investment. The first bilateral investment treaty (BIT) was signed in 1959, between West Germany and Pakistan, based on the preparatory work of the Abs-Shawcross Draft Convention.[43] The German program was then shortly thereafter followed by France, Italy, Switzerland, the Netherlands, Sweden and the Belgium-Luxembourg Economic Union, among others.[44] These early generation BITs were generally short and developed by the capital-exporting states to protect their economic interests abroad.[45] Given the success of these programs, the United States launched its own BIT program in the 1970's, and in the 1980's, newly-industrializing states were also concluding BITs with developing countries. By 1989, the European countries had concluded over 300 BITs.[46]

A vast world-wide expansion of BITs followed in the 1990's. Agreements were concluded across the globe, among non-industrialized states and industrializing countries such as India, Argentina, Brazil and Chile. The reason for this is thought to be two-folded. Firstly, the beginning of the 1990's witnessed a growing political commitment to economic liberalism and a positive view of IIAs for development, partly reinforced by the Washington Consensus, including the International Monetary Fund, the World bank and the United States Treasury. Secondly, there was a lack of alternatives to foreign direct investment (FDI) for developing states. International loans had become increasingly limited, due to growing debts and increase of defaults, and the recession in the 1980's affected the amount of aid given to developing countries. Thus, in order to encourage economic development, many developing states looked to FDI.[47]

The 1990's also saw another ambitious effort for a global investment framework. Between 1995 and 1998, negotiations were held for a Multilateral Agreement on Investment (MAI), prompted by the United States within the Organisation for Economic Co-operation and Development (OECD). An agreement was halted partly due to the timing of the negotiations and opposition by non-governmental organizations regarding the procedural

42. Gudgeon (1986), at 109.
43. Schill (2009), at 40.
44. Switzerland-Tunisia BIT (1961), Netherlands-Tunisia BIT (1963), Guinea-Italy BIT (1964), BLEU-Tunisia BIT (1964), Côte d'Ivoire-Sweden BIT (1965), France-Tunisia BIT (1972), Egypt-UK BIT (1975).
45. Newcombe and Paradell (2009), at 43.
46. Ibid.
47. Ibid, at 47-48.

and substantive provisions in investment treaties, including environmental considerations.[48] To date, international investment treaties have been limited in geographical scope or restricted to a particular sector.

In 2020, there are over 2300 BITs in force and additional 315 treaties with investment provisions (TIPs) that make up the immense system of IIAs.[49] In addition to IIAs, there also exists an open-ended category of investment-related instruments (IRIs), of both binding and non-binding nature. The number of new IIAs concluded in 2017 was however the lowest since 1983, suggesting that investment treaty making has reached a turning point.[50]

2.2 The emergence of investor-state arbitration

Already in the eighteenth century, states would establish arbitral commissions and tribunals to deal with disputes arising from the treatment of foreign nationals and their property. While the claims were based on individual losses, the states were the parties in the proceedings, in line with the diplomatic protection model mentioned in section 2.1. At the time, the United States and the European countries would use force and the threat of force in order to enforce their claims.[51] This so called "gunboat diplomacy" model, however, eventually led to resistance in the Latin American states.

Building on the Calvo Doctrine, the foreign minister of Argentina, Luis María Drago, sent a diplomatic note to the United States in 1902, in response to the intervention in Venezuela of the United Kingdom, Germany and Italy, arguing that "the public debt of an American state can not occasion armed intervention, nor even the actual occupation of the territory of American nations by a European Power".[52] A few years later, the Drago Doctrine was incorporated in the Hauge Convention II of 1907 Respecting the Limitations of the Employment of Force for the Recovery of Contract Debts,[53] forbidding armed force for the recovery of state debts unless there was a refusal to submit the claim to arbitration. The prohibition of the use of force in international law was not established until later in the General Treaty for the Renunciation of War 1928.[54]

48. See e.g. Picciotto (1998); Kurtz (2002).

49. Retrieved from International Investment Agreements Navigator, UNCTAD, 27 May 2020, available at <https://investmentpolicy.unctad.org/international-investment-agreements>.

50. World Investment Report 2018, UNCTAD, at 17-18.

51. Newcombe and Paradell (2009), at 7-10.

52. See Woolsey (1921), at 558-559.

53. Hague Convention II of 1907 Respecting the Limitations of the Employment of Force for the Recovery of Contract Debts, 18 Oct. 1907.

54. Newcombe and Paradell (2009), at 10.

The first investor-state arbitrations took place already in the nineteenth century.[55] However, it was not mainstreamed until many years later, following the increase of international commercial arbitration in the post-war era. International arbitration in the post-war era was however short of an effective enforcement mechanism of awards.[56] As a result, the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards was ratified in 1958 and came to play an important role in the recognition and enforcement of arbitral awards, in that it imposes a duty on national courts to guarantee the recognition and enforcement of foreign arbitral agreements and awards.[57]

Further, in 1965, the International Centre for Settlement of Investment Disputes (ICSID) Convention was negotiated and opened for signature. Three years later, the ICSID published a series of model arbitration clauses for use in BITs. The Chad-Italy 1969 BIT appears to be the first BIT that provides for investor-state arbitration with unqualified state consent.[58] Yet, it took until 1987 for the first BIT-based ISDS claim to be filed, in the case of *AAPL. Sri Lanka*.[59]

The increase of ISDS claims began in the 1990's, much due to the conclusion of the NAFTA in 1993. According to its preamble, the ISDS mechanism was included in NAFTA's investment chapter 11 to create a predictable environment for investment.[60] At the time, there were concerns over Mexico's judiciary independence, which is thought to have prompted the inclusion.[61] The following year, the ECT was established. It is a multilateral investment agreement that focuses on trade and foreign investment within the energy sector, and provides for ISDS. It has 55 member states and is to date the most frequently used investment treaty worldwide to launch investment arbitration against host states.[62]

Investment arbitration can be conducted through an ad hoc process or under an institution. If the IIA refers the dispute to an institution, arbitration rules of that institution will apply. Very often, IIAs provide for ICSID arbitration, which frequently updates and revises its rules. The United Nations Commission on International Trade Law (UNCITRAL) is another body,

55. Ibid, at 10, mentions that one of the earliest disputes was between a Turkish company, La Compagnie Universelle du Canal de Suez, and Egypt in 1864, regarding a law that disrupted a concession agreement to work on the Suez Canal.

56. Ibid, at 25.

57. Ibid.

58. Ibid, at 27, 58.

59. Ibid, at 58-59.

60. NAFTA Preamble, para 6.

61. Mann (2001), at 7.

62. 'The Energy Charter Treaty (ECT) Remains the Most Frequently Invoked IIA', (Jan 11, 2019), available at: <https://www.energycharter.org/media/news/article/the-energy-charter-treaty-ect-remains-the-most-frequently-invoked-iia/>

established by the UN General Assembly in 1966, that provides arbitral rules for ad hoc procedures. There are three different versions of the UNCITRAL Arbitration Rules, the 1976 version, the 2010 revised version and the 2013 version, called UNCITRAL Rules on Transparency for Treaty-based Investor-State Arbitration. The latter one only applies to investment treaties concluded after 1 April 2014.

Tribunals normally consist of three arbitrators, one appointed by the host state, one appointed by the investor and one appointed jointly by the parties, which will act as a president. In case the parties cannot agree on the third arbitrator, institutions like ICSID, which has a panel of arbitrators, can make an appointment on their behalf. To date, there are a total of 1023 known treaty based ISDS cases, including 343 pending cases. In 437 cases, the respondent state is a developing economy.[63]

2.3 Current reform programs of IIAs

Countries are increasingly engaged in modernizing existing old generation BITs, sometimes by replacing old BITs with newly negotiated ones. In 2017, 18 new IIAs were concluded, nine TIPs and nine BITs, and at least 22 IIAs were terminated.[64] The stock of old-generation IIAs, however, is still ten times larger.[65]

Interestingly, since 2012, over 150 countries have taken steps to formulate new generation of sustainable development-oriented IIAs.[66] The reforms include preservation of regulatory space through clarified obligations and limits to the treaty scope. These elements will be discussed in chapter 3.

Other improvements regard the ISDS mechanism. Modern treaties sometimes specify treaty provisions that are subject to ISDS, exclude certain policy areas from arbitration or restrict the allotted time period for submitting claims. Some IIAs further facilitate counterclaims by the respondent party and a few go even further by omitting ISDS altogether.[67] Some of these trends will be discussed in chapter 4.

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63. Retrieved from Investment Dispute Settlement Navigator, UNCTAD, 27 May 2020, available at < https://investmentpolicy.unctad.org/investment-dispute-settlement>.

64. Issue Note, Recent Developments in the International Investment Regime 2019, UNCTAD, at 3.

65. World Investment Report 2019, UNCTAD, at 109.

66. World Investment Report 2018, UNCTAD, at 17-18.

67. Ibid, at 5.

2.4 FDI, developing states & the environment

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".[68] According to the same benchmark definition, the direct investor must, directly or indirectly, own at least 10 % of the voting power of the direct investment enterprise for the relationship to be established. The threshold might vary according to the definition; however, the main motivation of the direct investor is always to influence or control the management of the enterprise and to establish a long-term relationship. This is also what primarily differentiates FDI from cross-border portfolio investments.[69]

As mentioned in section 2.1, one of the driving forces of IIAs in the 1990's was the increasingly positive attitude towards FDI. An IIA alone is, however, not thought to be a sufficient policy instrument to attract FDI. Instead, determinants for foreign investment seems to be a combination of several factors, such as: (1) the general policy framework for foreign investment, including economic, political and social stability; (2) economic determinants, such as the market size, or cost of labor and resources; and (3) business facilitation, such as incentives and promotions.[70]

The positive or negative impact of FDI on developing countries have been discussed frequently in the literature and public debate. FDI inflows are generally considered more favorable for development, as they are more stable and easier to service than portfolio investment or commercial debt. The precise impacts of FDI on economic development are however difficult to measure.[71] While some studies have shown a positive impact of FDI on growth, others have demonstrated the contrary or stated that growth is instead a determinant of FDI.[72] FDI inflows are nevertheless thought to bring certain benefits to developing countries by reducing gaps in resource, technology and foreign exchange. Moreover, FDIs can play a positive function for sustainable development, through transfer of clean technologies and modern environmental management systems.[73]

A central concern among some scholars and members of civil society is that FDI may trigger an environmental "race to the bottom", in which

68. OECD, Benchmark Definition of Foreign Direct Investment (2008), at 22.
69. Ibid, 22-23.
70. World Investment Report 1998, Trends and Determinants, UNCTAD at 91.
71. World Investment Report 1999, Foreign Direct Investment and the Challenges of Development, UNCTAD, at 315.
72. Ibid.
73. See e.g. Osano and Koine (2016).

environmental standards are reduced in order to attract foreign investment, i.e. lower standers would become a competitive factor between states.[74] As a result, developing countries would become “pollution havens”.[75] This relationship has been difficult to establish with significant results. Although developing countries might have lower standards for environmental protection at place, it is not necessarily correlated to FDI.

Nevertheless, there exists several cases of environmental exploitation and damage done by FDIs in developing countries. At the same time, there exists very few possibilities for accountability and relief for victims in situations where multinational corporations have abused human rights or harmed the environment of the host state.[76] In light of this, it is interesting to note that several scholars, perhaps most notably Tienhaara, argues that developing countries are far more likely than developed countries to face conflicts with investors over environmental issues in ISDS.[77]

Tieenhara points to four reasons: (1) developing countries are more likely to change environmental policy more rapidly and possibly more radically, since these countries in general have a lower-base line of environmental regulation; (2) there is less policy coherence in developing countries, which inevitably leads to conflict; (3) there is a higher instance of corruption in developing countries; and (4) courts in developing countries are less respected and trusted by the international community, why it is more likely that claims brought against foreign investors in domestic courts will be challenged in investment arbitration for lack of due process or denial of justice.[78] Other scholars note that the empirical evidence disconfirms this theory, but state that it is reasonable to assume “that many disputes against these states are being resolved in the shadow of the law”.[79]

2.5 Summary and concluding remarks on chapter 2

This chapter has provided an overview of the history and development of the current legal regime. The early form of foreign investment protection was practiced in the colonialized world through the use of force and vague legal doctrines that protected commercial interests and capital-exporting notions of property rights. Already at that time, there was profound resistance in capital-importing states, especially in the Latin Americas, towards the applicable

74. See e.g. Etsy and Geradin (1998).
75. See e.g. Woods (2006); Elliott (2005).
76. Sornarajah (2018), at 184-185.
77. Tienhaara (2009), at 273-274.
78. Ibid.
79. Behn and Langford (2017), at 44.

standards such as the international minimum standard and the obligation of compensation for expropriation.

In the post-colonial era, the conflicting ideologies between capital-exporting and importing states became even more evident due to nationalization processes in emerging states and communist countries. Several attempts for a multilateral investment treaty was thus halted. Yet, the capital-exporting states found other legal tools to impose their perspectives through FCN treaties and BITs. A larger expansion of BITs followed in the 1990's, mainly as a result of positive views on economic liberalisation and lack of alternatives to FDIs for development.

Consequently, the approximately 3000 IIAs is a result of longstanding controversies between capital-exporting and capital-importing states. Further, due to this historical evolution, most investment protection provisions are remarkably similar. While some new generation BITs are sensitive to issues of sustainable development, they only make up a small fraction of all treaties in force. Thus, in the end, the resistance of the capital-importing states was overruled by the efforts of capital-exporting states and the competition for foreign investment.

Finally, the chapter highlighted some of the issues on foreign direct investment in respect of the environment and development. IIAs alone are not thought to be sufficient to promote FDI. Some positive impacts of FDI on development was mentioned, yet, the impact on growth have been difficult to establish. At the same time, there is a profound risk of negative impacts of FDI on the local and global environment. This is particularly worrying considering that there are very few means, if any at all, to hold multinational corporations responsible for their environmental damages in developing countries. Lastly, it was mentioned that some scholars argue that developing countries are more likely to face ISDS claims over environmental concerns than developed countries.

3 Investment protection provisions

While the general purpose of most IIAs is the “promotion and protection” of foreign investment, the treaties can sometimes differ in structure and terminology. Some investment protection provisions can however be found in almost all IIAs. Several countries have further produced so called “model” BITs, which can typically be fitted into two broad categories: North American BITs, from the 1980’s, and European BITs, based on the Abs-Shawcross Draft Convention.[80]

This chapter introduces the reader to these key substantive provisions. It will give a description of the most commonly invoked investment protection standards and an overview of the environmental language included in new generation treaties. The concluding section will comment on some of the main limitations of the examined provisions in respect to public policy and environmental protection measures. The definitions of investment and investor are outlined in section 4.1.1.

3.1 National treatment

The national treatment standard is one of the core provisions in IIAs. It has its origin in trade agreements in the twelfth and thirteenth century and recur as one of the main principles of the Calvo Doctrine, as mentioned in section 2.1. The standard seeks to grant foreign investors treatment comparable to domestic investors. The most common formulation of the rule states that host countries must accord to foreign investors and their investments treatment that is “no less favorable” than the treatment accorded to its own nationals.[81]

The standard of treatment is relative, meaning there is no given minimum or absolute treatment. The prohibited discrimination is simply put between foreigners and nationals in “like situations”, or “like circumstances”, and can cover both procedural and substantive requirements, not necessarily leading to a direct financial disadvantage. Both *de jure* and *de facto* discrimination is covered.[82] Most often, comparisons are between domestic and foreign

80. Houde and Yannaca-Small (2004), at 3, describing that the main difference between the two categories is that the treatment provisions in the European BIT models generally only apply to an investment after establishment, while the North American BITs also cover investment at the pre-establishment phase.

81. See e.g. US BIT model 2012, Article 3.

82. Newcombe and Paradell (2009), at 152.

investments in the same economic sector or where there is a competitive relationship between the products produced by the investments.[83]

Tribunals will usually not engage in an evaluation of all circumstances of investors. This could for example exclude factors such as the environmental impact of an activity from the criteria determining “like circumstances”. Further, when considering whether an investor has been subject to “less favorable” treatment, tribunals will often focus on the effect of the measure rather than the purpose behind it.[84]

Legitimate, non-protectionist rationales can justify differences in treatment; however, there is yet no clear and coherent answer in investment treaty jurisprudence to what standards that need to be met in order to justify the differential treatment.[85] As pointed out by several observers, the national treatment standard might therefore frustrate certain environmental protection measures.[86] This is because preferential treatment can be desirable from an environmental perspective. For example, states sometimes impose measures that target certain carbon-intensive sectors, select certain projects that meet sustainability criteria over others, or grant special land use rights to local communities in order to protect and preserve certain sites.[87]

In many BITs, the national treatment rule applies only to treatment of foreign investment after its admission in the territory of the host country.[88] However, BITs by Canada and the Unites States, and a number of regional IIAs including the NAFTA, require that national treatment is accorded in respect of the admission and establishment of foreign investment as well.[89] This is however always subject to the ability of the parties to make exceptions in relation to particular sectors or policies. Some investment agreements, such as NAFTA or the ECT, identify specific economic activities or functions in respect of which national treatment is to be accorded to foreign investors and investments.[90]

3.2 Most favoured nation treatment

The most favoured nation (MFN) treatment provision is a very common standard in IIAs. It implies an obligation for the host state to accord to investors of the state party no less favorable treatment than accorded to other foreign investors (i.e. investors of any third states). Like the national

83. Ibid, at 160, 165, 170.
84. Miles (2011), at 269-270.
85. Ibid, at 178.
86. Romson (2015), at 225-227.
87. Tienharaa (2009), at 89.
88. See e.g. Austria model BIT art 3(3).
89. See e.g. 1999 El Salvador–United States BIT article II.
90. Article 10 (7) of ECT and Article 1102 (1) of NAFTA.

treatment standard, it is a relative standard that bestows no international minimum. Some IIAs, most typically those concluded by European countries, limit the MFN standard to the treatment of investors after the admission of an investment in the territory[91], while North American BITs apply MFN to the establishment of investment as well. However, the parties can make exceptions regarding specific sectors and measures.[92]

There has been some inconsistence in how the scope of the MFN provision should be interpreted. A narrow interpretation would imply that MFN only covers state measures and regulatory conduct, while a broader interpretation also would include content from a third-party IIA. Investors could then invoke MFN to import formulations that seem "more favorable" than the formulation in their own treaty. This was the case in *CME v. Czech Republic*, where the MFN standard was invoked to replace the criterion for compensation for expropriation in the Czech Republic-Netherlands BIT with the criterion set in the Czech Republic-United States BIT. The tribunal explained that:

> The determination of compensation under the Treaty between the Netherlands and the Czech Republic on basis of the "fair market value" finds further support in "the most favored nation" provision of Art. 3 (5) of the Treaty. That paragraph specifies that if the obligations under national law of either party in addition to the present Treaty contain rules, whether general or specific, entitling investment by investors of the other party to a treatment more favorable than provided by the present Treaty, "such rules to the extent that they are more favorable prevail over the present Agreement".[93]

In a controversial decision in the case *Maffezini v. Spain*, the tribunal concluded that the MFN provision in the Argentina-Spain BIT allowed the investor to rely upon the more favorable treatment regarding provision for dispute resolution in the Spain-Chile BIT. The Argentina-Spain BIT contained a provision requiring the investor to seek remedy at domestic courts before pursuing investment arbitration, while the Spain-Chile BIT had no such requirement. [94] To avoid this type of extensive interpretations, some IIAs have explicitly limited the provision to only relate to substantive provisions of the IIAs and not the provisions of dispute settlement.[95]

Tribunals have also concluded that the MFN clause make it possible to import a substantive treaty obligation from a third-party BIT even when the obligation is completely absent from the applicable treaty. The tribunal in the *White Industries v. India* case, for example, rejected India's argument that the

91. See e.g. Austria BIT model, Article 3(3).
92. See e.g. US and El Salvador BIT, Article II.
93. CME Czech Republic B.V. v. Czech Republic, para 500.
94. Emilio Agustin Maffezini v. Kingdom of Spain. See also discussion on inconsistent tribunal application of the MFN in respect of dispute resolution provisions, in Egli (2007).
95. US-Colombia BIT 2006, Canada-Colombia BIT 2008.

import of a clause would fundamentally undermine the “carefully negotiated balance of the BIT”.[96] The tribunal stated that “this does not ‘subvert’ the negotiated balance of the BIT. Instead it achieves exactly the result which the parties intended by the incorporation in the BIT of an MFN clause”.[97]

Consequently, several observers hold that the MFN clause smooth differences in the standard of protection between investment treaties,[98] ignore variations that might exist for good policy reasons and make it very difficult to foresee the potential scope of liability of states.[99]

3.3 The minimum standard & fair and equitable treatment

Both the Havana Charter of 1948 and the bilateral FCN treaties, mentioned in section 2.1, included the standard of fair and equitable treatment (FET). Today, it is among one of the most common provisions in IIA and frequently invoked in ISDS proceedings. The FET standard is an absolute standard, meaning that unlike the standards of national treatment and MFN-treatment, it applies without reference to how other investments are treated by the host state.[100] Most often, the standard appears in a provision that also requires the parties to accord “full and constant protection and security” to foreign investments and to “not impair by unreasonable or discriminatory measures” the management, operation, maintenance and use, inter alia, of foreign investments.[101]

There is a controversy in international investment law as to whether the FET standard is self-standing, which allows for a broad autonomous interpretation, or limited to the minimum standard of treatment of aliens under customary international law. When faced with this dilemma, tribunals have adopted different approaches, causing uncertainty regarding the meaning and scope of the standard.[102] This is also partly due to the fact that the different IIAs differ significantly in language. While some IIAs expressly link the standard to international law, others do not.[103]

The original purpose of the FET was to protect against many types of situations of unfairness, such as arbitrary cancellation of licenses, harassment

96. White Industries Australia Limited v. The Republic of India, para 11.2.1
97. Ibid. para 11.2.4.
98. Schill (2009), at 123.
99. Most-Favored-Nation Treatment (MFN) series II, UNCTAD, at 105-106.
100. Fair and Equitable Standard (FET), UNCTAD, at 6.
101. See e.g. Austria Model BIT Art 3.
102. FET, UNCTAD, at 12.
103 Ibid.

and unjustified penalties or other disruptions of business.[104] Tribunals have since interpreted the standard broadly to include specific requirements such as a state's obligation to act consistently, transparently, reasonably, without ambiguity, arbitrariness or discrimination, and to ensure due process in decision making and respect investors' legitimate expectations.[105] In the absence of a precise scope, however, there is little consistency in the tribunals' interpretation.[106]

3.3.1 Legitimate expectations

One of the most frequently invoked concepts of the FET standard is the notion of legitimate expectations. The idea is that a foreign investor that suffer adverse losses due to government-induced changes to economy, regulation or other conditions to the investment, may claim that the state violates the legitimate expectations of the investor that it had at the time the investment was made.[107] The case law offers highly divergent approaches to the doctrine. Some tribunals have allowed investors to base their expectations on an existing policy or law that encouraged the investor to make the investment, while others have upheld that there must be identifiable commitments or promises from behalf of the government that gave rise to expectations.

A few tribunals have gone quite far in suggesting that any adverse changes in the business or legal framework can give rise to a breach of the FET standard, as it undermines the investors' legitimate expectations of predictability and stability.[108] The tribunal in *Tecmed v. Mexico*, a dispute concerning a non-renewal of a landfill's operating permit, was one of the first to spell out the concept.[109] It held that the FET provision, in light of the good faith principle[110], requires the host state to provide foreign investments treatment that "does not affect the basic expectations taken into account by the foreign investor to make the investment".[111] Further, the tribunal stated that:

> The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparent in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations.[112]

104. FET, UNCTAD, at 6.
105. Ibid, at 11.
106. Ibid.
107. Ibid, at 63-64
108. Ibid, at 67
109. Tecmed v. Mexico.
110. Interesting to note, other tribunals have determined that the good faith principle is not an essential element of the FET standard, see Enron v. Argentina, para 263, 268.
111. Tecmed v. Mexico, para 154.
112. Ibid.

This far-reaching position, repeated in other awards as well, has been criticized over the years for implying impossible obligations on host states.[113] Foremost, it ignores that states over time undertake regulatory changes and that this ought to be legitimately expected by investors.[114] Consequently, several tribunals have since sought to limit the scope of the concept. An often cited definition, from the tribunal's award in *International Thunderbird Gaming Corporation v. Mexico*, provides a more restrictive approach, as the tribunal stated that legitimate expectations relates to a situation where a state's conduct "creates reasonable and justifiable expectations".[115] Similarly, in *Glamis Gold, Ltd. v. United States*, regarding changes in mining rules to more restrictive operating permits, the tribunal noted that a mere contract breach or only "not living up to expectations" cannot be enough to find a breach of the FET standard.[116]

Further, other tribunals have taken into account political or economic conditions of the host state, so that the expectations of the investor correlates to these conditions.[117] This approach is evident in the tribunal award of the case *Parkerings-Compagniet AS v. Lithuania*.[118] The tribunal first stated that it is each state's "undeniable right and privilege to exercise its sovereign legislative power"[119] and that any "investor knows that laws will evolve over time".[120] It further held that an investor must exercise due diligence and to "structure its investment in order to adapt to the potential changes of legal environment".[121] The tribunal then took into consideration the political environment in Lithuania at the time of the concession agreement, transitioning from a part of the Soviet Union to a candidate for the European Union membership, and concluded that the investor should have regarded legislative changes as likely. The FET claim was therefore dismissed.[122]

113. See e.g. Douglas (2006).
114. FET, UNCTAD at 67.
115. International Thunderbird v. Mexico, para 147: "Having considered recent investment case law and the good faith principle of international customary law, the concept of 'legitimate expectations' relates, within the context of the NAFTA framework, to a situation where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA party to honour those expectations could cause the investor (or investment) to suffer damages."
116. Glamis Gold, Ltd. v. United States of America, para 620.
117. FET, UNCTAD, at 14, 67-68.
118. Parkerings-Compagniet AS v. Republic of Lithuania.
119. Ibid. para 332.
120. Ibid. para 333.
121. Ibid.
122. Ibid. para 335-338.

3.4 Expropriation

The protection of foreign investors from uncompensated expropriations is another essential provision included in IIAs. The terminology of the provision might differ; takings can be referred to as expropriation, nationalization, deprivation or dispossession, but the meaning is largely the same. While nationalization usually refers to large-scale takings of private property, expropriation generally means taking of a specific property or enterprise. Both, when they are direct, involve the transfer of title or physical seizure of property.[123]

Over time, there has been two major phases of direct expropriations, the first during the revolutionary movements in Russia and Mexico and the second wave following the decolonization period after World War II. Since then, however, few outright expropriation measures have been taken by states. Instead, the concept of indirect expropriation has become more common, mainly prompted by the first cases brought under NAFTA.[124]

Cases arising from direct expropriation for environmental protection are therefore not particularly common.[125] A case often referred to is *Santa Elena v. Costa Rica*, concerning expropriation of a terrain including 30 kilometers of Pacific coastline, rivers, springs, valleys, forests and mountains.[126] The land had been purchased by the claimant in the 1970's with the intention of developing tourist resort and residential community. A few years later, Costa Rica issued an expropriation decree for the land for nature preservation purposes and proposed to pay approximately USD 1,9 million as compensation. The claimant did not oppose the taking, why the dispute was on the amount of compensation.[127] The tribunal stated that:

> 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.[128]

123. Expropriation, UNCTAD, at 5.
124. Ibid, at 1.
125. Viñuales (2015), at 295.
126. Compañia del Desarrollo de Santa Elena SA v. Republic of Costa Rica.
127. Ibid, paras 15-20.
128. Ibid, para 71.

The tribunal thus specified that where property is expropriated, even for domestic or international environmental purposes, the state is obligated to pay full compensation.[129]

The historical controversy between capital-exporting and importing states on the standard of compensation for expropriation is explained in section 2.1. In IIAs, the standard of compensation is usually referred to as "prompt, adequate and effective" compensation.[130] Some treaties further specify that the compensation should be based on the "fair market value" or "genuine value", however, there is very little guidance in the agreements on how the tribunals are supposed to determine the specific amount.[131] The uncertainties in IIAs regarding estimations for compensation in general is discussed in chapter 4.

3.4.1 Indirect expropriation & the police powers doctrine

Indirect expropriation is total or near-total deprivation of an investment without a formal transfer of title or direct seizure. This includes for example acts that cause loss of management, use or control, or a significant drop in the value of assets. As this concept is both broad and vague, it may be applicable to governmental regulatory measures aimed at protecting public welfare objectives, such as environmental protection.[132]

The jurisprudence of some arbitral tribunals have identified criteria to distinguish legitimate non-compensable regulations from indirect expropriation requiring compensation.[133] This approach is called the police powers doctrine and stands in contrast to the sole effect doctrine, which only acknowledges the economic burden as a parameter to determine whether an indirect expropriation has occurred.[134] It allows for tribunals to strike a better balance between objectives pursued and take into consideration the public purpose of a state measure.

In a case study from 2019 on environmental regulations and indirect expropriation, Zhu finds that tribunals tend to rely on the sole effects doctrine when assessing land use regulations.[135] This was the case in *Metalclad v. Mexico*, where Mexico had issued an ecological preservation decree covering the area of Metalclad's planned landfill site, as well as in *Unglaube v. Costa Rica*, where Costa Rica had issued a decree to build a national park to protect endangered turtles on an area including the investor's properties. In both

129. Ibid, para 72.
130. See e.g. Ecuador-UK BIT 1994 Art. 5(1).
131. Expropriation, UNCTAD, at 67.
132. Indirect Expropriation, OECD, at 2.
133. Ibid, at 10.
134. Ibid.
135. Zhu (2019), at 398-402.

cases, the tribunal did not consider the purpose behind the decree in order to determine whether there was a breach of the expropriation clause.[136]

Among the studied cases concerning environmental legislation or regulation, Zhu notes that the tribunals adopts the police powers doctrine, but in different manners.[137] Similarly, analyzing the cases cited by the tribunal in *Philip Morris v. Uruguay* to support the police powers doctrine, Ranjan cautions that there are significant differences in the jurisprudence concerning the articulation of the doctrine.[138]

3.4.2 Methanex v. United States and Tecmed v. Mexico

The tribunals' inconsistency on the police power doctrine is here illustrated by the reasonings in the awards of the cases *Methanex Corporation v. United States* and the abovementioned *Tecmed v. Mexico*.

The *Methanex v. United States* concerned a ban in California on the use of the gasoline additive MTBE due to environmental and health risks. Methanex, a producer and marketer of methanol, which is a component of MTBE, claimed that the ban was a measure tantamount to expropriation since it allegedly deprived Methanex of a substantial portion of its investments in California. The tribunal stated that:

> As a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.[139]

The tribunal noted that no specific commitments had been given to Methanex, and that the ban was made for a public purpose, in a non-discriminatory matter and accomplished with due process. The conclusion was therefore the measure was a lawful regulation that did not constitute expropriation of Methanex investment.[140]

A different approach was taken in the abovementioned *Tecmed v. Mexico*, where the foreign investor claimed that Mexico's denial of its permit to run a hazardous waste landfill constituted an expropriation.[141] Mexico argued inter alia that the landfill did not comply with the state's regulations in terms of

136. Ibid.
137. Ibid.
138. Ranjan (2019), at 113-116.
139. Methanex v. United States of America, at chapter IV, para 7.
140. Ibid, para 9
141. Tecmed v. Mexico, para 95-96.

its location and characteristics, and that a number of irregularities related to the operation of the landfill had resulted in strong community opposition.[142]

The tribunal first recognized that it is "undisputable" that the state's exercise of its sovereign power within the framework of its police powers can cause economic damage to investors without entitling the investors to any compensation.[143] However, the tribunal pointed out that there is no principle stating that regulatory actions are excluded from the Spain-Mexico BIT, even if they are beneficial to the society, particularly if the negative economic impact of such measures is sufficient to neutralize the value of the investment.[144]

In order to determine if a regulatory measure amounts to expropriation, the tribunal stated that it must examine the proportionality of the measure and whether it is reasonable with respect to its goals, the deprivation of economic rights and the legitimate expectation of the investor. It held that there must be a "reasonable relationship of proportionality" between the aim and the burden.[145] The tribunal then found that there was no evidence that the landfill was a real or potential threat to the environment, and that the measure was rather a response to the socio-political difficulties and community pressure, which did not constitute "a real crisis or disaster of great proportions".[146] Thus, it concluded that there was not sufficient justification for Mexico to expropriate Tecmed's investment without compensation.[147]

Following *Tecmed*, other tribunals have also emphasized the need for proportionality in the context of measures taken for a public purpose. As an example, in *Occidental Petroleum v. Ecuador,* one of the largest awards in an ICSID case, the tribunal held that "the overriding principle of proportionality requires that any such administrative goal must be balanced against the Claimants' own interests and against the true nature and effect of the conduct being censured".[148]

3.5 Environmental provisions in IIAs

An OECD study in 2011 of a sample of 1623 IIAs, shows that references to environmental concerns are rare in BITs (6.5 % of the sample treaties) and, in contrast, very common in non-BIT IIAs (all 30 non-BIT IIAs contained some sort of environmental language).[149] The survey further showed a large

142. Ibid, para 105.
143. Ibid, at 119.
144. Ibid, para 121.
145. Ibid, para 122.
146. Ibid, paras 127, 144, 147
147. Ibid, para 147.
148. Occidental Petroleum v. Ecuador, para 450.
149. Gordon and Pohl (2011), at 5.

variation in the country practices. 19 of the 49 countries covered in the study did not mention any environmental concerns, while a few countries systematically included environmental language since a given date.[150]

Moreover, there was a significant variation to the type of inclusion of environmental language. 4.1 % of the treaties included some form of general language on the protection of environment in the preambles. The most common provision regarded reserving policy space for environmental regulation for the entire treaty, which appeared in 5.2 % of the IIAs. Other less common inclusions were:

- provisions reserving policy space for environmental regulation for specific subject matters, included in 1.3 % of the treaties;
- provisions that preclude non-discriminatory environmental regulation as a basis for claims of "indirect expropriation", included in 0.75 % of the treaties;
- provisions that discourage the loosening of environmental regulation for the purpose of attracting investment, included in 3.1 % of the treaties;
- provisions related to the recourse to environmental experts by arbitration tribunals, included in 1 % of the treaties, and
- provisions encouraging strengthening of environmental regulation and cooperation, included in 1.3 % of the treaties.[151]

Finally, the study showed that the language of environmental concerns is mostly generic and almost never refers to recent concerns such as climate change and biodiversity[152], apart from the ECT.[153]

It is important to note that the study is a few years old and that several treaties with environmental language have since then been concluded.[154] A particularly interesting new example from 2016 is the Morocco-Nigeria BIT, which contains several references to sustainable development in the preamble and, inter alia, requires investors to contribute to sustainable development and to comply with environmental impact assessment requirements.[155]

Further, the results of the OECD study do not provide a judgement on the language used or an answer to whether the language has legal bite or results

150. Ibid, at 9-10.

151. Ibid, at 11.

152. Ibid, at 24.

153. See preamble of the ECT – reference to United Nations Framework on Climate Change, the Convention on Long-Range Trasnboudary Air Pollution etc. and also art. 19(3)(b) of the ECT mentions Environmental Impact on the environment, including climate.

154. Examples such as Morocco-Nigeria BIT 2016, Dutch Bit Model 2018, Indian BIT 2015. US model 2012 BIT.

155. Morocco-Nigeria BIT art 14, 24, art 1.

in greater regulatory flexibility. Very little guidance on the matter can be found in the case law and literature, as outlined in the following section.

3.5.1 Greater regulatory flexibility or merely explanatory?

A general exception provision reserving space for environmental regulations and measures can be found in the Dominican Republic-Central American Free Trade Agreement (CAFTA-DR). Its Article 10.11 states that:

> Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.

This provision was interpreted in the tribunal decision from 2018 in *David Aven v. Costa Rica*. The case concerned a planned tourism project, the so called Las Olas Project, on the Pacific Coast of Costa Rica, which was shut down by the Costa Rican authorities due to the existence of wetlands and forests on the project site. The tribunal stated that Article 10.11 subordinate the rights to investors to the right of Costa Rica to ensure that investments are carried out in a "matter sensitive to environmental concerns". However, this subordination is not absolute and requires that the actions by the state are in "line with principles of international law, which requires acting in good faith".[156] Further, the tribunal stated that the CAFTA-DR poses limits to the way in which a state may implement and enforce its own environmental laws. It must do so in a fair, non-discriminatory way, following principles of due process in both adoption and enforcement.[157]

In a report from 2007, UNCTAD concludes that general exception clauses with language such as "otherwise consistent with this treaty", like the CAFTA-DR provision and several other BITs[158], do not constitute a permission to disregard a treaty obligation. Instead, they are mainly explanatory and a tool for "sending a message to civil societies that the contracting parties take environmental concerns into account".[159]

On a similar note, Newcombe observes that arbitral tribunals usually interpret general exceptions narrowly and that, as a result, there is a risk that general exceptions on environmental and sustainable development policy might be interpreted restrictively as providing even less regulatory flexibility for states.[160] Newcombe further holds that "even if a measure […] is necessary for the environment, it is unlikely that an IIA tribunal will interpret a general

156. David R. Aven and Others v. Republic of Costa Rica, para 412
157. Ibid, para 413
158. See e.g. Article XVII(2) in the Canada-Armenia BIT.
159. World Investment Report 2007, UNCTAD, at 88-89.
160. Newcombe (2008), at 3, 8.

exception clause as excluding the requirement to pay compensation for the expropriation".[161]

A new trade deal, the United States-Mexico-Canada Agreement (USMCA), will take effect in July 2020, replacing the NAFTA. This deal provides an entire chapter on the environment, chapter 24, like most other FTAs.[162] However, several observers have hold that the language of the chapter is vague and narrow, without being enforceable or binding.[163] USCMA also includes several public welfare exceptions and specifications on the FET-standard and indirect expropriation. For example, it provides that:

> Non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations, except in rare circumstances.[164]

These types of provisions that preclude non-discriminatory environmental or public health regulation from indirect expropriation are intended to provide clearer guidelines for tribunals and greater regulatory flexibility for host states. Based on an empirical study of 2185 IIAs in 2019, Zhu notes that 118 agreements contain such clauses on indirect expropriation in three different models. One of the models identified is the type of carving out provision included in the USCMA. Zhu concludes that all three model exceptions are employed in a vague and uncertain manner, which still makes it difficult for tribunals to draw clear lines between legitimate environmental regulation and indirect expropriation.[165]

According to Viñuales, most treaties that include language on the relation between international investment law and international environmental law appear to be inadequate to solve potential normative conflicts between the two fields of international law. One potential exception, Viñuales mentions, can be found in the NAFTA.[166] Article 104 of the NAFTA states that:

1. In the event of any inconsistency between this Agreement and the specific trade obligations set out in:

    a) the Convention on International Trade in Endangered Species of Wild Fauna and Flora, done at Washington, March 3, 1973, as amended June 22, 1979,

161. Ibid, at 11,

162. See e.g. Chapter 17 in CAFTA-DR.

163. Weber, B. 'New trade deal doesn't address climate change: environmentalists', IATP Brief, 1 October 2018; Mertins-Kirkwood, H. 'Updated NAFTA deal a profound failure for climate action', behind the Numbers Blog, 12 October 2018.

164. Annex 14-B(3)(b) of the USCMA.

165. Zhu (2019) at 402-416.

166. Viñuales (2015), at 136-140.

b) the Montreal Protocol on Substances that Deplete the Ozone Layer, done at Montreal, September 16, 1987, as amended June 29, 1990,

c) the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, done at Basel, March 22, 1989, on its entry into force for Canada, Mexico and the United States, or

d) the agreements set out in Annex 104.1,

such obligations shall prevail to the extent of the inconsistency, provided that where a Party has a choice among equally effective and reasonably available means of complying with such obligations, the Party chooses the alternative that is the least inconsistent with the other provisions of this Agreement.

2. The Parties may agree in writing to modify Annex 104.1 to include any amendment to an agreement referred to in paragraph 1, and any other environmental or conservation agreement.

In *S.D. Myers v. Canada*, the tribunal made a reference to this provision. The case concerned a ban by the Canadian government on the export of the chemical compound Polychlorinated biphenyl (PCB), which prevented the claimant to export PCB for disposal within the United States. Canada argued that the purpose of the ban was to implement its international obligation under the Basel Convention to minimize the transboundary movement of hazardous waste. The tribunal noted that even if the NAFTA parties had ratified the Basel Convention, it should not be presumed, in accordance with Article 104, that Canada would have been able to justify the breach of a NAFTA provision. This is because, in a situation where a party has "a choice among equally effective and reasonable available alternatives for complying" with a Basel Convention obligation, it is obliged to choose the alternative that is most consistent with open trade.[167]

3.6 Summary and concluding remarks on chapter 3

This chapter firstly briefly introduced the reader to the national discrimination standard. It was mentioned that tribunals will usually not engage with the purpose behind a "less favorable" treatment or evaluate all circumstances when assessing whether domestic and foreign investments are in "like situations". Several scholars have therefore raised concerns on the potential conflict with environmental protection measures.

Regarding the FET standard, this chapter has illustrated how tribunals have interpreted the standard to include several requirements. Yet, the scope and meaning of these requirements set forth in the jurisprudence are far from clear and coherent, and some have been deemed as impossible for states to oblige with. This is especially evident when considering the concept of legitimate

167. S.D. Myers Inc. v. Canada, paras 215-21, 255-6.

expectations. While some tribunals have suggested that any changes in the business or legal framework can give rise to a breach of an investors legitimate expectations, others refer to “reasonable and justifiable expectations” or consider political conditions of the host state in their assessments. While this latter approach offers a much larger regulatory space for states, it is important to note that there is no system of precedent within international investment law, as will be further elaborated in chapter 4. This clearly leaves different arguments available to investors and a large uncertainty with respect to the scope of states’ obligations.

The expropriation standard has also evidently been subject to divergent interpretation by investment tribunals. Tribunals have in general relied on the sole effects doctrine when assessing land use regulations and in recent years the policy power doctrine in situations concerning environmental legislation. However, the art of differentiating between legitimate non-compensable regulations from compensable expropriation varies significantly. This was clear from the studied cases *Methanex v. United States* and *Tecmed v. Mexico*.

The tribunal in *Methanex* held that the regulation must be non-discriminatory, for a public purpose and enacted in accordance with due process. The tribunal in *Tecmed* instead took into consideration the negative economic impact of the measure and stated that tribunal must examine whether the regulatory measure is proportionate and reasonable with respect to its goals, the deprivation of rights and the legitimate expectations of the investor. This latter approach is more limiting for state regulation because it allows for tribunals to question the objectives and means of state regulations and to balance the interests in accordance with their own perceptions of “reasonableness”.

In sum, although the police powers doctrine can be considered as a positive development in the case law that allows for tribunals to consider public purpose regulation when assessing claims on expropriation, the tribunals provide distinct interpretations of the same standard, which evidently is not merely a result of the different circumstances in each case. These distinct interpretations can thus have serious implications for states’ regulations on public policy concerns.

The last section outlined some of the most common environmental languages included in recent IIAs. References to environmental concerns are in general rare in BITs and common in non-BIT IIAs. However, most provisions do not seem to change states’ obligations or provide much greater regulatory flexibility, especially considering the restrictive interpretation of general exceptions and the vague wording of most clauses. Importantly, the IIAs still pose a limit to the way in which states can implement environmental law according to the tribunals in *S.D Myers* and in *David Aven*. Thus, investment tribunals still have the mandate to assess states' environmental protection measures and balance the interests of investors and states.

An interesting question in this regard is whether the MFN standard can be used to ignore some of the variations included in modern BITs, to for example avoid certain carve-outs. As demonstrated in the chapter, the MFN standard has been interpreted broadly to allow investors to invoke more favorable provisions from third-party BITs, both substantive provisions and provisions on ISDS. As noted, one tribunal explicitly rejected the host state's argument that the import of a treaty obligation from a third-party BIT would fundamentally undermine the carefully negotiated balance of the BIT.

In conclusion, four inferences can be made from the examination of the substantive provisions in IIAs. First, investment protection provisions in IIAs are generally vaguely and broadly formulated, providing tribunals with a large amount of discretion. Second, the investment tribunals have interpreted these provisions to include several requirements on states in an inconsistent and unclear manner. Third, all investment protection provisions outlined can be invoked in order to challenge environmental protection measures in ISDS. Lastly, although efforts have been made to include environmental language in IIAs, they are few in number, not incorporated in a clear manner and can arguably be "ducked" through the MFN-standard.

4 Procedural issues of investment arbitration

This chapter outlines some of the fundamental procedural issues of investment arbitration and the ISDS mechanism. Like chapter 3, it is more descriptive in nature. The issues examined are (1) jurisdiction in investment arbitration, (2) costs, (3) the practice of treaty interpretation, and (4) transparency and public engagement.

Many more issues have been raised in the literature as shortcomings of investment arbitration that will not be elaborated on here. To mention a few: The appointment of arbitrators, the lack of annulment procedures and appeal mechanisms, and the lack of environmental experts in environmental related cases. While outside the scope of this treaty, it is noteworthy that these procedural matters also might impact host states environmental protection measures.

4.1 Jurisdiction in investment arbitration

Jurisdiction of investment tribunals is based on the consent of the parties to a dispute, stemming from either a contract, domestic law or a treaty. Since states are the parties to treaties, only their consent is given through the agreement, explicitly or implicitly. Investors then express their consent to arbitration normally by filing a request for arbitration.[168] In a few BITs, states have specified that they withhold their consent to arbitration, thus preventing investors from initiating proceedings only on the basis of the treaty.[169]

Consent can also apply to investments made before the treaty entered into force. Furthermore, IIAs often provide "survival-clauses" that guarantee that the provisions are in effect for a certain time period after the treaty is terminated, sometimes for as long as twenty years. Therefore, a state's consent to investment arbitration might still be in effect after the termination of a BIT or FTA.[170]

The subject-matter jurisdiction likewise varies according to the jurisdictional clauses in each treaty. A common approach in BITs is to have a very broad language, so that the jurisdiction extends to "any dispute" between an investor and a state party "in connection with an investment" or "arising directly out of an investment" in the territory of that state. This formulation therefore also

168. Investor-state dispute Settlement: A Sequel, UNCTAD, at 31-32.
169. Ibid, at 34, reference to Argentina-New Zealand BIT 1999 Art 12 (4).
170. Ibid at 37.

includes disputes not related to a treaty obligation. Clauses that are more narrowly formulated might refer to disputes "concerning an alleged breach of an obligation" of the treaty or contain lists of specific obligations in the treaties covered by the jurisdiction.[171]

Naturally, the definition of investment and investor in the treaty at hand further restricts the subject-matter jurisdiction. Depending on the type and purpose of the agreement at hand, the definitions can vary in different IIAs, from broad and comprehensive concepts to narrow and specific definitions.[172]

4.1.1 Definition of investment and investor

Most investment agreements include a broad definition of investment. A common reference is to "every kind of asset", usually followed by an illustrative and non-exhaustive list of assets, which includes both portfolio and direct investment.[173] Quite often, however, investment agreements with an asset-based definition include various limitations to narrow the scope of the treaty.[174] Firstly, some agreements specify that an investment is covered only if made in accordance with the laws of the host country. Second, certain types of investment are sometimes explicitly excluded from the scope, such as portfolio investments or a loan to a state enterprise.[175] Third, some IIAs limit the scope of covered investments by implying a minimum capital requirement or a time limit.[176] Finally, some agreements limit the definition to only cover certain sectors, such as the ECT.[177]

The definition of investor in IIAs usually include both natural persons and legal entities. Natural persons are included if there is a link between the states parties to an agreement and the person. The link is most often the nationality of a party, determined in accordance by the law of that party or public international law, but other links such as permanent residence, domicile, residence or other combinations might be sufficient as well. The legal entities, on the other hand, might be included or excluded depending on the type of entity, its legal form, its purpose or its ownership. Further, the criteria for determining the nationality of legal entities could vary. For example, it might

171. Ibid.
172. Scope and Definition, Series II, UNCTAD, at 47.
173. See e.g. the German Model BIT 2008 Article 1.
174. Scope and Definition, Series II, UNCTAD, at 18.
175. See e.g. art 1139, "investment", of the NAFTA.
176. Scope and Definition, Series II, UNCTAD, at 18-30.
177. Article 1(6) of the ECT provides: "[…] 'Investment' refers to any investment associated with an Economic Activity in the Energy Sector and to investments or classes of investments designated by a Contracting Party in its Area as 'Charter efficiency projects' and so notified to the Secretariat."

be the place of incorporation, the location of the company seat or the nationality of the controlling shareholders.[178]

4.1.2 Indirect investment, BIT-shopping & parallel proceedings

A number of treaties explicitly cover indirectly controlled investments, either through their definition of investor[179] or investment.[180] In addition, tribunals in investor-state disputes have held that if the treaty does not expressly exclude indirect ownership of investment, it is included.[181] This can lead to foreign minority shareholders, holding companies and investors of those actors to claim rights, even for domestic companies, on the basis of an IIA.[182]

The possibility of shareholders to bring claims for reflective loss, also make it possible for investors to initiate parallel proceedings regarding the same investment and against the same state conduct.[183] This was the situation in the widely discussed cases *CME v. Czech Republic* and *Lauder v. Czech Republic*. The claims were brought on the same time before two different tribunals, one in Stockholm and one in London. Interestingly, the *CME* tribunal found that the Czech Republic was liable for expropriation and breach of the FET standard, while the *Lauder* tribunal reasoned that there was no expropriation or violation of the FET.[184] Consequently, the Czech Republic was faced with two inconsistent decisions, which has been referred to as the "ultimate fiasco in investment arbitration".[185]

In practice, states cannot possibly know the different nationalities of all shareholders and the different obligations set out in the respective BITs in advance, when for example assessing a permit. It has therefore been argued that host states must treat obligations in BITs as obligations *erga omnes*, owed to every state and investor, assuming that all investments are covered by the BIT in force with the most far-reaching obligations.[186]

Overly broad definitions of investor further leave open for corporations to structure investments through holding companies located in different jurisdictions, in order to "forum-shop" and invoke the protection of a BIT of a state without any actual involvement based in that state.[187] The BITs of the

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178. Scope and Definition, UNCTAD, at 10.
179. See e.g. Netherlands-Venezuela BIT, Article 1
180. US Model BIT 2004.
181. Smutney (2009), at 373.
182. See Gaudkroger (2014).
183. On the matter of parallel proceedings in investment arbitration, see Kim and Ahnl (2019); see also Yannaca-Small (2008).
184. CME v. Czech Republic and Lauder v. Czech Republic; see lengthy analysis of the two decisions and their incompatibility in Franck (2015).
185. Buffard, Crawford, Pellet and Wittich (2008), at 116.
186. Legum (2006), at 5-6.
187. See e.g. Chaisse (2015); Pauwelyn and Salles (2009).

United States, among others, therefore include a denial-of-benefits-provision, which gives the host state the right to carve out shell companies owned by nationals of a third country or the host state from the definition of investor.[188] The efficiency of these clauses are however questioned due to the inconsistency in tribunals interpretation on whether they have prospective or retrospective effect.[189]

4.1.3 Admissibility issues: Exhaustion of local remedies and "fork in the road" clauses

A principle of customary international law requires that foreign investors first exhaust local remedies before bringing a claim to international arbitration. This principle can however be derogated from by a binding treaty.[190] As IIAs almost never require foreign investors to first exhaust domestic remedies, investors can bring claims directly before an arbitration tribunal without seeking prior redress.[191] Scholars have however acknowledged that there could be several benefits of including a local remedies rule in IIAs. It is thought to be able to strengthen domestic legal systems in host states and improve the decision-making of arbitration tribunals, by allowing the prior assessments of relevant domestic law by domestic courts.[192]

Some IIAs include so called "fork in the road" provisions, which offers the investor a choice between pursuing its claims either before host state's domestic courts or an international arbitration, but not both.[193] Observers have however noticed that states' objections based on the clauses almost always have been rejected.[194] Tribunals have held that only strict identity between the dispute at the domestic court and the dispute submitted before the tribunal would affect the admissibility of arbitrations. Most often, tribunals have applied the so-called triple identity test, meaning that there must be identity of parties, causes of action and relief.[195] This strict approach to the "fork in the road" clauses thus exacerbates the issue of parallel proceedings.

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187. See e.g. United States-Uruguay BIT (2005), Article 17(2): A Party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of the other Party and persons of a non-Party, or of the denying Party, own or control the enterprise.

189. Baumgartner (2016), at 117.
190. Klafter (2006), at 418.
191. See e.g. Peterson (1997).
192. Porterfield (2015), at 5-7.
193. See e.g. United States-Argentina BIT.
194. Petsche (2019) 391-428.
195. Ibid, at 406-407.

4.1.4 Stricter admissibility in two recent IIAs

As a reaction to the concerns raised on the ISDS mechanism, some countries have adopted alternatives or solutions that profoundly restrict access to ISDS. Two innovative and recent examples are worth noting.

The first is the new USCMA, which in its investment chapter 14 restricts the access to arbitration in Mexico and United States and provides that Canada withdraws from ISDS altogether. Hence, only state-to-state dispute settlement will be available between United States and Canada.[196] United States investors can file ISDS claims in Mexico and vice versa under some conditions. The USMCA distinguishes between investors who have government contracts and those who do not. The latter group of investors are restricted to file ISDS claims only regarding alleged breaches to the standards of national treatment, MFN treatment and direct expropriation. Further, investors must exhaust local remedies prior to filing a claim before arbitration.

Investments established or acquired while NAFTA is still in effect will have the possibility to file claims under NAFTA's chapter 11 within three years after the termination of NAFTA. In this respect, it is interesting to note that a global law firm is encouraging United States based investors in Mexico to restructure corporations in order to regain access to international arbitration through other Mexican BITs.[197]

The second example can be found in the Morocco–Nigeria BIT from 2016, which provides for an establishment of a joint committee that will assess any dispute between the parties prior to initiating arbitral procedure and have a "bilateral meeting" together with representatives of the host state and investor. If a dispute is not settled within six months, the investor may resort to international arbitration after exhausting domestic remedies.[198] It also provides for investors to be subject to civil actions for liability in their home state for activities that lead to significant damage or loss of life.[199]

196. Canada and Mexico can still file ISDS under the Trans-Pacific Partnership from 2018.

197. See Baker and McKenzie, notes that "US investors who are losing their right to arbitration under the USMCA should consider the manner in in which their investments are made so that they can benefit from other IIAs to which Mexico is a party and thereby regain 'full' access to international arbitration", available at: <https://www.bakermckenzie.com/en/insight/publications/2020/02/usmca-access-international-arbitration>.

198. Article 26.

199. Article 20.

4.1.5 Jurisdiction on disputes within the European Union

Since the Lisbon Treaty, the EU has an exclusive competence to conclude IIAs and trade agreements with third parties, on behalf of the member states. This has given rise to a quite peculiar situation where East European states that have joined the EU have been targeted by an investment claim under an old BIT concluded between the state and another member state, instead of the law of the EU.[200] However, in March 2018, the Court of Justice of the European Union (CJEU) rendered a decision in *Slovak Republic v. Achmea BV*, which held that investor-state arbitration clause in the Dutch-Slovak Republic BIT was incompatible with articles 267 and 344 of the Treaty on The Functioning of the European Union (TFEU).[201]

Shortly after the *Achmea* judgement came a decision, the *Decision on the Achmea Issue,* by the tribunal in *Vattenfall AB v. Germany (II).* The ongoing dispute regards Germany's decision in 2011, after the nuclear disaster in Fukushima, to phase out its own nuclear power plants by the end of 2022 and to immediately shut down eight of its 17 reactors, including the Swedish energy company Vattenfall AB's plants in Krümmel and Brunsbüttel. In 2012, Vattenfall initiated arbitral proceedings against Germany at the ICSID, seeking 4,7 billion euros in compensation for breaches of the ECT. In the light of the *Achmea* judgment, Germany requested for all claims pending in the proceedings between Vattenfall and Germany to be dismissed. The tribunal, however, found that EU law and the *Achmea* judgement were not applicable to the assessment of the tribunal's jurisdiction, and consequently rejected Germany's jurisdictional objection.[202]

4.1.6 The juristidction and admissibility of host states' counterclaims

In several cases, host states have issued counterclaims for alleged damages caused by investors' activities or violations of applicable law. These are most often rejected on jurisdictional or admissibility grounds, because, although most arbitration rules such as the ICSID and UNCITRAL accept the possibility for counterclaims, very few IIAs contain an express provision on the matter.[203] In a few recent cases, however, tribunals have been willing to recognize jurisdiction and admissibility nonetheless. Three distinct trends in the investment jurisprudence are highlighted in the following paragraphs.

200. See Söderlund (2007).
201. C-284/16.
202. Vattenfall v. Germany (II), paras 121–135, 207.
203. Article 46 of the ICSID Convention, Article 21(3) of the 2010 UNCITRAL Arbitration Rules.

In *Saluka v. Czech Republic*, the tribunal held that the Netherlands-Czech Republic BIT provided it with jurisdiction to decide on “all disputes” between the parties concerning an investment, which it considered encompassing counterclaims.[204] Yet, the tribunal added that there is a general legal principle which holds that the counterclaim must have a close connection with the primary claim.[205] Because the Czech Republic counterclaims were based on breaches of domestic competition and banking laws, the tribunal held that the claims lacked connection insofar that they did not “fall to be decided” through investment protection procedures of the BIT.[206] It thus inter alia imposed a requirement of a legal connection between the primary claim and the counterclaims, which it deemed that the Czech counterclaim lacked.[207]

A similar jurisdictional clause in the Spain-Argentina BIT was assessed by the tribunal in the case of *Urbaser v. Argentina.*[208] Argentina claimed that the investors had breached the international human right to water. The tribunal found that it had jurisdiction on the basis of the clause, since the clause was “completely neutral as to the identity of the claimant or respondent in an investment dispute arising ‘between the parties’”.[209] It further held that there was a factual connection between the principal claim and the counterclaim, seeing that both of them were based on the same investment and in relation to the same concession.[210] The tribunal stated that the factual connection was sufficient, but it also added that there was a legal connection, in the sense that both claims related to international law.[211] It therefore ultimately accepted jurisdiction over the counterclaim, but nevertheless dismissed the claim on its merits, because it could not find that the claimants were bound by a legal obligation based on international law to provide drinking water.[212]

Tribunals can also find jurisdiction based on the explicit consent of the parties. This was the case in *Burlington v. Ecuador,* where Ecuador filed a counterclaim alleging that Burlington’s activities had resulted in environmental and infrastructure damages and breaches of the country’s environmental laws.[213] The tribunal’s jurisdiction was thus undisputable, based on a post-dispute agreement between Burlington and Ecuador with express consent to jurisdiction over the counterclaims. The tribunal’s reasoning is particularly interesting in that it applied Ecuadorian environmental laws, which provides for strict liability for environmental

204. Saluka Investments B.V. v. Czech Republic, para 76.
205. Ibid.
206. Ibid, para 79.
207. Ibid, paras 80-82.
208. Urbaser S.A v. The Argentine Republic.
209. Ibid, paras 1443, 1150.
210. Ibid, para 1151.
211. Ibid.
212. Ibid, para 1221.
213. Burlington Resources Inc. v. Republic of Ecuador, para 6.

harm. This is the first case where a state has succeeded on its counterclaim on the merits.

4.2 Economic costs of investment arbitration

In a survey in 2012 on ISDS costs, the OECD found that the average costs for both parties' legal fees was roughly over USD 8 million.[214] However, this number varies significantly from case to case, and not all accounts are publicly available. Among the most expensive cases identified in the literature, the parties' combined costs for legal fees exceeded USD 60 million, while the costs in the least expensive case amounted to around USD 250,000.[215] In addition, costs for tribunals and administration is estimated to in general just under USD 1 million.[216]

Perhaps not very surprising, the total cost of investment arbitration, i.e. the legal costs of the claimants and the respondent states as well as the costs of tribunal and administration, is highly linked to the length of arbitration. The average case length in ICSID tribunals, from a request to an award, has been estimated to about three and a half years.[217] Yet, the more time required for a final award, the higher the legal fees and the tribunal expenses.[218]

Most often, tribunals follow a "pay-your-own-way" baseline when allocating the costs, meaning that the parties are responsible for their own legal fees. However, due to lack of express rules on the matter, several tribunals have instead shifted costs. This practice has been found to be done in an unequal manner. Franck's study shows that when states have won, tribunals have been twice as likely to use the pay-your-own-way approach. Thus, when cost-shifting do occur, winning investors are more likely to benefit compared to winning states.[219]

4.2.1 Third-party funding

In connection to costs of arbitration, it is crucial to mention the "growing, multi-billion-dollar industry"[220] of third-party litigation funding. The practice, which in itself is not considered new, has been described as "an arrangement where an entity with no prior interest in the merits of a dispute provides funding to a party involved in the dispute", usually in exchange for

214. Gaukrodger and Gordon (2012), at 19.
215. See generally discussion in Franck (2005), at 200-206.
216. Ibid at 206-208. See also LCIA, Costs and Duration: 2013-2016.
217. Ibid at 121-122.
218, Ibid, at 136.
219. Ibid, at 217.
220. Stroble and Welikson (2020), at 2.

a return or a share of the recovery.[221] Normally, the share is around 15 to 50 percent of the total amount recovered in the dispute.[222]

In recent years, there has been a significant increase in the number of funded cases, much do to modern “entities whose sole business is the financing of disputes”.[223] While it is theoretically possible for third-party financing of respondent claims as well, it has been noted that there exists no “financial upside” that can attract funders to do so.[224] Given that the average awarded amount in ISDS is around USD 120 million and the costs for a claim is around USD 4-5 million, the return for financing investors claims is remarkably high. In addition, in two-thirds of all claims, the claimants either succeed or the states settle for compensation or other types of remedies. Claimant funding in ISDS is therefore thought of as an attractive business.[225]

The practice of third-party funding is considered by some to provide benefits, such as greater access to justices for small and medium-sized enterprises who otherwise would not have the funds to initiate a claim.[226] Yet, some concerns have also been raised. Firstly, third-party funding might impact settlement incentives. A third-party funder might for example object to a settlement that involves non-pecuniary remedies or that does not meet its expectations.[227] Second, third-party funding is thought to result in more ISDS claims in general, by eliminating the financial downsides for claimants to raise a wide range of claims.[228] Third, scholars have argued that there is an asymmetry in the risks that investors and states face in ISDS, and that third-party funding significantly aggravates this asymmetry.[229] This argument, as it is put forward by Guven and Johnson, is elaborated in the following paragraphs.

An investor initiating an ISDS faces the risk of not recovering its losses. Normally however, there are other avenues for investors to seek relief too, through for example political risk insurance coverage, domestic law claims against the government or contract-based claims. Further, a high percentage of the claimants are large multinational corporations.[230] A study from 2016

221. Howie and Moysa (2019), at 465.
222. Ibid.
223. International Council for Commercial Arbitration, Report of the ICCA–Queen Mary task force on third-party funding in international arbitration (2018), at 466.
224. Guven and Johnson (2019), at 8-9.
225. Ibid, at 6-7.
226. Gaukrodger and Gordon (2012), at 38-40.
227. Ibid.
228. Ibid, at 25, reasoning that: “As for a state, it takes monetary resources for an investor to raise losing arguments. But for investors, and unlike for respondent states, success on a previously unsuccessful argument can result in an actual win, a financial upside. The cost-benefit analysis of raising a wide range of claims, even if one or two are dismissed, may be worth the additional expense. And, with third-party funding, that calculation shifts even further as the financial downsides to the claimant are mitigated or eliminated.”
229. Ibid, at 31-32.
230. Ibid.

found that ISDS have primarily benefited extra-large corporations with more than USD 10 billion in annual revenue. [231]

In contrast, 40 percent of the host states faced with ISDS claims are graduated developing economies.[232] The "worst-case scenario" for states instead involves paying large amounts in damages in addition to the parties' legal fees. Awards can range from under USD 1 million to 1,7 billion. Franck acknowledges that these sums may be "substantial for developing states, particularly after currency conversions and relative to their gross domestic product or tax base".[233] Likewise, the OECD recognized that large awards could "seriously affect a respondent country's fiscal position".[234] In light of this, Guven and Johnson draws the conclusion that investors are in general more risk tolerant than respondents. According to them, third-party investors, providing "deep experience, expertise, insider information and resources", may therefore "exacerbate the unbalanced power dynamics that already exist".[235]

4.2.2 Compensation for future lost profits

Valuation and calculation of compensation and damages in ISDS is a noteworthy issue that can vary significantly from tribunal to tribunal.[236] Here, only one small aspect will be mentioned, in order to illustrate one of the reasons to why awards can vary from fairly small sums to billions of dollars.

The damages awarded in the natural resources sector, including extraction of crude oil and natural gas, mining and quarrying and renewables, is observed to be disproportionately large.[237] On this finding, Guven and Johnson rightfully comments that: "In these disputes, tribunals often calculate damages by looking, inter alia, at future lost profits over the duration of the concession or expected life of the project, which may extend decades".[238]

The idea of compensating for both direct damages and lost profits (the doctrine of *damnum emergens* and *lucrum cessans*) is the traditional remedy approach for breaches of contracts or internationally wrongful acts. The aim

231. See Van Harten and Malysheuski (2016).

232. Retrieved from Investment Dispute Settlement Navigator, UNCTAD, 27 May 2020, available at < https://investmentpolicy.unctad.org/investment-dispute-settlement>.

233. Franck (2019), at 210-211.

234. Gaukrodger and Gordon (2012), at 7.

235. Guven and Johnson (2019), at 32.

236. For an excellent overview of all the issues at hand, including valuation, burden of proof, calculation of interest and more, see Wälde and Sabahi (2008).

237. Caldwell (2018), at 294.

238. Guven and Johnson (2019), at 6, footnote 21.

is to provide full compensation that places a party in the same economic situation it would have been in if not for the state conduct.[239]

As explained in chapter 3, many IIAs provide that compensation for expropriation must be according to the "fair market value". There is no further guidance in investment treaties on the applicable standards of compensation for the FET standard or national treatment standard, why some tribunals have held that the standard of "fair market value" is suitable even for breaches of the FET standard.[240] Early tribunals' valuation methods have relied on historic cost and book values of investments. This approach has changed in recent years to instead look forward, to estimate the market value of the investment based on its ability to generate profits in the future.[241]

While several tribunals have noted that "speculative profits" and elements are not be a part of the compensation, this method is thought to rely precisely on only speculation.[242] This was also noted in an analysis comparing the different valuation methods of the tribunals in the cases *CMS, LG&E, Enron, Sempra* and *BG Group,* related to Argentina's last financial crisis and the gas sector.[243] While the *LG&E* tribunal found that future losses were too speculative to compensate, the other tribunals "side-stepped the certainty analysis" by applying a method of valuation of "fair market value" that reflected future profits.[244]

When this modern valuation approach of "fair market value" is applied in combination with the notion of compensation for both direct damages and lost profits, compensation for future profits are included twice in the calculation. This concept is called "double recovery" or "double counting", and is not always easily detected. In order to avoid this risk, several scholars conclude that the *damnum emergens* and *lucrum cessans* approach should not be applied when calculating the compensation for a breach of a standard according to the "fair market value".[245]

4.3 The practice of treaty interpretation in investment arbitration

Two conclusions from chapter 3 are recalled. The first is that most of the investment protection provisions are broadly and vaguely formulated. Investment tribunals are therefore constantly asked to interpret the meaning

239. Wälde and Sabahi (2010), at 728.
240. See e.g. Enron v. Argentina, para 363.
241. See e.g. CMS v Argentina and CME v. Czech Republic.
242. Wälde and Sabahi (2008), 728-230.
243. Khamsi (2010), at 165-185.
244. Ibid. 181.
245. See Wälde and Sabahi (2006); Marboe (2006).

of these provisions. The second is that tribunals sometimes arrive at vastly different conclusions on the meaning and scope of these provisions. This section aims to examine some of the main issues discussed in the literature relating to tribunals treaty interpretation practice. The issues covered are (1) the fragmentation of the sources of investment law, (2) precedent in investment arbitration, (3) the application of the customary rules on treaty interpretation, and (4) interpretative notes issued by state parties.

4.3.1 Fragmentation contra multilarization

One commonly raised explanation to the inconsistency in investment treaty interpretation relates to the large number of existing IIAs. As previously mentioned, there are approximately 3000 different treaties with sometimes different histories, objectives, and languages. As a result, investment protection provisions that are similar on the outset can be interpreted differently in each case. This was recognized by the tribunal in the *Methanex v. United States*[246] case, quoting the International Tribunal for the Law of the Sea, which stated that "the application of international law rules on interpretation of treaties to identical or similar provisions of different treaties may not yield the same results, having regard to, inter alia, differences in the respective contexts, objectives and purposes, subsequent practices of parties and travaux préparatoires".[247] In accordance with this viewpoint, the same state measure could justifiably be assessed differently under two different investment treaties.

Contrary to the idea of fragmentation of bilateral instruments, some scholars, perhaps most notably Schill, instead advance the theory that there are several tendencies towards a multilateralization of international investment law. Interestingly, the process of multilateralization is thought to be particularly evident in the interpretational approaches of the tribunals, and especially in their use of third-party treaties as an interpretive aid.[248] Similarly, Mitchell and Munro have identified a number of ISDS cases where tribunals have interpreted the investment treaty before them with reference to third-party BITs, including model BITs, often through an incorrect application of the interpretative rules of the Vienna Convention on the Law of Treaties.[249] Tribunals had for example based their understanding of the "ordinary meaning" of a treaty term on one or a few third-party BITs of questionable

246. Methanex v. United States of America, para 16.
247. Ibid.
248. See Schill (2009).
249. Mitchell and Munro (2017).

relevance[250], or used third-party BITs with no connection to the treaty at hand as a “supplementary means” of interpretation.[251]

In light of this trend, Mitchell and Munro raises an arguably more crucial interpretational issue than the one identified by the *Methanex* tribunal, namely, the potential of tribunals to disregard textual differences in IIAs on the assumption that all have the same purpose, which could have consequences for contemporary developments in treaty drafting and undermine states’ efforts to progress towards better IIAs.[252]

4.3.2 De facto precedent system

The inconsistency of investment treaty interpretation is thought to be exacerbated by the fact that tribunal decisions do not make binding precedent, meaning that past decisions do not determine or constrain the outcome of future disputes. As a result, some tribunals can rely on earlier decisions while others can adopt different solutions with or without referring to previous awards.[253] This is not unique to investment arbitration in international law.[254] One obvious advantage to this freedom accorded to arbitrators and judges is that it enables progress and adaptability in line with the developments in society. Yet the total lack of precedent can also bring about uncertainty on the rights and obligations of the parties and unequal treatment in disputes.[255]

Nevertheless, it is quite common for tribunals to cite or refer to other tribunals’ decisions for inspiration and guidance. Even more so in recent years, due to the greater availability of awards. As a result, previous decisions to some extent shape both the explanations provided by arbitrators as well as the arguments that lawyers make.[256] Some scholars argue that this tendency of a *de facto* precedent system could contribute to clarified rules and more coherence in international investment regime.[257] Similarly, in *Burlington v. Ecuador*, the majority held that tribunals have a duty to “adopt solutions established in a series of consistent cases” and to “contribute to the harmonious development of investment law”.[258]

Of an opposite opinion, Schultz notes that the arbitrator’s obligation is to do justice in the individual case and that “an arbitrator concerned with the systematic aspects of the regime – an arbitrator who sees his role as a law-

250. Ibid, at 682-686.
251. Ibid, at 690-694.
252. Ibid, at 695.
253. Schreuer and Weininger, at 1196.
254. See e.g. ICJ Statute.
255. See Guillaume (2011).
256. Weidemaier (2010), at 1900.
257. See e.g. Schill (2009).
258. Burlington v. Ecuador, Decision on Liability, para 187.

maker – is more likely to sacrifice justice in the individual case to ensure consistency with past decision".[259] Arguing against the notion of consistency for the sake of consistency, Schultz states that a "bad rule applied consistently, in a predictable way, in highly regularized patters, may do more harm than the same rule applied inconsistently, occasionally, in an unpredictable way".[260] Other sceptics to a *de facto* precedent system argue that it constitutes a methodology of "cherry-picking" of awards to support tribunals' reading of provisions, which sidesteps the primary means of interpretation laid out in the Vienna Convention.[261]

4.3.3 The application of the Vienna Convention & influences from commercial arbitration

It is generally accepted that the interpretation of investment treaties is governed by the customary rules on treaty interpretation, codified in Articles 31-33 of the Vienna Convention.[262] While these rules in themselves have led to interpretational difficulties, their application in investment arbitration, or rather the lack thereof, have been subject to critique by several scholars as well as arbitrators.[263] Indeed, in a study conducted in 2008, Fauchald found that the tribunals only in exceptional decisions integrated the Vienna Convention into their reasoning beyond general references.[264]

Another central critique is that tribunals sometimes misuse certain rules of the Vienna Convention to justify a desired outcome. A recent example is the award in *Philip Morris v. Uruguay,* which has been criticized for its misapplication of Article 31(3)(c) of the Vienna Convention.[265] While acknowledging that the outcome of the case was significant for upholding Uruguay's right to adopt measures for the protection of public health, Ranjan provides for a lengthy analysis on the tribunal's reasoning and application of the Article 31(3)(c), and concludes that it was "internally inconsistent, based on a misuse of arbitral precedents and suffered from minimalism".[266]

259. Schultz (2014), at 297.

260. Ibid, at 316.

261. See e.g. Kuijper, Pernice, Hindelang, Schwarz and Reuling (2014), at 66-68.

262. Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331; Gazzini (2016), at 4.

232. See e.g. Industria Nacional de Alimentos v. Republic of Peru, Dissenting Opinion of Sir Franklin Berman, para 8, 12.

264. Fauchald (2008), at 314.

265. Article 31(3)(c) of the Vienna Convention provides that any relevant rules of international law applicable in the relationship between the parties should be taken into account together with the context. The article thus provides for bringing other rules of international law outside the investment treaty, into the interpretation of the treaty in question.

266. Ranjan (2019), at 121. Ranjan, claims that the Philip Morris tribunal did not identify the police powers rule precisely and that four cases cited in support of the police powers rule differed from each other, thus amounted to a misuse of precedent, see at 117.

The poor application of the Vienna Rules is thought to partly relate to arbitrators influences from international commercial arbitration, or, as Wälde puts it, the "'struggle' for the soul of investment arbitration between international commercial arbitration and (public) international law bars".[267] According to Wälde, the style characteristics of commercial arbitration is at times very evident in the case law of investment arbitration.[268] This style invokes the moral authority of the arbitrators and provides a larger attention to procedure and facts, rather than in depth legal reasoning. In addition, and in large contrast to the approach laid out in the Vienna Convention, commercial arbitrators tend to focus on the text of contracts, irrespective of context, purpose and history.[269]

Similarly, the dissenting opinion of arbitrator Paulsson to the tribunal award in *Hrvatska Elektroprivreda d.d. v. Slovenia*, highly criticized the majority's "vision of commercial logic".[270] Paulsson argued that the majority seemed to "reverse-engineer from their desired outcome"[271] and "turn the VCLT on its head"[272] by only retaining the elements from Article 31(1) of the Vienna Convention that confirmed their "subjective gloss", such as the perceptions of good faith and object and purpose, and "ignoring those which are of an objective nature", like the textual terms and context.[273]

Another explanation regarding the misapplication of the Vienna Convention relates to the perceived role of investment tribunals as lawmakers rather than adjudicators. As an example, Schill argues that the vagueness of the FET standard goes beyond the common notion that "law is inherently vague and indeterminate" and that the application of the rules of the Vienna Convention is therefore not sufficient to clarify the meaning of the concept. Tribunals have therefore taken the role as primary rule makers along with states, instead of merely applying the law to the facts.[274]

4.3.4 Interpretative notes

In order to influence the interpretation of an investment agreement, state parties to a treaty can agree to issue interpretive notes that are binding on arbitral tribunals, in accordance with Article 31(3)(a) of the Vienna

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Further, Ranjan, points out that the tribunal did not discuss the issue of applicability of the police powers rule between Uruguay and Switzerland, as the mechanism in article 31(3)(c) provides.

267. Wälde (2009), at 725

268. Ibid, at 727-728.

269. Ibid, at 727.

270. Hrvatska Elektroprivreda d.d. v. Republic of Slovenia, Individual Opinion of Jan Paulsson, para 44.

271. Ibid, at 7, 50.

272. Ibid, at 41.

273. Ibid, at 47.

274. Schill (2009), at 263.

Convention. These are however not particularly common. The NAFTA parties have established a special treaty organ, the Free Trade Commission (FTC), that has been given the competence to issue such interpretations.[275] So far, this has only been done once by FCT.

In 2001, an interpretative note by the FCT covered issues on transparency and the FET standard in Article 1105. As a response to past tribunals' expansive reading of the article, the FCT held that the FET standard in NAFTA is limited to a minimum standard of treatment of aliens in accordance with customary international law.[276] Schill finds that while some tribunals have accepted the note as a source of instruction, others have questioned the way it was given, observing that it might be closer to an amendment of the treaty rather than an interpretation. Further, some tribunals have held that customary international law has an evolutionary character, meaning that even if it is accepted that the FET standard has to be interpreted in accordance with customary international law, indeed the content of customary international law has been shaped by the investment regime in the last few decades. This view thus allows tribunals to apply an autonomous interpretation of the FET standard.[277]

4.4 Transparency & public engagement

This section will briefly touch on issues related to transparency and possibilities for public engagement. While confidentiality in commercial arbitration often is viewed as a positive aspect for the parties, the lack of transparency at the different stages of an investor-state dispute has since long been a central aspect of critique towards ISDS. The argument is not simply that investment arbitration concerns itself with public policy issues and involves public funds. Several commentators instead recognize that transparency can expose the parties as well as the arbitrators to several external influences and public scrutiny that, in the end, might impact the outcomes of the disputes.[278]

As a response to the criticism, several steps have been taken by arbitral institutions and states to enhance transparency. The FCT interpretational note of 2001 stated that nothing in the NAFTA imposes a general duty of

275. NAFTA, Article 1131(2) and 2001.

276. Part B, North American Free Trade Agreement Notes of Interpretation of Certain Chapter 11 Provisions, NAFTA Free Trade Commission, July 31, 2001.

277. See the reasoning in Schill (2009), at 270-275.

278. See e.g. Mills (2014), at 449-450. According to Mills, the move towards greater transparency would likely restrain host states in making arguments that lower standards of protection for investors, in order to not send a negative signal to other potential foreign investors. Further, investors might similarly be worried about their business reputation and think twice about pursuing arguments that potentially lower environment or health standards. In addition, greater transparency can allow activists to seek to influence the investors through publicity campaigns.

confidentiality and that all parties to an investor-state dispute should make all documents submitted to or issued by an investment tribunal available to the public, with some few exceptions.[279] The NAFTA parties have further taken measures to encourage public hearings, by issuing a statement on the matter in 2003.[280]

The ICSID today provides that hearings are open, providing there is no objections from the parties. Further, ICSID has a public registry with all administrated disputes. In contrast, the rules of UNCITRAL let the disputing parties decide on confidentiality, why the existence of a dispute can be kept secret if the parties so wish. New rules have been adopted that provide for open oral hearings and publication of key documents, however, these rules will only apply to arbitrations under future IIAs concluded after April 2014, as mentioned previously.[281]

In several cases, rights and interests of local communities are upheld in states' defence strategies, and in a handful of occasions, grassroots organisations and NGOs have made submissions to the arbitral tribunals through so called *amicus curiae* submissions.[282] *Amicus curiae*, meaning friend of the court, is where a third party seeks to participate in a specific arbitration dispute in order to provide a neutral opinion regarding an issue of public concern. This is provided for by both the ICSID, since 2006, and the new rules of UNCITRAL from 2014, and is thought to provide for larger attention to community perspectives in proceedings.[283] However, commentators have noted several limitations already, among others things in the discretion of tribunals to decide on whether to accept a submission, the petitioners' limited access to case documents or hearings, and in the tribunals' lack of engagement with the arguments raised in the submissions.[284]

4.5 Summary and concluding remarks on chapter 4

First, this chapter examined matters on jurisdiction and admissibility in investment tribunals. It was mentioned that jurisdiction is based on the consent of the disputing parties, which for states is normally given through

279. Part A, North American Free Trade Agreement Notes of Interpretation of Certain Chapter 11 Provisions, NAFTA Free Trade Commission, July 31, 2001.

280. Joint Statement of Canada and the United States on Open Hearings in NAFTA Chapter Eleven Arbitrations, Oct 7, 2003, available at the website of Foreign Affairs and International Trade Canada.

281. See overview in Svoboda (2020).

282. See e.g. Biwater Gauff v. Tanzania, Methanex Corporation v. United States, Pac Rim v. El Salvador, Bear Creek v. Peru.

283. ICSID Rules of Procedure for Arbitration Proceedings, Rule 37(2); The UNCIRAL Rules on Transparency in Treaty-Based Investor-State Arbitration, applied on investment treaties concluded after 1 April 2014.

284. De Brabandere (2019), at 12; see also Cotula and Schröder (2017), at 22-23.

the investment treaty at hand. However, it was noted that many IIAs provide survival-clauses which allows for investors to file claims against states for a time period sometimes as long as twenty years after the termination or a withdrawal from a treaty. While these types of clauses are an obvious advantage for any investor who wants to establish itself long-term, they pose a significant challenge in a situation where a state wants to reform its ISDS commitments or discontinue its consent.

The chapter also highlighted the ongoing debate on jurisdiction of investment tribunals to hear intra-EU disputes. The question seems to remain if the CJEU decision would affect future and pending investment arbitrations within the EU, and more specifically if the reasoning extends to non-BIT IIAs. The answer to that question is particularly important for disputes regarding environmental protection measures related to the energy sector, given that several disputes launched under the ECT is of intra-EU nature.

Moreover, the section on jurisdiction presented an overview of the most common definitions of investment and investor. These definitions directly impact the scope of the treaties and the actors that might be entitled to a claim. Broad definitions for example make it possible for holding companies or foreign minority shareholders to bring claims for damages to domestic companies. It can further allow investors to structure their investments in a manner that allows them to claim rights on the basis of the most advantageous BIT in the host state. It was also noted that the practice of BIT-shopping through corporate restructuring can make it possible for United States investors in Mexico to gain access to "unrestricted" ISDS even after the termination of NAFTA.

Another issue related to extensive jurisdiction clauses is the possibility to initiate parallel proceedings in investment tribunals against a host states for the same state conduct and relating to the same investment. This increases the risk for states to be faced with several inconsistent decisions and double recovery. Further, given the ineffectiveness of the "fork in the road" clauses, investors are not hindered to pursue a claim regarding the same state conduct in both domestic courts and international arbitration.

Being faced with several claims is evidently very costly. In this chapter, it was illustrated that the legal fees of the parties can vary from USD 250,000 to as high as USD 60 million, depending much on the length of arbitration. Most often, the parties have to pay for their own legal fees, however, when cost-shifting practice occurs, winnings investors are far more likely to benefit than winning states. Further, the growing multi-billion-dollar industry of third-party funding of investors' claims was mentioned. It was noted that the practice can contribute to more claims in ISDS by eliminating the financial downsides for claimants, change the incentives for settlement, and exacerbate the cost and risk asymmetry between states and investors.

It was also noted that damages can range from under USD 1 million to over USD 1,7 billion, with the largest amounts usually awarded in the natural resources sector. Tribunals' practices of calculating damages vary significantly, much due to the lack of guidance on the matter in IIAs. While some deem future lost profits to be too uncertain or speculative to compensate, others include future loss profits in their valuation of "fair market value". In connection to this, several observers have noted a risk of "double recovery".

The possibilities for counterclaims by respondent states were examined through a comparison of three different cases. Recent tribunals have held that the broad ISDS clauses, which enables them with jurisdiction over "all disputes", includes counterclaims. However, tribunals might still reject admissibility based on their assessment of "close connection" between the primary claim and the counterclaims. If a tribunal, like the *Saluka* tribunal, holds that there must be a connection in regard to the legal instruments, it would be impossible to invoke a counterclaim on the basis of breaches of domestic law. This can be an obstacle for environmental and (positive) human rights counterclaims, considering that international law is silent on binding obligations on private actors. An explicit agreement between the disputing parties on counterclaims was however exemplified as a successful, but perhaps not a very likely, possibility.

Regarding issues on transparency in investment arbitration, it was noted that transparency is important not only because investment arbitration sometimes concerns itself with issues of public concern, but also because transparency can put arbitrators' reasonings and parties' arguments under public scrutiny, which in the end is thought to possibly impact the outcomes. There are some developments towards greater transparency overall, yet, some disputes could still be kept from becoming public knowledge. The concept of *amicus curiae* is another positive step towards larger public engagement and more attention to community perspectives. However, tribunals still have large discretion in deciding on whether to accept submissions and the level of consideration given to the arguments presented.

The examination of issues of treaty interpretation revealed several shortcomings. First, it can be concluded that the fragmentation of the sources of IIAs is not a prominent issue when it comes to interpretation practices. Rather, the multilateralization approach of tribunals and the use of third-party IIAs as an interpretative aid has led tribunals to ignore textual differences between BITs. This was noted to possibly undermine states' efforts to draft IIAs with public policy considerations.

Second, while there is no binding precedent system in investment arbitration, there seems to exist a *de facto* precedent system. This has been regarded as desirable by scholars as well as arbitrators in search of consistency and coherence. However, citing other awards without accurately assessing the reasonings sidesteps the primary means of treaty interpretation in the Vienna Convention and has been deemed as a methodology of "cherry-picking" of awards. Indeed, without a proper hierarchy between the decisions, this type of precedent system is arguably not a step towards more consistency and predictability, but rather a leeway for tribunals to choose an argument without proper justification, in order to support a desired outcome.

Third, several observers and arbitrators have held that there is a systematic lack of application or misapplication of the customary interpretation rules in investment arbitration. This is thought to relate to the both influences from commercial arbitration, where the moral authority of the arbitrators is more evident than an in depth legal reasoning, as well as the vagueness of the investment protection provisions, which requires arbitrators to take the role as primary rule makers. In addition, it was noted that when the NAFTA parties aimed to specify the FET provision through an interpretive note, thus correct the vagueness, by limiting the standard to a minimum standard of customary international law, tribunals have managed to sidestep the limitation by arguing that the customary international law has an evolutionary character.

In conclusion, three inferences are made from this examination. The first is that the host states' exposure to ISDS claims is significantly increased by the tribunals' extensive jurisdiction accorded in IIAs and the increasing practice of third-party funding. The second conclusion is that inconsistent interpretations of treaty provisions are issues deeply rooted within the ISDS mechanism and the tribunals practices. This is evident from, among other things, the absence of clear rules, the lack of application of the Vienna Rules, the tendencies to cite and misuse prior decisions and third-party IIAs, and the influences from commercial arbitration. To this can be added the lack of a review mechanisms, precedent system and effective means for states to influence the interpretation of provisions, which seems to leave tribunals almost completely free to adopt their own interpretation.

The third and last conclusion is that there is a clear imbalance and asymmetry between the interests of host states and the interests of foreign investors in the ISDS setting, on several aspects. The asymmetry is visible in the different risks faced by investors and states, in the funding and means available for the parties, in the rights and obligations of the parties, and in their respective possibilities of effectively representing their interests. The next chapter will further elaborate on these three issues and discuss their implications on environmental protection in host states.

5 Analysis: The potential impact on environmental protection measures

Chapter 2, 3 and 4 has presented the current legal regime as well as highlighted several issues identified. Not all conclusions will be repeated here. This chapter instead aims to answer the two research questions posed in the introductory chapter of the thesis, by bringing some of the findings together.

The first question asked was: What are the potential procedural shortcomings of the ISDS mechanism in relation to environmental protection? In order to answer this question, it is important to first clarify how the thesis aims to measure the impact of procedural shortcomings on environmental protection.

As mentioned in the introductory chapter, environmental protection in the thesis refers to any government activity that seeks to maintain or restore the quality of the natural environment. This could therefore relate to a broad range of different principles and government actions or inactions, at the local, regional or national level. Common principles represented in positive law are, here very simplified, the polluter-pays principle, requiring the polluter to take responsibility for external costs arising from pollution, the principle of prevention, requiring measures to prevent damage from arising, and the precautionary principle, allowing preventative action in a context of uncertainty.[285] A few examples of government actions, including some which have given rise to ISDS claims, are bans of pesticides or chemicals likely to cause harm, environmental taxations, regulations of hazardous waste facilities, establishments of nature reserves, measures requiring backfilling of open-pit metallic mines, or refusals of permits to build landfills.

The potential impact of ISDS on environmental protection is only indirect. Although there are several instances where regulatory measures for environmental protection have been directly challenged in an investment arbitration, as evident in chapter 3, the arbitration tribunals can never abolish or amend a regulation. That could perhaps be a slightly more desirable outcome from an environmental protection perspective, given that it would require tribunals to carefully balance the interests at stake to find a suitable and enforceable environmental regulation. As noted in chapter 4, states can instead be found liable for hundreds of millions or even billions of euros, in addition to paying average legal fees and tribunal expenses of around USD 4-5 million. The indirect impact thus refers to the potential of the investment regime to constrain the governments in their legitimate decision-making on

285. See e.g. De Sadeleer (2002).

environmental protection, by giving rise to a so called regulatory chill. The concept of regulatory chill is explained in the following paragraphs.

The early notion of the regulatory chill hypothesis suggests that governments might fail raising environmental standards due to the fear of capital loss and loss of competitiveness, much similar to the “raise to the bottom” theory presented in chapter 3.[286] Several authors have since extended the concept to encompass states’ concern over investment arbitration, meaning that the potential threat of a dispute or knowledge of existing disputes might prevent regulatory measures on environmental protection.[287] During the discussions in the UNCITRAL regarding a potential reform of ISDS, several states also raised concerns on the matter of regulatory chill.[288]

There are quite a few obvious difficulties to provide empirical evidence in support of the regulatory chill theory, most notably that the “claim refers to the absence of something that would otherwise have happened”.[289] There are however a few cases involving an actual threat of arbitration and the subsequent withdrawal of a regulation that has been highlighted in the literature.[290] Likewise, several authors have emphasized that there is a strong incentive for states to settle cases in favor of investors, even when they are likely to win, in order to avoid the time, money and reputational demands of ISDS.[291] Further, a case study from Canada conducted by Van Harten and Scott in 2016, suggests that government ministries have changed their decision-making to account for trade concerns including ISDS and that the government lawyers play a key role in assessing trade and ISDS risks.[292]

Nevertheless, given the urgency of protecting the global environment and in the absence of effective mechanisms to enforce international environmental law, this thesis holds the view that governments should be able to take legitimate legislative or executive acts concerning the protection of the natural environment, without the potential threat of investment arbitration. When assessing the impacts on environmental protection, the thesis thus considers whether the procedural issues exacerbate this potential threat.

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286. Neumayer (2001).

287. See e.g. Tienhaara (2009), Miles (2008).

288. See e.g. the submission by the government of Indonesia, stating that: “Any time a government changes or promulgates new regulations, it exposes itself to potential legal claims by investors. The fear that international arbitration panels decide in favour of the investors may affect governments’ action in carrying out legitimate policy changes in the future.”, UN Doc A/CN.9/WG.III/WP.156.

289. Neumayer, at 3.

290. Tienhaara (2006), on a mining-case in protection forests in Indonesia.

291. See e.g. Slater (2015); Miles (2008), at 25, on Ethyl Corporation and Canada settlement, where Canada agreed to repeal the ban on a fuel additive, after it was faced with a claim.

292. Van Harten and Scott (2016).

The first point made in this connection is that the inconsistent interpretational practice of investment tribunals has the potential of inhibiting environmental protection measures by creating a legal environment of uncertainty for governments. The argument is elaborated in the following two paragraphs.

One of the main conclusions drawn from chapter 3 and 4, is that investment tribunals are constantly inconsistent in their decision-making. Different tribunals have reached different conclusion regarding the same protection standard in the same investment treaty, or regarding the same investment, the same state measure and similar treaty standards. Tribunals have also been inconsistent in the procedural standards and calculations of damages. Thus, the inconsistency is not merely a result of the different circumstances of the cases or differences in the texts of IIAs. It has been shown that it rather relates to the broad and open-ended investment protection provisions, the lack of application or misapplication of the interpretational rules of the Vienna Convention, the different standards of review applied, and the lack of a binding precedent system.

It is important to note, consistency in itself should not be a goal. In fact, by seeking consistency and coherence, tribunals have given rise to a *de facto* precedent system, arguably at the cost of correctness and the application of the Vienna Convention rules. Further, as quoted in section 4.3.2, a “bad rule” applied consistently can do more harm than if the same rule is applied in an inconsistent manner occasionally. Yet, the inconsistency has given rise to unpredictability and unequal treatment in investment arbitration. These issues relate closely to the notion of rule of law, but more importantly for the purpose of this thesis, it becomes impossible for states to understand the scope of their obligations and what actions that could give rise to a claim in investment arbitration. The unpredictability thus means that although there might be a few encouraging recent cases where tribunals have for example considered the police powers doctrine, the next tribunal faced with a dispute over an environmental policy measure might as well apply another standard. Consequently, states cannot take regulatory actions to protect the environment without facing the risk of arbitration.

The second point is that that the tribunals extensive jurisdiction and third-party funding constrains environmental protection measures by significantly increasing host states’ exposure to investor claims. This relates to another of the main conclusions drawn from chapter 4. The investment regime allows shareholders to initiate parallel proceedings, possibly in both domestic courts and investment arbitration. Investors can also restructure their investments in a manner that allows them to benefit from different BITs. In addition, the increasing practice of third-party funding is thought to eliminate the financial downsides for claimants to raise a wide range of claims. A single environmental protection measure, only affecting one investment, could thus give rise to multiple claims, potentially under different BITs.

The third and last point is that the legal uncertainty and the asymmetries in the investment regime might invite investors to submit claims that challenge environmental protection measures, even in the absence of a “strong” legal argument.

Recalling the last conclusion from chapter 4, there is a clear imbalance between the investors’ interests and the host states’ interests in the ISDS setting, visible in several aspects. As outlined in section 4.2.1, scholars argue that there is an asymmetry in the risks faced by investors and states, as well as in the funding and means available, exacerbated by third-party funding. In addition, there is an asymmetry in the rights and obligations of the parties, as well as in their respective possibilities to effectively represent their interests. This is evident from the limited abilities of states to raise environmental and human rights counterclaims, examined in section 4.1.5, as well as from the limited rights of the public to have their *amicus curiae* submissions accepted and considered in the disputes, outlined in section 4.4. This is particularly problematic considering that environmental protection measures contested in ISDS often directly impact local communities.

As already noted by several scholars in relation to the regulatory chill theory, the imbalance and the fear of a worst-case scenario might change states’ incentives to settle cases or avoid them altogether. Given the large uncertainties in the outcome of the disputes and the advantages held by investors through the systematic imbalance in both costs and risks, an investor who wants to put pressure on a state to revoke a measure that negatively impacts its investment, might therefore rationally be encouraged to file a claim even in the absence of a strong legal argument.

In conclusion, the answer to the first research question is that several of the procedural shortcomings identified in chapter 4, related to extensive jurisdiction, inconsistent treaty interpretation practices, the uneven burden of costs, limitations to public engagement and counterclaims, all potentially negatively impact environmental protection in host states, in the sense that they clearly increase the risk for states’ legitimate environmental measures to be challenged in investment arbitration. Thus, it can be argued that a few positive developments in the case law, where tribunals have attempted to give states larger policy space, does not change the overarching issues that are inherent to the ISDS mechanism.

This very last argument also relates to the second research question asked: Are the ongoing reforms of IIAs to include environmental language adequate to combat the issues identified? In order to answer this question, it is first crucial to define what is meant by “adequate”. As explained above, the issues identified here relates to the increased threat of investment arbitration when governments seek to take legitimate action in order to protect the environment. Moreover, the reform efforts outlined in chapter 3 all have clear policy purposes, they either seek to reserve policy space for environmental regulation for the entire treaty or in relation to specific treaty standards. When asking the question if the reform efforts are "adequate", this thesis therefore considers whether the reform efforts make it less likely that legitimate environmental regulations will be challenged in investment arbitration.

The argument put forward is that the reform efforts are inadequate in two main aspects. Firstly, none of the reform efforts found addresses the most crucial abovementioned systematic shortcomings of unpredictability and the overall imbalance of the regime. Recalling the examination in chapter 3, references to environmental concerns are in general rare in BITs and common in non-BITs. It was concluded that most provisions did not seem to change states' obligations, provide any new obligations for investors or give any clarity on the interpretation of the FET standard or indirect expropriation. The most common general exceptions included wordings such as "otherwise consistent with this treaty" or "except in rare circumstances", which were noted by several scholars to be vague and unhelpful formulations. Further, both the tribunals in *S.D Myers* and in *David Aven*, the latter being a recent case, concluded that the IIAs still pose limits to the way in which states can implement their environmental law. It was noted that investment tribunals still have the mandate to assess states' environmental protection measures and balance the interests of investors and states.

Second, even if one or two of the reform efforts would be considered clear and specific enough to be enforceable and provide larger regulatory space, they might arguably be ignored or overruled through several mechanisms identified in this thesis, namely the MFN standard, the use of third-party IIAs as an interpretative aid, the possibility of multiple claims and BIT-shopping.

This issue in relation to the MFN standard was mentioned in the concluding section of chapter 3. It was shown that the MFN standard has been interpreted broadly by tribunals to allow investors to invoke more favorable substantive and procedural provisions from third-party BITs, and noted that one tribunal specifically rejected the host state's argument that the import of a treaty obligation from a third-party BIT would fundamentally undermine the carefully negotiated balance in the treaty. It was also revealed that several observers have hold that the MFN clause can smooth differences in the standard of protection between investment treaties, ignore variations that might exist for good policy reasons and make it very difficult to foresee the potential scope of liability of states.

The limits to how broadly the MFN standard can be interpreted is set by the customary rules on treaty interpretation. Therefore, some might argue that a broad interpretation of the standard, which would sidestep the public welfare policy considerations of modern treaties, would lead to a result which is “manifestly absurd or unreasonable” in accordance with the Vienna Rules. Yet, as was evident from chapter 4, the investment tribunals do not always strictly apply the customary rules on treaty interpretation. Thus, it is therefore not clear whether the MFN standard could be used to ignore certain general exceptions or carve-outs in BITs, which are incorporated to provide more environmental regulatory space.

In chapter 4, it was also noted that several scholars had noticed a trend in tribunals practices to use third-party IIAs as an interpretative aid, poorly justified by the Vienna Convention, which systematically ignored differences between BITs. This was mentioned to potentially frustrate the attempts of drafting “better” IIAs.

Arguably the worst issue is however the possibility of multiple claims and BIT-shopping. Considering that some countries have over a hundred BITs in force, the issue of multiple claims creates a large uncertainty regarding which BITs that potentially can be invoked. Consequently, building on the idea that governments have to treat all obligations in BITs as obligations *erga omnes*, although host states might have adopted a few modern BITs with environmental language and supposedly larger regulatory flexibility, they must still assume that all investors and companies on their territory are covered by the BIT in force with the most far-reaching obligations. That most IIAs also provide for investors to restructure their investments in order to claim rights on the basis of the most advantageous BIT, could also further frustrate the potential positive impact of modern BITs with environmental language, by simply providing other channels for investors.

In short, the ongoing reform efforts might increase the interaction between investment law and environmental law and shed some light on environmental protection perspectives. However, they are not adequate, in the sense that they do not make it less likely for states’ environmental regulations to be subject to challenge in ISDS. There is evidently a need for more systematic and radical reforms, adopted throughout all existing BITs, in order to eliminate the potential negative impacts of ISDS on host states’ environmental protection.

6 Concluding remarks

Climate change is one of the most pressing global challenges facing humanity. While several global efforts have been made to protect and preserve the environment in the last few decade, it is clear that the international community lacks the ability to enforce these standards on all actors. It is in light of this that I find it particularly worrying to see that the international investment regime provides such a powerful tool for investors, that enables them to undermine democratic decisions, risk millions in public funds and potentially exploit and harm the natural environment.

Recalling the findings in chapter 2, the investment arbitration mechanism and the near 3000 bilateral treaties in force are a result of a longstanding controversy between capital-exporting and capital-importing states, where in the end, the capital-exporting states' perspectives prevailed. This was however due to the attractiveness at the time to compete for FDI, in the lack of other alternatives for development. While IIAs alone are not considered to be sufficient to promote FDI, as noted in section 2.4, I think it is reasonable to question the states' *rationale* behind preserving international investment arbitration as it stands today. Is there a fear of a wide-spread adoption of protectionist measures or capital flight, if foreign investors are not granted extensive protection through IIAs? Would there be a remarkable change in the flow of FDI across the globe, if it were not for the ISDS mechanism? I think that these questions are important to think about, when considering the findings in this thesis and thinking about solutions to the issues.

Lastly, it is outside of the scope of this thesis to present and assess alternative ways or propose adequate changes to the current legal regime. Yet, it can be noted that several such proposals have been laid out by legal scholars already.[293] When looking forward, however, it is important to bear in mind whether the proposed alternative measures resolves the significant concerns identified in this thesis. As an example, a permanent world investment court with a binding precedent system might create larger consistency and predictability, however, it would for example not solve the issue of the imbalance between interests in the investment regime.

293. See e.g., Kelsey, J. 'UNCITRAL Working Group III: Promoting alternatives to investor–state arbitration as ISDS reform', IISD, (Oct 2, 2019); Johnson, Coleman, Güven and Sachs (2019).

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