ENVIRONMENTAL POLICY-MAKING AND TRIBUNAL DECISION-MAKING: ASSESSING THE SCOPE OF REGULATORY POWER IN INTERNATIONAL INVESTMENT ARBITRATION

ARETA JEZ*

ABSTRACT

International environmental standards are rapidly changing, prompting states to reevaluate the sustainability of their developmental policies, including the negative effects that free trade agreements and investment treaties can have on the environment. This Article explores the tensions between international investment law and international environmental law that prompt investors to bring claims to international courts and arbitral tribunals alleging that their rights have been violated. It discusses how arbitral tribunals evaluate investor claims and how they assess the legitimacy of governmental environmental protective measures. The Article then examines ways in which states can increase the likelihood that tribunals are sensitive to the need for environmental conservation and defer to state decision-making.

* J.D., 2019, University of Pennsylvania Law School; B.A., 2016, American University. I am grateful to Matthew Swanson, Timothy Decker and the staff of the University of Pennsylvania Journal of International Law for their editing and revisions. All opinions expressed in this Comment are my own.
TABLE OF CONTENTS

Introduction .................................................................................. 991
1. Treaty Interpretation and the Vienna Convention on the
   Law of Treaties ........................................................................ 993
2. Trade and the GATT ................................................................ 993
   2.1. Preambular provisions .................................................. 994
   2.2. Current Standards ........................................................ 996
3. Bilateral Investment Treaties .................................................. 998
   3.1. Preambular Provisions ................................................. 999
   3.2. Explicit Exceptions ..................................................... 1000
4. Standards Under International Law ................................... 1001
   4.1. Fair and Equitable Treatment .................................... 1002
      4.1(a). Suez et al. v. Argentina .................................. 1003
      4.1(b). Renewable Energy in Spain ......................... 1004
   4.2. Expropriation .............................................................. 1007
      4.2(a). Metalclad v. Mexico ....................................... 1011
      4.2(b). The Chemtura and Bilcon Cases .............. 1012
5. FET and Expropriation Claim Assessment......................... 1013
6. Conclusion .............................................................................. 1016
INTRODUCTION

Increasing globalization of economic activities through both trade and investment has contributed to rising GDP, improved standards of living, and general economic development in many parts of the world. And while these advancements are positive, they do not come without costs, especially environmental ones. As consensus emerges about the negative impact of human activity leading to environmental degradation, states are increasingly prioritizing environmental protection and sustainable development. States are beginning to cooperate on climate change issues as well, incorporating provisions that integrate environmental concerns in free trade agreements and bilateral investment treaties (BITs). International courts and arbitral tribunals are following the same trend, and are starting to weigh environmental concerns more heavily when deciding the scope of a state’s regulatory sphere in investment arbitrations.

Incorporating environmental provisions into BITs can prove disadvantageous to investors, however, thus prompting them to bring arbitral claims in hopes of securing more preferential treatment or compensation for their losses. A growing number of investor claims based on losses suffered due to environmental regulations has “raised concerns that [. . . ] large compensation bills might unduly constrain regulatory space.”1 Given these tensions between individual investors and the environmental goals of host states, arbitral tribunals must carefully balance interests.

An important avenue for arbitral tribunals to justify deference to states’ environmental regulations is through treaty interpretation. Favorable treaty interpretation can help shield host states from claims based on violations of fair and equitable treatment or expropriation, and can ensure that states have the space to regulate based on both domestic environmental needs and their international commitments.

Important questions remain, however. How do arbitral tribunals evaluate the legitimacy of governmental regulations purported to prioritize environmental and human health? And how much deference should tribunals accord, even when these measures are legitimate? In drafting BITs, states can help extend the deference

offered by tribunals by modeling provisions on those commonly included in free trade agreements and by looking towards other international courts to borrow their justifications for evolutionary treaty interpretation. This Article will review the role preambular provisions and explicit exceptions play in both trade and investment matters. It will examine the investor treatment standards of fair and equitable treatment and expropriation to analyze how and under what circumstances arbitral tribunals are most likely to defer to states and their policy-making in investment cases.

Part 1 will discuss treaty interpretation as codified in the Vienna Convention on the Law of Treaties, building the foundation for the application of treaty interpretation discussed throughout the paper. Part 2 examines trade disputes as they relate to the General Agreement on Tariffs and Trade (GATT). In this section, the Article focuses on the way the GATT’s preambular provisions helped the Tribunal in the Shrimp/Turtle Dispute navigate the interpretation of the exceptions enshrined under GATT Article XX(g), and looks at the way in which current environmental and legal standards not yet formally enshrined in text can be incorporated into decision-making, as seen in the Gabčíkovo-Nagymaros case. Part 3 then moves on to Bilateral Investment Treaties and first reviews BITs’ preambular provisions before summarizing explicit exceptions and carve outs. Part 4 reviews standards of international law that are most applicable to investment disputes, namely the standard of fair and equitable treatment and expropriation, and includes discussion of notable cases. Part 5 analyzes how tribunals should—and do—assess fair and equitable treatment and expropriation claims, and provides recommendations to ensure that tribunals reach decisions that are sensitive to environmental measures.

---

2 In dispute resolution relating to treaties or agreements, courts and tribunals must often decide whether the meaning of terms enshrined in the documents in question can evolve over time or whether they retain the same meaning regardless of the changing socio-political context. Evolutionary treaty interpretation favors the former approach: it involves applying modern conceptions of a term’s meaning, understood at the time of the dispute, instead of applying the understanding of the terms held at the time of the treaty’s inception. See Joost Pauwelyn & Manfred Elsig, The Politics of Treaty Interpretation: Variations and Explanations Across International Tribunals, in INTERDISCIPLINARY PERSPECTIVES ON INTERNATIONAL LAW AND INTERNATIONAL RELATIONS: THE STATE OF THE ART 445, 453 (Jeffrey L. Dunoff & Mark A. Pollack eds., 2013) (stating that temporal considerations play a large role in determining the meaning behind a term).
1. TREATY INTERPRETATION AND THE VIENNA CONVENTION ON THE LAW OF TREATIES

Investment treaties are not entered into in vacuums; thus, it is important to recognize that while these treaties are aimed at attracting foreign investment by offering attractive protections and incentives to investors, host states must remain cognizant of their other international legal obligations. Since many BITs do not contain specific provisions relating to environmental conservation or those provisions, if they do exist, are sparse and largely unhelpful, tribunals can turn to treaty interpretation to broaden their scope. In these instances, tribunals turn to the rules of treaty interpretation codified in the 1969 Vienna Convention on the Law of Treaties. Tribunals must interpret treaties “in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose.”

The Vienna Convention specifies that context for the purpose of treaty interpretation includes: any additional agreements made between the parties, subsequent agreements, State practice, other relevant rules of international law in force between the parties, and intent. The Vienna Convention also provides for supplementary means of interpretation, which include “the preparatory work of the treaty and circumstances of its conclusion.”

2. TRADE AND THE GATT

The General Agreement on Tariffs and Trade (GATT), a multilateral trade agreement, entered into force in 1948 as a mechanism to increase international trade between member states by reducing or eliminating barriers to trade. In the decades since

---

6 Id. art. 31.
7 Id. art. 32.
the agreement’s conception, however, tensions have risen between liberalized trade and environmental protection, prompting disputes between member states. Many of these disputes are resolved in arbitral tribunals or courts, which often look to preambular provisions enshrined in agreements and to current standards in environmental management and conservation to determine whether measures could be justified under exceptions to the agreement.

2.1. Preambular provisions

Arbitral tribunals commonly turn to preambles to help reveal the object and purpose of a treaty and to guide the interpretation of substantive provisions, especially in disputes regarding free trade agreements. One notable example of preambular provisions informing a decision from an arbitral tribunal is the Shrimp-Turtle Dispute. In this case, the United States passed regulations requiring the use of Turtle Excluder Devices (TEDs) in all areas where there was a likelihood that shrimp would interact with sea turtles. These regulations resulted in an import ban on all shrimp and shrimp products from countries where shrimp was harvested using commercial technology that could adversely affect sea turtles. The regulations provided, however, that this ban would not apply to countries that were certified. India, Pakistan, Thailand, and Malaysia argued that these laws violated WTO rules because the import ban constituted “unjustifiable discrimination between countries where the same conditions prevail[ed].” The tribunal considered whether Article XX(g) of the GATT, which states that


10 Id. para. 3.

11 Certification would be granted to countries whose fishing environments posed no threats to sea turtles. First, countries would be certified given the absence of the relevant species of sea turtles in their waters. Second, certification would be granted if countries harvested shrimp exclusively in ways that posed no threat to sea turtles, such as artisanal ways. And third, countries would be certified if they harvested shrimp in waters that had no sea turtles at all. Certification would also be granted to countries who fell outside of the aforementioned parameters, but “that provide[d] documentary evidence of the adoption of a regulatory program governing the incidental taking of sea turtles . . . that [was] comparable to the United States program and where the average rate of incidental taking of sea turtles by their vessels [was] comparable to that of United States vessels.” Id. para. 3–4.

12 Id. para. 10.
countries can be exempted from GATT rules if the measures undertaken relate to “the conservation of exhaustible natural resources,”\(^\text{13}\) was applicable, and turned to preambular provisions to instruct its determination. In interpreting the term “exhaustible natural resources,” the tribunal explained that:

The words of Article XX(g), “exhaustible natural resources”, were actually crafted more than 50 years ago. They must be read by a treaty interpreter in the light of contemporary concerns of the community of nations about the protection and conservation of the environment. While Article XX was not modified in the Uruguay Round, the preamble attached to the WTO Agreement shows that the signatories to that Agreement were, in 1994, fully aware of the importance and legitimacy of environmental protection as a goal of national and international policy. The preamble of the WTO Agreement – which informs not only the GATT 1994, but also the other covered agreements – explicitly acknowledges “the objective of sustainable development.”\(^\text{14}\)

The arbitral tribunal explained that the term “exhaustible natural resources” is not static, but indeed evolutionary,\(^\text{15}\) and found that sea turtles can be categorized as exhaustible natural resources. This determination led to the tribunal’s decision that while the U.S. import ban did indeed fall under the purview of the exception enshrined in Article XX(g) and under Article XX’s chapeau

\(^{13}\) GATT, supra note 8, art. XX(g); see also id. art. XX(b) (specifying that Parties may take any measures “necessary to protect human, animal or plant life or health.”). Article XX’s chapeau conditions these exceptions on the guarantee that states will “not appl[y] [the measures] in a manner that would constitute a means of arbitrary or unjustifiable discrimination.” This requires that the measure be taken in good faith, because the exceptions are intended to help Parties promote their legitimate interests, not to retaliate amongst other Parties or gain an unfair advantage. Compliance with the chapeau can be demonstrated in a variety of ways. The accused Party can show that the measures were a result of cooperation and agreement at the international level and that the measure was designed with flexibility in mind, taking into account different situations in different countries. The offending Party may also put forth an analysis showing a clear connection between the measure and the discrimination, identifying reasonable justifications for its reasoning. WTO rules and environmental policies: GATT exceptions, WORLD TRADE ORGANIZATION, https://www.wto.org/english/tratop_e/envir_e/envt_rules_exceptions_e.htm [https://perma.cc/X8XW-FYAG].

\(^{14}\) Shrimp/Turtle Dispute, supra note 9, para. 129.

\(^{15}\) Id. para. 130.
procedurally, it failed to fulfill the requirements substantively. The tribunal found that the measure was applied in a manner that constitutes arbitrary and unjustifiable discrimination in that the ban was applied differently in “countries where the same conditions prevail.”

Tribunals in international investment arbitrations could potentially borrow the approach the tribunal took in the Shrimp-Turtle Dispute in deciding trade disputes relating to supposed environmental conservation. The tribunal stressed the importance of preambular provisions by explaining that “the specific language of the preamble to the WTO Agreement . . . gives colour, texture and shading to the rights and obligations of Members under the WTO Agreement, generally, and under the GATT 1994, in particular.” And although the tribunal did not ultimately completely defer to the United States in its regulatory policy-making, the Shrimp-Turtle Dispute was nonetheless a pioneering case in that it affirmed that “WTO Members are free to adopt their own policies aimed at protecting the environment as long as, in so doing, they fulfill their obligations and respect the rights of other Members under the WTO Agreement.”

2.2. Current Standards

International investment arbitral panels could also more readily consider current standards in international environmental management, policy-making, and law as opposed to standards in effect at the time of entrance into the agreement, as do courts such as the International Court of Justice (ICJ). A notable case in which the ICJ applied current standards is the Gabčíkovo-Nagymaros case,

---

16 Id. para. 145.
17 Id. para. 160. In this case, the distinction between procedural and substantive adherence to Article XX(g) is one of superficial compliance versus compliance in application; intended versus actual effect. In the case of procedural compliance, the Tribunal examined the ban on its face to determine whether its general design reasonably related to the policy goal it intended to serve: protecting sea turtles. Id. at para. 137–142. Substantively, the Tribunal was concerned that the measure’s application did not constitute arbitrary discrimination and that it was not a “disguised restriction on international trade” as per the conditions set out in Article XX’s chapeau. Id. at para. 160.
18 Id. para. 184.
19 Id. para. 155.
20 Id. para. 186.
where the Court considered the principles of prevention and precaution, intergenerational equity, and sustainable development.\textsuperscript{21}

In the \textit{Gabčíkovo-Nagymaros} case, Hungary and Czechoslovakia entered into a treaty to construct a system of dams on the Danube river.\textsuperscript{22} But after learning of the environmental risks associated with the project’s completion and after garnering intense criticism, Hungary suspended and then permanently abandoned the project.\textsuperscript{23} Although the Court found that Hungary violated its treaty obligations by terminating construction,\textsuperscript{24} the Court stressed the importance of seriously considering the project’s detrimental impact on the environment and explained that current standards should be applied in these considerations:\textsuperscript{25}

Owing to new scientific insights and to a growing awareness of the risks for mankind – for present and future generations – of pursuit of such interventions at an unconsidered and unabated pace, new norms and standards have been developed, set forth in a great number of instruments during the last two decades. Such new norms have to be taken into consideration, and such new standards given proper weight, not only when States contemplate new activities but also when continuing with activities begun in the past. This need to reconcile economic development with protection of the environment is aptly expressed in the concept of sustainable development.\textsuperscript{26}

By discussing the importance of current standards, the Court affirmed the living nature of treaties and their ability to evolve over time to adapt to changing norms in international law. Therefore, although the Court ordered Hungary to resume its treaty obligations, it called on the parties to jointly decide on alternative measures that would be less taxing on the environment.\textsuperscript{27} The Court’s call to both the parties and future benches and panels to consider current standards in their decision-making was taken

\begin{flushleft}
\textsuperscript{21} Boisson de Chazournes, \textit{supra} note 4, at 375.
\textsuperscript{22} Case Concerning the Gabčíkovo-Nagymaros Project (Hungary/Slovakia), 1997 I.C.J., para. 15 [hereinafter Gabčíkovo-Nagymaros Case].
\textsuperscript{23} \textit{Id.} para. 22.
\textsuperscript{24} \textit{Id.} para. 59.
\textsuperscript{25} \textit{Id.} para. 140.
\textsuperscript{26} \textit{Id.}
\textsuperscript{27} \textit{Id.} para. 141.
\end{flushleft}
seriously in subsequent decisions. For example, in the *Iron Rhine Arbitration*, the Tribunal referenced the living nature of treaties developed in the *Gabčíkovo-Nagymaros* case by noting that an “evolutive interpretation, which would ensure an application of the treaty that would be effective in terms of its object and purpose, will be preferred to a strict application of the intertemporal rule.”  

Tribunals have continued the trend of interpreting treaties according to principles of international environmental law in place at the time of the decision in other cases as well. In the *Indus Water Kishenganga Arbitration*, the Tribunal said “principles of international environmental law must be taken into account even when . . . interpreting treaties concluded before the development of that body of law.”

### 3. BILATERAL INVESTMENT TREATIES

Although one could plausibly argue that environmental considerations are not as central to investment as they are in trade, countries are increasingly recognizing the necessity of including conservation provisions in BITs as a way to both propel environmental protection and broaden the scope of their regulatory sphere in that area. Scholars such as Laurence Boisson de Chazournes have categorized these provisions in three categories. The first category, provisions enshrined in preambles, function similarly to preambular provisions in free trade agreements, in that the commitments are expressed in general terms and are generally not binding. Second, provisions can function as exceptions, such as those found within Article XX(g) of the GATT Agreement. These provisions may carve out a State’s specific regulatory powers. Such provisions are meant to provide States with space to set up environmental frameworks consistent with the goals of the BITs without the constant fear that they will be found to be in

---

28 Iron Rhine Railway (Kingdom of Belgium v. Kingdom of the Netherlands), PCA Case Repository, para. 80 (2005).
29 Indus Water Kishenganga Arbitration (Pakistan v. India), Partial Award, PCA Case Repository, para. 452 (2013).
30 Boisson de Chazournes, supra note 4, at 380.
31 Id.
32 Id.
33 Id.
violation of investment standards such as fair and equitable treatment, expropriation, national treatment, or most favored nation. And third, these environmental obligations may be found in provisions that delineate investors’ rights and responsibilities. These obligations can include, but are not limited to, provisions on corporate social responsibility (CSR) or requirements to submit environmental impact assessments at specified times. This third category of protection, however, is outside the scope of this paper and will not be discussed further.


Provisions enshrined in preambles can help tribunals decipher the object and purpose of a treaty as codified by the treaty interpretation rules in the Vienna Convention on the Law of Treaties (VCLT). Trends show that states are increasingly beginning to include goals of environmental protection and sustainable development in the preambles of BITs; this is especially true of the past decade. For example, a BIT between the United States and Rwanda from 2008 states that the goals of economic development should be “achieve[d] . . . in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labor rights.” In 2013, Canada and Benin entered into a BIT that “[r]ecogniz[ed] that the promotion and the protection of investments of investors . . . [is] conducive to the stimulation of mutually beneficial economic activity, the development of economic cooperation between both countries and the promotion of sustainable development.” And a BIT between Canada and China specified that that investment should be “based on the principles of sustainable development.”

34 Id.
35 Id.
37 Agreement for the Promotion and Reciprocal Protection of Investments, Benin-Can., preamble, Jan. 9, 2013.
38 Agreement for the Promotion and Reciprocal Protection of Investments, Can.-China, preamble, Sept. 9, 2012.
3.2. Explicit Exceptions

BITs sometimes give states more explicit direction in their substantive provisions that discuss environmental policy-making. For example, many BITs entered into by the U.S. in the recent past provide that “[n]othing in [the] Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with [the] Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.”\(^{39}\) Canada’s Model BIT from 2004 carves out exceptions similar to those in Article XX of the GATT:

[N]othing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures necessary: (a) to protect human, animal or plant life or health; (b) to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement; or (c) for the conservation of living or non-living exhaustible natural resources.\(^{40}\)

Many BITs specify that the promotion of investment cannot simultaneously result in compromising environmental standards. The effect of these provisions is that they enlarge the scope of a State’s regulatory sphere by expressly declaring that states can adopt or monitor their environmental laws as they see fit. Both the U.S. and Canadian Model BITs provide for this kind of provision.\(^{41}\) A 2006 BIT between Belgium, the Luxembourg Economic Union, and Mozambique is a notable example of a BIT that includes this kind of strong provision. The BIT provides:

1. Recognizing the right of each Contracting Party to establish its own levels of domestic environmental


\(^{41}\) See U.S. Model BIT, supra note 39, art. 12(2) (discouraging weakening domestic environmental protections in order to encourage investment); Canadian Model BIT, supra note 40, art. 11 (similarly discouraging relaxing environmental protections in order to encourage investment).
protection and environmental development policies and priorities, and to adopt or modify accordingly its environmental laws, each Contracting Party shall strive to continue to improve those laws . . .

3. The Contracting Parties reaffirm their commitments under the international environmental agreements, which they have accepted. They shall strive to ensure that such commitments are fully recognized and implemented by their domestic laws. These provisions could also be relevant in cases where new scientific evidence has emerged since the parties have entered into the BIT. In these cases, the state may have a duty to heed the overwhelming scientific consensus, especially if other states are taking on new obligations. The failure to keep up with standards in environmental law may inadvertently and unfairly lead to competitive advantages that benefit states who have not adopted more stringent environmental provisions to the detriment of the more environmentally progressive states. Thus, provisions that allow states, or even obligate them, to prioritize new international environmental agreements and standards are important because they reduce the perverse incentive for states to delay the enactment of new environmental provisions in hopes of becoming comparatively more competitive in attracting foreign investment.

4. STANDARDS UNDER INTERNATIONAL LAW

Preambular provisions and explicit exceptions may deflate the likelihood of investor recovery in some cases, but they do not shield states from all investor claims. It is essential to bear in mind standards that are foundational to international investment, and evaluate investor claims on a case by case basis. Although standards like most favored nation and national treatment are important in investment, the standards that are most relevant to investment in relation to environmental conservation and policy-making are fair

and equitable treatment (FET) and expropriation. These two standards will be the focus of this section.

4.1. Fair and Equitable Treatment

The FET standard in international investment law is an obligation for States to treat investors fairly; it is intended to protect investors from discriminatory or arbitrary conduct. FET is an absolute minimum standard by which the host state promises to treat investors in accordance with international law. FET includes the obligations of providing a stable and predictable environment, the protection of legitimate expectations, substantive and administrative due process, transparency, reasonableness, and proportionality in relation to host states’ governmental actions. A violation of FET does not always require bad faith on the part of the host state; investors may be able to claim damages if the host state is acting in an improper or unreasonable way. Arbitral tribunals have awarded damages in a variety of circumstances, such as cases where the State changed its tax rates, where the State has refused to modify its gas tariff rates and transferred the rights to another public utility service during a financial crisis, or where a State failed to issue municipal landfill permits. Some scholars say that governmental actions likely violate FET if specific representations, assurances, or contractual obligations are violated, or if legislative changes are accompanied by procedural deficiencies.

---

43 Azernoosh Bazrafkan & Alexia Herwig, Reinterpreting the Fair and Equitable Treatment Provision in International Investment Agreements as a New and More Legitimate Way to Manage Risks, 7 EUR. J. RISK REG. 439, 441 (2016).
44 Id.
45 Id.
46 Id.
47 Occidental v. Ecuador (UNCITRAL/LCIA Case No. UN3467, Final Award, 1 July 2004), paras. 85, 92.
48 Suez et al. v. Argentina (ICSID Case No. ARB/03/19, Decision on Liability, 30 July 2010), para. 226 [hereinafter Suez v. Argentina].
49 Metalclad v. Mexico (ICSID Case No. ARB(AF)/97/1, Award, Aug. 30, 2000), paras. 103–107 [hereinafter Metalclad].
50 Bazrafkan et al., supra note 43, at 442.
4.1(a). *Suez et al. v. Argentina*

In the case of *Suez et al. v. Argentina*, the Argentine government privatized the country’s public services because of the deterioration of the water and sewage quality and the inability of the service to reach all inhabitants of the city of Buenos Aires. At the same time, Argentina was beginning to get mired in financial troubles. During the financial crisis in 2000, the government de-linked the Argentine peso from the U.S. dollar, majorly devaluing the currency. This caused the Claimants’ costs for providing the services to rise, but the government refused to modify the tariff rates they were allowed to collect to cushion the setbacks in profits. Consequently, investors were not able to earn a reasonable rate of return and the company was not able to continue investment in service improvements, leading to suspect levels of nitrate in the water. Concerned with water quality, the government transferred the water management company to another entity (one owned by the Argentine government) without allowing the Claimants time to remedy the situation. Although the Tribunal did not find that the government expropriated the Claimant’s company in this case, it did find that the investor’s legitimate expectations were frustrated, and thus ruled that Argentina violated the fair and equitable treatment standard.

The result of *Suez et al. v. Argentina* is hardly surprising, especially given that the government’s decision-making was not clearly motivated by strong environmental interests. Although one reason for the government’s decision to transfer ownership from the Claimant to another entity was its dissatisfaction and concern with the water quality, it is likely that the greater motivation was the unraveling of the country’s financial stability. Concern with financial stability in turn led to restructuring of the currency peg that forced the Claimants into financial ruin, preventing them from providing quality services to inhabitants of the area. It is possible

---

51 *Suez v. Argentina*, *supra* note 48, paras. 26–29.
52 *Id.* para. 44 (discussing the Argentine government’s actions during the 2000 financial crisis).
53 *Id.* para. 50 (discussing the results in *Suez v. Argentina*).
54 *Id.* paras. 55–56.
55 *Id.* para. 56.
56 *Id.* para. 226.
57 *Id.* para. 56.
that the result would differ had the government’s environmental concerns been at the forefront of their decision-making. It seems, then, that in cases where concern for the environment is a justification for a measure taken by a state, a tribunal will more likely dismiss investor claims if the environmental justification is at the center of the state’s decision-making.

4.1(b). Renewable Energy in Spain

While arbitral cases in which investors claim losses due to the negative impact that new environmental regulations have on their investments are fairly common, cases in which investors are harmed due to a state revoking laws and regulations that actually positively affect the environment are quite rare. In these cases, tribunals, especially more progressive tribunals seeking to promote environmentally conscious policies, may be faced with unique challenges in their decision-making: should the tribunal award compensation to investors in hopes of stressing the importance of the now-defunct environmental policies, or should the tribunal “maintain[] the State’s sovereign ability to revoke support systems as it sees fit?”

Spain’s recent withdrawal of substantial support for renewable energy poses this conundrum.

In the mid-1990s, Spain sought to take advantage of its abundant sunshine and windy Northern regions by implementing a feed-in tariff scheme that sought to encourage investors to participate in

59 See A Guide to the Winds of Spain, SPAIN GUIDES, https://spainguides.com/weather/winds-spain/ [https://perma.cc/S66A-VSCV] (listing the many terms the Spanish use for wind and commenting on the importance of wind as a part of Spain’s energy generation portfolio); see also Climate in Spain, JUST LANDED, https://www.justlanded.com/english/Spain/Articles/Culture/Climate-in-Spain [https://perma.cc/3PZW-FQJL] (noting that Spain has roughly 300 days of sunshine per year and strong winds with sustained speeds of up to 200km/h in the northern regions of the country).
60 See Toby Couture & Yves Gagnon, An Analysis of Feed-in Tariff Remuneration Models: Implications for Renewable Energy Investment, 38 ENERGY POLICY 955, 955 (2010) (noting that feed-in tariffs offer investors guaranteed prices over a fixed period of time for production of renewable energy, and asserting that this scheme reduces investment risk by “enabl[ing] investors to be remunerated according to the actual costs of [renewable energy] project development”).

https://scholarship.law.upenn.edu/jil/vol40/iss4/1
the precursor to the clean energy revolution.61 The purpose of the feed-in tariffs was to stimulate investment by assuring ease of market entry and a high purchase price for all developers, both large and small.62 However, Spanish laws prohibited utilities from passing on these high rates to consumers,63 so the government provided large subsidies to offset the utilities’ internalized costs.64 By 2012, the Spanish government had given out over 8.1 billion euros in subsidies to all renewables, leading to a massive tariff deficit65 accounting for 3% of Spanish GDP: this contributed to Spain’s serious financial crisis in 2008.66 To manage debt that was spiraling out of control, Spain passed a law that retroactively cut subsidies.67

Investors in renewable energy projects are understandably frustrated, as these retroactive measures are less about achieving


66 The cost del sol, supra note 64.

environmental goals than they are reflective of Spain’s poor financial planning. Distraught investors are bringing FET claims in Spain’s highest courts and in arbitral tribunals, claiming that Spain has violated obligations under the Energy Charter Treaty (ECT) which governs these agreements. There are arguments, albeit weak ones, that Spain’s measures could be protected under either Article 24(2)(b)(i) of the ECT, which gives governments space to enact measures necessary to protect human, animal or plant life or health, or Article 24(3)(c), which allows states to enact measures necessary for the maintenance of the public order. The retroactive subsidy cuts could be seen as protecting human life and health under Article 24(2)(b)(i) if one assumes that a financial crisis resulting from a government’s large debt would prevent the government from providing crucial public services (such as healthcare) in order to first service non-essential spending on promises made to foreign investors. It is also possible that these cost-cutting measures could be justified as a means to keep public discontent over the state’s finances at bay under Article 24(3)(c), if the government has reason to believe that this discontent could somehow negatively affect the functioning of the State.

These arguments, however, are tangential at best, and it is obvious that Spain’s motives stemmed not from concern for public health, but because the government realized just how unsustainable its subsidy program was. Thus far, investors have had more luck recovering damages in arbitration than in domestic courts: the Spanish Supreme Court is standing by the government’s debt management strategy and ruled in 2016 that the retroactive subsidy cuts were constitutional. Investors have had better luck in the International Centre for the Settlement of Investment Disputes (ICSID). In 2017, ICSID found that Spain violated the fair and equitable treatment standard, thus violating Article 10 of the Energy

---


69 Id. art. 24(2)(b)(i).

70 Id. art. 24(3)(c).

71 Reyes Rincón, Spain’s Supreme Court backs renewable energy cuts, El País (June 2, 2016), https://elpais.com/elpais/2016/06/02/inenglish/1464860925_523010.html [https://perma.cc/9YKG-87NT].
Charter Treaty, and awarded the claimants 128 million euros in compensatory damages.\textsuperscript{72} A year later, in May 2018\textsuperscript{73} and June 2018\textsuperscript{74}, ICSID once again found that Spain violated the standard of fair and equitable treatment and ruled in favor of investors.

A plausible interpretation of these rulings is that ICSID sees the value in encouraging the proliferation of clean energy and seeks to promote a host state’s policy-making targeted in that direction. By ordering compensation for investor losses, ICSID may be signaling that revoking environmental benefits should be avoided, even if a state finds itself in a precarious budgetary dilemma. In this way, ICSID may be trying to prevent aversion for further investment in renewables or other environmentally sound policies, especially in the particular host state.\textsuperscript{75} The results of these arbitral cases, then, may have important implications for environmental law-making in the future, as these results indicate that fulfilling investor expectations, especially in relation to environmental incentives, is crucial if the goal is to increase innovation and investment in renewable energy.

4.2. Expropriation

Foreign investors may also bring claims in arbitral tribunals based on expropriation, which can be generally defined as the


\textsuperscript{75} Nathanson, \textit{supra} note 58, at 902–903.
confiscation of property by a state. Protection from expropriation can be found in BITs, multilateral agreements, and international investment agreements: in most cases, these provisions are similarly drafted. For the purposes of this paper, the North American Free Trade Agreement (NAFTA) will be used as an example of a multilateral agreement containing such a provision.

Protection from expropriation can be found in Article 1110 of NAFTA. This provision specifies that governments cannot nationalize or expropriate any investment except for a public purpose, on a non-discriminatory basis, in accordance with due process of law and international law, and on payment of fair compensation. Expropriation need not be outright and deliberate; instead, veiled interference with the use of property that deprives the owner, at least in significant part, of the reasonably expected economic benefit is also expropriation, albeit indirect expropriation. Cases have shown that in assessing expropriation claims, tribunals will often consider three main factors: (1) the extent of the interference; (2) the reasonableness of the investors' legitimate expectations; and (3) the character and purpose of the measure. The greater the interference with the investment, the more likely it is that a tribunal will find that the state is in violation of its obligations. NAFTA requires governments to treat arbitration awards as binding.

While the treaty provides ample protections for investors, it also recognizes the importance of environmentalism. The Preamble states that Parties should endeavor to achieve treaty goals “in a manner consistent with environmental protection and conservation,” to “promote sustainable development,” and to “strengthen the development and enforcement of environmental protection.”


Id.

Metalclad, supra note 49, para. 103.

Moloo et al., supra note 3, at 24.

Id.

International Centre for the Settlement of Investment Disputes (ICSID), Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Mar. 18, 1965, 575 U.N.T.S. 159, 194, art. 54(1).
laws and regulations.”\textsuperscript{83} NAFTA also includes provisions regarding the environment in its investment chapter. Article 1114 specifies that nothing in the agreement prevents Parties from “adopting, maintaining, or enforcing any measure \ldots that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.”\textsuperscript{84} The same provision also details that Parties cannot relax domestic health, safety, or environmental measures to encourage investment.\textsuperscript{85} Furthermore, NAFTA specifically carves out exceptions for environmental protection by borrowing the language enshrined in GATT Articles XX(b) and XX(g)\textsuperscript{86} which detail instances in which parties may be exempt from WTO rules in pursuit of their environmental goals.\textsuperscript{87} Parties that believe that other members have relaxed their environmental standards to attract investment are not powerless and may seek consultations with the other Party to remedy the issue.\textsuperscript{88}

NAFTA’s goals to increase free trade without compromising environmental quality do sometimes result in tension. Because increased trade and investment often result in environmental degradation, states must often make compromises between forging favorable investment climates and protecting the environment. In justifying regulations that promote environmental health but harm investors, states often refer to the “polluter pays principle,” a key tenet of international environmental law implied in the Rio Declaration on Environment and Development that states that those responsible for environmental harm must also bear the cost of protecting the environment.\textsuperscript{89} This principle can be interpreted to mean that states can shift the burden of protecting the environment on those who directly harm it: the investors that engage in pollution or other environmental harm through the normal operation of their investments. Notwithstanding this principle, states are not free to shift all costs of environmental protections on investors and are still

\begin{footnotes}
\item[83] NAFTA, \textit{supra} note 77, preamble.
\item[84] \textit{Id.} art. 1114.
\item[85] \textit{Id.}
\item[86] \textit{Id.} art. 2101.1.
\item[87] See note 9 and accompanying text for discussion of articles XX(b), XX(g), and the chapeau. GATT, \textit{supra} note 8, art. XX(b), art. XX(g).
\item[88] NAFTA, \textit{supra} note 77, art. 1114.2.
\end{footnotes}
subject to expropriation claims. Even if governmental measures that shift burdens are necessary to protect human and animal life and health, investors may bring claims of expropriation when their property is confiscated, either partially or fully. For the most part, however, international law specifies that a “State is not liable for economic injury which is a consequence of bona fide ‘regulation’ within the accepted police power of states,” so regulations seen as essential to state function, such as anti-trust, environmental protection, and land planning, are outside the scope of categorization as takings. As long as the actions leading to indirect expropriation bear are “reasonable,” tribunals will generally disallow compensation for expropriation claims. Some scholars go further, however, and feel that protective measures should not be subject to expropriation claims in all but the most extreme circumstances. They argue that allowing actionable claims to arise from legitimate environmental measures and forcing the government to provide compensation results in an undesirable externality: instead of making the “polluter pay” for their wrongdoing, this shifts the cost of environmental harm onto the innocent general public.

Determining whether a governmental regulation amounts to expropriation and is thereby compensable is made more difficult if the expropriation is indirect rather than direct. It is easier for courts and arbitral tribunals to decide whether an expropriation is compensable in the latter case. Although there is no codified standard to guide courts and tribunals in determining what qualifies as indirect expropriation and what falls short, common themes are emerging for general considerations. One of these criteria is the effect of the measure on the owner. Measures may be seen as indirect expropriation if they result “[ . . . ] in the effective loss of management, use or control, or a significant depreciation of the value, of the assets of a foreign investor.” Tribunals sometimes

---

91 Wagner, supra note 76, at 517.
92 Id.
93 Id. at 528.
refuse to consider a government’s intent in its policy-making, and merely consider the effect of the measure;\textsuperscript{96} this is called the “sole effect doctrine.”\textsuperscript{97} In cases where courts eschew applying the sole effect doctrine, they also consider the measure’s character and purpose.\textsuperscript{98} Here, the government’s intent is important; courts will rarely find that bona fide policy-making, if applied generally, does not fall within the state’s police powers and amounts to indirect expropriation.\textsuperscript{99}

4.2(a). Metalclad v. Mexico

A notable and foundational example of a tribunal’s deferral to investor interests is the case of Metalclad v. Mexico, in which the Tribunal found that the government of Mexico violated both the standards of fair and equitable treatment and indirect expropriation.\textsuperscript{100} In Metalclad, the municipality in question denied a local construction permit because of its conviction that granting it would cause the landfill to fill with hazardous waste that would have a negative impact on the water quality and environment.\textsuperscript{101} The denial of the permits was not baseless: environmental experts, geologists, and local citizens were skeptical of the environmental impact assessment completed by Metalclad that was required by the government.\textsuperscript{102} In light of reports from geologists that stated the landfill could poison the local water supply, the Governor decided to shut down the landfill.\textsuperscript{103} Notwithstanding these environmental assessments, the Tribunal found that the municipality was acting outside its authority and that the refusal to grant the permits was unfounded.\textsuperscript{104} The Tribunal also took issue with the Ecological Decree, an official order by the Governor that created an ecological preserve that included the landfill site.\textsuperscript{105} This Decree essentially

\begin{itemize}
\item \textsuperscript{96} Metalclad, \textit{supra} note 49, para. 111.
\item \textsuperscript{97} Dolzer, \textit{supra} note 94, at 79–80.
\item \textsuperscript{98} Moloo et al., \textit{supra} note 3, at 15.
\item \textsuperscript{99} \textit{Id.} at 16.
\item \textsuperscript{100} Metalclad, \textit{supra} note 49, para. 104.
\item \textsuperscript{101} \textit{Id.} para. 106.
\item \textsuperscript{102} \textit{Id.}
\item \textsuperscript{103} \textit{Id.}
\item \textsuperscript{104} \textit{Id.}
\item \textsuperscript{105} \textit{Id.}
\end{itemize}
had the effect of forever barring the operation of the landfill; the Tribunal did not take the Government’s arguments to the contrary seriously.\textsuperscript{106} It decided that the Government’s motivation for passing this measure was irrelevant to the claim, and that although a finding that the Ecological Decree was expropriation was not necessary to find that the government violated NAFTA Article 1110, the implementation of the Decree amounted to expropriation.\textsuperscript{107} In coming to this conclusion, the Tribunal utilized the sole effect doctrine and considered only the effect of the measure on the investor, without taking into account the government’s motivations or intent.\textsuperscript{108} These facts, combined with Metalclad’s reasonable reliance on the representations of the Mexican government, led the Tribunal to decide in favor of the investor.\textsuperscript{109}

4.2(b). The Chemtura and Bilcon Cases

Recent investment claims challenging environmental regulations have been less successful than early ones such as Metalclad,\textsuperscript{110} exemplifying that tribunals are beginning to take environmental measures and states’ justifications for enacting them more seriously. In a significant case from 2010 involving a U.S.-based chemical manufacturer claiming that Canada violated its treaty obligations by banning an agro-chemical called lindane,\textsuperscript{111} the Tribunal rejected the Claimant’s arguments requesting compensation for expropriation and breach of FET.\textsuperscript{112} The Tribunal unanimously decided that the environmental measures taken by Canada were a valid use of their police powers, in part because the acts were “[ . . . ] motivated by the increasing awareness of the dangers presented by lindane for human health and the environment.”\textsuperscript{113}

\begin{flushleft}
\textsuperscript{106} Id. paras. 109–111.
\textsuperscript{107} Id.
\textsuperscript{108} Id. para. 111.
\textsuperscript{109} Id. para. 107.
\textsuperscript{110} Moloo et al., supra note 3, at 1.
\textsuperscript{111} Chemtura Corp. v. Canada, Final Award, NAFTA/UNCITRAL paras. 11–14 (Perm. Ct. Arb. 2010).
\textsuperscript{112} Id. paras. 92–96.
\textsuperscript{113} Id. para 266.
\end{flushleft}
Nonetheless, steps forward are also countered with steps back. In the 2015 *Bilcon*, the Canadian government rejected investors’ project proposals to construct and operate a quarry amongst criticism from the community concerned about the quality of the environment and quality of life were the quarry to be constructed, and an unfavorable report detailing the detrimental impact to the environment. The Tribunal agreed with the investor’ arguments that the government violated their legitimate expectations for profit because it found that the government made specific assurances that were disappointed. On the other hand, the dissent argued that the Tribunal’s dismissal and misunderstanding of the substance, and of the importance, of the community’s “core values,” (the historic preservation of the use of the area by the Aboriginal people, fishing, quality of life, a high quality of air and water, and a sense of community and heritage), was unwarranted. The dissent lamented the implications of this decision, stating that “ . . . the decision [ . . . ] will be seen as a remarkable step backwards in environmental protection.” This case elucidates the prominent influence of corporate interests on environmental policy-making, and the lack of respect for, or recognition of, the legitimacy of concern regarding the deterioration of community values. The *Bilcon* case highlights the importance of backing up sincere concerns for quality of life with real scientific evidence or rigorous studies showing a significant detrimental effect.

5. FET AND EXPROPRIATION CLAIM ASSESSMENT

Although assessments of expropriation and FET claims involve the use of different tests, it may be useful to think about state wrongdoing in a somewhat more abstract sense that combines elements of both evaluative standards. When assessing a claim, tribunals must decide whether the environmental justifications underlying governmental regulations were legitimate. They must

---

115 *Id.* paras. 162–163, 219.
116 *Id.* paras. 447–448.
118 *Id.* para. 51.
look to see that they are objectively, scientifically backed, and that the measure is not merely a veiled attempt at protectionism or a political play.\textsuperscript{119} States should also take care to comply with requirements to conduct risk assessments or cost-benefit evaluations.\textsuperscript{120} Even though many agreements do not require risk assessments, doing so can add credence to the state’s claim that their measures are backed by objective scientific evidence.

Specific commitments and assurances made to investors complicate this analysis: if specific commitments are made to an investor and the state knowingly regulates against those assurances, their actions may not be legitimate. In this case, even objective evidence of the validity of the environmental concern may not be enough to shield government actions.\textsuperscript{121} Regardless of whether specific promises were made or not, tribunals should take care to evaluate the specific facts of the case. If the time elapsed between the specific assurances and the measure is long enough, tribunals may find the specific assurance less central to their determination. Tribunals should look at both current standards of international environmental law and the state of knowledge at the time the specific assurance was made and the time the regulation went into effect. If new scientific discoveries have been made in the interim, tribunal may find that the regulation was legitimate and that the harm may not be compensable.\textsuperscript{122}

A tribunal’s assessment does not end at the finding that the regulation was legitimate, however; it must next consider whether the measure is proportionate to its aim.\textsuperscript{123} When determining compensation, the tribunal must engage in balancing: citizens should not bear the entire cost of regulations as a result of new scientific discoveries in the environmental sphere, but investors should not have to bear all the risk associated with new and often unpredictable discoveries.\textsuperscript{124} Inherent in balancing interests is the need to determine whether the investor’s expectations were legitimate. Scholars suggest that tribunals should adopt a simple distinction to allot an appropriate amount of political risk to

\begin{itemize}
\item \textsuperscript{119} Id. para. 33.
\item \textsuperscript{120} Id. para. 54.
\item \textsuperscript{121} Id.
\item \textsuperscript{122} Id. para. 33. An accepted principle of international law is that a state may be excused from its obligations if it encounters certain unforeseen and fundamental changes in circumstances. See generally, Gabčíkovo-Nagymaros, supra note 22.
\item \textsuperscript{123} Moloo et al., supra note 3, at 1.
\item \textsuperscript{124} Id. 35.
\end{itemize}
investors, namely that investors be compensated when specific assurances are made but not compensated when assurances of this nature are not made.\textsuperscript{125} Although this distinction is helpful, investors should nonetheless be able to make a showing why the government’s act was disproportionate and tribunals should carefully attempt to balance interests in these determinations.\textsuperscript{126}

Some cases suggest that a proportionality analysis must include a determination of whether the measure adopted was least restrictive with trade or investment. In the NAFTA dispute of \textit{S.D. Meyers}, the Canadian government banned the export of a hazardous chemical compound called polychlorinated biphenyl (PCB), effectively eliminating the Claimant’s purpose for investing in Canada.\textsuperscript{127} Canada asserted that the ban was necessary to protect human life and health and the environment, because exportation without the assurance that the PCBs would be correctly disposed of poses a significant threat to the environment.\textsuperscript{128} The Tribunal found that Canada violated the minimum standard of treatment,\textsuperscript{129} and that it was obligated to adopt an alternative that was least restrictive to trade.\textsuperscript{130} Scholars argue that in interpreting case law arising out of WTO agreements, the Tribunal adopted too restrictive of a standard that cannot be read into the text of the NAFTA or GATT and that an evaluation of the proportionality of the measure is sufficient.\textsuperscript{131}

The precautionary principle is also relevant to the proportionality analysis. If the potential risk is grave enough and the potential effects detrimental enough, a state may be able to make the case that their regulations are still appropriate, even though no actual harm has yet been suffered.\textsuperscript{132} Tribunals should also consider whether there were any serious procedural deficiencies that further harmed the investor.\textsuperscript{133} States can ensure that their actions are procedurally fair by ensuring that they are transparent, consistent,
and provide investors with procedural fairness in governmental regulating.\textsuperscript{134}

6. CONCLUSION

As consensus that environmental conversation is a necessity grows, tribunals will likely defer to states in their environmental policy-making at a higher rate. In order to expand their regulatory spheres and increase the likelihood of favorable results, states should be sure to include provisions that carve out exceptions for environmental policy-making in their BITs. Further, states should include the centrality of environmentalism and sustainable development to their national priorities in preambular provisions, which may help guide the interpretation of exceptions included further in the treaty. Cases have shown that states have the greatest success in justifying environmental regulations when the reasons behind the policy-making are based on objective, scientific evidence instead of merely aspirational concerns for the well-being of the inhabitants or environment. Substantively fair and legitimate policy-making is not enough to stand the tests of arbitral tribunals, however; states must not forget that providing a stable investment environment also involves according administrative due process and upholding a high level of transparency. By holding themselves to high standards of policy-making, states will be able to fairly allocate the cost of environmentalism between their citizens and investors and build trusting relationships with current and future investors, ensuring both a flourishing investment environment and a path to sustainable development.

\textsuperscript{134} Id.