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With all my gratitude

to my parents

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Contents

1. Introduction

'Investment protection can no longer be considered in isolation from the protection of other values such as human rights or the environment.' (Jorge E. Viñuales)

An increasing number of experts is concerned about the imbalance between the rights and obligations of foreign investors and those of host states stipulated in international investment agreements (IIAs). In August 2010, more than 50 academics from all over the globe signed a public statement of concern about the harm done to public welfare by IIAs. In essence, this statement asserts that IIAs hamper the ability of host states to act for their people in response to concerns regarding human development and environmental sustainability.[1]

Sharing these concerns, this thesis examines how investment tribunals have included sustainable development considerations in the interpretation of common standards of investment protection contained in IIAs and presents options for a sustainable development friendly drafting of IIAs.

Therefore, after a brief elaboration on jurisdictional issues and the sustainable development related law applicable to investment disputes, the first part of the thesis presents sustainable development relevant lines of arbitral adjudication concerning the expropriation standard, the standards of 'fair and equitable treatment' and 'full protection and security' as well as non-discrimination obligations. The second part of the thesis will show how common IIA provisions can be adapted in order to become more conducive to sustainable development and will present new provisions tailored to the integration of sustainable development concerns into IIAs.

[1] *Public Statement on the International Investment Regime*, 31 August 2010, available at http://www.osgoode.yorku.ca/public-statement-international-investment-regime-31-august-2010/ (accessed 07 August 2016, 02:00 PM); compare VanDuzer et al (2013), p 415

2. Definition and history of sustainable development

The term 'Sustainable Development' ('SD') is used in various disciplines. In international law, the legal character as well as the normative content of SD are by no way settled. While some authors treat SD only as a common purpose among states, others see it as primary objective of many international agreements. Some states and non-governmental organizations have even argued that SD – or at least a certain core content of a human right to development[2] – has become a customary principle of international law. However, the invocation of SD by states may engage a certain interstitial normativity and therefore trigger the resonance of more settled principles and invite them to fill in normative loopholes.[3]

SD as a legal concept has evolved over more than five decades, mostly within the fields of international environmental and human rights law, but it has also roots in labor law and other socially associated areas. Its environmental roots can be traced back to the UN Conference on the Human Environment in 1972 in Stockholm, which acknowledged that '[t]he protection and improvement of the human environment is a major issue which affects the well-being of peoples and economic development throughout the world'[4].

The most established contemporary definition of SD was formulated in the Brundtland Report of 1987 which specified SD as 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs'[5].The further rise of the concept of SD was evidenced by the UN Conference on Environment and Development in 1992 ('Earth Summit') in Rio de Janeiro whose 'Agenda 21' made SD a core objective of international cooperation. In 1997, a special session of the UN General Assembly ('Earth Summit+5') was held to review the progress toward the targets set at the Earth Summit. The outcome of that session, the 'Programme of Further Action to Implement Agenda 21', pointed out that SD comprises three 'interdependent and mutually reinforcing' pillars: economic development, social development and environmental protection.[6]

In 2002, the 'World Summit on Sustainable Development' took place in Johannesburg for reinforcing the global commitment to SD. It was mainly in the Plan of Implementation of the

[2] Compare Constantinides, Aristoteles, *Human Right to Development*, in Mihr et al (2014), pp 955 f
[3] Compare Cordonier Segger et al (2011), pp 110 ff
[4] *Declaration of the United Nations Conference on the Human Environment*, Stockholm, 16 June 1972, available at http://www.unep.org/documents.multilingual/default.asp?documentid=97&articleid=1503 (accessed 07 August 2016, 02:00 PM)
[5] *Our Common Future: Report of the World Commission on Environment and Development*, Oslo, 20 March 1987, Chapter 2, para 1, available at http://www.un-documents.net/our-common-future.pdf (accessed 07 August 2016, 02:00 PM)
[6] *UN General Assembly Resolution S-19/2*, 19 September 1997, para 23, available at http://www.un.org/documents/ga/res/spec/aress19-2.htm (accessed 07 August 2016, 02:00 PM)

2002 World Summit that the social pillar of SD was filled with life. Therefore, the operational focus of the concept was broadened in order to cover an integrated agenda which includes strategies to address social purposes like poverty eradication, sanitation and health, and not exclusively environmental protection and development.[7]

The human rights roots of SD go back to the 1960s when, as a result of decolonization, the newly independent states became the majority in the UN membership. Numerous bodies like UNCTAD and UNDP were created to serve development purposes. The developing world tried to bring about changes in customary international law through resolutions and declarations adopted by consensus or unanimously by the General Assembly. These efforts were crowned in May 1974 by the adoption of the Declaration and a Programme of Action on the Establishment of a New International Economic Order ('NIEO') within the General Assembly. The NIEO was based on the principles of equity and solidarity, it was meant to make good for colonial exploitations and to promote an economic balance between the global North and South. Therefore, it aimed at standardizing national sovereignty over natural resources, preferential treatment of developing countries and democratization of decision making in international financial and trade relations.

A few months later, in December 1974, the General Assembly adopted the Charter of Economic Rights and Duties of States which aimed at imposing concrete obligations on developed countries along the lines of the NIEO. However, the Charter was not adopted unanimously since most developed states either abstained or cast negative votes and thus denied the *opinio juris* necessary for the creation of corresponding customary international law. Instead, the developed world started conditioning its financial assistance to developing countries via IMF and World Bank on liberalization, privatizations and structural adjustment and monetary policies known as the 'Washington consensus'.

With the collapse of the Soviet Union, the global policy shift away from the NIEO agenda was complete. Many NIEO claims were however rearticulated in the language of human rights, mostly by the pronouncement of a human right to development. When by the end of the 1980s it became evident that the neoliberal doctrine of the Washington consensus was bringing more hardship and setbacks in the promotion of human rights than economic prosperity to the developing world, the UN reacted by organizing a series of conferences and global summits aimed at the creation of an enabling environment for sustainable human development.[8]

It was mostly in the international endeavors of goal and agenda setting that environmental and human rights concerns were operatively merged into an overarching integrated concept of SD. In this spirit, the Millennium Development Goals ('MDGs') were set up in the aftermath of the

[7] Compare Cordonier Segger et al (2011), p 109
[8] Compare Constantinides, Aristoteles, *Human Right to Development*, in Mihr et al (2014), pp 943 ff

2000 Millennium Summit, consisting of eight targets – reaching from poverty eradication and primary education over the combat of HIV and other diseases to gender equality and environmental sustainability – which should be reached by 2015. Although the MDGs cannot directly be equated with human rights ('human rights based approach'), they strongly resonate with economic, social and cultural human rights as well as with solidarity rights.[9]

The limited success of the MDG efforts has resulted in the fundamental revision of the MDGs. Therefore, the outcome document of the 'Rio+20' Conference on Sustainable Development in 2012, 'The Future We Want', has launched a parallel initiative to develop a set of Sustainable Development Goals ('SDGs') which should replace the MDGs and ultimately lead to a single post-2015 development agenda with SD at the core. Finally, at the UN Sustainable Development Summit in September 2015 in New York, a set of 17 Sustainable Development Goals as well a comprehensive '2030 Agenda for Sustainable Development' were adopted. The content and design of these outcome documents leave no doubt that SD has become the leading development paradigm on the international level. Moreover, the 2030 Agenda informs us about the basic ingredients of the concept of SD in its present shape: 'We are committed to achieving sustainable development in its three dimensions – economic, social and environmental – in a balanced and integrated manner.'[10]

Its legal character and normative content, however, remain unclear and vague. The outcome documents continuously use the terms 'goals' and 'targets' for describing the nature of the SDGs. Even the means of implementation contained in those documents are formulated vaguely and on a high level of abstraction. States are given large discretion on how SD shall look like in their territories and on how to achieve it. There is lack of clear measures and commitments.

SD as used in those documents reflects the concept's status in international law generally. The present consensus on the legal nature of SD is that it is an 'interstitial norm that facilitates and requires reconciliation of other legal norms relating to environmental protection, social development and economic growth'.[11] As such, it pulls or pushes into play 'a group of congruent norms, a corpus of international legal principles and treaties, which address the areas of intersection between international economic law, international environmental law and international social law in the interests of both present and future generations'.[12]

For the purposes of this thesis, sustainable development encompasses all attempts to maintain the balance between economic, environmental and social factors in the creation and

[9] E.g.: the rights to an adequate standard of living, food, housing, education, health, social security, and the right to a healthy environment
[10] *UN General Assembly Resolution A/RES/70/1*, 25 September 2015, para 2, available at http://www.unfpa.org/sites/default/files/resource-pdf/Resolution_A_RES_70_1_EN.pdf (accessed 07 August 2016, 03:00 PM)
[11] Compare Gehring et al (2005), p 5
[12] Ibid, p 6

interpretation of international investment law. In this thesis, sustainable development will often be associated with the public interest as such and with social and ecological interests of host states and of all stakeholders affected by the foreign investment. While the first part of the thesis (about the sustainable development relevant interpretation of common IIA standards by investment tribunals) focuses on environmental and human rights considerations, the second part (about options for drafting sustainable development friendly IIAs) will also take into account labor rights, the rights of indigenous peoples, the ban of bribery and corruption and other development priorities.

3. First Part:

Sustainable development relevant lines of arbitral adjudication

Investment schemes can have an impact on various systems of real life within a host state such as trade, labor, water- and electricity supply, food and agriculture, health, social justice, environment and eco-systems, just to name a few. Foreign investments are subject to a wide array of legal rules at different levels (treaty law, customary international law, general principles of law, contracts and domestic rules) with a different substantive focus (reaching from investment law in a strict sense over tax regulations and human rights to labor and environmental rules).

For investment tribunals, the question arises in how far social and environmental issues related to an investment should and can be taken into account on a factual and legal basis. The issue of 'should' raises the question of how much weight shall be given to social and environmental factors in the challenge to strike a just balance between the interests of the foreign investor on the one side and the host state and other stakeholders (e.g. employees, nature, the host state's population as a whole) on the other side. The issue of 'can' raises specifically legal questions related to the scope of jurisdiction, the applicable law, methods of establishing the facts as well as the interaction between substantive investment law and legal sources with social and environmental objects.[13]

3.1. Sustainable development and the definition of 'investment'

Sustainable development can play a role already in the definition of 'investment' in the sense of international investment law. In practice, the scope *ratione materiae* of investment regimes is determined in two ways. Mostly, the applicable IIA carries its own definition of investment. This is typically a general phrase defining investment in a broad manner (such as 'all assets') together with a couple of illustrative categories.[14] Where an explicit definition is lacking, the method of interpreting 'investment' in the context of treaty law must follow the customary rules of treaty interpretation as reflected by Articles 31 to 33 of the 1969 Vienna Convention on the Law of Treaties ('VCLT'). This becomes relevant especially in ICSID ('International Center for Settlement of Investment Disputes') arbitration, where the 'double keyhole' test requires

[13] Compare Viñuales (2012), pp 83 ff
[14] Compare Dolzer/Schreuer (2012), p 63

the existence of an investment in the sense of the applicable investment treaty as well as in the sense of Art 25 (1) of the ICSID Convention. Since the ICSID Convention does not define 'investment', there has been a wide ranging debate on the normative content of that term.

Although there are voices calling for an interpretation of that term in the light of the disputing parties' understanding of investment ('party-defined' or 'subjectivist' approach), Rule 2 of the ICSID Institution Rules implies that this term has its own objective meaning ('self-contained' or 'objectivist' approach).[15] Therefore, arbitral practice and doctrine have developed criteria for the determination of an investment in the sense of the ICSID Convention. These criteria, however, should not be understood as jurisdictional requirements but as typical characteristics of an investment.[16] Hence, a typological holistic assessment will be required to determine the existence of an investment in the sense of Art 25 of the ICSID Convention. These are the seven most common features of an investment:[17]

(1) a certain *contribution* by the investor
(2) a certain *duration* of the project
(3) an element of *risk*
(4) a certain *regularity of profit and return*
(5) a contribution to the *development of the host state*
(6) *legality* of the investment
(7) *bona fide (good faith)*

Tests on the 'objective' existence of an 'investment' in the sense of Article 25 (1) ICSID Convention use between three and six of these criteria. While in arbitral practice, all tests included *contribution*, *duration* and *risk, regularity of profit and return* was included only occasionally. One tribunal added the criteria *legality* of the investment and *good faith*.[18] In the context of sustainable development, the fifth criterion (contribution to the *development of the host state*) is of special interest. It happens that specifically this criterion is the most controversial one in arbitral practice. It was in *Salini v Morocco* ('*Salini* test') that the tribunal added this criterion to the uncontested triplet:

> 'The doctrine generally considers that investment infers: contributions, a certain duration of performance of the contract and a participation in the risks of the transaction […] In reading the Convention's preamble, one may add the contribution to the economic development of the host state of the investment as an additional condition.'[19]

[15] Compare Schreuer et al (2009), p 117
[16] Compare Dolzer/Schreuer (2012), pp 69, 76
[17] Ibid, p 75
[18] Ibid, p 75
[19] *Salini v Morocco*, Decision on Jurisdiction, 23 July 2001, para 52

Some tribunals rejected this criterion as a separate characteristic of an investment:

In *Fakes v Turkey*, the tribunal held:

> '[W]hile the preamble refers to the "*need for international cooperation for economic development*" it would be excessive to attribute to this reference a meaning and function that is not obviously apparent from its wording. In the Tribunal's opinion, while the economic development of a host State is one of the proclaimed objectives of the ICSID Convention, this objective is not in and of itself an independent criterion for the definition of an investment.'[20]

The tribunal in *Quiborax v Bolivia* stated:

> '[T]he element of contribution to the development of the host State is generally regarded as part of the well-known four-prong *Salini* test. Yet, such contribution may well be the consequence of a successful investment; it does not appear as a requirement. If the investment fails, it may end up having made no contribution to the host State development. This does not mean that it is not an investment. For this reason and others, tribunals have excluded this element from the definition of investment.'[21]

In *Deutsche Bank v Sri Lanka*, the tribunal promoted a minimalistic approach with respect to the number of criteria:

> 'The development of ICSID case law suggests that only three of the above criteria, namely contribution, risk and duration should be used as the benchmarks of investment, without a separate criterion of contribution to the economic development of the host State and without reference to a regularity of profit and return. It should also be recalled that the existence of an investment must be assessed at its inception and not with hindsight.'[22]

And in the two *LESI* cases, the tribunals argued:

> '[I]t is not necessary that the investment contribute more specifically to the host country's economic development, something that is difficult to ascertain and that is implicitly covered by the other three criteria.'[23]

Some tribunals, however, confirmed the development-criterion as being part of the test.

[20] *Fakes v Turkey*, Award, 14 July 2010, para 111
[21] *Quiborax v Bolivia*, Decision on Jurisdiction, 27 September 2012, para 220
[22] *Deutsche Bank v Sri Lanka*, Award, 31 October 2012, para 295
[23] *LESI-DIPENTA v Algeria*, Award, 10 January 2005, para II. 13 (iv) in fine; *LESI & ASTALDI v Algeria*, Decision on Jurisdiction, 12 July 2006, para 72 (iv) in fine

The ad hoc Committee in *Mitchell v Congo*, for example, found that characteristic to be relevant:

> '[T]he existence of a contribution to the economic development of the host State as an essential – although not sufficient – characteristic or unquestionable criterion of the investment, does not mean that this contribution must always be sizable or successful; and, of course, ICSID tribunals do not have to evaluate the real contribution of the operation in question. It suffices for the operation to contribute in one way or another to the economic development of the host State, and this concept of economic development is, in any event, extremely broad but also variable depending on the case.'[24]

The ad hoc Committee furthermore stated:

> '[I]t would be necessary for the Award to indicate that, through his know-how, the Claimant had concretely assisted the DRC, for example by providing it with legal services in a regular manner or by specifically bringing investors.'[25]

In a similar vein, the tribunal in *Malaysian Historical Salvors v Malaysia* held:

> 'The Tribunal finds that […] the Contract did not make any significant contributions to the economic development of Malaysia. The Tribunal considers that these factors indicate that, while the Contract did provide some benefit to Malaysia, they did not make a sufficient contribution to Malaysia's economic development to qualify as an "investment" for the purposes of Article 25(1) or Article 1(a) of the BIT.'[26]

This support is mostly drawn from the reference in ICSID's preamble to the host state's development as well as from the argument that it is the investor's contribution that generates the rights and values protected in the definition of the applicable IIA.[27] Some authors call for a cautious handling of the development-criterion, arguing that the assessment of an investment's contribution to the host state's development would be widely based on subjective views. They add, that host states should be able to decide which investments they perceive to be conducive to their development and accordingly should enjoy legal protection. In this line of argumentation, every legal investment should be protected.[28] Moreover, the argument has been advanced, that ICSID's reference to host state development would imply the presumption that an international transaction that is designed to promote the host state's development automatically is an investment in the sense of the ICSID Convention.[29]

[24] *Mitchell v Congo*, Decision on the Application for Annulment of the Award, 1 November 2006, para 33
[25] *Mitchell v Congo*, Decision on the Application for Annulment of the Award, 1 November 2006, para 23
[26] *Malaysian Historical Salvors v Malaysia*, Award on Jurisdiction, 17 May 2007, para 143
[27] Compare Dolzer/Schreuer (2012), p 75
[28] Ibid
[29] Compare Schreuer et al (2009), p 134

However, in the context of ICSID arbitration, the development criterion in the definition of investment could theoretically work as an emergency break. It could safeguard the public interest in case of normative loopholes that would allow for a misuse of the investor-state dispute settlement process. I am referring to cases involving BITs lacking sophisticated scope definitions and carve-outs, where a certain project basically falls within the scope of investment protection but by all means does not deserve protection.

Another interesting issue related to the determination of an investment is illustrated by *Bayview v Mexico*, where the US-based claimant argued that the diversion of Rio-Grande-waters by Mexico amounted to a breach of Chapter 11 of NAFTA. The tribunal held, that such water rights were not protected under Art 1101 of NAFTA:

> '[I]n order to be an 'investor' within the meaning of NAFTA Art. 1101(a), an enterprise must make an investment in another NAFTA State, and not in its own. Adopting the terminology of the *Methanex* v. *United States* Tribunal, it is necessary that the measures of which complaint is made should affect an investment that has a 'legally significant connection' with the State creating and applying those measures. The simple fact that an enterprise in a NAFTA State is affected by measures taken in another NAFTA State is not sufficient to establish the right of that enterprise to protection under NAFTA Chapter Eleven: it is the relationship, the legally significant connection, with the State taking those measures that establishes the right to protection, not the bare fact that the enterprise is affected by the measures.'[30]

In a similar vein, in *Canadian Cattlemen v United States*, a NAFTA tribunal concluded that it did not have jurisdiction 'where all of the Claimants' investments at issue are located in the Canadian portion of the North American Free Trade Area' and not in the United States.[31] This approach was confirmed in *Grand River v United States*, where the claimants unsuccessfully argued that their cigarette export business from Canada qualified as an investment in the United States.[32] Therefore, only investments with a legally significant connection – in the sense that they are located in the host state's territory – are protected under Chapter 11 of NAFTA.[33] This ratio can arguably be extended to investment cases outside of the NAFTA regime.

3.2. Jurisdiction over environmental and human rights claims and applicable law

The jurisdiction of investment tribunals, like the jurisdiction of any international tribunal, is based on the parties' consent and limited to the extent accepted by the parties. Therefore,

[30] *Bayview v Mexico*, Award, 19 June 2007, para 101
[31] *Canadian Cattlemen v United States*, Award on Jurisdiction, 28 January 2008, para 233
[32] *Grand River v United States*, Award, 12 January 2011, paras 81-122
[33] Compare Viñuales (2012), p 96

affirmative claims based on environmental or human rights law would in most cases be outside the jurisdiction of arbitral tribunals convened pursuant to dispute settlement clauses contained in BITs. Hence, environmental or human rights based claims in the investment context are likely to be framed as defenses advanced by respondent states or third-party interveners.[34]

However, there are legal ways to have environmental law or human rights law considered by investment tribunals. The most straight forward option is to include explicit reference to environmental and human rights norms in the IIA. For this purpose, the ICSID Convention as well as the UNCITRAL Arbitration Rules contain choice-of-law provisions that direct tribunals to apply the law chosen by the parties in the first place. In a similar fashion, parties could include substantive environmental and human rights obligations and carve-outs into the IIA (or use reservations in the sense of Article 2 (1) (d) of the VCLT in the case of multilateral treaties) and adapt common IIA standards accordingly. A related tool is a procedure allowing state parties to issue binding interpretations of IIA provisions. Existing BITs could be altered accordingly upon consent.

But even without explicit environmental or human rights language, the impact of foreign investments to such non-investment priorities can be considered by investment tribunals according to customary principles of treaty interpretation. Even if the scope of the legal obligations of the parties is limited to the IIA, environmental and human rights norms can be relevant as external rules in the process of interpretation. In this sense, the ICJ ('International Court of Justice'), to give an example, has looked to evolving international law in order to interpret generic or relative terms contained in the treaty to be interpreted.[35] Furthermore, the ICJ has employed the presumption that treaties are intended to produce effects in accordance with existing rules of law (which could be environmental and human rights norms).[36] Moreover, limits to states' legal ordering of their relations are set by *jus cogens* which imposes a 'legally insurmountable limit to permissible treaty interpretation'.[37]

Finally, there is Art 31 (3) (c) VCLT which requires the interpreter to take into account 'any relevant rules of international law applicable in the relations between the parties'. Within the confines of the method of treaty *interpretation* (as opposed to treaty *modification*), Art 31 (3) (c) VCLT can be seen as the legal basis for 'systemic integration' of various specialized

[34] Compare Simma, Bruno/Kill, Theodore, *Harmonizing Investment Protection and International Human Rights: First Steps towards a Methodology*, in Binder et al (2009), p 679
[35] Ibid, p 685; PCIJ in *Nationality Decrees Issued in Tunis and Morocco*, Advisory Opinion, 7 February 1923, PCIJ, Series B, No 4 (1923) 24; ICJ in *Legal Consequences for States of the Continued Presence of South Africa in Namibia (South West Africa) notwithstanding Security Council Resolution 276 (1970)*, Advisory Opinion, 21 June 1971, ICJ Reports (1971) 16, 31; ICJ in *Aegean Sea Continental Shelf (Greece v Turkey)*, 19 December 1978, ICJ Reports (1978) 3, 32, para 77
[36] Compare PCIJ in *Territorial Jurisdiction of the International Commission of the River Oder*, Judgment, 10 September 1929, PCIJ, Series A, No. 23 (1929) 20
[37] Compare ICJ in *Oil Platforms (Iran v USA)*, Merits, Judgment, 6 November 2003, ICJ Reports (2003) 161, 330, para 9 (Separate Opinion of Judge Simma)

('fragmented') fields of international law such as international investment, environmental and human rights law. In this context, the ILC's ('International Law Commission') Final Report on Fragmentation of 2006 underlines that it is a 'key point … that the normative environment cannot be ignored and that when interpreting the treaties, the principle of integration should be borne in mind'.[38]

The criteria stated by Art 31 (3) (c) VCLT are threefold. Environmental or human rights norms are proper reference points from which to draw meaning for IIAs, if: (1) those norms are indeed *rules* deriving from treaty law, customary international law or general principles of (international) law, (2) those rules are *relevant* to the subject matter of the case, and (3) those norms are *applicable in the relations between the parties*. As for (2) the relevance of rules, '[a]lmost any rule of international law will be 'relevant' when considered with the proper degree of abstraction' whereas an external source will be arguably of significant importance in the interpretation efforts if it provides 'operational guidance' for determining the normative content of an IIA provision.[39] The (3) third criterion refers to the requirement that the rule in question must be legally binding for both state parties involved in the dispute as a matter of treaty law, customary international law or general principles. These are tight requirements when applied strictly. There are, however, mitigating concepts like *erga omnes* that lend themselves to ensuring the applicability of human rights norms where a specific treaty is binding on one state party only.

In any event, 'where the gap between obligation and action is sufficiently great … rules relating to a State's obligations to meet the basic material needs of its own citizens can indeed also become a matter of community concern, so that they may be 'applicable in the relations' of all States, even if not formally owed *erga omnes'*.[40]

Apart from the avenues mentioned above, the inclusion of sustainable development concerns like environmental and human rights issues into IIA interpretation is a matter of handling IIA standards themselves. It is well conceivable to stick to notions of fairness, equity and justice when interpreting the fair and equitable treatment standard.[41] In the eyes of international lawyers whose thoughts are not totally consumed by the idea of investment protection as the sole purpose, the task for an investment tribunal in applying FET is 'to decide whether in all the circumstances the conduct in issue is fair and equitable or unfair and inequitable'.[42] There is – and must be – room for all legitimate purposes – including environmental, human rights

[38] International Law Commission, *Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law*, 13 April 2006, UN Doc A/CN.4/L.682, para 419
[39] Compare Simma, Bruno/Kill, Theodore, *Harmonizing Investment Protection and International Human Rights: First Steps towards a Methodology* in Binder et al (2009), p 696
[40] Ibid, p 701
[41] At this point, I do not discuss the various meanings of FET implied by different formulations of the obligation.
[42] Mann, Frederick A, *British Treaties for the Promotion and Protection of Foreign Investments*, 52 *British Yearbook of International Law* (1981) 241, 244, cited in Simma, Bruno/Kill, Theodore, *Harmonizing Investment Protection and International Human Rights: First Steps towards a Methodology*, in Binder et al (2009), p 704

and other non-investment priorities – in these considerations. In a similar vein, the police powers doctrine and related balancing approaches can be applied with a heart for the common good when testing expropriation. It is not at least a question of (eco-social) values to determine where a host state's regulatory space ends.

3.2.1. Environmental and human rights claims as part of a conventional investment claim

In this sense, one way to bring an environmental or human rights claim in the field of investment arbitration is to assert that the violation of certain environmental or human rights norms amounts to a violation of a particular IIA obligation. This may, for example, be the case when a healthy environment is essential for the prosperity of an investment. A prominent example for such a constellation is the case of *Peter A Allard v Barbados*[43]. The claimant asserted that Barbados had undermined the profitability of the investment – an eco-tourism facility – by failing to enforce applicable national and international environmental law in connection with the protection of a natural wetlands eco-system. Hence, the investor argued, that the unlawful damage of the respective wetland would reduce the attractiveness of his facility for tourists, lower the earning power of the investment and would therefore amount to a breach of the FET, FPS and expropriation standards of the BIT between Canada and Barbados. Since the investor asserted the breach of a BIT standard which is definitely covered by the arbitration clause establishing the tribunal's jurisdiction, there is nothing special about such a constellation from a jurisdictional point of view.[44]

3.2.2. Environmental and human rights claims as independent heads of claim

The jurisdictional analysis becomes more complex when the claim is not based on the breach of a typical IIA protection standard but on the violation of a specific environmental or human rights norm which does not arise from the instrument (primarily) covered by the arbitration clause. This constellation can be illustrated by *Biloune v Ghana*[45], a contractual investment dispute with a possible human rights context. Antoine Biloune, a Syrian investor, was held in custody without charge for thirteen days and afterwards deported from Ghana to the neighbor country Togo. The investor filed a request for investment arbitration and sought redress also for alleged violations of international human rights. In response, the investment tribunal held that it lacked jurisdiction to hear a human rights claim as an independent cause of action. Yet it

[43] *Peter A Allard v Barbados*, Notice of Dispute, 8 September 2009, available at http://www.graemehall.com/legal/papers/BIT-Complaint.pdf (accessed 7 August 2016, 06:00 PM)
[44] Compare Viñuales, Jorge E, *Investment Law and Sustainable Development: The Environment breaks into Investment Disputes*, in Bungenberg et al (2015), p 1719
[45] *Biloune v Ghana*, Award on Jurisdiction and Liability, 27 October 1989

noted that alleged human rights violations could be relevant in the assessment of the investment claim.[46] In this sense, the tribunal acknowledged that customary international law demands that states accord a minimum standard of treatment to foreign nationals and that all individuals, no matter of which nationality, have inviolable human rights. The tribunal explained that, while an independent human rights claim does not fall within its jurisdiction, a dispute will become arbitrable to the extent that the human rights violations affect the investment.[47]

There are, however, also decisions which suggest that human rights claims as independent heads of claim are permissible if the arbitration clause is broad enough to cover them.[48] It is never the less still unclear if this reasoning could be extended to environmental claims. For one thing – provided a tribunal may hear claims based on customary international law – it is easier to find primary norms of customary nature in human rights law than in the field of environmental law where such primary obligations based on custom are emerging but still rare. For the other – in the light of the common contents and origins of human rights and investment law – it is probably more usual for an investment tribunal to assert jurisdiction over human rights actions (e.g. in the context of denial of justice, discrimination or arbitrary treatment) than over environmental claims where such similarities appear only marginal.[49]

3.2.3. Environmental and human rights counter-claims

By now, host states have not introduced investment arbitration claims or counter-claims against investors for human rights violations.[50] However, in the Argentina cases, human rights arguments were frequently put forward by the host state in order to justify measures with adverse effects on foreign investments.[51] The situation is similar for counter-claims based on environmental grounds. States typically prefer to bring environmental claims against foreign investors before their own courts. One reason for a state party to choose arbitration never the less in this constellation could be to facilitate the set-off of the investor's original claim. Another reason could be the benefits of the international regime of recognition and enforcement of arbitral awards (especially Section 6 of the ICSID Convention and Art V of the New York

[46] Compare Viñuales, Jorge E, *Investment Law and Sustainable Development: The Environment breaks into Investment Disputes*, in Bungenberg et al (2015), p 1720
[47] Compare Reiner, Clara/Schreuer, Christoph, *Human Rights and International Investment Arbitration*, in Dupuy et al (2009), p 84
[48] *Chevron Corporation (USA) and Texaco Petroleum Corporation (USA) v Ecuador*, UNCITRAL, Interim Award, 1 December 2008, para 209; *Chevron Corporation (USA) and Texaco Petroleum Corporation (USA) v Ecuador*, UNCITRAL, Partial Award on the Merits, 30 March 2010, paras 166, 170; *Toto Construzioni Generali Spa v Lebanon*, ICSID Case No ARB/07/12, Decision on Jurisdiction, 11 September 2009, paras 157-158
[49] Compare Viñuales, Jorge E, *Investment Law and Sustainable Development: The Environment breaks into Investment Disputes*, in Bungenberg et al (2015), p 1720
[50] Compare Reiner, Clara/Schreuer, Christoph, *Human Rights and International Investment Arbitration*, in Dupuy et al (2009), p 89
[51] E.g. *CMS v Argentina*, *Azurix v Argentina*, *Siemens v Argentina*, *Sempra v Argentina*

Convention).[52] Provisions like Art 46 of the ICSID Convention and Article 23 (3) of the UNCITRAL Arbitration Rules of 2010 state the requirements for a state counter claim in investment arbitration: (1) the counter claim must arise directly out of the subject matter of the dispute; (2) it must fall within the scope of the parties' consent; and (3) it must (otherwise) fall within the jurisdiction of ICSID (for ICSID arbitration).

Let us turn to the first requirement. The 'arising directly' clause of Art 46 of the ICSID Convention must not be confused with the similar term 'arising directly out of an investment' in Art 25 of the ICSID Convention, which is a condition for jurisdiction and refers to an investment. The term 'arising directly' in Art 46, by contrast, presupposes jurisdiction and refers to a particular dispute. Its focus is on the connection of an ancillary claim to the dispute before the tribunal. The 'arising directly' issue was, however, never discussed in most cases involving ancillary claims, since the close connection to the dispute's subject matter was probably too obvious to be critically discussed.[53] Therefore, one could only speculate about how the respective test could look like. The determination of a close substantial connection is arguably quite case specific. For environmental or human rights counter claims, however, an important factor to be considered is the existence of legal obligations (e.g. environmental or human rights obligations arising from a contract or domestic law) capable of founding such a counter claim. If there is no such legal obligation, then the counter claim has no legal ground or the connection between the counter claim and the subject matter will be more difficult to establish.[54] In case the tribunal interprets the connection requirement narrowly, as happened in *Saluka v Czech Republic*, it might be difficult to advance a treaty arbitration, especially when the treaty's choice of law provision does not refer to domestic law.[55]

The second question is if the counter claim falls within the scope of the parties' consent. In the case of a contractual dispute, an arbitration clause like 'any dispute arising from or in connection with the contract' is probably broad enough to cover counter claims based on environmental and human rights terms.[56] The case may be different, where jurisdiction is based on a general offer of arbitration by the host state contained in a treaty or in domestic legislation. In these cases, the consent will be perfected by the investor's acceptance of the offer (i.e. the initiation of an investor-state dispute settlement process). The consent will be restricted by the terms of the acceptance. It is, however, arguable, that a counter claim which has a strong substantial connection to the investor's claim, will be covered by the parties' mutual consent.[57] To meet the third requirement, the tribunal will have to examine whether ICSID's jurisdiction

[52] Compare Viñuales, Jorge E, *Investment Law and Sustainable Development: The Environment breaks into Investment Disputes*, in Bungenberg et al (2015), p 1721
[53] Compare Schreuer et al (2009), pp 751 ff
[54] Compare Viñuales, Jorge E, *Investment Law and Sustainable Development: The Environment breaks into Investment Disputes*, in Bungenberg et al (2015), p 1721
[55] C93
[56] E1722
[57] Compare Schreuer et al (2009), p. 756

extends to the ancillary claim under Art 25 of the ICSID Convention. Since consent is part of the requirements for jurisdiction in this context, the discussion of the second requirement is also relevant for the question if the counter claim 'otherwise' falls within the jurisdiction of ICSID. However, the interpreter has to beat in mind that Art 46 was not meant to extend the tribunal's jurisdiction.

3.2.4. Choice of law clause in investment contracts

Especially IIAs in contract format often choose the host state's law as applicable law, although they may likewise choose the law of the home state, of a third state or other bodies of law such as international law. As for the relevance of environmental and human rights law in this context, the main question is, again, if environmental and human rights norms are covered by the scope of the choice. If host state law is chosen, the answer is arguably affirmative. The situation is less clear when the law of the investor's home state or a third state's law is chosen, since there are legal limitations for the application of a foreign public law. Moreover, when foreign law is chosen to govern contractual matters, there is some merit in asserting that specific environmental and human rights norms of the host states must be applied to the extent that they can be qualified as overriding norms ('*lois de police*'). Arbitral practice, however, is cautious on the concept of overriding norms and tends to decline this approach.[58]

3.2.5. Default rules

Provisions indicating how the applicable law must be determined in the absence of a choice of law by the parties are contained in all the arbitration rules most frequently used.

Art 35 (1) of the UNCITRAL Arbitration Rules, states:

> 'The arbitral tribunal shall apply the rules of law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the arbitral tribunal shall apply the law which it determines to be appropriate.'

Art 42 (1) of the ICSID Convention goes a step further by expressly determining the applicable law:

> 'The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the

[58] Compare Viñuales, Jorge E, *Investment Law and Sustainable Development: The Environment breaks into Investment Disputes*, in Bungenberg et al (2015), p 1723

> Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.'

In this sense, host state law and applicable rules of international law shall be applied in the absence of a pertinent choice. The meaning of 'and' in Art 42 (1), second sentence of the ICSID Convention, however, is subject to discussion. In this context, most writers tend to ascribe a supplemental and corrective function to international law (with different emphasis on domestic or international law), i.e. to close any gaps in domestic law ('*lacunae'*) and to remedy any violations of international law through the application of domestic law. Some authors, however, have called for an autonomous application of international law.[59] In the arbitral practice of ICSID tribunals, there is a trend to a simultaneous application of international law and domestic law. This means, that in cases falling under Art 42 (1), second sentence, the tribunals will apply domestic law to some aspects and international norms to other aspects of disputes.[60] Tribunals will have to identify the questions to which the respective legal system applies. In fact, in many decisions of the past fifteen years, the tribunals took a more pragmatic, fact-specific approach in determining the applicable law, especially in handling the relationship between domestic and international law.[61]

3.2.6. Investments contrary to environmental law

Whenever IIAs include the requirement that the investment has to be 'in accordance with host state law', the question arises if such a reference (which also points to domestic environmental and human rights law) amounts to a jurisdictional requirement or should only provide a substantive defense for the host state. Tribunals have different views on this question. One major line of arbitral practice tends to decline that such a reference concerns the definition of 'investment' itself. In this sense, the tribunal in *Salini v Morocco* held[62]:

[59] Compare Schreuer et al (2009), p 626
The main rules emerging from arbitral practice in this respect, may be summarized as follows (ICSID Commentary, Art 42, para 230):
'1. A tribunal applying the second sentence of Art. 42(1) may not restrict itself to applying either the host State's law or international law but must examine the legal questions at issue under both systems.
2. A decision which can be based on the host State's domestic law need not to be sustained by reference to general principles of law.
3. A tribunal may give a decision based on the host State's domestic law, even if it finds no positive support in international law as long as it is not prohibited by any rule of international law.
4. A tribunal may not render a decision on the basis of the host State's domestic law which is in violation of a mandatory rule of international law.
5. A claim which cannot be sustained on the basis of the host State's domestic law must be upheld if it has an independent basis in international law.'

[60] Ibid, p 628

[61] Ibid, pp 628 ff

[62] Similar reasoning in *LESI-DIPENTA v Algeria*, *Gas Natural v Argentina*, *Bayandir v Pakistan*, *Saipem v Bangladesh*, *Aguas del Tunari v Bolivia*

> 'The Tribunal cannot follow the Kingdom of Morocco in its view that paragraph 1 of Article 1 [of the BIT] refers to the law of the host State for the definition of "investment". In focusing on "*the categories of invested assets (…) in accordance with the laws and regulations of the aforementioned party*", this provision refers to the validity of the investment and not to its definition. More specifically, it seeks to prevent the Bilateral Treaty from protecting investments that should not be protected, particularly because they would be illegal. More specifically, it seeks to prevent the Bilateral Treaty from protecting investments that should not be protected, particularly because they would be illegal.'[63]

A differentiated solution was proposed by the tribunal in *Fraport v Philippines*. In its analysis, the tribunal distinguished between initial and subsequent illegality, considering, that the former could potentially limit jurisdiction, whereas the latter could only operate as a substantive defense.[64]

On the question whether any illegality – as long as it is initial – excludes jurisdiction or whether only some forms of illegality have this effect, the tribunal in *Fakes v Turkey* held that only the illegality arising from a violation of the host state's law relating to the admission of investments would have such effect.[65]

In *Inceysa v El Salvador*, however, the tribunal decided that it had no jurisdiction since the respondent had not consented to extend the protections of the treaty or those of its domestic code to an investment made in an openly illegal manner.[66]

In effect, environmental and human rights law arguably can play a role in determining the legality of an investment for jurisdictional purposes. An illustrative example in this context could be a case where a landfill or a chemical production plant has been established in a developing country in violation of domestic norms requiring the conduct of an environmental or human rights impact assessment, especially if the investor has resorted to corruption or other means prohibited by international public policy.[67]

3.2.7. Relevance

The fact that a choice of law provision points to a certain body of law, does not mean that all norms stemming from this specific sphere is relevant to the specific case. Due to the *iura novit curia* principle, tribunals have a wide discretion in terms of deciding which norms are relevant for the case at hand. In conducting such analysis, three considerations are of special importance

[63] *Salini v Morocco*, Decision on Jurisdiction, 23 July 2001, para 46
[64] *Fraport v Philippines*, Award, 16 August 2007, para 345
[65] *Fakes v Turkey*, Award, 14 July 2010, para 119
[66] *Inceysa v El Salvador*, Award, 2 August 2006, paras 257, 264
[67] Compare Viñuales (2012), p 99

in this relation: (1) the boundaries of the dispute, (2) the pleas of the parties and (3) some specific uses of environmental law.[68]

3.2.8. Boundaries of the dispute

First, the type of dispute is decisive. In the case of treaty claims (as opposed to contractual claims), the contracts as well as the domestic norm governing those contracts, would probably be less relevant than the provisions of the respective IIA and other norms of international law. In *Bayindir v Pakistan*, the tribunal held:

> 'As a threshold matter, the Tribunal recalls that its jurisdiction covers treaty and not contract claims. This does not mean that it cannot consider contract matters. It can and must do so to the extent necessary to rule on the treaty claims. It take contract matters, including the contract's governing municipal law, into account as facts as far as they are relevant to the outcome of the treaty claims. Doing so, it exercises treaty not contract jurisdiction.'[69]

In *Azurix v Argentina*, the tribunal held that domestic law was relevant for the assessment of the treaty claim, but only as 'an element of the inquiry':

> 'Azurix's claim has been advanced under the BIT and, as stated by the Annulment Committee in Vivendi II, the Tribunal's inquiry is governed by the ICSID Convention, by the BIT and by applicable international law. While the Tribunal's inquiry will be guided by this statement, this does not mean that the law of Argentina should be disregarded. On the contrary, the law of Argentina should be helpful in the carrying out of the Tribunal's inquiry into the alleged breaches of the Concession Agreement to which Argentina's law applies, but it is only an element of the inquiry because of the treaty nature of the claims under consideration.'[70]

3.2.9. The pleas of the parties

Since investment arbitration in strongly party-driven, the parties' pleas will also be an important indication of the relevance of a certain set of norms. In *Chemtura v Canada*, for example, the respondent explicitly referred to the provisions of the Aarhus Protocol on Persistent Organic Pollutants to the LRTAP Convention in order to justify the review of a chemical substance

[68] Ibid, p 108
[69] *Bayindir v Pakistan*, Award, 27 August 2009, para 135
[70] *Azurix v Argentina*, Award, 14 July 2006, para 67

named lindane, which could eventually result in the suspension of the registration of some of the claimant's products that were based on this substance. The tribunal basically accepted this argument.[71]

However, tribunals are not confined to considering only those arguments that were explicitly brought by the parties. In *Klöckner v Cameroon*, the Ad Hoc Committee held, that the tribunal that had issued the award under review was in principle free to base its decision on other legal arguments than those that had been advanced by the claimant or the respondent, as long as the tribunal would stay within the legal framework established by the parties.[72] The tribunal added, that 'arbitrators must be free to rely on arguments which strike them as the best ones, even if those arguments were not developed by the parties'[73].

Therefore, there is arguably some freedom for tribunals to consider environmental and human rights issues even beyond the parties' pleadings. Likewise, tribunals can leave such issues aside if they find these points irrelevant; or they can mention these points without including them in the analysis. That investment tribunals feel free to rely on human rights considerations on their own initiative is also evidenced by occasional cross references to the jurisprudence of human rights courts such as the European Court of Human Rights ('ECtHR').[74]

3.2.10. Specific uses of environmental norms

Legal norms can have different functions: (1) they can govern a particular conduct, (2) they can be relevant as tools of interpretation and (3) they can provide inspirational guidance. Whereas the *iura novit curia* principle arguably is a sufficient basis for options (2) and (3), option (1) would probably require an additional basis such as a referral clause, a sufficiently broad jurisdictional clause or the inclusion of environmental obligations in the instrument primarily concerned by the jurisdictional clause.[75]

An example for (1) is *SPP v Egypt*, where the tribunal held that the UNESCO World Heritage Convention obliged the respondent to abstain from acts or contracts contrary to that convention.[76] Furthermore, in *Chemtura v Canada*, the tribunal stated that the Aarhus POP Protocol governed the conduct of Canada in terms of the government's reassessment of its restrictions of the use of lindane.[77] An example for (2) is provided by *Parkerings v Lithuania*,

[71] *Chemtura v Canada*, Award, 2 August 2010, paras 139-141
[72] Compare *Klöckner v Cameroon*, Decision on Annulment, 3 May 1985, para 91; Viñuales (2012), p 110
[73] *Klöckner v Cameroon*, Decision on Annulment, 3 May 1985, para 91
[74] E.g. in *Tecmed v Mexico*, Award, 29 May 2003, para 116; *Saipem v Bangladesh*, Decision on Jurisdiction and Recommendation on Provisional Measures, 21 March 2007, paras 130, 132; *Mondev v United States*, Award, 11 October 2002, paras 138, 141-144
[75] Compare Viñuales (2012), p 114
[76] *SPP v Egypt*, Award, 20 May 1992, para 78
[77] Compare *Chemtura v Canada*, Award, 2 August 2010, paras 139-141

where the tribunal interpreted the MFN clause of the applicable BIT in the light of the UNESCO World Heritage Convention and concluded that two foreign investors were not in a like position.[78] Moreover, in the *Pulp Mills* case, the ICJ held that certain environmental agreements and principles of general international law were not applicable as such but were relevant in the interpretation of the Statute of the River Uruguay.[79] As for (3), in *Tecmed v Mexico*, the tribunal sought intellectual guidance from the European Court of Human Rights in its methods of interpretation, although Mexico was not a party of the European Convention of Human Rights.[80]

3.3. Amicus curiae participation

Sustainable development considerations such as environmental and human rights concerns can be introduced into an investment dispute in various ways. First, the parties to the dispute may refer to sustainable development considerations whenever they deem them relevant in support of their case. Although environmental or human rights arguments will in practice mostly be advanced by host states, they can also be brought by the foreign investor. Second, the tribunal itself can take up sustainable development considerations (as discussed in the context of the applicable law) or could at least invite the parties to state their positions on the applicability of certain environmental or human rights obligations that have not been addressed in the pleadings. Third, a non-disputing party could bring in sustainable development considerations. An *amicus curiae* ('friend of the court') participation can be conducive to the proceedings in different ways. In past times characterized by considerable uncertainty as to the contents of the law, *amici curiae* could make valuable contributions by bringing points of law to the tribunals' attention. Still today, NGOs and other organizations of the civil society can provide relevant legal expertise in terms of interpreting and applying specific environmental or human rights norms. Nowadays, however, it is mainly the factual points of *amicus curiae* submissions that can be interesting for a tribunal. In this sense, non-disputing parties can inform the tribunal of the specific development consequences of a certain project. Another important advantage of *amicus curiae* participation is that it potentially raises the legitimacy of the tribunal's *modus operandi* and of the decision itself, since the procedure opens up for external participation and expertise.[81]

In the history of investment arbitration, tribunals had different views on the permissibility of *amicus* participation. The tribunal in *Aguas del Tunari v Bolivia* for example found that it did not have the authority – absent the parties' agreement – to grant the request of a group of

[78] Compare *Parkerings v Lithuania*, Award, 11 September 2007, para 392
[79] Compare ICJ in *Pulp Mills in the River Uruguay (Argentina v Uruguay)*, Judgment, 20 April 2010, paras 64-66
[80] Compare *Tecmed v Mexico*, Award, 29 May 2003, para 122; Viñuales (2012), p 112
[81] Compare Viñuales (2012), pp 113 ff

petitioners to participate as parties or at least to be granted *amicus curiae* status.[82] A different view was taken by the identically composed tribunals in *Suez et al v Argentina* and *Suez and AWG v Argentina* where the tribunals held they had the power under Art 44 of the ICSID Convention to grant *amicus* submissions to parties who had 'the expertise, experience and independence to be of assistance' in appropriate cases.[83] The tribunals defined three criteria for the acceptance of amicus submissions in the ICSID context: (1) the appropriateness of the subject matter of the case, (2) the suitability of a given non-party to act as *amicus curiae* in the case at hand, and (3) the procedure by which the *amicus* submission is made and considered. In a similar vein, NAFTA tribunals operating in the framework of the UNCITRAL Arbitration Rules allowed third parties to make written submissions.[84]

Today, procedural codes like the ICSID Arbitration Rules and the UNCITRAL Rules on Transparency have formalized *amicus curiae* interventions. ICSID Arbitration Rule 37 (2), in force since 10 April 2006, reads as follows:

> (2) After consulting both parties, the Tribunal may allow a person or entity that is not a party to the dispute (in this Rule called the "non-disputing party") to file a written submission with the Tribunal regarding a matter within the scope of the dispute. In determining whether to allow such a filing, the Tribunal shall consider, among other things, the extent to which:
>
> (a) the non-disputing party submission would assist the Tribunal in the determination of a factual or legal issue related to the proceeding by bringing a perspective, particular knowledge or insight that is different from that of the disputing parties;
>
> (b) the non-disputing party submission would address a matter within the scope of the dispute;
>
> (c) the non-disputing party has a significant interest in the proceeding.
>
> The Tribunal shall ensure that the non-disputing party submission does not disrupt the proceeding or unduly burden or unfairly prejudice either party, and that both parties are given an opportunity to present their observations on the non-disputing party submission.

[82] Compare *Aguas del Tunari v Bolivia*, Decision on Jurisdiction, 21 October 2005, paras 15-18; Schreuer et al (2009), p 705
[83] Compare *Suez et al v Argentina*, Order in Response to *Amicus Curiae* Petition, 17 March 2006, paras 14, 23; *Suez and AWG v Argentina*, Order in Response to Transparency and *Amicus Curiae* Petition, 19 May 2005, paras 15, 24; Schreuer et al (2009), p 705
[84] Compare *Suez et al v Argentina*, Order in Response to *Amicus Curiae* Petition, 17 March 2006, para 17; *Suez and AWG v Argentina*, Order in Response to Transparency and *Amicus Curiae* Petition, 19 May 2005, para 17; Schreuer et al (2009), p 705

In a similar manner, Article 5 of the UNCITRAL Rules on Transparency (effective date: 1 April 2014) provides:

> 1. The arbitral tribunal shall, subject to paragraph 4, allow, or, after consultation with the disputing parties, may invite, submissions on issues of treaty interpretation from a non-disputing Party to the treaty.
>
> 2. The arbitral tribunal, after consultation with the disputing parties, may allow submissions on further matters within the scope of the dispute from a non-disputing Party to the treaty. In determining whether to allow such submissions, the arbitral tribunal shall take into consideration, among other factors it determines to be relevant, the factors referred to in article 4, paragraph 3, and, for greater certainty, the need to avoid submissions which would support the claim of the investor in a manner tantamount to diplomatic protection.
>
> 3. The arbitral tribunal shall not draw any inference from the absence of any submission or response to any invitation pursuant to paragraphs 1 or 2.
>
> 4. The arbitral tribunal shall ensure that any submission does not disrupt or unduly burden the arbitral proceedings, or unfairly prejudice any disputing party.
>
> 5. The arbitral tribunal shall ensure that the disputing parties are given a reasonable opportunity to present their observations on any submission by a non-disputing Party to the treaty.

In effect, *amicus* intervention is allowed if the petitioner can make (1) a substantive (points of law or fact) and (2) a procedural (enhancing legitimacy) contribution to the proceedings , (3) without severely encroaching on the parties' due process and equal treatment rights, confidentiality rights and process efficiency (proportionality).

The first time a tribunal was explicitly confronted with ICSID Arbitration Rule 37 (2) was in *Biwater Gauff v Tanzania*, a case concerning a possible privatization of water and other infrastructure services. In this dispute, a group of five petitioners requested *amicus curiae* status, arguing that the combination of natural resources and human rights involved in the case would justify the participation of civil society groups. The petitioners furthermore stressed that under Arbitration Rule 37 (2) the tribunal had the power to accept *amicus curiae* submissions even without the parties' agreement. The tribunal reacted by emphasizing that the ICSID Arbitration Rules do not provide for an *amicus curie* status in terms of a standing equal to the

parties but only for two specific types of *amicus* participation: the filing of written submissions and the attendance at hearings.[85]

Environment or human rights related disputes like those concerning water services, natural resource extraction, waste treatment facilities or regulated substances always involve public good considerations which must be taken into account by the tribunal. Therefore, if used responsibly, *amicus curiae* participation can definitely deepen the tribunal's understanding of a project's ecological and social impacts.

3.4. Assessment of evidence

Disputes involving sustainable development issues require the arbitrators to understand complex social and ecological processes and interrelations. Such a comprehension is an important basis for following a scientific debate during the proceeding and for substantiating the tribunal's decision. The arbitrators' lack of expertise in this relation can be compensated in various ways. For one, the tribunal can downplay the role of science for the case at hand, i.e. declining that a specific scientific question, debate or argument is pertinent for the tribunal's decision.[86] Mostly, however, the tribunal will have to take a position on a scientific debate advanced by the parties. Therefore, established procedural codes allow the tribunal to appoint its own expert. In this sense, Art 27 (1) of the UNCITRAL Arbitration Rules states:

> 'The arbitral tribunal may appoint one or more experts to report to it, in writing, on specific issues to be determined by the tribunal. A copy of the expert's terms of reference, established by the arbitral tribunal, shall be communicated to the parties.'

A very similar language is used by Art 6 (1) of the IBA ('International Bar Association') Rules on the Taking of Evidence in International Commercial Arbitration, which are also used in the context of investment arbitration, and by Art 27 (1) of the PCA ('Permanent Court of Arbitration') Optional Rules. Moreover, according to Art 24 (4) of the PCA Optional Rules, the tribunal may ask the parties to provide non-technical summaries or explanations of the scientific or technological issues relevant to the dispute. It can, however, be assumed that the request covered by this Art 24 (4) would be encompassed by the tribunal's general procedural or implied powers anyway.[87]

[85] Compare *Biwater Gauff v Tanzania*, Procedural Order No 5, 2 February 2007, paras 12, 14, 17; Schreuer et al (2009), pp 706 f
[86] Compare ICJ in *Gabčíkovo-Nagymaros Project (Hungary v Slovakia)*, Judgment, 25 September 1997, para 55; *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, [WTO] Panel Report, 18 September 2000, para 8.181
[87] Compare Viñuales (2012), p 120

Another way to ease evidential hurdles is the adjustment of evidentiary standards, which makes it easier for a party to establish social or environmental risk or harm. Technically, this can become possible by shifting the burden of proof by means of a treaty provision. An example is given by the London Dumping Convention as amended by the 1996 Protocol, which provides that the party dumping industrial waste or other substances at sea must prove that such dumping is not harmful for the environment. As a further example, during WTO ('World Trade Organization') negotiations in the context of the Doha round, the European Community has proposed a conventional shift of the burden of proof regarding general exceptions. The suggestion was that trade restrictions based on multilateral environmental agreements should enjoy the presumption of being justified by Art XX GATT ('General Agreement on Tariffs and Trade'), unless this presumption could be rebutted.[88] Such an approach could be qualified as an implementation of the precautionary principle. Without a treaty providing for evidential facilitations, however, it would be difficult to shift the burden of proof.[89]

What the tribunal can nevertheless do, is relaxing the standard for proving certain facts. Such has happened in *EC – Hormones*, where the WTO Appellate Body confirmed that, under the SPS ('Sanitary and Phytosanitary Measures') Agreement, the claimant only needs to make a *prima facie* showing that the respondent has breached its obligations.[90] Similarly, in the *Southern Bluefin Tuna* cases, ITLOS followed a precautionary approach by applying a lower standard of proof in the context of provisional measures than is mostly assumed by international law in this regard:

> '[A]lthough the Tribunal cannot conclusively assess the scientific evidence presented by the parties, it finds that measures should be taken as a matter of urgency to preserve the rights of the parties and to avert further deterioration of the southern bluefin tuna stock;'[91]

I want to express my personal support for such practical approaches which meet the needs of social fairness and effective environmental protection and are therefore in the service of justice.

3.5. Sustainable development relevant interpretation of common IIA standards

The following chapters will be dedicated to the elucidation of different lines of arbitral jurisprudence with respect to the sustainable development relevant interpretation of common

[88] Compare Viñuales (2012), p 122
[89] Compare ICJ in *Pulp Mills in the River Uruguay (Argentina v Uruguay)*, Judgment, 20 April 2010, para 164; The ICJ in the *Pulp Mills* case has held that the precautionary approach may be relevant for the interpretation and application of certain treaty provisions but could not shift the burden of proof.
[90] Compare *European Communities – Measures concerning Meat and Meat Products (Hormones)*, [WTO] Appellate Body Report, 16 January 1998, para 109
[91] Compare ITLOS in *Southern Bluefin Tuna (New Zealand v Japan; Australia v Japan)*, Provisional Measures, ITLOS No 3 and 4, paras 79-80; Viñuales (2012), p 123

IIA standards of protection, such as *expropriation*, *fair and equitable treatment* and *full protection and security* as well as non-discrimination standards like *most favored nation treatment* and *national treatment*.

3.5.1. Expropriation

Expropriation is the most rigorous form of interference with property. In most IIAs, expropriation refers to the foreign investment as such, but some tribunals have also accepted the possibility of a partial expropriation (i.e. the expropriation of particular rights that were part of an overall business operation). International law has recognized a state's right to expropriate alien property under four classical legality-requirements: (1) a genuine public purpose, (2) non-discrimination, (3) due process, (4) adequate, prompt and effective compensation.[92] While the formal taking of the investment (which involves the transfer of title) can be easily qualified as expropriation, the analysis gets more complex in cases of determining an indirect expropriation. The problem in this context is that it is neither possible nor appropriate that each and every sovereign interference of a host state with foreign property automatically triggers (full) compensation.

The challenge here is to distinguish measures of non-compensable acts of legitimate host state regulation (i.e. general regulations and targeted measures) from compensable acts of expropriation[93]. Since IIAs mostly do not offer sufficient guidance in this respect (especially older BITs), investment tribunals have basically developed three lines of adjudication to deal with this challenge: (1) the 'sole effects' doctrine, (2) the 'police powers' doctrine and (3) balancing approaches.

The 'sole effects' approach determines a compensable expropriation by simply looking at the economic impact of a state's sovereign interference with a foreign investment. If the interference is substantial (deprives the investor of all or most of the benefits of the investment for at least a substantial period of time) then an expropriation has occurred. This approach completely disregards the host state's regulatory purpose and the measure's contribution to the public good.[94]

[92] Compare Reinisch (2008), pp 171 ff; Dolzer/Schreuer (2012), pp 99 ff; Bishop et al (2014), pp 589 ff
[93] Compare Reinisch (2008), pp 151 ff; The traditional view is that an expropriation – once it has occurred – without (full) compensation is unlawful and therefore triggers the state's duty to pay damages. Due to different methods of calculation, this amount can be higher than the investment's 'fair market value'.
[94] Compare Kriebaum, Ursula, *Regulatory Takings: Balancing the Interests of the Investor and the State*, in 8 *The Journal of World Investment & Trade*, 2007, p 724

In *Santa Elena v Costa Rica*, the tribunal emphasized that the fact that measures were taken for purposes of environmental protection did not affect their nature as an expropriation and that therefore the host state was under the obligation to pay compensation:

> 'Expropriatory environmental measures – no matter how laudable and beneficial to society as a whole – are in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state's obligation to pay compensation remains.'[95]

Santa Elena represents one of the rare cases involving a direct expropriation and is furthermore interesting in the context of the calculation of damages.

Another flagship case in this context, *Metalclad v Mexico*, was about a facility for the treatment of hazardous waste in Mexico which was owned by the American company Metalclad Corporation. While the federal government provided all necessary approvals for the company to build the hazardous waste treatment site, the respective municipality denied the local construction permit and declared a large area for the protection of a rare species of cactus. The tribunal found that by condoning the municipality's denial of a construction permit and the establishment of the environmental protection area, Mexico had prevented Metalclad from operating its landfill, which amounted to acts tantamount to expropriation. The tribunal held:

> '[E]xpropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as the outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.'[96]

The tribunal further stated:

> 'The Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree. Indeed, a finding of expropriation on the basis of the Ecological Decree is not essential to the Tribunal's finding of a violation of NAFTA Article 1110. However, the Tribunal considers that the implementation of the Ecological Decree would, in and of itself, constitute an act tantamount to expropriation.'[97]

Metalclad is a classical example for an indirect expropriation by measures targeted at a specific investment. The tribunal's effects-based determination extended the meaning of expropriation

[95] *Santa Elena v Costa Rica*, Final Award, 17 February 2000, para 72
[96] *Metalclad v Mexico*, Award, 30 August 2000, para 103
[97] Ibid, para 111

well beyond its traditional scope and exposed environmental and social regulations enacted for public welfare purposes to the risk of challenge in the form of investor-state arbitration. Some authors argued that 'using investor protection measures to attack public welfare regulation was a far cry from their intended purpose as a 'shield' against arbitrary governmental action and that the result of this approach was to stifle public policy development'.[98]

Emphasizes on effect can also be found in IUSCT ('Iran-United States Claims Tribunal') cases like *Starrett Housing*[99] and *Tippetts*[100]. In *Phelps Dodge*[101], the tribunal rejects completely the relevance of the regulatory perspective.

In effect, the 'sole effects' doctrine leads to the result, that – whenever the severity of an interference exceeds a certain level – the investor receives either full compensation (this is mostly associated with the 'fair market value') or full damages (in case of an unlawful expropriation).

The 'police powers' approach, in its radical form, looks only at a measure's (public) purpose to determine if an indirect expropriation had occurred. No expropriation will be found, whenever that measure serves a legitimate public purpose.[102]

In *Methanex v United States*, the tribunal held that non-discriminatory regulations taken in the public interest and in accordance with due process which affect, among others, foreign investors, do not qualify as being expropriatory unless the host state has given specific commitments to the foreign investor.

> '[A]s a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign Investor or Investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign Investor contemplating investment that the government would refrain from such regulation.'[103]

In a similar manner, the tribunal in *Saluka v Czech Republic* stated:

> 'In the opinion of the Tribunal, the principle that a State does not commit an expropriation and is thus not liable to pay compensation to a dispossessed alien investor when it adopts

[98] Miles (2013), p 158
[99] Compare IUSCT in *Starrett Housing Corporation v Iran* (1983) 4 Iran-USCTR 122, para 154
[100] Compare IUSCT in *Tippetts, Abbett, McCarthy, Stratton v TAMS-AFFA* (1984) 6 Iran-USCTR 219, paras 225-226
[101] Compare IUSCT in *Phelps Dodge Corp v Iran* (1986) 10 Iran-USCTR 121, para 130
[102] Compare Kriebaum, Ursula, *Regulatory Takings: Balancing the Interests of the Investor and the State*, in 8 *The Journal of World Investment & Trade*, 2007, p 725
[103] *Methanex v United States*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, Part IV, Chapter D, page 4, para 7

> general regulations that are "commonly accepted as within the police power of States" forms part of customary international law today. There is ample case law in support of this proposition. As the tribunal in *Methanex Corp. v. USA* said recently in its final award, "[i]t is a principle of customary international law that, where economic injury results from a *bona fide* regulation within the police powers of a State, compensation is not required."'[104]

From a doctrinal perspective, the expropriation test used in the context of the police powers doctrine differs significantly from the customary expropriation-test. Three of the four traditional criteria (i.e. *non-discriminatory*, *public purpose*, *due process*) for determining if an expropriation is legal or not (which decides between compensation or damages), are used here for determining whether or not a (compensable) expropriation has occurred at all (which decides whether or not payment from the side of the host state is due at all). Hence, the 'police powers' approach leads to a fragmentation of (traditional) international law in so far as a direct expropriation will trigger compensation while a regulatory interference – even if as severe in effect as a direct expropriation – basically will not.[105] However, this approach means an important shift of the analytical focus from the investor's needs to the host state's needs.

The balancing approach[106] walks the middle-ground between the two lines already discussed. It looks at the effect as well as at the purpose of the host state's interference with the foreign investor's rights. In practice, tribunals applying this doctrine start by analyzing whether a substantial deprivation has taken place and (if this is the case) go on by applying a proportionality test which balances the interests of the foreign investor and the host state.[107]

The importance of taking both effect and purpose into account, was recognized by the tribunals in *S.D. Meyers v Canada*[108] and *Feldman v Mexico*[109] for example. However, the tribunals did not explain how exactly to value the purpose in relation to the effect of a measure.

In *LG&E v Argentina*, the tribunal noted:

> 'In order to establish whether State measures constitute expropriation … the Tribunal must balance two competing interests: the degree of the measure's interference with the right of ownership and the power of the State to adopt its policies.'[110]

[104] *Saluka v Czech Republic*, Partial Award, 17 March 2006, para 262
[105] Compare Kriebaum, Ursula, *Regulatory Takings: Balancing the Interests of the Investor and the State*, in 8 *The Journal of World Investment & Trade*, 2007, p 726
[106] Some authors call it 'moderate police powers' approach
[107] Compare Kriebaum, Ursula, *Regulatory Takings: Balancing the Interests of the Investor and the State*, in 8 *The Journal of World Investment & Trade*, 2007, p 727
[108] Compare *S.D. Meyers v Canada*, First Partial Award, 13 November 2000, para 285
[109] Compare *Feldman v Mexico*, Award, 16 December 2002, para 98
[110] *LG&E v Argentina*, Decision on Liability, 3 October 2006, para 189

The tribunal went on to explain:

> 'It is this Tribunal's opinion that there must be a balance in the analysis both of the causes and the effects of a measure in order that one may qualify a measure as being of an expropriatory nature. It is important not to confound the State's right to adopt policies with its power to take an expropriatory measure.'[111]

Finally, the tribunal concluded:

> 'With respect to the power of the State to adopt its policies, it can generally be said that the State has the right to adopt measures having a social or general welfare purpose. In such a case, the measure must be accepted without any imposition of liability, except in cases where the State's action is obviously disproportionate to the need being addressed.'[112]

In *Tecmed v Mexico,* the tribunal balanced the charge imposed on the investor against the public interest behind this measure:

> 'After establishing that regulatory actions and measures will not be initially excluded from the definition of expropriatory acts, in addition to the negative financial impact of such actions or measures, the Arbitral Tribunal will consider, in order to determine if they are to be characterized as expropriatory, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to Investments, taking into account that the significance of such impact has a key role upon deciding the proportionality.'[113]

In the balancing process, the tribunal especially relied on three factors: (1) the reasonableness of the government measures with respect to their goals, (2) the deprivation of economic rights and (3) the investor's legitimate expectations. The tribunals in *Azurix v Argentina*[114] and *LG&E v Argentina*[115] also relied on this approach. The proportionality considerations in *Tecmed* are inspired by the proportionality test of the European Court of Human Rights[116]. However, the difference is that the ECtHR uses the test to determine whether an expropriation was justified

[111] Ibid, para 194
[112] Ibid, para 195
[113] *Tecmed v Mexico*, Award, 29 May 2003, para 122
[114] Compare *Azurix v Argentina*, Award, 14 July 2006, paras 311, 312, 322
[115] Compare *LG&E v Argentina*, Decision on Liability, 3 October 2006, paras 189, 194, 195
[116] The proportionality-test of the ECtHR comprises a three step-analysis: After finding a genuine public purpose, the Court considers whether the measure is (1) suitable and (2) necessary to pursue the public purpose and (3) if the relation between the ends and the means is proportional.

while the tribunal in *Tecmed* used the test to decide whether an expropriation had occurred at all.[117]

3.5.1.1. Compensation in the context of expropriation

Let me say a few words on compensation in the context of expropriation. As already discussed, following traditional international law, an expropriation triggers the host state's obligation to pay adequate compensation. 'Adequate' means 'full' and usually refers to the foreign investment's 'fair market value'. Market-based valuations usually use valuation methods and procedures which reflect the nature of the property and the circumstances under which given property would most likely trade in the market. They are mostly based on the economic principle of substitution and usually use market-derived data.[118] As to the methods of valuation, the 1992 World Bank Guidelines on the Treatment of Foreign Direct Investment, for example, distinguish three situations:

> 'Without implying the exclusive validity of a single standard for the fairness by which compensation is to be determined and as an illustration of the reasonable determination by a State of the market value of the investment under Section 5 above, such determination will be deemed reasonable if conducted as follows:
>
> (i) for a going concern with a proven record of profitability, on the basis of the discounted cash flow value;
>
> (ii) for an enterprise which, not being a proven going concern, demonstrates lack of profitability, on the basis of the liquidation value;
>
> (iii) for other assets, on the basis of (a) the replacement value or (b) the book value in case such value has been recently assessed or has been determined as of the date of the taking and can therefore be deemed to represent a reasonable replacement value.'[119]

Traditional international law hence demands an 'all-or-nothing' approach[120] in terms of compensation upon expropriation. This is why the level of liability in this context is so critical. It is, however, outmost understandable, that host states have called upon tribunals to include public interest considerations also in the determination of the amount of compensation.

[117] Compare Kriebaum, Ursula, *Regulatory Takings: Balancing the Interests of the Investor and the State*, in 8 *The Journal of World Investment & Trade*, 2007, pp 727 ff
[118] Compare Marboe (2009), p 170
[119] 1992 World Bank Guidelines on the Treatment of Foreign Direct Investment, para 6
[120] Compare Kriebaum, Ursula, *Regulatory Takings: Balancing the Interests of the Investor and the State*, in 8 *The Journal of World Investment & Trade*, 2007, p 719

In *Santa Elena v Costa Rica*, the host state referred to its international legal obligations to protect its unique ecological sites when it explained its taking of a large area of coastline and rainforest owned by a Costa Rican company that had been formed by an American syndicate (Compañía del Desarollo de Santa Elena) in which the majority of shareholders were American citizens. While the direct nature of the taking as well as Costa Rica's right to expropriate were uncontested, the dispute was about the amount of compensation due. The host state argued that the environmental purposes for which the taking was carried out should affect the methodology for valuing the property.

The tribunal, however, held that the environmental objectives of the expropriation as well as the fact that it was done in fulfilment of international environmental obligations, did not alter the application of international rules on foreign investment protection. Neither on the level of liability nor on the level of compensation did the tribunal make concessions to non-investment priorities such as the preservation of the global environment or the assistance of developing countries in their endeavors to comply with national and international norms of environmental protection.[121]

It is alarming that international investment law can frustrate sustainable development objectives in this way and it is clear that investors will use this mechanism if it remains available. What it takes is a balancing of all relevant interests in international law at play in the particular circumstances, without absolute exclusion of any of these interests.

As discussed earlier, the amount of compensation in the context of expropriation of foreign property has been subject to comprehensive discussions between the industrialized and the developing world. UN General Assembly Resolution 1803 on the 'Permanent Sovereignty over Natural Resources' of December 1962 can be regarded as the last expression of a common *opinio iuris* of the international community concerning the compensation standard for expropriation. Article 4 of this resolution speaks of the obligation to pay 'appropriate compensation' which – in accordance with international law – must also be assessable by an international judicial body. This compromise allowed both an interpretation in terms of the *Hull* formula ('prompt, adequate and effective' compensation) and of a lesser standard.

Later resolutions of the General Assembly like those relating to the NIEO, accepted even less compensation or left the payment of compensation dependent on the possibilities of the expropriating state without reference to international law or international judicial review.[122] In this sense, the 'Charter of Economic Rights and Duties of States', for example, provided:

> 'Each State has the right … [to] nationalize, expropriate or transfer ownership of foreign property in which case appropriate compensation should be paid by the State adopting

[121] Compare Marboe (2009), pp 56 f
[122] Compare Marboe (2009), pp 44 f

> such measures taking into account its relevant laws and regulations and all circumstances that a State considers pertinent.'[123]

The consideration of all relevant circumstances should lead to a more just distribution of wealth between capital exporting (industrialized) and financially powerful transnational corporations of capital importing (developing) countries. These references to domestic law and circumstances could even be interpreted in such a way that no compensation would be due at all. The General Assembly resolutions promoting the NIEO, *inter alia*, suggested that compensation should no longer be a condition for the lawfulness of an expropriation but rather the consequence of a lawful act, which should depend on a number of factors, including the host state's financial condition and past profits of the foreign company.

In this vein, tribunals in *LIAMCO v Libya*[124] and *Aminoil v Kuwait*[125] for example, regarded expropriation without payment of compensation as lawful.[126] Unfortunately, many core claims of the NIEO have not gained universal acceptance in contemporary international law. Nevertheless, there have been international judges calling for compensation less than the market value under certain circumstances. In *INA v Iran*, for example, the Iran-US Claims Tribunal held in an *obiter dictum*:

> 'In the event of such large-scale nationalisations of a lawful character, international law has undergone a gradual reappraisal, the effect of which may be to undermine the doctrinal value of any 'full' or 'adequate' (when used as identical to 'full') compensation standard as proposed in this case.'[127]

These considerations were dedicated to the situation of many newly independent countries not being in the financial position to fully compensate all foreign proprietors in the event of large-scale nationalizations. Otherwise, those states would be prevented from exercising their right to territorial sovereignty and remain in their disadvantaged position as victims of colonialism.[128]

Moreover, Brownlie in his separate opinion in *CME v Czech Republic* showed a certain understanding for the financial problems which a high compensation award would pose for a relatively small (developing) country. Brownlie argued that not only in case of a lawful expropriation but also in cases of state responsibility (damages) the amounts awarded should take into consideration the financial abilities of the host state. In support of his arguments, he referred to cases where even reparations after wars and unlawful acts of aggression had reflected this aspect. In this sense, he pointed to the *Gulf of Maine* case where the ICJ held that the

[123] *UN General Assembly Resolution No 3281 (XXIX)*, 12 December 1974, Art 2 (2) (c), available at http://www.un-documents.net/a29r3281.htm (accessed 8 August 09:00 AM)
[124] Compare *LIAMCO v Libya*, Award, 12 April 1977, para 194
[125] Compare *Aminoil v Kuwait*, Award, 24 March 1982, para 115
[126] Compare Marboe (2009), p 53
[127] *INA Corporation v Iran*, 8 Iran-USCTR (1985) , paras 373-384
[128] Compare *INA Corporation v Iran*, Dissenting Opinion Ameli, 8 Iran-USCTR (1985), paras 403, 416-417

legitimate scruple lies in the avoidance of methods that were 'likely to entail catastrophic repercussions for the livelihood and economic well-being of the population of the countries concerned'.[129]

There were also discussions if large-scale expropriations following decolonization should trigger 'just' (similar to 'appropriate') compensation, meaning compensation less than full commercial value.[130] In this context, it was for example contemplated if an investor claim for full compensation or damages following the withdrawal of unduly generous natural resource concessions given to foreign investors during colonization should be seen as abuse of rights.[131]

With regard to the calculation of compensation in the context of expropriation, Kriebaum has suggested an approach inspired by persistent human rights jurisprudence of the ECtHR. While an illegal expropriation should trigger damages in full amount, the calculation of the amount of compensation in case of legal expropriations should involve proportionality considerations requiring a balancing of investor protection against certain factors relating to the public interest and principles of equity.[132]

Furthermore, tribunals dealing with cases concerning the economic crisis in Argentina between 2000 and 2002 showed some understanding for the host state's economic situation. In this sense, the tribunal in *CMS v Argentina* explained:

> 'The question for the tribunal is then how does one weigh the significance of a legal guarantee in the context of a collapsing economic situation. It is certainly not an option to ignore the guarantee, as the Respondent has advocated and done, and neither is it an option to disregard the economic reality which underpinned the operation of the industry.'[133]

In *LG&E v Argentina,* the tribunal held:

> 'The essential interests of the Argentine State were threatened in December 2001. It faced an extremely serious threat to its existence, its political and economic survival, to the possibility of maintaining its essential services in operation, and to the preservation of its internal peace. There is no serious evidence on the record that Argentina contributed to

[129] *CME v Czech Republic,* Separate Opinion on the Issues at the Quantum Phase, 14 March 2003, para 77, citing ICJ in *Gulf of Maine, Delimitation of the Maritime Boundary in the Gulf of Maine Area (Canada v United States of America),* Judgment, 12 October 1984, para 237
[130] Compare Schachter, Oscar, *International Law in Theory and Practice*, Martinus Nijhoff Publishers, Leiden, 1991, p 324, cited in Dupuy et al (2009), p 291
[131] Compare Dupuy et al (2009), p 291
[132] Compare Kriebaum (2008), pp 572 f
[133] *CMS v Argentina,* Award, 12 May 2005, para 165

> the crisis resulting in the state of necessity. In this [sic] circumstances, an economic recovery package was the only means to respond to the crisis.'[134]

In contrast to the tribunal in *CMS*, the tribunal in *LG&E* came to the conclusion that Argentina was in a state of necessity[135] and that Argentina was not internationally responsible for the violation of its obligations during the state of necessity. However, due to omissions after that state of necessity, Argentina was held responsible for the violations of its obligations after that time.[136]

3.5.2. Fair and Equitable Treatment

'Fair and equitable treatment' ('FET') is the most frequently invoked standard of investment protection and can be found in most IIAs. Since the majority of successful investment claims are based on a violation of FET, it is also the standard with the highest practical relevance. Depending on its formulation, there are different variations of the standard. The enigmatic nature of FET is evidenced by the discussion of the standard's relation to customary international law (the international minimum standard of treatment of aliens in particular).

FET provisions appear in IIAs either as stand-alone expressions of fair and equitable treatment, as clauses containing references to international law or as clauses that mention fair and equitable treatment together with other standards of treatment (e.g. MFN, NT, FPS). In interpreting FET, one of the major questions is if the provision shall be understood as an autonomous, self-contained standard or if the respective provision derives its meaning from the international minimum standard (and/or other standards of international law).

However, the normative content of the respective FET clause primarily has to be determined by interpretation in accordance with Article 31 VCLT, duly taking into account the provision's context and history. The FET standard has the function of a general clause of good faith within IIAs. As such, it is used in arbitral practice to fill normative loopholes which may be left by the more specific standards. In this sense, FET is often relied on as a fallback provision whenever there is too little evidence in support of a claim for expropriation. That's why some authors call the FET standard 'expropriation light'.

Notwithstanding text-specific normative characteristics, FET is mostly seen as a unified concept that might overlap and interact with other standards but still has normative substance

[134] *LG&E v Argentina*, Decision on Liability, 3 October 2006, para 257
[135] Compare Art 25 of the International Law Commission ('ILC'), *Articles on the Responsibility of States for Internationally Wrongful Acts*, *UN General Assembly Resolution A/Res/56/83*, 21 December 2001, Annex, available at https://www.ilsa.org/jessup/jessup11/basicmats/StateResponsibility.pdf (accessed 8 August 2016, 12:00 AM)
[136] Compare Marboe (2009), p 151

on its own. In this sense, arbitral practice has shaped out a couple of typical normative elements of FET: Stability and the protection of the investor's legitimate expectations, transparency, compliance with contractual obligations, procedural propriety and due process, good faith and freedom from coercion and harassment.[137] Due to their relevance in the context of sustainable development, the following discussion shall focus on the elements of *the investor's legitimate expectations* and *stability*.

Some tribunals consider the investor's legitimate expectations as the dominant element of the FET standard.[138] Today, it is common ground that the principal basis for a legitimate expectation is an explicit promise or guaranty from the host state. As the tribunal in *Parkerings v Lithuania* held:

> '[T]he expectation is legitimate if the investor received an explicit promise or guaranty from the host-State, or if implicitly, the host-State made assurances or representation that the investor took into account in making the investment. Finally, in the situations where the host-State made no assurance or representation, the circumstances surrounding the conclusion of the agreement are decisive to determine if the expectation of the investor was legitimate. In order to determine the legitimate expectation of an investor, it is also necessary to analyse the conduct of the State at the time of the investment.'[139]

Therefore, legitimate expectations are not subjective hopes and perceptions on the side of the investor. They must be based on objectively verifiable facts and must be reasonable in the circumstances. Moreover, some tribunals have found that mere political statements were not capable of creating legitimate expectations on the side of the investor.[140] In addition, the disappointment of legitimate expectations must be sufficiently serious and material in order to trigger damages. Otherwise, every subtle misconduct from the side of the host state could be brought before an investment tribunal, whose purpose is not to act as a general-recourse administrative law tribunal.[141]

Another point is that tribunals are inclined to recognize the difference between contractual expectations and expectations under international law. Therefore, the tribunal in *Parkerings v Lithuania* held:

> 'It is evident that not every hope amounts to an expectation under international law. The expectation a party to an agreement may have of the regular fulfilment of the obligation by the other party is not necessarily an expectation protected by international law. In other

[137] Compare Reinisch (2008), pp 111 ff; Dolzer/Schreuer (2012), pp 130 ff; Bishop et al (2014), pp 756 ff
[138] E.g.: *Saluka v Czech Republic*, Partial Award, 17 March 2006, paras 301-302
[139] *Parkerings v Lithuania*, Award, 11 September 2007, para 331
[140] Compare Dolzer/Schreuer (2012), p 149; *Continental Casualty v Argentina*, Award, 5 September 2008, para 261(i); *El Paso v Argentina*, Award, 31 October 2011, paras 375-379, 392-395
[141] Compare Reinisch (2008), p 129; *Thunderbird v Mexico*, Separate Opinion (Dissent in Part) by Professor Thomas Wälde, 26 January 2006, para 14

> words, contracts involve intrinsic expectations from each party that do not amount to expectations as understood in international law. Indeed, the party whose *contractual expectations* are frustrated should, under specific conditions, seek redress before a national tribunal.'[142]

In recent years, there has been growing empathy for the public interest and the host state's regulatory flexibility among investment tribunals. Fortunately, the principle of proportionality and balancing considerations in the context of FET are gaining importance in investment arbitration. In this sense, the tribunal in *Lemire v Ukraine* held:

> 'The protection of the legitimate expectations must be balanced with the need to maintain a reasonable degree of regulatory flexibility on the part of the host State in order to respond to changing circumstances in the public interest.'[143]

Other tribunals have also taken balancing approaches.[144]

In addition, according to the tribunal in *Bayandir v Pakistan*, the investor's legitimate expectations will be seriously reduced if there is general instability in the political conditions of the country concerned.[145]

Concerning the sub-element of stability, tribunals increasingly emphasize that stability is not an absolute requirement and that the state has the right to exercise its sovereign power to legislate and to adapt its legal system to changing circumstances.[146] In this context, tribunals analyze whether state measures exceed normal regulatory powers and whether those measures fundamentally change the regulatory framework for the investment beyond an acceptable degree. In the absence of specific stabilization promises, changes to general legislation are seen as a legitimate exercise of the host state's governmental powers which are not prevented by the FET standard.[147] In *EDF v Romania*, the tribunal held:

> 'The idea that legitimate expectations, and therefore FET, imply the stability of the legal and business framework, may not be correct if stated in an overly-broad and unqualified formulation. The FET might then mean the virtual freezing of the legal regulation of economic activities, in contrast with the State's normal regulatory power and the

[142] *Parkerings v Lithuania*, Award, 11 September 2007, para 344
[143] *Lemire v Ukraine*, Decision on Jurisdiction and Liability, 14 January 2010, para 500
[144] Compare *Total v Argentina*, Decision on Liability, 27 December 2010, paras 123-4, 162, 309, 333, 429; *Plama v Bulgaria*, Award, 27 August 2008, para 177; *EDF v Romania*, Award, 8 October 2009, para 299; *El Paso v Argentina*, Award, 31 October 2011, para 358; Dolzer/Schreuer (2012), p 141
[145] *Bayindir v Pakistan*, Award, 27 August 2009, paras 192-197
[146] Compare Dolzer/Schreuer (2012), p 148; *Parkerings v Lithuania*, Award, 11 September 2007, paras 327-38; *BG Group v Argentina*, Final Award, 24 December 2007, paras 292-310; *Plama v Bulgaria*, Award, 27 August 2008, para 219; *Continental Casualty v Argentina*, Award, 5 September 2008, paras 258-61; *AES v Hungary*, Award, 23 September 2010, paras 9.3.27-9.3.35; *Impregilo v Argentina*, Award, 21 June 2011, paras 290-1; *El Paso v Argentina*, Award, 31 October 2011, paras 344-52, 365-74
[147] Compare Dolzer/Schreuer (2012), p 148

> evolutionary character of economic life. Except where specific promises or representations are made by the State to the investor, the latter may not rely on a bilateral investment treaty as a kind of insurance policy against the risk of any changes in the host State's legal and economic framework. Such expectation would be neither legitimate nor reasonable.'[148]

In a similar vein, the tribunal in *Enron v Argentina* noted that the stabilization requirement inherent to FET 'does not mean the freezing of the legal system or the disappearance of the regulatory power of the State.'[149]

Therefore, even in the context of stability, tribunals increasingly weigh the investor's legitimate expectations against the state's obligation to act in the public interest.

Finally, it can be observed that tribunals have started to take investor conduct into account when considering violations of FET. In *Azinian v Mexico*, the tribunal found that the foreign investor made a series of misrepresentations and held that the revocation of the concession and the subsequent conduct of the domestic courts upholding the revocation did not amount to a breach of the FET standard.[150] In a similar vein, the tribunal in *Genin v Estonia* held that the revocation of a banking license was not a breach of FET, since the investor had not complied with certain information requests pertaining to its shareholder structure. The tribunal found that the host state's procedural shortcomings were outweighed by serious misgivings concerning the bank's management.[151]

3.5.2.1. Other provisions concerning stability

Let me now add a few supplementary thoughts on the issue of stability. Next to the FET standard, there are other clauses in the field of investment treaty law which can promote legal stability: (1) choice-of-law clauses, (2) stabilization clauses, (3) re-negotiation or adjustment clauses and (4) umbrella clauses.

3.5.2.1.1. Choice-of-law clauses

Choice-of-law clauses basically opt out of host state law and refer to the domestic law of another state and/or international law. Such an exclusion of local law, however, has its limits. In particular, the concept of *loi de police* may require that certain sets of domestic norms – despite

[148] *EDF v Romania*, Award, 8 October 2009, para 217
[149] *Enron v Argentina*, Award, 22 May 2007, para 261
[150] *Azinian v Mexico*, Award, 1 November 1999, paras 107 f, 124
[151] *Genin v Estonia*, Award, 25 June 2001, paras 361 ff

the choice-of-law – stay applicable to the investment situation as overriding mandatory rules. Article 7 of the Rome Convention on the law applicable to contractual obligations, to name an example, expressly reserves the application of the 'mandatory rules' of the forum or of a third state. Whereas it seems widely accepted that a national court may apply the concept of *loi de police*, it is less clear, if an arbitral tribunal would have the same prerogative.[152] However, there are commentators who claim that – for environmental purposes – arbitral tribunals have considerable leeway in deciding whether the host state's environmental laws may be applied as overriding mandatory rules.[153]

3.5.2.1.2. Stabilization clauses

Stabilization clauses *stricto sensu* freeze the law of the host state applicable to a contract at a given point in time. Since a change of law in breach of the stabilization clause triggers the host state's duty to compensate the investor, many authors have recognized that stabilization clauses can lead to 'regulatory chill' or at least 'regulatory distortion', dissuading host states from adopting normal and necessary regulations because of the potential litigation risk. In this context, it must be mentioned that social and environmental systems are by nature evolving and dynamic. The promise to freeze the law relevant for sustainable development cannot be treated in the same way as a promise to freeze the tax law. Therefore, the host state must be free to change the regulatory framework according to changes in the social and environmental reality.

Moreover, social and environmental norms call for a dynamic interpretation, at least of generic terms, which are likely to be found in law texts relating to sustainable development. Stabilization clauses usually cover legislative and regulatory changes. However, it is unclear, whether – in the absence of textual changes – interpretative changes of the same provisions would also be covered by the freezing clause. A change of interpretation can potentially have the same effect as the enactment of new provisions. Most of what is called a 'human rights approach' to environmental protection has developed through the evolving interpretation of human rights provisions in treaties or constitutions.[154]

In *Duke Energy v Peru*, the tribunal analyzed the relation between a stabilization clause and a change in the interpretation of domestic tax law. The tribunal noted that a breach of a stabilization clause would require prove of '(i) the existence of a pre-existing law or regulation (or absence thereof) at the time the tax stability guarantee was granted, and (ii) a law or regulation passed or issued after the LSA [Legal Stability Agreement] that changed the pre-

[152] Compare Viñuales (2012), p 341
[153] Compare Brozolo, L Radicati di, *Arbitrage commercial international et lois de police. Considérations sur les conflicts de jurisdictions dans le commerce international*, in *Recueil des cours de l'Académie de droit international*, Volume 315, 2005, p 402, cited in Viñuales (2012), p 341
[154] Compare Viñuales (2012), pp 341 f

existing regime'.[155] Concerning a change of interpretation, the tribunal held that it would be sufficient for an investor to prove '(i) a stable interpretation or application at the time the tax stability guarantee was granted, and (ii) a decision or assessment after the LSA that modified that stable interpretation or application':[156] The tribunal noticed that this second test was much more demanding than the first test, because 'compelling evidence' was required. According to the tribunal, statements and actions of the host state that merely imply a specific interpretation, are not evidence enough for the finding of a violation of the stabilization clause.[157]

As far as it concerns human rights, some authors have argued that – depending on the standing of specific norms in international law – states cannot simply contract out of certain norms by way of stabilization clauses.[158] Most human right treaties allow for a derogation from certain human rights provisions in times of public emergency. In other times, however, derogations would be legally precluded.[159] Following this line of argumentation, a conflict between human rights norms and a stabilization clause cannot in all cases be solved by simply determining a breach of the stabilization clause and the subsequent application of the concept of state responsibility. This makes sense in the context of human rights.

There are authors who recommend to extend such approach to environmental norms.[160] Due to the unique standing of human rights in international law, it is, however, unclear, if such an argumentation would hold for environmental norms also. A possible dogmatic bridge from human rights law to environmental law in this context, could be nevertheless established by a human rights based approach to environmental law. In this case, one could argue that – in the mantle of specific human rights – certain environmental norms were immune to being contracted out by stabilization clauses.[161] In any event, it would be a challenge to argue that a specific state measure in violation of a stabilization clause was actually necessary because required by a certain human rights or environmental norm.

Following another line of argumentation, inherent limitations of the normative content of stabilization clauses can also be drawn from the concept of legitimate expectations.[162] Supporters of this theory argue that it would be unreasonable and therefore illegitimate for a foreign investor to expect that a host state would breach its human rights obligations (or assimilated environmental obligations) in order to comply with stability commitments. 'There

[155] *Duke Energy v Peru*, Award, 25 July 2008, para 217
[156] *Duke Energy v Peru*, Award, 25 July 2008, para 218
[157] Ibid, paras 220 ff
[158] Compare Leader, Sheldon, *Human Rights, Risks, and New Strategies for Global Investment*, 9 *Journal of International Economic Law* (2006), at 657, cited in Viñuales (2012), p 344
[159] Compare Viñuales (2012), pp 344 f
[160] Compare Cotula, Lorenzo, *Reconciling Regulatory Stability and Evolution of Environmental Standards in Investment Contracts: Towards a Rethink of Stabilization Clauses*, 1 *Journal of World Energy Law and Business* (2008), pp 172-175, cited in Viñuales (2012), p 344
[161] Compare Viñuales (2012), p 345
[162] Ibid, p 346

are limits to what a state can promise and at least some of these limits are manifest enough to require investors to be (factually or constructively) aware of them', Viñuales explains[163] in this context, referring to *Parkerings v Lithuania*:

> 'The investor will have a right of protection of its legitimate expectations provided it exercised due diligence and that its legitimate expectations were reasonable in the light of the circumstances. Consequently, an investor must anticipate that the circumstances could change, and thus structure its investment in order to adapt it to the potential changes of legal environment.'[164]

Similarly, the tribunal in *Plama v Bulgaria* noted that an investor who had not been diligent in determining the implications of the domestic environmental law applicable to its investment could not claim that its legitimate expectations have been frustrated.[165]

Accordingly, one could argue that a host state may not be bound to compensate an investor for costs of complying with basic or normal human rights standards. Complementary, one could argue that the costs for exceeding a normal human rights standard in order to comply with an extraordinary high human rights standard could be compensable.[166]

Possible ways forward in the context of stabilization clauses exist on the legislative as well as on the interpretative level. Hence, host states might commit themselves not to exercise their sovereign rights but at the same time not to evade their international obligations relating to sustainable development (most of all human rights and environmental obligations). As for interpretation, an evolutionary approach was already accepted in the *Gabčíkovo-Nagymaros* case.[167] In this sense, new international norms (such as a stabilization clause) shall not undermine existing obligations but they must be taken into account in their implementation. Both approaches are capable of relativizing stabilization clauses in order to accommodate obligations relating to sustainable development.

3.5.2.1.3. Re-negotiation or adjustment clauses

Such provisions focus on the maintenance of the economic equilibrium between the investor and the host state. If a certain triggering event occurs, a duty to re-negotiate or adjust certain provisions is set in motion in order to restore the initial economic equilibrium between the

[163] Ibid, p 346
[164] *Parkerings v Lithuania*, Award, 11 September 2007, para 333
[165] *Plama v Bulgaria*, Award, 27 August 2008, paras 220-221
[166] Compare Viñuales (2012), p 346
[167] Compare ICJ in *Gabčíkovo-Nagymaros Project (Hungary v Slovakia)*, Judgment, 25 September 1997, para 112 et al

parties to the investment contract. Many of the above remarks on stabilization clauses fit in this context, too. However, there are some specific issues left to discuss.

The first issue is that a distinction has to be drawn between 'full economic equilibrium clauses' and 'limited economic equilibrium clauses'.[168] Concerning the latter, certain types of new laws (e.g. laws protecting the health, the environment, individual safety or security) will be exempt from giving rise to compensation. It is remarkable that limited economic equilibrium clauses are significantly more frequent in contracts concluded by OECD ('Organization for Economic Co-operation and Development') countries whereas in contracts concluded by non-OECD countries full economic equilibrium clauses are dominant. This difference might be the result of the unequal bargaining power of industrialized and developing countries in their negotiations with foreign investors. Another reason could be the different levels of stability and political risk.

However, it is a truism that for developing countries, the protection of sustainable development (concerning most of all human rights, distributive justice and ecological issues) are of particular importance. Therefore, host states of the global South should strive for the limited type of equilibrium clause. At least a normal level of human rights and environmental standards should be anticipated when formulating the respective clause.[169]

The second issue is about the legal consequences following a triggering event. It is clear that the duty to re-negotiate calls for negotiations in good faith. An example for bad faith negotiations is provided by *Suez v Argentina*, where the tribunal found that Argentina was in breach of its treaty obligations because of the coercive manner in which it conducted the re-negotiation of the applicable tariff.[170] The duty to restore the economic equilibrium can take different forms, including the adjustment of tariffs, the extension of a concession, tax reductions, and monetary compensation whereas compensation might also be due when the re-negotiations were not pursued in good faith by the host state.[171]

Developing countries should aim at contractually requiring the foreign investor to absorb a certain level of loss before the restoration obligation is activated or by contractually arranging that only discriminatory laws could trigger compensation. As for the distribution of risk resulting from regulatory change between investor and host state, it appears justified for the investor to bear the costs, the more generally applicable a regulation is and the more the costs it entails can be passed on to users.[172] Moreover, a thorough balancing of private and public

[168] Compare Viñuales (2012), p 347
[169] Ibid, pp 347 f
[170] Compare *Suez v Argentina*, Decision on Liability, 30 July 2010, paras 241-3
[171] Compare Viñuales (2012), p 348
[172] Compare Viñuales (2012), p 349; Shemberg, Andrea, *Stabilization Clauses and Human Rights: A Research Project Conducted for IFC and the United Nations Special Representative to the Secretary General on Business and Human Rights*, 11 March 2008, para 92, available at:
http://www.ifc.org/wps/wcm/connect/9feb5b00488555eab8c4fa6a6515bb18/Stabilization%2BPaper.pdf?MOD=

interests seems appropriate when determining the new economic equilibrium. Furthermore, from the perspective of sustainable development, it would be desirable to think not only about clauses restoring the economic equilibrium between investor and host state, but also about clauses restoring the social and ecological balance that could be distorted by the investment.

3.5.2.1.4. Umbrella clauses

Umbrella clauses are treaty provisions that guarantee the observance of obligations assumed by the host state vis-à-vis the foreign investor. Such clauses bring contractual commitments under the treaty's protective umbrella.[173] As a rule, the normative scope of an umbrella clause will depend on the specific wording of the clause and will have to be determined on a case-by-case basis. However, stabilizing clauses tend to be seen as contractual provisions capable of being elevated to treaty level. In *El Paso v Argentina*, the tribunal held:

> '[An] umbrella clause … will cover additional investment protections contractually agreed by the State as a sovereign – such as a stabilization clause – inserted in an investment agreement.'[174]

In *Plama v Bulgaria*, the tribunal went even further, considering that a regular commercial clause distributing the risk of liability for environmental damage had to be assessed in the light of the umbrella clause contained in Article 10 (1) of the Energy Charter Treaty. The tribunal rejected the claim because it found that the investor had not violated the contract and was hence consistent with the umbrella clause of the ECT.[175]

There is, however, a line of case law in favor of a restrictive application of umbrella clauses.[176] According to this approach, violations of a contractual commitment limiting the host state's regulatory space in matters relating to sustainable development could not be the basis for a treaty claim unless those violations were (separately) in breach of a standard of protection contained in the treaty. This restrictive approach will mostly benefit the host state's right to regulate.

AJPERES (accessed 8 August 2016, 01:00 PM) – Shemberg uses two criteria in this context: the character of the law (generally applicable, specific, or discriminatory) and the character of the project (whether the costs can be passed on to the users).

[173] Compare Dolzer/Schreuer (2012), p 166

[174] *El Paso v Argentina*, Decision on Jurisdiction, 27 April 2006, para 81

[175] Compare Viñuales (2012), p 350; *Plama v Bulgaria*, Award, 27 August 2008, para 224

[176] Compare Dolzer/Schreuer (2012), p 171; *SGS v Pakistan*, Decision on Jurisdiction, 6 August 2003

3.5.2.2. Compensation in the context of FET

Concerning protection standards other than expropriation, such as FET, full protection and security or non-discrimination standards, tribunals generally assess the amount of damages on the basis of the law of state responsibility. In this context, the principle of full reparation as formulated by the PCIJ ('Permanent Court of International Justice') in the *Chorzów* case and reflected in the ILC Articles on State Responsibility, is still of pertinent relevance.[177]

As for the appropriate calculation methodology, the so-called 'differential method' will mostly be adequate for wiping out all adverse economic consequences on the side of the foreign investor. This method compares the investor's actual financial position with the investor's hypothetical position, would the host state's unlawful act or omission have not occurred. Only rarely, investment tribunals make use of an objective valuation approach (as in the case of a lawful expropriation where the investment's fair market value is due) when determining damages.[178]

In the context of complex long-term contracts, the distinction between *damnum emergens* and *lucrum cessans* is of little practical value since it invites the danger of over-compensation by double-counting damage positions.[179] Therefore, awards should either cover the investor's actual expenses related to the investment or the future return[180] of investment (by using the DCF method[181] for example).[182]

A reduction of the amount of damages is traditionally possible in cases of contributory negligence and violation of the duty to mitigate damages.[183] An example in this context is provided by *MTD v Chile* where the tribunal reduced the compensation by 50 percent because the investor had acted without due diligence. The tribunal mentioned in this context that BITs were not designed as an insurance against business risks.[184]

However, as mentioned earlier, there have been calls for a reduction of the amount due for other reasons.[185] As mentioned earlier, arbitrator Brownlie, in his separate opinion in *CME v Czech Republic*, wrote in favor of an appropriate consideration of the host state's financial situation.[186] Therefore, the awarded amounts should take into consideration the financial abilities of the host

[177] Compare Marboe (2009), p 87
[178] Ibid, p 96
[179] Ibid, pp 99
[180] i.e. the net present value of future cash flows
[181] DCF = Discounted Cash Flow
[182] Compare Marboe (2009), p 106
[183] Ibid, p 120
[184] Compare *MTD v Chile*, Award, 25 May 2004, paras 246, 166-178
[185] Compare Marboe (2009), p 149
[186] *CME v Czech Republic*, Separate Opinion on the Issues at the Quantum Phase, 14 March 2003

state not only in cases of expropriation, but also in cases of state responsibility. In a similar vein, the tribunal in *Himpurna California v PLN* tried to find a balanced interpretation of a contractual provision which was obviously formulated to the investor's benefit. As the host state was in a serious financial crisis, the tribunal limited the amount of damages for lost profits:

> 'In such circumstances, it strikes the Arbitral Tribunal as unacceptable to assess lost profits as though the claimant had an unfettered right to create ever-increasing losses for the State of Indonesia (and its people) by generating energy without any regard to whether or not PLN had any use for it. Even if such a right may be said to derive from explicit contractual terms, the Arbitral Tribunal cannot fail to be struck by the fact that the claimant is seeking to turn the ESC into an astonishing bargain in circumstances when performance of the Contract would be ruinous to the respondent.'[187]

The tribunal applied the principle of the prohibition of 'abuse of right' as a general principle of law in order to justify the reduction of the amount of damages due.[188]

In a similar manner, the tribunal in *Tecmed v Mexico* emphasized that it 'may consider equitable principles when setting the compensation owed to the Claimant, without thereby assuming the role of an arbitrator *ex aequo et bono'*.[189]

Similarly, the Iran-US Claims Tribunal referred to 'reasonableness' or the 'relevant circumstances' in order to explain inexact calculations or estimations.[190]

Case law shows that the principle of equity may be used in the field of investment arbitration in order to estimate compensation and damages that cannot be (or are extremely difficult to be) valued otherwise and to take equitable considerations into account that shall alter the calculated amount. Although tribunals have used this principle mostly to the advantage of investors[191], it is well conceivable that it can also serve as a basis to reduce the amount of damages in order to satisfy requirements of sustainable development.

3.5.3. Non-discrimination standards

Measures relating to Sustainable Development may introduce significant differences of treatment among economic operators which may potentially conflict with investment disciplines. This section will analyze four potential entry points for environmental considerations in the context of non-discrimination standards in IIAs: (1) the issue of 'like

[187] *Himpurna California v PLN*, Award, 4 May 1999, para 318
[188] *Himpurna California v PLN*, Award, 4 May 1999, paras 325 ff
[189] *Tecmed v Mexico*, Award, 29 May 2003, para 190
[190] E.g. in *American International Group v Iran*, 4 Iran-US CTR (1983) 96, 109
[191] Compare Marboe (2009), pp 145 ff

circumstances', (2) the fact of discrimination, (3) possible justifications and (4) differentiation at various stages of the investment cycle.

Let us start by introducing the concepts of Most-Favoured-Nation treatment ('MFN') and National Treatment ('NT') as the most important non-discrimination standards in IIAs. They are meant to ensure a level playing field between the foreign investor and local competitors (NT) or between the foreign investor and the investors of the 'most favored' third states (MFN). NT shall prevent all forms of negative differentiation – relating to the enactment and application of regulations – between foreign and local investors.[192] MFN shall ensure that every relevant benefit which the host state confers to the investors of third states are automatically extended to the beneficiary of the MFN clause.[193] The test for determining a violation of the MFN or NT standards comprises the questions of the existence of 'like circumstances', discriminatory treatment and possible justifications.[194]

The most sensitive issue here is the first question (1), since – depending on the wording – only investors or investments in 'similar' or 'like' situations or circumstances enjoy the protection of the MFN or NT clause. This is an expression of the *ejusdem generis* principle ('of the same kind') which – in the case of MFN – requires that only provisions contained in treaties regulating the same subject matters can be 'imported' by use of the MFN clause. The choice of the appropriate comparator is extremely critical, since minor differences at this point can be decisive for the applicability of the provisions. Since the concepts of MFN and NT are central pillars in the legal framework of the WTO also, the question arises if the large corpus of WTO jurisprudence concerning the notion of 'likeness' in Articles I and III (2) and (4) of the GATT could be relevant for investment arbitration, too.

A comparison of trade law and investment law, however, shows significant conceptual differences between these two fields of international economic law. Trade law is concerned primarily with reducing the hurdles for transboundary movements of goods and services and only secondarily with the production of these products. An investment, by contrast, does not (only) comprise single trade transactions of finished products but typically encompasses multiple stages of value creation, including production.[195] All corporate conduct can have severe repercussions to social and environmental systems in the host state. That is why production methods are a primary concern of any assessment of 'likeness' in the investment context.[196] In *Methanex v United States*, a Canadian producer of methanol challenged California's ecologically motivated ban on methyl tertiary-butyl ether ('MTBE'), a gasoline

[192] Compare Dolzer/Schreuer (2012), p 198
[193] Ibid, p 206
[194] Compare Reinisch (2008), pp 37 ff; Dolzer/Schreuer (2012), pp 198 ff; Bishop et al (2014), pp 863 ff
[195] Compare Viñuales (2012), pp 324 f
[196] To my personal opinion, production methods should be given more attention in the trade law context, too. This would be an incentive for states to tighten social and environmental regulation. Why should irresponsibly produced products granted the same benefits as products with a clean eco-social track?

additive for which methanol is a feedstock. The claimant argued that the only effective competitor of MTBE was ethanol. Invoking the NT standard, the investor had to prove that it was in 'like circumstances' with producers of ethanol, who allegedly received the more favorable treatment, rather than with producers of methanol or MTBE. Since there were other producers of methanol who were affected in the same way as Methanex, the tribunal applied a rather narrow understanding of 'like circumstances':

> '[I]t would be as perverse to ignore identical comparators if they were available and to use comparators that were less 'like', as it would be perverse to refuse to find and to apply less 'like' comparators when no identical comparators existed.'[197]

The tribunal found that Methanex was in 'like circumstances' with producers of methanol (not ethanol), hence the claimant could not prevail on its NT claim.

> In *Bayandir v Pakistan*, the tribunal found that two companies active in exactly the same business and moreover engaged in the same project, were not in 'like circumstances' due to differences 'in the financial terms; the constitution of the two entities; their level of experience and expertise; the scope of work; and the commitment of the two entities to progressing with the works'.[198]

In *S.D. Myers v Canada*, the tribunal stressed that general policy considerations, such as environmental concerns, should play a role in the analysis of 'likeness':

> '[T]he interpretation of the phrase 'like circumstances' in Article 1102 [of the NAFTA] must take into account the general principles that emerge from the legal context of the NAFTA, including both its concern with the environment and the need to avoid trade distortions that are not justified by environmental concerns. The assessment of 'like circumstances' must also take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest.'[199]

Moreover, the tribunal made reference to instruments like NAAEC (the environmental side agreement of the NAFTA), the Rio Declaration on Environment and Development and the OECD Declaration on International and Multinational Enterprises for purposes of assessing likeness.

In *Parkerings v Lithuania*, the tribunal found that two foreign investors engaged in the construction of car parks were not in 'like circumstances' due to their different impact on the

[197] *Methanex v United States*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, Part IV, Ch. B, para 17
[198] *Bayindir v Pakistan*, Award, 27 August 2009, paras 402-11
[199] *S.D. Myers v Canada*, First Partial Award, 13 November 2000, para 250

old town of Vilnius, a UNESCO protected site. It emphasized that '[t]he historical and archaeological preservation and environmental protection could be and in this case were a justification for the refusal of the project' and that the claimant's project was not in a situation similar with the multi-story car park constructed by the competitor.[200] Such a finding is highly relevant for promoting sustainable development, since for example high-polluting and cleaner industries could be found not to be in 'like circumstances'.

On the other end of the scale, the tribunal in *Occidental v Ecuador* found that two entities were in 'like circumstances' despite the lack of any competitive relationship between them. The tribunal noted that the purpose of NT is to protect foreign investors, and that it would be inappropriate to solely address the sector in which the activity in question was undertaken.[201]

In effect, arbitral practice suggests that the scope of 'like circumstances' represents quite a large continuum and that the specific facts of the case will be decisive for the determination of the appropriate comparator.[202] To my opinion, this continuum allows for all specificities of investments that have a potential impact to the host state's sustainable development and legitimate public interests to play a role in the determination of discrimination.

Let us turn to (2) the fact of discrimination, which requires the claimant to prove that – despite being in 'like circumstances' – it received less favorable treatment than the comparator.[203] This is a rather objective test, since arbitral practice has held that the intent to discriminate on the basis of nationality is not necessary for a breach of a non-discrimination standard to be found.[204] Therefore, the social or environmental motivation of a host state measure has been found to be irrelevant for the question of the existence of a differentiation.[205] In this sense, the tribunal in *Corn Products v Mexico* held:

> 'Discrimination does not cease to be discrimination, nor to attract the international liability stemming therefrom, because it is undertaken to achieve a laudable goal or because the achievement of that goal can be described as necessary.'[206]

Conversely, discriminatory intent may be an important element when assessing the breach of a non-discrimination standard, even if the measure was also taken for sustainable development

[200] *Parkerings v Lithuania*, Award, 11 September 2007, para 392
[201] Comapre *Occidental v Ecuador*, Final Award, 1 July 2004, para 173
[202] In the words of the tribunal in *Pope & Talbot v Canada*: 'By their very nature, 'circumstances' are context dependent and have no unalterable meaning across the spectrum of fact situations … the concept of 'like' can have a range of meanings, from 'similar' all the way to 'identical'.', see *Pope & Talbot v Canada*, Award on the Merits of Phase 2, 10 April 2001, para 75
[203] Compare Viñuales (2012), p 330; *Parkerings v Lithuania*, Award, 11 September 2007, para 393
[204] Compare *Feldman v Mexico*, Award, 16 December 2002, para 181; *Pope & Talbot v Canada*, Award on the Merits of Phase 2, 10 April 2001, para 79; *S.D. Myers v Canada*, First Partial Award, 13 November 2000, para 254; *Bayindir v Pakistan*, Award, 27 August 2009, para 390
[205] Compare Dolzer/Schreuer (2012), p 201
[206] *Corn Products v Mexico*, Decision on Responsibility, 15 January 2008, para 142

purposes.[207] In *Tecmed v Mexico*, the investor did not rely on MFN or NT since there was no suitable comparator. Rather, the investor invoked the FET standard. The tribunal found that the non-renewal of the operation permit of a land fill was not a result of genuine environmental concerns, but rather an attempt to cope with public protests.[208] Therefore, the claimant's argument referring to intent was successful. However, there must be some negative impact on the claimant for a non-discrimination claim to succeed.[209]

Concerning (3) possible justifications, it is widely accepted that differentiating host state measures are justifiable on the basis of rational grounds.[210] In this sense, the tribunal in *S.D. Myers v Canada* noted that the 'assessment of "like circumstances" must also take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest'.[211] Justification may be implied by specific exceptions (e.g. carve-outs limiting the scope of MFN or NT provisions) and general exceptions (similar to Article XX of the GATT) in the applicable IIA as well as by customary circumstances precluding wrongfulness (as codified in the ILC Articles on State Responsibility). It is, however, impossible to precisely name all possible grounds of justification in this context. It is, for example, unclear, in how far the police powers doctrine could be harnessed to justify differential treatment.[212] Be that as it may, a genuine and legitimate public purpose (e.g. ecologically and socially associated) will mostly be a major component of justifying factors.[213] The stronger the nexus between host state measure and genuine public purpose, the higher the probability that the measure was not adopted with a discriminatory intent and the higher the legitimacy of the measure in question.[214]

Treaty exceptions related to non-discrimination standards often include justification clauses referring to measures pursuing sustainable development. In this sense, the Protocol attached to the BIT between Germany and China of 2003 states in its paragraph 4 (a), that '[m]easures that have to be taken for reasons of public security and order, public health or morality shall not be deemed "treatment less favourable" within the meaning of Article 3' (which contains MFN and NT clauses). Similarly, the BIT between Uganda and the Benelux States of 2005 provides in its Article 3 (2) that '[e]xcept for measures required to maintain public order, such investments shall enjoy continuous protection and security, i.e. excluding any unjustified or discriminatory measure which could hinder, either in law or in practice, the management, maintenance, use,

[207] Compare Viñuales (2012), p 331
[208] Compare *Tecmed v Mexico*, Award, 29 May 2003, para 164
[209] Compare Reinisch (2008), p 49
[210] Compare Dolzer/Schreuer (2012), p 202
[211] *SD Myers v Canada*, First Partial Award, 13 November 2000, para 250
[212] Compare Viñuales (2012), p 333
[213] Ibid, p 333
[214] In the non-discrimination context, a 'reasonable nexus' between a host state measure and rational government policies was held to be required e.g. by the tribunal in *Pope & Talbot v Canada* (*Pope & Talbot v Canada*, Award on the Merits of Phase 2, 10 April 2001, para 78).

possession or liquidation thereof'. The discussion of the facilitation of sustainable development objectives by exceptions will be continued in a separate section.

It is rather unclear, in how far factors beyond treaty and customary law can justify differential treatment. Case law, however, suggests that particularly considerations of proportionality could work as a justification on its own.[215] In this context, the *Arcelor* case[216] might have some relevance. The claimant, a large steel producer, argued that the European Emissions Trading Directive ('ETS Directive') and the French implementing measures violated the equal treatment standard because they discriminated between sectors in like circumstances (steel, chemical and aluminium producers). Despite the fact that the chemical and aluminium sectors also produce a large amount of greenhouse gases, only the steel producers had been included in the first phase of the cap-and-trade system established by the ETS Directive.

The ECJ found that the three sectors were indeed in a comparable position and that they had been treated differently. Nevertheless, the Court held that the differential treatment was justified, since the European Community had acted within its broad discretion and based on 'objective criteria appropriate to the aim pursued by the legislation … taking into account all the facts and the technical and scientific data available at the time of adoption of the act in question'.[217] In explaining those 'objective criteria', the Court referred to factors like the excessive administrative complexity in case of including the chemical sector into the first phase of the cap-and-trade system[218], the significantly different levels of direct emissions between the sectors[219] and the fact that the EC's actual measure did not lead to manifestly less appropriate results than other measures suitable for the object pursued.[220] This line of reasoning has some resonance with the police powers doctrine and the margin of appreciation doctrine and strongly relies on considerations of proportionality.

Concerning (4) different stages of the investment cycle, the main distinction is that between the pre-establishment stage (before the investment is made in the host state) and the post-establishment stage (after the investment is made in the host state). In principle, host states are free to regulate admission of foreign investments into their territories. Potential regulatory policies in this context range from the simple prohibition of entry over licensing requirements, tax arrangements, capitalization and control requirements, requirements of local collaboration, requirements relating to the environment and human rights standards (including environmental,

[215] Compare Viñuales (2012), p 335
[216] *Société Arcelor Atlantique et Lorraine et al. v Premier Ministre, Ministre de l'Economie, des Finances et de l'Industrie, Ministre de l'Ecologie et du Développement Durable*, ECJ Case C-127/07, Judgment, 16 December 2008
[217] Ibid, para 58
[218] Ibid, para 68
[219] Ibid, para 72
[220] Ibid, para 59

social and human rights impact assessments) to a far-reaching liberalization backed by clauses ensuring the right of establishment and prohibiting certain performance requirements.[221]

Unless the host state has (explicitly or implicitly) agreed to limit its sovereign right to regulate the issue of admission, the host state's domestic law will apply, whereas schemes of notification, registration and different types of approval mechanisms – including case-by-case screening – may have to be observed.[222] In this sense, there is nothing unlawful about granting access only to ecologically and socially responsible investors and investments. Environmental, social and human rights due diligence, however, is basically not sensitive to nationality issues, since the legitimate dividing line will be between responsible and irresponsible actors and not (primarily) between domestic and foreign investors.[223]

Granting an unconditional right of admission to foreign investors, conversely, bears great risks for the host state from a sustainable development perspective. IIAs that grant a right of admission, therefore usually include lists with all economic sectors that are or are not open to foreign investors (positive and negative lists).

Exceptions can be designed to apply to certain categories of both investors and investments. Some IIAs provide that future exceptions may not place the nationals of the other state(s) in a less favorable position. Again other IIAs allow for a tightening of admission-related measures over the time or refer to admission requirements contained in the host state's domestic law.[224] In order to grant a right of admission, many IIAs extend the scope of the MFN or NT clauses to admission, combined with positive or negative lists. An example is provided by the 2012 US Model BIT which states in its Article 3 section 1:

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

Exceptions to this rule can be found in Article 14 section 2 of the US Model BIT, which states that the provisions on NT, MFN, performance requirements and 'Senior Management and Boards of Directors' do not apply to any measures adopted with respect to sectors, subsectors and activities as set out in the schedule to Annex II of the BIT to be concluded.

It is arguably easier for a host state to ensure that only responsible investments may enter if the respective IIA uses positive lists that enumerate those types of investments that are likely to be conducive to sustainable development. In all events, a case-by-case screening and approval of

[221] Compare Viñuales (2012), p 322
[222] Compare Dolzer/Schreuer (2012), p 90
[223] Compare Viñuales (2012), p 322
[224] Compare Dolzer/Schreuer (2012), pp 89-90

incoming investments allows for a maximum of control in terms of harnessing foreign investment for sustainable development. Such a strategy, however, requires the host state to have a sophisticated idea of what constitutes a responsible and beneficial investment as well as powerful screening and assessment resources to administrate such case-by-case decisions.

Clauses granting a right of admission often go along with provisions prohibiting performance requirements. Performance requirements are conditions imposed by host states on foreign investors relating to the establishment and operation of investments or in exchange for a particular advantage.[225] Neo-liberal voices would call them inconsistent with the principles of free markets, arguing that performance requirements are a disincentive for foreign investors who will refrain from investing under conditions impeding the free management of their investments and forcing them to conduct business in ways that reduce their efficiency and profitability.[226] Nevertheless, such conditions are a suitable possibility to ensure a fair host state participation in the management and the economic benefits of the investment. In this way, investors can for example be obliged to hire nationals of the host state, to use locally produced raw materials or inputs, and to export a portion of the finished product.

In an UNCTAD study of 2006, six different types of provisions on performance requirements were examined:[227] (1) Many BITs which do not contain a specific clause on performance requirements include an 'application of other rules' provision that aims at ensuring that the host state provides MFN treatment to the foreign investor with respect to the application of its domestic laws or international obligations, such as those under the Agreement on Trade Related Investment Measures (TRIMs). (2) Many BITs limit the use of performance requirements while stating that the obligations undertaken in this regard do not extend beyond those assumed in the context of the TRIMs Agreement. (3) A third group of IIAs includes a general restriction on the use of performance requirements. (4) A fourth group bans the use of performance requirements as stated in an exhaustive positive list. (5) Other IIAs contain sophisticated clauses which include additional restrictions on the use of performance requirements and deny the host state to make certain performance requirements a condition for granting diverse advantages or incentives. (6) A sixth group of IIAs uses clauses that ban performance requirements not only with regard to investors of the countries party to the respective IIA but towards investors and investments of all states, which shall ensure a single investment policy.[228]

Despite the usual calls for investment (and trade) liberalization in order to steer FDI ('Foreign Direct Investment') flows to developing countries, those countries are well advised to maintain the regulatory space necessary to carefully select those investments that are really beneficial to

[225] Compare UNCTAD (2004), pp 19, 96, 144-145
[226] Compare Baetens, Freya, *The Kyoto Protocol in Investor-State Arbitration: Reconciling Climate Change and Investment Protection Objectives*, in Cordonier Segger (2013), p 702
[227] Ibid, pp 702 ff; UNCTAD (2007), pp 64-69
[228] Compare Baetens, Freya, *The Kyoto Protocol in Investor-State Arbitration: Reconciling Climate Change and Investment Protection Objectives*, in Cordonier Segger (2013), pp 702-703

the host state and eco-socially responsible and to ensure a fair participation of the host state in the management and in the profits of the foreign investment. Therefore, developing countries should think twice before admitting to clauses that grant a right of admission and that prohibit performance requirements.

3.5.4. Full Protection and Security

'Full Protection and Security' ('FPS') is a standard less frequently applied than other standards (e.g. FET and expropriation), therefore arbitration practice in this context is not common and literature is rare.[229] Despite the existence of various formulations to express this standard[230], arbitral practice does not seem to attach much significance to the exact wording in the applicable IIA.[231] The scope of the standard undisputedly comprises physical protection of the assets and individuals connected with the foreign investment.[232] Some tribunals, however, extended 'full protection and security' beyond physical safety in order to also cover forms of legal protection.[233] According to these lines of reasoning, the standard requires the host state to make available its legal system to protect the investor's interests or even covers the stability of the investment climate and the legal framework.[234] It is obvious that such an extensive interpretation may detract from the host state's regulatory space and flexibility to adapt its framework of social and ecological regulations over the time.

Fortunately, the prevailing approach in investment arbitration shows understanding for a large degree of sovereign appreciation. Tribunals following this line of reasoning are inclined to examine whether the measures taken by the host state obviously deviate from a reasonable standard. In this sense, the tribunal in *Saluka v Czech Republic* held that the standard of 'full protection and security' was not breached if the host state's behavior was not totally unreasonable and unjustifiable by some rational legal policy.[235] The existence of such a large margin of appreciation is also confirmed by the ICJ in the *ELSI* case.[236]

Among the moderated approaches, it is common ground that the standard requires the host state to exercise due diligence to ensure the safety of the investment. This is an obligation of conduct, and not an obligation of result (also referred to as 'strict liability').[237] In the determination of

[229] Compare Reinisch (2008), p 131
[230] E.g.: 'full protection and security', 'the most constant protection', 'protection and security', 'full legal protection and full legal security'
[231] Compare Reinisch (2008), p 134
[232] Ibid, p 131
[233] Compare Dolzer/Schreuer (2012), p 163
[234] Compare Reinisch (2008), pp 144 f
[235] Compare *Saluka v Czech Republic*, Partial Award, 17 March 2006, para 490
[236] Compare ICJ in *Elettronica Sicula S.p.A. (ELSI) (United States of America v Italy)*, Judgment, 20 July 1989, para 106; Reinisch (2008), p 141
[237] Compare Reinisch (2008), p 139; Dolzer/Schreuer (2012), p 161

the appropriate standard of due diligence, tribunals like the one in *Bayindir v Pakistan* were willing to consider all circumstances prevailing in the host state, including the political, socioeconomic, cultural and historical conditions.[238] In a similar vein, the tribunal in *Toto v Lebanon* held that in a situation of severe political disturbances, investors cannot expect a smooth functioning of the judiciary.[239]

The level of a host state's development, shall however, not be capable of justifying the deprivation of fundamental due process rights. In this sense, the tribunal in *Pantechniki v Albania* emphasized that the threshold for a denial of justice should be absolute and not be influenced by a host state's level of development. Conversely, protection against physical violence should depend on the host state's resources.[240]

In effect, violence stemming from state organs or a refusal to intervene on the side of the official forces to stop violence by private actors is unlikely to be found as subject to the mitigating effect of the host state's stage of development. The situation is different, however, in the case of violence emanating from private actors when the host state is incapable of ending the violence due to lack of resources.[241]

3.6. Considerations of the level of development in investment arbitration

As a matter of fact, most investment tribunals have not systematically examined the economic and political circumstances prevailing in host states in their assessment of the state's compliance with protection standards contained in IIAs. However, a couple of tribunals have considered factors like the level of development or political stability.[242] Such considerations can either have an effect on the decision of liability or on the amount of compensation awarded.

The cases where economic or political conditions in the host state were taken into account on the level of liability, can be divided into three situational groups: awards concerning (1) ex-communist countries in transition, (2) economic and financial crises and (3) ongoing political disturbances.[243] Tribunals have discussed those issues either in connection with specific protection standards like expropriation, FET or 'full protection and security' or independently.

Mostly, the immediate gateway for debating factors linked to the host state's stage of development were the legitimate expectations of the investor. Concerning the first group (1),

[238] Compare *Bayindir v Pakistan*, Award, 27 August 2009, paras 192-195, 197-199; Kriebaum in Baetens (2013), p 337
[239] Compare *Toto v Lebanon*, Decision on Jurisdiction, 11 September 2009, paras 139-144; Kriebaum in Baetens (2013), p 337
[240] Compare *Pantechniki v Albania*, Award, 30 July 2009, para 82; Kriebaum in Baetens (2013), pp 337 f
[241] Compare Kriebaum in Baetens (2013), p 340
[242] Ibid, p 333
[243] Ibid, p 333

the tribunal in *Genin v Estonia* noted that that Estonia was a country in transition from a communist country to a free market economy and therefore found that shortcomings in administrative proceedings did not violate the FET standard in question.[244] For the same reason, the tribunal in *Parkerings v Lithuania* found that there was no basis for the investor to reasonably expect that the domestic laws of Lithuania would remain unchanged.[245] Hence, there was no violation of FET.

Examples for (2) economic and financial crises as trigger elements for reducing the standard of liability are provided by disputes against Latin American countries. In this sense, the tribunal in *LG&E v Argentina* found that an unspecified reduced standard of FET was applicable, which, however, was not assumed to have been met.[246] In *Duke Energy v Ecuador*, the tribunal emphasized that 'also the political, socioeconomic, cultural and historical conditions prevailing in the host State' must play a role when assessing the host state's compliance with the FET standard.[247] In a similar vein, the tribunal in *El Paso v Argentina* held that the FET standard involves considerations of reasonableness and proportionality and that '[t]here can be no legitimate expectation for anyone that the legal framework will remain unchanged in the face of an extremely severe economic crisis'.[248] The tribunal in *National Grid v Argentina*, while rejecting Argentina's plea of necessity, took the difficult economic circumstances under which Argentina had implemented the measures at issue into account and concluded that Argentina was not liable for the claimant's losses during the first six months of the crisis.[249]

Examples for awards willing to consider (3) ongoing political disturbances in host states on the level of liability are provided by the previously cited cases *Bayindir v Pakistan*[250], *Toto v Lebanon*[251] and *Pantechniki v Albania*[252]. As mentioned earlier, the bottom line in this context seems to be that a lack of executive resources in a host state may justify the assumption of a lower protection standard while a denial of justice shall not be capable of being justified by a low stage of development.[253]

Technically speaking, the second level at which the host state's stage of development can be considered to the benefit of developing countries is the determination of the amount of compensation (or damages) due. In *AMT v Zaire*, the tribunal decided that the host state was liable for not protecting the foreign investment during riots and acts of violence. The tribunal,

[244] Compare *Genin v Estonia*, Award, 25 June 2001, para 370
[245] Compare *Parkerings v Lithuania*, Award, 11 September 2007, para 335
[246] Compare *LG&E v Argentina*, Decision on Liability, 3 October 2006, para 139
[247] *Duke Energy v Ecuador*, Award, 18 August 2008, para 340
[248] *El Paso v Argentina*, Award, 31 October 2011, para 374
[249] Compare *National Grid v Argentina*, Award, 3 November 2008, paras 179 f; Kriebaum in Baetens (2013), p 336
[250] *Bayindir v Pakistan*, Award, 27 August 2009, paras 192-5, 197-9
[251] *Toto v Lebanon*, Decision on Jurisdiction, 11 September 2009, paras 139-44
[252] *Pantechniki v Albania*, Award, 30 July 2009, para 82
[253] Compare Kriebaum in Baetens (2013), p 337

however, took Zaire's unstable political and business environment into account when calculating compensation and, in particular, lost profits and interests.[254] In *CMS v Argentina*, the claimant had been given guarantees for price adjustments for the transportation of natural gas. During the economic crisis, Argentina first suspended and then terminated these guarantees. The tribunal decided that the crisis was not severe enough to exclude the host state's liability or the wrongfulness of the sovereign measures. However, the tribunal considered Argentina's economic situation on the level of compensation, hence establishing an economic burden sharing between the foreign investor and the host state.[255]

Moreover, there are voices calling for a general provision for a host state's financial abilities when determining the amount of compensation.[256] Definite clauses in IIAs requiring the consideration of the host state's level of development in the interpretation of protection standards are still rare. There is, however, such a provision in the Investment Agreement for the Common Market for Eastern and Southern Africa (COMESA) Common Investment Area.[257] Its Article 14 sophisticatedly defines an FET obligation, whereas paragraph 3 of this Article states: 'For greater certainty, Member States understand that different Member States have different forms of administrative, legislative and judicial systems and that Member States at different levels of development may not achieve the same standards at the same time…'.

Other cases in which tribunals were willing to reduce the amount of compensation or damages due, have already been presented in the chapters about compensation and damages in the context of expropriation and FET.

3.7. Exceptions

On the level of norm creation, exceptions and reservations are the most important tools for limiting an investment agreement's scope of investment protection.[258] The burden of proving that an exception applies, usually rests on the state party invoking the exception. As for the interpretation of exceptions, some tribunals have suggested to apply a narrow understanding[259],

[254] Compare *AMT v Zaire*, Award, 21 February 1997, paras 7.14, 7.15
[255] Compare *CMS v Argentina*, Award, 12 May 2005, paras 240, 248
[256] E.g. Brownlie in *CME v Czech Republic*, Separate Opinion on the Issues at the Quantum Phase, 14 March 2003
[257] Compare Kriebaum in Baetens (2013), p 332
[258] The terms 'exceptions' and 'reservations' as used in this thesis, refer to treaty provisions that limit the scope or applicability of substantive obligations. The term 'reservation' in this context must not be confused with reservations in the sense of Article 2 (1) (d) VCLT. Usually, 'exception' refers to subjects completely excluded from the treaty's scope and addresses broader carve-outs from IIA obligations while 'reservation' is typically used for more specific exceptions and addresses narrower limitations to the scope of IIA obligations. Some IIAs speak of 'non-conforming' and 'non-precluded' measures. (Compare Newcombe et al (2009), p 483)
[259] E.g. the tribunals in *Canfor Corporation v United States* and *Terminal Forest Products Ltd. v United States*, Decision on Preliminary Question, 6 June 2006, para 187; *Enron Corporation and Panderosa Assets, L.P. v Argentina*, Award, 22 May 2007, para 331

referring to the treaty purpose of investment protection. A narrow interpretation, however, may not fit in every case and can contradict with the intentions of the treaty partners. Useful guidance on this point is provided by the WTO Appellate Body's general exceptions jurisprudence which stresses that an exception is another treaty provision that should be interpreted in accordance with the ordinary rules of treaty interpretation and not by the mere application of presumptions.[260] This approach was also taken by the tribunal in *UPS v Canada*, where the majority of arbitrators applied an extensive interpretation of an exception referring to cultural industries.[261] For the purpose of this thesis, I distinguish will distinguish between general and obligation specific exceptions.[262] While both types of exceptions can be used to preserve the host state's regulatory space and hence to accommodate sustainable development concerns, there are significant conceptual differences implying different legal effects.

3.7.1. General exceptions

Let us now examine the potential of general exceptions to create an IIA regime conducive to sustainable development. Following an OECD study, 82 out of 1623 IIAs examined in 2011 contain clauses expressly reserving policy space for environmental regulation. 32 of these 82 clauses are general exceptions modelled on Article XX GATT.[263] This Article limits the scope of various treaty standards – crucial to the WTO framework – such as Article I (MFN clause), Article III (National Treatment clause) and Article XI (Prohibition of Quantitative Restrictions) of the GATT. An example for a GATT-modelled general exception is provided by Article X of the Canadian Model FIPA ('Foreign Investment Protection Agreement') 2004, which reads:

> General Exceptions
>
> 1. Subject to the requirement that such measures are not applied in a manner that would constitute arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction on international trade of investment, nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures necessary:

[260] Compare *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, Appellate Body Report, 6 November 1998, para 121; Newcombe et al (2009), p 487
[261] Compare *UPS v Canada*, Award on the Merits, 24 May 2007, paras 165-72
[262] Following another categorization, at least five categories of exceptions and reservations are relevant for IIA treaty practice: (1) essential security exceptions, (2) other general exceptions, (3) exceptions for specific sectors or types of measures, (4) exceptions for existing non-conforming measures and amendments and (5) exceptions for future measures. (Compare Newcombe et al (2009), p 484)
[263] Compare Gordon, Kathryn/Pohl, Joachim, *Environmental Concerns in International Investment Agreements: A Survey*, OECD Working Paper on International Investment 2011/1, OECD Publishing, 2011, cited in Mestral et al (2013), p 273

(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 sources.

The list of legitimate public purposes can be extended to protect other policy objectives related to sustainable development. In this sense, the Energy Charter Treaty in its Article 24 contains an exception for measures 'designed to benefit Investors who are aboriginal people or socially or economically disadvantaged individuals or groups'.[264]

General exceptions provide for a broad carve-out from the host state's obligations enshrined in the respective IIA. On their face, such clauses appear to offer a holistic and innovative solution to include sustainable development concerns into the framework of investment protection. Indeed, an *effet utile* interpretation of general exception clauses might suggest that the parties intended to preserve a large portion of regulatory flexibility for the host state and that they agreed on a lower level of investment protection in general. Hence, general exceptions could mitigate the risk of overly broad interpretations of IIA protection standards.

There is, however, no guarantee that tribunals would apply such a host state-friendly interpretation. Tribunals could also read general exceptions restrictively, assuming a small degree of regulatory space for the host state. Indeed, most investment tribunals have constructed IIA exceptions rather narrowly.[265] Since general exceptions usually provide a closed list of legitimate policy objectives, tribunals might apply the interpretative principle *expressio unius est exclusio alterius* and hence limit the range of legitimate objectives to those represented in the list. Given the fact that in the absence of express general exceptions to IIA obligations, tribunal have been willing to assume implied justification of sovereign measures based on all kinds of public purposes that seemed legitimate, the presence of closed lists in this context could have the unintended consequence of limiting (instead of expanding) the host state's regulatory space.[266]

But there are potentially more unintended consequences of general exceptions in this context. GATT-like general exceptions might seduce the interpreter to use trade law jurisprudence even if it does not fit for the purposes of investment law.[267] As compared to the trade context, the weighing and balancing in the investment context must include far more factors (e.g. relevant to the public interest), since an investment typically has a larger impact to all kinds of host state systems than incoming streams of ready made products or services. With respect to exceptions,

[264] Compare UNCTAD (1999), p 44
[265] Compare Mestral et al (2013), p 278
[266] Ibid, pp 277, 279
[267] Ibid, p 279

many investment tribunals have applied a softer approach (i.e. host state-friendly) than the WTO Appellate Body in applying Article XX GATT. Particularly, investment tribunals tend to find a 'reasonable' or 'rational' nexus between a sovereign measure and a legitimate public objective sufficient for justification purposes.[268] Conversely, the WTO Appellate Body tends to use stricter necessity criteria in the context of general exceptions.[269]

Generally, in the light of the interpretative uncertainty, there is the danger of strayed balancing between public and private interests. In this regard, general exceptions also displace where in the legal analysis the balancing between public and private rights is to occur – at the stage of analyzing the primary obligation or at the stage of defense by way of exception to the primary obligation.[270] This distinction might have repercussions to the burden or prove. Moreover, general exceptions have an uneasy relationship with customary international law standards of investment protection. Hence, vague language might seduce the interpreter to simply equate the exception's normative content with the customary minimum standard without contemplating further relevant legal distinctions. With regard to the expropriation standard, general exceptions might probably be interpreted as not having the effect of preventing compensation, even if the expropriation is justified.[271] Ultimately, uncertainty about the scope of FET and other generally worded protection standards is not sufficiently reduced by use of general exceptions. Therefore, IIA parties are well advised to include exceptions at the level of the primary obligations by accurately clarifying the scope of each single standard of investment protection.[272]

3.7.2. Obligation specific exceptions

As for expropriation, more recent model BITs like the Canadian Model FIPA of 2004 and the US Model BITs of 2004 and 2012 provide detailed guidance to tribunals on the interpretation of expropriation. While the main expropriation clauses in those model BITs are similar to other IIAs, they require that expropriation shall be interpreted in accordance with an annex which elaborates on the meaning of expropriation. This approach has been realized for example in the US-Uruguay BIT of 2005 and in investment chapters of several US bilateral free trade agreements.[273] From a sustainable development perspective, the clarifications on indirect expropriations are remarkable. In this sense, paragraph 4 of Annex B of the 2012 US Model BIT / the 2005 US-Uruguay BIT states:

[268] Compare *Pope & Talbot v Canada*, Award on the Merits of Phase 2, 10 April 2001, para 78; *GAMI v Mexico*, Final Award, 15 November 2004, para 114
[269] Compare DiMascio/Pauwelyn, *Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin*, (2008) AJIL 48, cited in Mestral et al (2013), p 281
[270] Compare Mestral et al (2013), p 269
[271] Compare Echandi et al (2013), p 362
[272] Compare Mestral et al (2013), p 283; Echandi et al (2013), p 370
[273] E.g.: FTAs with Australia, Chile, Dominican Republic and Morocco

(a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:
    (i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
    (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
    (iii) the character of the government action.
(b) Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.

This approach is consistent with the moderate police powers doctrine since it basically relies on the legitimacy of the public purpose (lit b) but also adds a balancing component (lit a) which requires other factors – economic impact, the investor's legitimate expectations and the character of government action – to be considered. Applied with a proper mind-set of eco-social values in the background, this provision is a valid frame for balancing public and private interests while considering sustainable development concerns as an important sovereign agenda.

Another example for an expropriation clause open to the consideration of the public interest is provided by Article 6 of the 2007 Norwegian Model BIT which states:

1. A Party shall not expropriate or nationalize an investment of an investor of the other Party except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
2. The preceding provision shall not, however, in any way impair the right of a Party to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other conditions or penalties.

In addition, the commentary on the 2007 Norwegian Model BIT explains that this expropriation provision, while providing effective and intentional investment protection, shall be understood to safeguard the host state's right to implement general regulations and administrative decisions without incurring liability to pay compensation.[274]

[274] Compare Newcombe et al (2009), p 335; *Comments on the Model for Future Investment Agreements*, 19 December 2007, at 21, available at http://www.italaw.com/sites/default/files/archive/ita1029.pdf (accessed 8 August 2016, 05:00 PM)

Technically speaking, those clauses are definitions of the scope of indirect expropriation but materially function as exceptions. The 2005 Model International Agreement on Investment for Sustainable Development[275] ('IISD Model Agreement'), drafted by the International Institute for Sustainable Development, defines expropriation in no less than nine sub-paragraphs. Its Article 8 (I) states:

> 'Consistent with the right of states to regulate and the customary international law principles on police powers, *bona fide*, non-discriminatory regulatory measures taken by a Party that are designed and applied to protect or enhance legitimate public welfare objectives, such as public health, safety and the environment, do not constitute an indirect expropriation under this Article.'

This wording is attributable to the strict police powers approach and seems to aim at hardening the customary underpinning of the formula that non-discriminatory host state measures taken in good faith and due process while pursuing a genuine public purpose shall not be deemed expropriatory.[276] In any event, such a clause effectively ensures a large regulatory space that can be used to realize sustainable development policies.

An example for an obligation specific exception to MFN is provided by the 2006 Canada-Peru BIT. Its Annex III provides that the MFN obligation shall not apply to treatment accorded under international agreements in force or at least signed prior to the entry into force of the BIT and shall not apply to treatment according to agreements relating to aviation, fisheries and maritime matters as well as to agreements establishing or expanding a free trade or customs union. Furthermore, the annex clarifies that the MFN obligation 'shall not apply to any current or future foreign aid programme to promote economic development, whether under a bilateral agreement, or pursuant to a multilateral arrangement or agreement, such as the OECD Agreement on Export Credits'.[277] The MFN guarantee in this case is prospective and does not extend to treatment accorded under existing agreements.

Clarifications of the exact scope of the MFN obligation are crucial from a sustainable development perspective, given the fact that some tribunals have extended the MFN standard to procedural and even jurisdictional matters ('*Maffezini* approach'[278]) which allows for a comprehensive provision shopping from IIAs within the range of the MFN clause. To prevent such a broad reading of MFN, parties during IIA negotiations have added footnotes into the draft texts which explicitly refuse the *Maffezini* approach.[279] The 2006 Swiss-Colombia BIT

[275] IISD Model International Agreement on Investment for Sustainable Development, 2005, available at https://www.iisd.org/pdf/2005/investment_model_int_agreement.pdf (accessed 8 August 2016, 05:00 PM)
[276] Compare *Saluka v Czech Republic*, Partial Award, 17 March 2016, para 262; *Methanex v United States*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, Part IV, Chapter D, page 4, para 7
[277] Annex III, para 3
[278] *Maffezini v Spain*, Decision on Jurisdiction, 25 January 2000
[279] E.g. draft versions of the Central America-Dominican Republic-United States Free Trade Agreement (CAFTA)

even explicitly clarifies that 'the most favourable nation treatment … does not encompass mechanisms for the settlement of investment disputes provided for in other international agreements concluded by the Party concerned.'[280]

In a similar vein, the European Commission in a working paper has expressed its intention to limit the scope of MFN in future IIAs to establishment, thus signaling that expropriation and dispute settlement provisions shall not be covered by the standard.[281] Interestingly, it was exactly the tribunal in *Maffezini v Spain* which correctly noted that an MFN clause should not enable a party to 'override *public policy considerations* that the contracting parties might have envisaged as fundamental conditions for their acceptance of the agreement in question'.[282]

The IISD Model Agreement in its Article 6, restricts MFN to substantive provisions of future IIAs. A right to establishment is guaranteed in cases where the comparator who achieved establishment or acquisition, did so in accordance with host state law. Paragraph E of Article 6 contains, *inter alia*, subject specific exceptions for treatment according to the rules of any 'customs union, free trade area, common market [and] any international environmental agreement to which the investor's home state is not a Party'. While there is obviously a carve-out for obligations arising out of environmental agreements, a straight forward exception for necessary environmental or social purposes is missing.

As for 'national treatment', the BIT between Italy and Morocco contains some sustainable development language:

> 'Investors of the two Contracting Parties shall not be entitled to national treatment in terms of benefiting from aid, grants, loans, insurance and guarantees accorded by the Government of one of the Contracting Parties exclusively to its own nationals or enterprises within the framework of activities carried out under national development programmes.'

Protocol 2 of the BIT between Indonesia and Switzerland permits a derogation from national treatment of Swiss investors 'in view of the present stage of development of the Indonesian national economy'. However, Indonesia would grant 'identical or compensating facilities to investments and nationals of the Swiss Confederation in similar economic activities'.

Similarly, Germany has accepted certain exceptions to NT provided these are undertaken for development purposes only, e.g. for the development of small-scale industries, and that the measures do not substantially impair investments from a German investor.

[280] Article 4 para 2 of the Protocol to the Swiss-Colombia BIT of 2006
[281] Compare Reinisch (2008), p 82
[282] *Maffezini v Spain*, Decision on Jurisdiction, 25 January 2000, para 62

Generally, IIAs commonly provide express exceptions and reservations to relative standards of treatment, often in annexes or protocols. In this sense, certain sectors or activities such as government procurement and the provisions of subsidies are common subjects to exceptions.[283]

Concerning minimum standards of treatment (especially FET if linked to the international minimum standard), IIAs usually do not contain specific exceptions or reservations. Host states may, however, be able to rely on express general exceptions, reservations or defenses under customary international law.[284]

The IISD Model Agreement in its Article 7 clarifies that foreign investors must not expect treatment more favorable than that prescribed by the international minimum standard and that FET and 'full protection and security' do not create additional substantive rights. Furthermore, Article 7 contains a reference to Article 19 which defines procedural fairness and therefore provides a detailed description of the investor's due process rights guaranteed by the IIA to be concluded. In this sense, Article 19 prohibits a denial of justice and arbitrary proceedings and calls for a fair process including the possibility of the judicial review of administrative decisions. This right of appeal is, however, 'commensurate with the level of development of the host state' (Article 19 para (C)).

Moreover, Article 19 (D) expresses the parties' understanding that 'different Parties have different forms of administrative, legislative and judicial systems, and that states at different levels of development may not achieve the same standards or qualities for their administrative and judicial processes.'

As we can see, the IISD Model IIA explicitly calls for consideration of the host state's level of development when determining a breach of due process standards.

3.8. Common defense arguments

Let me now present some defense arguments that can potentially be used to justify host state measures based on sustainable development considerations. There is, for one thing, the police powers doctrine which has already been presented in the context of expropriation. As the tribunal in *Methanex v United States* told us, 'a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process … is not deemed expropriatory and

[283] Compare Newcombe et al (2009), p 190
[284] Ibid, p 319

compensable unless specific commitments had been given' to the foreign investor.[285] Let us have a look at the elements of this formula.

Finding a *public purpose* that can potentially justify a sovereign measure is basically not difficult. Legal authors have stressed that 'the requirement of public purpose for a taking to be lawful is not much of a limitation in modern times'[286] and that '[…] it is very easy for an expropriating state to couch any taking in terms of some "public purpose"'[287]. Investment tribunals have been reluctant to second-guess a host state's determination of a public purpose '[…] perhaps because the concept of public purpose is broad and not subject to effective re-examination by other states'[288]. Nevertheless, this requirement is a corrective in cases of blatant misuse, e.g. where private elites put on the public interest for personal enrichment or where expropriations are carried out in the context of serious human rights violations, genocide or crimes against humanity.[289]

As for the requirement of *non-discrimination*, the fact that only one entity (the foreign investor) is affected by a sovereign measure, does not per se make the measure discriminatory. Unlawful discrimination basically requires the specific targeting of foreign investors on the basis of unreasonable policies or motives like racism and political retaliation against nationals of another state.[290] Arbitral practice strongly promotes the non-discrimination requirement as a condition for the legality of an expropriation not only under customary international law but also under specific IIA provisions. While tribunals usually find politically motivated forms of discrimination to be unlawful, they are more careful with respect to expropriations that affect only some foreigners if such discrimination is backed by a genuine public purpose.[291]

Unlike the elements of *public purpose* and *non-discrimination*, the requirement of *due process* is less certainly established in customary international law. The due process requirement appears in different forms in IIA practice. It may be phrased as a mere condition for the expropriation to be legal or it may expressly require the foreign investor's right to have the expropriation (and the compensation) decision reviewed. The scarce case law in this regard suggests that the possibility of judicial review embedded in a fair procedure is crucial.[292]

[285] *Methanex v United States*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, Part IV, Chapter D, page 4, para 7
[286] Sornarajah, *The International Law on Foreign Investment*, 2nd edition, 2004, p 395, cited in Reinisch (2008), p 179
[287] Rubins and Kinsella, *International Investment, Political Risk and Dispute Resolution. A Practitioner's Guide*, 2005, pp 155, cited in Reinisch (2008), p 179
[288] American Law Institute, *Restatement (Third) of the Foreign Relations Law of the United States*, 1987, § 712, Comment (e), cited in Reinisch (2008), p 179
[289] Compare Reinisch (2008), p 179
[290] Ibid, p 190
[291] Ibid, p 190
[292] Ibid, p 190

Concerning the element of (the absence of) *specific commitments*, it must be noted that, basically '[…] the exercise of the State's regulatory powers (and more specifically the application of the police powers doctrine) is not subordinated, in customary international law, to the absence of specific assurances'.[293] The legal basis of this element can rather be found in considerations of good faith.[294]

In *Methanex v United States*, the tribunal specified five conditions for the determination of an actionable specific commitment (or 'assurance'): (i) the assurance must be given by the regulating government (i.e. the regulator itself and not by another governmental agency); (ii) to the foreign investor itself (and not to a third party or to 'any potential investor'); (iii) at the time the investor is thinking about making the investment (when the foreign investor is deciding to enter the market); (iv) the commitment must be specific (concerning specific regulations; it is not enough to state that the government has promised to refrain from adopting adverse regulations) and (v) the assurance must be given in good faith (e.g. not be given by a corrupt official).[295]

The more specific a commitment is, the more it will be legally relevant. However, many markets are subject to radical and unforeseeable changes. Therefore, an investor can for example not reasonably expect that, if the harmful character of a substance used for production is unveiled, the host state will not take action. As a matter of good faith, this should apply even in the presence of specific commitments, since such assurances are not to be construed as an insurance against obsolete lines of business.[296]

Another defense strategy is to rely on the 'margin of appreciation doctrine' which was developed by the ECtHR in the context of derogations from human rights standards as enshrined in the ECHR. Confronted with the challenge to define the normative content of the notion of 'morals' in the *Handyside* case, the Court stated that

> '[b]y reason of their direct and continuous contact with the vital forces of their countries, State authorities are in principle in a better position than the international judge to give an opinion on the exact content of these requirements as well as on the 'necessity' of a 'restriction' or 'penalty' intended to meet them'.[297]

The Court conceded this 'margin of appreciation' to both the domestic legislator and the domestic bodies that were to apply the respective laws. Accepting a state's margin of appreciation is, basically, a standard of deference given to the national authorities to assess a

[293] Viñuales (2012), p 372
[294] Compare Viñuales (2012), p 372
[295] Ibid, p 374
[296] Ibid, p 376
[297] *Handyside v United Kingdom*, ECtHR Application No. 5493/72, Judgment, 7 December 1976, para 48

situation because of their closer relation to the local situation and their better position to understand it.[298]

In the context of investment arbitration, for example the tribunals in *Methanex v United States*[299] and in *Glamis v United States*[300] used the margin of appreciation concept. In these cases, the tribunals noted that their role was not to judge the scientific conclusions on which the measures challenged by the claimant were based, but only the validity of the process followed to reach those conclusions.

The tribunal in *Chemtura v Canada*, however, emphasized that focusing only on process may sometimes lead to unsatisfactory solutions, since under some circumstances, it could be unreasonable to penalize a host state that took a decision based on sound science but through a procedurally inefficient process. Mere procedural breaches would only be relevant to the extent that they have imposed an unnecessarily heavy burden on the foreign investor.[301] In *Chemtura v Canada*, the tribunal decided that the delays in the registration process of a lindane-free replacement substance submitted by the investor did not amount to a violation of Article 1105 NAFTA.[302] In addition, compared to the tribunals in *Methanex* and *Glamis*, the tribunal in *Chemtura* took a more nuanced stance on the standard of review relevant for investment tribunals:

> 'In assessing whether the treatment afforded to the Claimant's investment was in accordance with the international minimum standard, the Tribunal must take into account all the circumstances, including the fact that certain agencies manage highly specialized domains involving scientific and public policy determinations. This is not an abstract assessment circumscribed by a legal doctrine about the margin of appreciation of specialized regulatory agencies. It is an assessment that must be conducted *in concreto*.'[303]

Following the tribunal in *Chemtura*, the margin of appreciation can be smaller or larger, depending on the case.

Another question in this context is the relationship between the margin of appreciation doctrine and the police powers doctrine. Although these concepts are similar to a certain degree, a closer look reveals some differences. First, the police powers doctrine is only relevant in connection with expropriation, since the considerations underlying this concept are already taken into

[298] Compare Viñuales (2012), p 377
[299] Compare *Methanex v United States*, Award, 3 August 2005, Part III, Ch. A, para 101
[300] Compare *Glamis v United States*, Award, 16 May 2009, para 779
[301] Compare *Chemtura v Canada*, Award, 2 August 2010, paras 133-134
[302] Ibid, paras 217-220
[303] Ibid, para 123

account in the definition and scope of other standards of protection (e.g. FET). In this context, the tribunal in *Suez v Argentina* held:

> '[T]he application of the police powers doctrine as an explicit, affirmative defense to treaty claims *other* than for expropriation is inappropriate, because in judging those claims and applying such principles, as full protection and security and fair and equitable treatment, both of which are considered in subsequent sections of this Decision, a tribunal must take account of a State's reasonable right to regulate. Thus, if a tribunal finds that a State has violated treaty standards of fair and equitable treatment and full protection and security, it must of necessity have determined that such State has exceeded its reasonable right to regulate. Consequently, for that same tribunal to make a subsequent inquiry as to whether that same State has exceeded its legitimate police powers would require that tribunal to engage in an inquiry it has already made. In short, a decision on the application of the police powers doctrine in such circumstance would be duplicative and therefore inappropriate.'[304]

Second, the margin of appreciation doctrine mainly seeks to avoid second-guessing the scientific or technical assessment conducted by a specialized agency while the police powers doctrine simply recognizes a host state's regulatory space that is inherent to sovereignty. Third, the margin of appreciation doctrine concerns factual analysis while the police powers doctrine concerns liability. Where a measure is found to be covered by a state's police powers, the measure challenged does not violate investment disciplines. Fourth, the margin of appreciation doctrine is more open for considerations of proportionality than the police powers doctrine. While the latter excludes the host state's liability as such, the former allows tribunals to respect the environmental or social assessment conducted by state authorities while considering that the measures taken on that basis were not proportional.[305]

A combination of both approaches has been used in *Tecmed v Mexico*, where the tribunal first held that in principle it was up to the host state to choose and take the measures appropriate to protect the public interest (police powers doctrine), whereas the tribunal insisted on its right to review whether those measures were proportional with respect to their goals. Hence, the tribunal assumed a certain (limited) margin of appreciation for the host state to choose its measures.[306] Therefore, the link between deference and exemption of liability can be mediated by considerations of proportionality, whereas, under the police powers doctrine, proportionality is relevant only with respect to the question whether the doctrine is applicable or not.[307]

[304] *Suez v Argentina*, Decision on Liability, 31 August 2010, para 148
[305] Compare Viñuales (2012), p 379 f
[306] Compare *Tecmed v Mexico*, Award, 29 May 2003, para 122
[307] Compare Viñuales (2012), p 381

3.9. Necessity

Another defense strategy involving sustainable development considerations could be the invocation of customary circumstances precluding the wrongfulness of an action or the reliance on an emergency clause enshrined in the applicable IIA. Among the seven customary 'circumstances precluding wrongfulness'[308] as codified in the 2001 ILC Articles on State Responsibility, 'necessity' seems to be the most promising route to accommodate environmental or social arguments. By now, no investment tribunal has addressed necessity in the context of an environmental crisis. There are, however, seven investment cases dealing with necessity during the economic crisis in Argentina. Moreover, there is the *Gabčíkovo-Nagymaros* case in the field of general international law, which teaches various lessons about necessity based on environmental considerations. In order to prevent abuse, necessity should only rarely be available to excuse the non-performance of an international obligation and therefore is subject to strict limitations.[309]

Therefore, Article 25 of the ILC Articles[310] sets high hurdles for a state to overcome. More precisely, a state must demonstrate that violating its obligations 'is the *only way* for the State to safeguard an *essential interest* against a *grave and imminent peril*'[311]. Furthermore, the violation must not 'seriously impair an *essential interest* of the State or States towards which the obligation exists, or of the international community as a whole'[312]. Moreover, 'the international obligation in question must *not exclude* the possibility of invoking necessity'[313] and the state must *not have contributed* to the situation of necessity[314]. In addition, the plea of necessity is not self-judging, that means that the state 'is not the sole judge of whether those conditions have been met'[315]. *Prima facie*, these are hard obstacles for soft issues like sustainable development concerns. While, as a matter of principle, necessity could be invoked in order to respond to, *inter alia*, economic, political and environmental crises, this does not mean that the plea of necessity is always practically available to promote those social and

[308] i.e. consent, self-defense, countermeasures, *force majeure*, distress, necessity, compliance with *ius cogens*
[309] Compare ILC, *Report of the International Law Commission on the work of its fifty-third session, commentary on Article 25 of the 2001 ILC Articles on State Responsibility*, 2008, para 2
[310] Article 25 (emphasis added): *Necessity*
1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act:
(*a*) is the *only way* for the State to safeguard an *essential interest* against a *grave and imminent peril*; and
(*b*) *does not seriously impair an essential interest* of the State or States towards which the obligation exists, or of the international community as a whole.
2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if:
(*a*) the international obligation in question *excludes* the possibility of invoking necessity; or
(*b*) the State has *contributed* to the situation of necessity.
[311] Compare Article 25 (1) lit a
[312] Compare Article 25 (1) lit b
[313] Compare Article 25 (2) lit a
[314] Compare Article 25 (2) lit b
[315] ICJ in *Gabčíkovo-Nagymaros Project (Hungary v Slovakia)*, Judgment, 25 September 1997, at 40

environmental aspects that can be subsumed under the concept of sustainable development.[316] On the one hand, sustainable development goals are rather general in nature and therefore not likely to prevail over specific treaty obligations. On the other hand, where certain sustainable development regulations contradict a state's investment obligations, tribunals may be reluctant to find the situation sufficiently severe to constitute imminent peril.[317]

Let us have a closer look on the necessity requirements. An 'essential interest' can be easily demonstrated. Thus, the ICJ in the *Gabčíkovo-Nagymaros* case had 'no difficulty in acknowledging that the concerns expressed by Hungary for its natural environment in the region affected by the Gabčíkovo-Nagymaros Project related to an "essential interest" of that State'[318]. Indeed, 'safeguarding the ecological balance' is nowadays accepted as an essential interest of all states.[319] The requirement of 'grave and imminent peril' is more difficult to meet. According to the ICJ, 'imminent' is synonymous with 'immediacy' or 'proximity' and goes far beyond the concept of 'possibility'.[320] Following the Court, not only a certain degree of immediacy, but also a certain degree of certainty must be present. This certainty requires that the peril must be established by evidence reasonably available at the time.[321] In sum, the element of imminence is hard to establish. The danger of immediate extinction of a species would probably fulfill this requirement. Long-term environmental effects of de-forestation probably not. Especially in the context of ecology, it could be wise to read 'imminence' as 'irreversibility'. It seems appropriate to state that the graver the peril, the less stringent the imminence requirement can be construed.[322]

The next element, 'only means' refers to the requirement that there is no other option for a state to save its vital interests than to violate its international obligation. If other measures to prevent the peril are available, the state must choose those options, even if they are more difficult or costly. Moreover, compliance with the international obligation must resume as soon as possible.[323] In the *Gabčíkovo-Nagymaros* case, the ICJ concluded that there were other options available for Hungary to prevent ecological harm than to abandon its obligations under the treaty with Slovakia.[324] Similarly, in *CMS v Argentina*[325] and *Enron v Argentina*[326], the tribunals found that there were various approaches available to effectively respond to the economic crisis. By contrast, the tribunal in *LG&E v Argentina*, applied a more abstract analysis and recognized

[316] Compare Bjorklund in Cordonier Segger (2011), p 380
[317] Compare Schreuer, Christoph, *Preface* for Bjorklund in Cordonier Segger (2011), p 371
[318] ICJ in *Gabčíkovo-Nagymaros Project (Hungary v Slovakia)*, Judgment, 25 September 1997, at 41
[319] Compare Bjorklund in Cordonier Segger (2011), p 385; ICJ in *Gabčíkovo-Nagymaros Project (Hungary v Slovakia)*, Judgment, 25 September 1997, at 42
[320] Ibid
[321] Compare Bjorklund in Cordonier Segger (2011), p 385
[322] Ibid, p 386
[323] Ibid, p 387
[324] Compare ICJ, *Gabčíkovo-Nagymaros* case, [1997] I.C.J. Rep. 7, at 44-5
[325] Compare *CMS v Argentina*, Award, 12 May 2005, para 323
[326] Compare *Enron v Argentina*, Award, 22 May 2007, para 308

that an economic recovery package was the only means available to Argentina to respond to the crisis.[327] Applying a literal understanding of 'only means', would probably preclude the plea of necessity in many situations relating to sustainable development issues. While in cases of exhaustion of natural resources, banning their exploitation might indeed be the only option available, the preservation of clean air or water could maybe achieved by various measures.[328] An overly literal reading of 'only means' would therefore make the necessity defense inappropriately unavailable.

A promising solution in this context has been suggested by Reinisch, who proposed to 'incorporate considerations of adequacy and proportionality' particularly in the context of economic emergencies.[329] The idea is that a reasonable nexus between the end (preventing the peril) and the means (breach of international obligation) shall suffice to meet the 'only means' requirement. Introducing proportionality considerations at this point would preserve the availability of the necessity defense as well as the gate-keeping nature thereof. A strict least-restrictive-means test (or 'sharp proportionality' test) at this stage would inappropriately diminish the scope of the necessity concept.

Balancing considerations to some authors should also play a role when determining whether a state's invocation of necessity seriously impairs an essential interest of the state(s) towards which the obligation exists or of the international community as a whole. 'The interest relied on must outweigh all other considerations, not merely from the point of view of the acting State but on a reasonable assessment of the competing interests, whether these are individual or collective.'[330] In the *Gabčíkovo-Nagymaros* case, the ICJ did not find necessary to balance the interests of Hungary and Slovakia, since the Court found that Hungary had failed to meet the first three necessity requirements.[331] In *CMS* and *Enron*, the tribunals addressed the issue that in the process of balancing the interests between the states party to the pertinent IIA also the interests of the investors as beneficiaries of the treaty had to be taken into consideration. While the *CMS* tribunal denied the essential interest criterion after noting the relevance of the investor's interests in principle, the *Enron* tribunal found that the investors' interests were seriously impaired by Argentina's invocation of the necessity defense.[332] Given the hybrid nature of investor-state dispute settlement, it seems to be appropriate to consider not only the interests of the state parties or the international community as a whole but also the interests of the investors affected. Since the ILC Articles on State Responsibility were not particularly

[327] Compare *LG&E v Argentina*, Decision on Liability, 3 October 2006, para 257
[328] Compare A, p 388
[329] Reinisch, August, *Necessity in International Investment Arbitration - An Unnecessary Split of Opinions in Recent ICSID Cases?*, 8 *The Journal of World Investment & Trade*, 2007, 191, at 201, cited in Bjorklund in Cordonier Segger (2011), pp 388 f
[330] Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries*, Cambridge University Press, 2002, cited in Bjorklund in Cordonier Segger (2011), p 389
[331] Compare Bjorklund in Cordonier Segger (2011), p 389
[332] Compare Bjorklund in Cordonier Segger (2011), p 390

designed for the needs of investment arbitration, it seems important to find an understanding of Article 25 of the ILC Articles that is appropriate for the investment context.[333]

In addition to the demonstration that the positive necessity requirements are met, a respondent state must prove that none of the exceptions to the doctrine apply: exclusion of the necessity plea (Article 25 (2) lit a), contribution to the situation (Article 25 (2) lit b) and departure from a peremptory norm (Article 26 of the ILC Articles). As for the first exception, an IIA can implicitly or explicitly preclude the invocation of necessity as an excuse for a violation of an international obligation. It is, for example, not possible for a state in times of war to dispense with humanitarian rules on grounds of necessity, since international humanitarian law has been specifically designed for armed conflicts. One question in the investment context is therefore, whether – in the absence of clear provisions – a foreign investor could successfully raise the argument that a necessity plea would run counter to the object and purpose of the respective IIA. Some investors have actually argued that BITs are designed specifically to protect investors in stormy times or that – by entering into a BIT – the parties waived their right to raise the necessity defense.[334] However, it would run against established principles of treaty interpretation to find a waiver of defenses grounded in customary international law in the absence of an explicit treaty provision saying so.

In this sense, the ICJ in the *ELSI* case dismissed the United State's argument that the Treaty of Friendship, Commerce and Navigation had waived the requirement of exhaustion of local remedies: 'Yet the Chamber finds itself unable to accept that an important principle of customary international law should be held to have been tacitly dispended with, in the absence of any words making clear an intention to do so.'[335] In a similar vein, the tribunal in *National Grid v Argentina* held that it cannot be assumed that Argentina, by the mere conclusion of a BIT with the United Kingdom, had 'limit[ed] its powers that as a sovereign it would have under international law except to the extent provided in the treaty'.[336] Similarly, the tribunal in *CMS v Argentina* found that the act of entering into an IIA alone did not preclude the necessity defense provided that the economic difficulties were sufficiently grave.[337] Another exception to the availability of the necessity doctrine applies when the state invoking the necessity defense has itself contributed to the situation of necessity, whereas this contribution must be 'sufficiently substantial and mot merely incidental or peripheral'.[338] In the *Gabčíkovo-*

[333] Ibid, p 331
[334] Compare Bjorklund in Cordonier Segger (2011), p 392; e.g. in *BG Group v Argentina*, Final Award, 24 December 2007, para 409
[335] ICJ in *Elettronica Sicula S.p.A. (ELSI) (United States of America v Italy)*, Judgment, 20 July 1989, para 50
[336] *National Grid v Argentina*, Award, 3 November 2008, para 254
[337] Compare *CMS v Argentina*, Award, 12 May 2005, para 354
[338] Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries*, Cambridge University Press, 2002, at 185, cited in Bjorklund in Cordonier Segger (2011), p 394

Nagymaros case, the ICJ found that Hungary 'had helped, by act or omission, to bring [the state of necessity] about'.[339]

In the Argentina cases, the majority of tribunals found that both exogenous and endogenous factors contributed to the situation of necessity. In *CMS v Argentina*, the tribunal stated that while there were exogenous factors, Argentina's government policies and shortcomings significantly contributed to the crisis and the emergency situation and hence did not exempt Argentina from its responsibility.[340] The *Enron* tribunal came to a similar conclusion, noting that the requirement of a state's non-contribution to its condition of necessity derives from the general principle of law that a party should not be allowed to take advantage of its own fault.[341] While the tribunals in *Sempra v Argentina* and *National Grid v Argentina* relied on a similar reasoning, the tribunal in *LG&E v Argentina* again chose another route. First, it found that the claimant was unable to prove Argentina's contribution to the crisis. Second, it noted that Argentina could show a desire to reduce by all means the severity of the crisis.[342]

In cases of individual investment agreements (containing specific concessions), the investor will probably argue that certain ecological or social consequences were foreseeable for the host state at the time of the conclusion of the agreement. In such a case, the state's position will be weaker if the need for its non-compliance with an obligation is the result of the state's policy change. Conversely, the state's position will be stronger if it can show certain unforeseeable social or environmental consequences of the investment agreement.[343] Finally, Article 26 of the ILC Articles implies that necessity cannot be invoked to preclude the wrongfulness of non-compliance with *jus cogens*. Thus, host states are for example not allowed to retaliate against investors from enemy states in times of war.[344]

Mostly, necessity does not permanently relieve a state of its international obligations but only for the period of time that the extraordinary circumstance exists. Only rarely will the state of necessity result in the termination (as compared to the suspension) of an obligation.[345] In any case, the question remains, whether compensation is due. Article 27 lit b of the ILC Articles provides that '[t]he invocation of a circumstance precluding wrongfulness … is without prejudice to … the question of compensation for any material loss caused by the act in question'. The ILC Articles do not precisely distinguish between a non-wrongful act and an act that has been excused. It is not entirely clear whether (all) circumstances precluding wrongfulness (completely) exonerate a state acting in breach of its international obligations.[346] The final

[339] ICJ in *Gabčíkovo-Nagymaros Project (Hungary v Slovakia)*, Judgment, 25 September 1997, at 46
[340] Compare *CMS v Argentina*, Award, 12 May 2005, para 329
[341] Compare *Enron v Argentina*, Award, 22 May 2007, para 311
[342] Compare *LG&E v Argentina*, Decision on Liability, 3 October 2006, para 256
[343] Compare Bjorklund in Cordonier Segger (2011), p 395
[344] Ibid, p 396
[345] Article 61 VCLT states that a treaty may be terminated by supervening impossibility of performance, although if the possibility is only temporary the obligation is suspended rather than terminated.
[346] Compare Bjorklund in Cordonier Segger (2011), p 398

version of the commentary on Article 27 lit b, however, calls the provision on compensation 'a proper condition, in certain cases' and emphasizes that '[w]ithout the possibility of such recourse [compensation], the State whose conduct would otherwise be unlawful might seek to shift the burden of the defence of its own interests or concerns onto an innocent third State'.[347] Moreover, in the *Gabčíkovo-Nagymaros* case, the ICJ noted that 'Hungary expressly acknowledged that, in any event, such a state of necessity would not exempt it from its duty to compensate its partner'.[348] In the investment context, the *CMS* tribunal held that '[t]he plea of necessity may preclude the wrongfulness of an act, but it does not exclude the duty to compensate the owner of the right which had to be sacrificed'.[349] The tribunal recognized, however, that the adverse consequences stemming from the crisis should be weighed when it considered compensation.[350]

Due to the open-ended nature of Article 27 and the fact, that the ILC Articles have not been specifically designed for the investment context, various approaches on the issue of compensation could be followed by tribunals. One route would be to require a burden sharing between the host state and the foreign investor. Another way would be to assume suspension of compensation during the state of necessity combined with the resuscitation of compensation in better times. A third approach could be that 'the breaching State be relieved from the duty to pay full reparation, but be required to recompense the injured party for actual losses'.[351] A fourth route has been taken by the *LG&E* tribunal, which did not resolve the issue of compensation on the basis of Article 27 of the ILC Articles, but simply relied on Article XI (security exception) of the US-Argentina BIT. The tribunal found that Article XI was an exception to Argentina's treaty obligations which exempted the state from liability.[352] Therefore, Argentina was found to be excused from paying damages arising during the state of necessity, which was determined to last from 1 December 2001 to 26 April 2003.[353]

As for the relationship between express exceptions in IIAs and customary circumstances precluding wrongfulness, it is nowadays common ground that the former are primary rules delimiting the scope of the substantive IIA obligations while the latter are secondary rules which only preclude the wrongfulness of the violation of an existing international obligation.[354] Therefore, the plea of necessity is basically subsidiary to that of an IIA exception.

[347] ILC, *Articles on State Responsibility*, 2001, Commentary on Article 27, para 5
[348] ICJ in *Gabčíkovo-Nagymaros Project (Hungary v Slovakia)*, Judgment, 25 September 1997, at 101
[349] *CMS v Argentina*, Award, 12 May 2005, para 388
[350] Ibid, para 356
[351] Bjorklund in Cordonier Segger (2011), p 400
[352] Compare *LG&E v Argentina*, Decision on Liability, 3 October 2006, para 260
[353] Compare *LG&E v Argentina*, Decision on Liability, 3 October 2006, paras 260, 267(d)
[354] In the words of the *CMS* Annulment Committee: 'Art. XI is a threshold requirement: if it applies, the substantive obligations under the Treaty do not apply. By contrast, Article 25 is an excuse which is only relevant once it has been decided that there has otherwise been a breach of those substantive obligations.' (*CMS v Argentina*, Decision of the *Ad Hoc* Committee on the Application for annulment of the Argentine Republic, 25 September 2007, para 129)

3.10. Corporate Social Responsibility

International law in its current shape imposes only few obligations relating to sustainable development on Multi National Corporations (MNCs) directly. In the field of international human rights law, only norms prohibiting the most serious war crimes and crimes against humanity directly bind business actors.[355] In the field of international environmental law, just a few multilateral environmental agreements like the 1999 Protocol to the Basel Convention on Liability and Compensation for Damage resulting from Transboundary Movements of Waste and their Disposal contain provisions directly obliging MNCs.[356] In the field of international labor law, hard law addressing corporations directly is practically non-existent.[357]

Domestic law is still the most important source of law for effectively regulating the conduct of corporations located in the host state's territory. However, hard obligations for MNCs regarding sustainable development are by all means still rare and it remains difficult to hold international corporations liable for misconduct in this regard.

The concept of Corporate Social Responsibility ('CSR') has evolved in order to complement the small body of hard law binding on MNCs with respect to sustainable development. A prominent definition of CSR has been developed by the International Labour Organization ('ILO'), according to which CSR is 'a way in which enterprises give consideration to the impact of their operations on society and affirm their principles and values both in their own internal methods and processes and in their interaction with other actors. CSR is a voluntary, enterprise-driven initiative and refers to activities that are considered to exceed compliance with the law'.[358]

Today there are 'dozens of multi-stakeholder initiatives; hundreds of industry association codes; and thousands of individual company codes' dealing with CSR.[359] The most prominent CSR codes, however, have been developed by international organizations like the OECD, the IFC ('International Finance Corporation'), the ILO and the UN.[360] One of the most important documents in this respect, the OECD Guidelines for Multinational Enterprises, determines

[355] Compare Muchlinski, Peter, *Corporate Social Responsbility*, in Muchlinski et al (2008), p 656
[356] Ibid, p 667
[357] Ibid, pp 646 ff
[358] ILO Subcommittee on Multinational Enterprises, *InFocus Initiative on Corporate Social Responsibility (CSR)*, GB.295/MNE/2/1, March 2006, para 1, available at http://www.ilo.org/public/english/standards/relm/gb/docs/gb295/pdf/mne-2-1.pdf (accessed 8 August 2016, 09:00 PM)
[359] UNCTAD (2012), pp 13 f
[360] OECD: OECD Guidelines for Multinational Enterprises, IFC: IFC Sustainability Framework, ILO: ILO Declaration on Fundamental Principles and Rights at Work, UN: UN Global Compact

eleven central goals of CSR, which reflect an emerging consensus on the sociological obligations of MNEs[361]:

> 'Enterprises should take fully into account established policies in the countries in which they operate, and consider the views of other stakeholders. In this regard, enterprises should:
>
> 1. Contribute to economic, social and environmental progress with a view to achieving sustainable development.
>
> 2. Respect the human rights of those affected by their activities consistent with the host government's international obligations and commitments.
>
> 3. Encourage local capacity building through close co-operation with the local community, including business interests, as well as developing the enterprise's activities in domestic and foreign markets, consistent with the need for sound commercial practice.
>
> 4. Encourage human capital formation, in particular by creating employment opportunities and facilitating training opportunities for employees.
>
> 5. Refrain from seeking or accepting exemptions not contemplated in the statutory or regulatory framework related to environmental, health, safety, labour, taxation, financial incentives, or other issues.
>
> 6. Support and uphold good corporate governance principles and develop and apply good corporate governance practices.
>
> 7. Develop and apply effective self-regulatory practices and management systems that foster a relationship of confidence and mutual trust between enterprises and the societies in which they operate.
>
> 8. Promote employee awareness of, and compliance with, company policies through appropriate dissemination of these policies, including through training programmes.
>
> 9. Refrain from discriminatory or disciplinary action against employees who make *bona fide* reports to management or, as appropriate, to the competent public authorities, on practices that contravene the law, the *Guidelines* or the enterprise's policies.
>
> 10. Encourage, where practicable, business partners, including suppliers and sub-contractors, to apply principles of corporate conduct compatible with the *Guidelines*.
>
> 11. Abstain from any improper involvement in local political activities.'[362]

Another important CSR code is the UN Global Compact. It is a framework which encourages companies to align their operations with ten universally accepted principles relating to human rights, labor, environment and anti-corruption[363]:

> **Human Rights:**
>
> Businesses should:

[361] Compare Muchlinski, Perter, *Corporate Social Responsbility*, in Muchlinski et al (2008), p 643
[362] OECD, *OECD Guidelines for Multinational Enterprises*, 2008, pp 14 f, available at http://www.oecd.org/corporate/mne/1922428.pdf (accessed 8 August 2016, 09:00 PM)
[363] Compare https://www.unglobalcompact.org/what-is-gc/mission/principles (accessed 8 August 2016, 09:00 PM)

Principle 1: Support and respect the protection of internationally proclaimed human rights; and

Principle 2: Make sure that they are not complicit in human rights abuses.

Labour Standards:

Businesses should uphold:

Principle 3: the freedom of association and the effective recognition of the right to collective bargaining;

Principle 4: the elimination of all forms of forced and compulsory labour;

Principle 5: the effective abolition of child labour; and

Principle 6: the elimination of discrimination in employment and occupation.

Environment:

Businesses should:

Principle 7: support a precautionary approach to environmental challenges;

Principle 8: undertake initiatives to promote environmental responsibility; and

Principle 9: encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption:

Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

The values inherent to these goals have been derived from international documents like the Universal Declaration of Human Rights, the ILO's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the UN Convention against Corruption.[364]

Despite the fact that CSR is basically a voluntary initiative taken by corporations and mostly forms part of soft law, it is a valid first step for the evolvement of effective investment policies and hard law in this field. If taken seriously and not misused as a fig leave to hide an irresponsible business concept, CSR can be a valuable contribution to sustainable development.

[364] Compare Reiner, Clara/Schreuer, Christoph, *Human Rights and International Investment Arbitration*, in Dupuy et al (2009), p 87

4. Second Part:

Options for drafting IIAs in accordance with sustainable development principles

The following part presents options for drafting an IIA in accordance with sustainable development principles.

In any event, the state parties to the agreement should align their investment commitments with their development and investment strategies. In this sense, states should carefully consider the overall costs and benefits of each commitment – on political, economic and eco-social levels – in the field of tension between investment protection/attraction and the preservation of regulatory flexibility.[365]

A sustainable IIA must ensure the balance of the overall give and take in the relation between the investor and the host state as well as the balance between economic, environmental and social priorities. The host state gives its natural and human resources, investment protection and a chance for the investor to gain profits; and the host state takes economic and social advantages (appropriate share of profits, fiscal revenues, improvement of infrastructure, transfer of knowledge and technology, job creation and reduction of poverty) as well as the investor's respect of the host state's ecological borders, social standards and public order.

While these categories of give and take (the costs and benefits) are undisputed, the issue of how to find a fair balance between both sides and all the priorities involved, is quite complex.[366] This balance is highly dependent on the policy makers' values (e.g. the relative importance attached to different – economic, ecological and social – purposes) as well as their beliefs of how these values can and should be realized (e.g. neo-liberal vs eco-social economic approaches). Finding this balance and realizing it through the process of IIA negotiation is a challenge for the wisdom and skills of the political decision makers and state representatives. Unfortunately, the outcome of treaty negotiations is subject to the distortive forces of various practical constraints and the imbalances of political reality.

[365] Compare UNCTAD, *Investment Policy Framework for Sustainable Development*, United Nations, New York/Geneva, 2012, pp 11 ff, 15 ff

[366] It makes sense to require a threefold balance: 1. balance between the IIA parties (i.e. the investor and its home state vs the host state); 2. balance between the (host state) systems affected by the investment (i.e. economic, ecological and social systems); and 3. balance between all (host state) actors/stakeholders within these systems (i.e. all actors that bear legitimate interests as a result of being affected by the investment, e.g. employees, host state population, indigenous peoples and other specially affected groups or individuals, other companies, a representative for the environment).

However, this part of the thesis is a sort of toolbox presenting options (i.e. existing best practice examples as well as options that cannot yet be found in existing IIAs) for strengthening the sustainable development component of IIAs as well as the host state's position as such.

The inclusion of sustainable development into IIAs follows three basic technical ratios:[367]

1. Adjustment of common existing IIA provisions by using hortatory language, clarifications and carve-outs;

2. Creation of new provisions that enhance host state rights, introduce investor obligations and include home state support;

3. Inclusion of 'Special and Differential Treatment' by introducing asymmetrical obligations, lowering the level of obligation for the developing party and requiring development friendly interpretation.

4.1. Adjustment of common existing IIA provisions

4.1.1. Preambles

Where they have preambles at all, most existing IIAs refer only to the protection and attraction of investment. A smaller part of IIA has preambles prescribing a more expansive set of goals. The preamble of the India-Singapore CECA[368], for example, recognizes the parties' 'right to pursue economic philosophies suited to their development goals and their right to regulate activities to realize their national policy objectives'. The COMESA Investment Agreement[369] underlines the importance of 'sustainable economic growth'. The ASEAN Agreement[370] emphasizes the different levels of development of the member states, the 'special and differential treatment' and the connection between investment flows and development.

Since preambles are an important part of the interpretative context, careful thought must be given to their wording. It is essential for the parties to identify their most important considerations as objectives of the IIA. Moreover, the preamble should be consistent with the objectives provisions in order to enhance the likelihood of consistent interpretation. Drafting the preamble with a fully elaborated description of the parties motivations, intentions, objects

[367] Compare UNCTAD (2012), pp 45 ff
[368] Comprehensive Economic Cooperation Agreement between the Republic of India and the Republic of Singapore, 2005
[369] Common Market for Eastern & Southern Africa Investment Agreement, 2007
[370] Association of Southeast Asian Nations, Comprehensive Investment Agreement, 2009

and priorities will help to ensure that exceptions and reservations as well as the host state's right to regulate for the public welfare are interpreted extensively.[371]

Here are examples for preamble provisions promoting sustainable development considerations:[372]

'*Seeking* to ensure that investment is consistent with and facilitative of the protection of health, safety and the environment, the promotion and protection of internationally and domestically recognized human rights, labor rights and the rights of indigenous peoples;

Recognizing that each party has, in accordance with general principles of international law, the right to pursue its own development objectives and priorities and the right to take regulatory or other measures to ensure that development in its territory is consistent with the goals and principles of sustainable development and with other social and economic policy objectives, including the promotion and protection of human rights, labor rights, the rights of indigenous peoples, and the protection of the environment;

Reaffirming their commitment to democracy, the rule of law, human rights and fundamental freedoms in accordance with their obligations under international law, including the principles set out in the United Nations Charter, the Universal Declaration of Human Rights, customary international law and provisions of international agreements relating to the environment, human rights, labor rights and the rights of indigenous peoples binding on the parties and desiring to have this agreement interpreted in a manner consistent with these commitments;

Determined to promote corporate social responsibility;'

4.1.2. Definition of 'investment'

Defining 'investment' and 'investor' establishes (in combination with other provisions) the scope of a host state's obligations as well as its exposure to investment claims. There are basically three options to define what constitutes an investment in the sense of an IIA:

- Open definition of 'investment': 'Every kind of investment, including …'
- Closed definitions of 'investment', limited to the specific forms of assets identified
- Possible limiting elements in an open or closed definition

[371] Compare VanDuzer, J Anthony/Simons, Penelope/Mayeda, Graham, *Integrating Sustainable Development into International Investment Agreements – A Guide for Developing Country Negotiators*, Commonwealth Secretariat, London, 2013, pp 42 ff
[372] Compare VanDuzer et al (2013), pp 47 f; UNCTAD (2012), p 48

As discussed earlier, ICSID tribunals have identified up to seven typological requirements for investments to satisfy Article 25 (on jurisdiction) of the ICSID Convention, regardless of the IIA definition of 'investment' (compare the list a to g below). If ICSID arbitration shall be an available dispute settlement option, IIA parties should bear the requirements of this Article in mind when specifying the types of investment that shall enjoy IIA protection. In the interest of clarity and predictability, it is advisable to use closed definitions with several exclusions. In this sense, parties can require an 'investment' to have some or all of the following attributes to be protected by the IIA:

(1) a certain *contribution* by the investor
(2) a certain *duration* of the project
(3) an element of *risk*
(4) a certain *regularity of profit and return*
(5) a contribution to the *development of the host state*
(6) *legality* of the investment
(7) *bona fide (good faith)*

Moreover, parties can exclude specific categories of investment, for example:[373]

- portfolio investment
- debt claims and other claims to money
- intellectual property
- government securities and debt
- property not used for a business purpose
- agricultural land
- assets below a specific value
- other categories of investment in accordance with the domestic policy of the host state

Although some of the above mentioned attributes introduce some uncertainty in terms of interpretation, they help to ensure that only those investments enjoy IIA protection that substantially benefit the host state and make a valuable economic contribution to the host state. Attribute (5) 'contribution to the *development of the host state*' can for example prevent the misuse of the investor-state dispute settlement system in cases where an investor sets up a subsidiary in a host state and transfers an already existing investment to that state for the sole purpose of bringing an investment claim against that state. Attribute (6) '*legality* of the investment' allows the host state to control through its domestic policies what foreign investment obtains the benefit of the IIA. Such a power is especially important for host states with limited capacities to regulate an investor once it has entered the country.

[373] Compare VanDuzer et al (2013), p 70

The selection of the categories of investment to be excluded is always related to a careful balancing of pros and cons in the tension field of investment attraction and minimization of claims. Here are examples for exclusions:[374]

- Volatile short-term debt with a maturity of less than three years: Such transactions are unlikely to directly contribute to new economic activity in the host state. The threshold of three years is an arbitrary choice but is backed by IIA practice.
- Debt securities issued by a state or a state enterprise: The exclusion of these securities might ensure some flexibility for the host state to deal with its debt obligations in the event of a financial crisis but might also make it more difficult for states and state companies to raise capital in international markets.
- Claims to money arising out of commercial contracts for the sale of goods or services between national enterprises in different party states and property not used for a commercial purpose: Such kinds of interests are not investments as commonly understood and are unlikely to make a direct contribution to new economic activity in the host state.
- Portfolio investments: are investments that cannot be qualified as FDI.[375] Protecting portfolio investments gives the chance of instituting an investment claim to many small shareholders who typically do neither have a long-term relationship to nor a significant degree of influence over the investment. Given the substantial investor protection typically undertaken in an IIA, a state may prefer to limit the number of potential claimants. On the other side, one could argue that the exclusion of portfolio investments would scare small investors off who would otherwise be ready to invest in important projects and that an investment claim is too expensive for a small shareholder without allies anyway.[376]
- Intellectual property: One important aspect here is to avoid that holders of business patents do not use these patents to the benefit of the host state but prevent others from using the relevant technology or method. For this purpose, the COMESA Investment Agreement provides that an intellectual property right has to be connected with an investment in the host state to be eligible for protection. Another option is to limit the protection of intellectual property rights to categories of rights consistent with the TRIPs Agreement that are recognized in host state law. Therefore, a state can preserve its right to issue compulsory licenses of patented pharmaceuticals, a right granted in TRIPs, if the IIA provides that compulsory licenses are not to be considered expropriations. Moreover, derogations from MFN and National Treatment are allowed by TRIPs; these derogations can also be allowed

[374] Compare VanDuzer et al (2013), pp 62 ff, 73 ff
[375] The OECD benchmark definition of 'Foreign Direct Investment' involves the elements of a *long-term relationship* to the investment and a *significant degree of influence* over the management of the investment, whereas a direct or indirect ownership of at least *ten percent* will normally suffice to establish such a relationship. (Compare OECD, *Benchmark Definition of Foreign Direct Investment*, 4th Edition, OECD, Paris, 2008)
[376] Compare VanDuzer et al (2013), pp 57 ff

by express IIA exceptions. In addition, copyrights in music, literature and other forms of art could be excluded from the IIA obligations.[377]

4.1.3. Definition of 'investor'

IIAs apply only to investments by investors (usually natural and juridical persons) of a party state in the territory of the latter. The main question in the context of sustainable development is what link an investor must have with a party state in order to enjoy IIA protection. A state targeting a limited class of investors might prefer a definition of 'investor' that requires a strong genuine link to the other party state, in order to minimize the risks of treaty shopping. Therefore, it is useful to grant the status of 'investor' only to 'a national of a party state (as determined by that state)'. For some developing states, however, it might be of interest to include own former citizens of their own, who emigrated to an industrialized country, into the definition of 'investor'. Extending the IIA protection to 'permanent residents' could attract these former citizens to return to and invest in their former home country. As for dual-nationals, the general public international law doctrine of dominant or effective nationality has been rejected by a number of investment tribunals as a test for determining the effective nationality of dual-nationals for the purposes of investment arbitration.[378] Therefore, it makes sense to explicitly mention that 'a person who is a dual citizen shall be deemed to be exclusively a citizen of the state of his or her dominant and effective citizenship'.

For the ICSID context, however, Article 25 of the ICSID Convention excludes nationals of the host state from the investor definition. For juridical persons, the genuine link to the party state can be ensured by requiring that the investor 'must be an enterprise incorporated or organized under the law of that state, must have its seat (or effective management) in that state, must carry on substantial business activities in that state and/or must be owned or controlled by nationals (legal or natural persons) of that state'. 'Incorporation and organization in a state' is a requirement almost universally used. The elements 'seat' and 'substantial business activity' could be further defined by more detailed requirements. The dual-nationality problem typically does not arise for corporations and other legal persons. For the ICSID context, however, Article 25 (2) (b) of the ICSID Convention allows the parties to stipulate that a local legal person – because of foreign control – shall be treated as a foreign investor.

In addition to the core definition of 'investor', a denial-of-benefits clause can be included into the IIA. If, for example, an IIA defines 'investor' as 'an enterprise constituted or organized under the law of a party that has its seat and carries on substantial business activities in that party', the state parties can add a denial-of-benefits clause stating that 'A party may deny the

[377] Compare VanDuzer et al (2013), pp 62 ff; UNCTAD (2012), p 48
[378] E.g. *Micula v Romania*, Decision on Jurisdiction and Admissibility, 24 September 2008

benefits of this agreement to an investor of the other party that is an enterprise of such party and to investments of such investors if investors of such non-party do not own or control the enterprise'. Such a clause allows the party states to impose – by notification to the other state party – the additional jurisdictional requirements contained in that clause on selected investors. In the interest of clarity, it is useful to add a clause ensuring that a denial of benefits is possible even after a claim has been filed ('at any time prior to the expiry of the time within which jurisdictional challenges may be filed').[379]

4.1.4. Statement of objectives

The preamble and explicit statements of objectives are important parts of the interpretative context of an IIA and are meaningful tools to give priority to specific objectives. Consistency between the preamble and the statement(s) of objectives is important since it enhances the chance of consistent and predictable interpretation as well as the weight of the object and purpose of the IIA in the process of interpretation. Making the contribution to sustainable development a treaty objective will alter the interpretive direction towards the state's right to regulate and the public interest.

The COMESA Agreement, for example, states that the objective of the agreement is also 'to provide COMESA investors with certain rights in the conduct of their business within an overall balance of rights and obligations between investors and Member States'. In a similar vein, the ASEAN Agreement identifies 'flexibilities to Member States depending on their level of development and sectoral responsibilities' as one of its guiding principles. Such clauses suggest that investment protection is not the sole overriding purpose of the respective treaties.

Defining a small number of objectives will enhance the strength of the single objectives stated in the IIA. Here is an example for a strong statement of objectives: 'The objective of this agreement is to promote foreign investment that supports and facilitates sustainable development in accordance with legitimate regulation by the host state, including the protection of internationally and domestically recognized human rights, labor rights, the rights of indigenous peoples and the environment.'[380]

[379] Compare VanDuzer et al (2013), pp 74 ff; UNCTAD (2012), p 49
[380] Ibid, pp 92 f

4.1.5. Scope of application

Next to the definitions of investor and investment, provisions defining the scope of an IIA are an opportunity to expressly clarify what is (not) covered by the agreement. Hence, a scope provision can be used to promote sustainable development in various ways:[381]

- It can define when the host state's (and the investor's) obligations begin. Since the protection of investments that already exist in the host state will mostly not induce new capital flows, a host state might wish to limit the scope of protection to those investments made after the treaty comes into force. On the other side, protecting pre-existing investments would be an incentive for the affected investors to stay and to re-invest in the host state.
- It can limit the scope to investments made in accordance with host state law. As discussed earlier, this requirement can be included in the definition of investment already. Together with host state regulations describing the sorts of foreign investments that are permissible, such a provision ensures that only investments that fit to the host state's development strategy will enjoy IIA protection. In any event, careful coordination with pre-establishment rights (if there are any) is necessary.
- It can exclude sensitive policy areas, sectors and measures. Therefore, some IIAs exclude government procurement, subsidies to local businesses and social services like health and education. The Colombian model agreement, for example, excludes a policy area, taxes and certain measures relating to the financial sector. The scope of an IIA can also be limited by agreeing to the application of the treaty only to sectors listed by the party states in national schedules of reservations. One advantage of excluding specific areas by means of a scope provision instead of an exception or reservation, is that a scope limitation might not be interpreted restrictively.
- It can exclude the application of the IIA to (acts of) sub-national official actors. State parties can create their own regime of attribution for the purpose of state responsibility. Therefore, some IIAs have express exclusions for acts by municipalities and other sub-national actors. Such an exclusion will benefit host states where the coordination and the political relations between the central government and the regional administrative levels are difficult.
- It can limit access to the dispute settlement system. Fields such as environmental protection, human rights, labor rights and rights of indigenous peoples are so sensitive that the state parties might decide not to make them subject to the dispute settlement system. Moreover, parties might want to prevent investors from filing investor-state claims on the basis of obligations for which individual investors are not direct beneficiaries (e.g. an obligation for states to consult on technical assistance).

[381] Compare VanDuzer et al (2013), pp 94 ff; UNCTAD (2012), p 49

- It can limit the scope of umbrella clauses. Umbrella clauses have the potential to expand the scope of host state obligations in unpredictable ways. It is therefore advisable to provide carve-outs for issues relating to sustainable development or not to use umbrella clauses at all.

4.1.6. Right of establishment

As UNCTAD emphasizes, '[t]he right to control admission and establishment remains the single most important instrument for the regulation of FDI'[382]. Pre-establishment rights limit the host state's ability to use domestic law to keep out foreign investment. This again, can drastically reduce the host state's regulatory space to protect human rights and the environment and can hinder the attainment of other development and regulatory objectives. A right to establishment will deprive a host state of an important tool that cannot be easily replaced by local regulations. Host states should notice that any retreat from the level of openness guaranteed by a right to establishment in an IIA could result in an investment claim by prospective foreign investors. Especially host states with little regulatory capacity to deal with the conduct of investors after their admission, should not grant a right to establishment. They should rather carefully screen the foreign investment candidates, critically select those projects that are really beneficial to them, impose such conditions on the investors as are conducive to sustainable development and ensure a fair host state participation in the management and the profits of the investment. The costs of such procedures could be imposed to the investors applying for entry.

Those states that decide to include a right to establishment should carefully limit that right. This can be achieved by using positive or negative lists of the policy areas, sectors and measures to which the right to establishment obligation does (not) apply. In general, positive lists leave more policy-making flexibility to the host state. Moreover, they are easier to administrate than negative listings that force the state to establish a sophisticated inventory of restrictions. Another way of limiting the right to establishment is to agree to negotiate right of establishment commitments at a later date. Such an approach may be desirable for host states whose foreign investment policy is just evolving. Again another option is to include establishment rights into the IIA but exclude these commitments from the investor-state dispute settlement system. Finally, states can also agree to limit their commitment regarding establishment rights to 'best endeavors'.[383]

[382] UNCTAD, *World Investment Report 2003: FDI Policies for Development: National and International Perspectives*, United Nations, New York and Geneva, 2003, p 102
[383] Compare VanDuzer et al (2013), pp 104 ff; UNCTAD (2012), pp 61 f

4.1.7. National Treatment

As discussed earlier, a national treatment (NT) obligation in an IIA prohibits state parties from treating foreign investors from other party states and their investments less favorably than domestic businesses and their investments. Typically, *de jure* and *de facto* discrimination are covered. Regarding the latter, it is usually not necessary to prove discriminatory intent on the part of the state.

Hardly any state grants national treatment to foreigners in every situation without qualifications. In any event, states need to bear the relative nature of the NT standard in mind on an ongoing basis to ensure that they are in compliance with their obligations. The most common formulation of NT in the investment context is to require treatment 'no less favorable than' accorded to domestic businesses, which implies the possibility of better treatment for foreign investors. While finding the right comparator in the NT context is an inherent requirement of applying a NT obligation, many treaties, like the Canadian and the US model BITs, direct the interpreter to investigate whether the foreign investor and a domestic investor are truly comparable by specifying that they be in 'like circumstances'. Moreover, the scope of NT is often limited to certain identified activities. In a similar vein, the IISD Model Agreement in its Article 5 (A) also contains the 'in like circumstances' qualification, but goes on in Article 5 (E) to expressly require the following factors to be considered in the effort of determining whether investors are 'in like circumstances':

- the effect of the investment on third persons and the local community
- the effect of the investment on the local, regional or national environment or the global commons, including effects relating to the cumulative impact of all investments within a jurisdiction
- the sector in which the investor operates
- the goal of the alleged discriminatory measure
- the regulatory scheme applied to the investor
- and other factors directly related to the investment of the investor in relation to the measure concerned

One could add factors like 'the human right of individuals and rights of indigenous peoples' and 'the environment, including effects that relate to the cumulative impact of all investments within a jurisdiction'. Such phrases ensure that systemic effects are part of the tribunal's enquiry. Moreover, it is possible to clarify that a less favorable treatment is not inconsistent with the NT obligation 'if it is adopted and applied in pursuit of a legitimate public purpose that is not based on the foreign nationality of investors (including the protection of health, safety, the environment and internationally and domestically recognized human rights, labor rights, the

rights of indigenous peoples and the elimination of bribery and corruption) and it bears a reasonable connection to the purpose'.

As for limiting the NT obligation to specific matters, the respective standard (Art 4) in the 1991 Netherlands-Jamaica BIT, for example, limits the scope of NT to 'taxes, fees, charges and exemptions'. Such a positive-list-approach is more effective in restricting the scope than a negative-list-approach. Excluding terms like 'establishment', 'acquisition' and 'expansion' from the scope of NT, will ensure that the NT clause does not create a right to establishment. To this end, it is also useful to clarify that the agreement applies only to investments admitted by a state in accordance with its laws and regulations. In addition, an obligation to grant NT but only subject to domestic law of the host state, would not commit the host state to grant NT but only to ensure that any discrimination was authorized by domestic law.[384]

Determining the appropriate business for the comparison is a complex and fact-specific enquiry. In any event, there is usually nothing in the formulation of the standard or in the arbitral case law that requires a tribunal to compare the treatment of a foreign investor to the treatment of all domestic businesses in a specific sector. There is no rule that all foreign investors must be given the best treatment given to any domestic investor in the host state or treatment that is no less favorable than the average treatment of domestic investors.

As presented earlier, also general exceptions can be used to exclude sectors (e.g. policy areas like health, development and the environment) or measures from the scope NT. However, broad exceptions are likely to create uncertainty for both the foreign investor and the host state.

Another question is, if *de facto* national treatment shall be excluded from the scope of NT. Such an exclusion would massively limit the scope of the provision and provide legal certainty. This limitation could, however, be misused by states. They could draft measures that avoid discriminatory language but then apply the measures in a discriminatory way.

Again another question is whether the NT obligation shall apply to sub-national governments also. The issue here is whether sub-national governments must grant foreign investors the same treatment they give to local investors within their sub-national region or whether it is enough if they grant the same level of protection that they accord to other domestic investors from outside the region. In the Canadian model FIPA and in the US model BIT, for example, sub-national governments must only provide treatment that is no less favorable than the treatment that they grant to domestic investors from other parts of the country. This is a permission to discriminate in favor of local businesses and against foreign investors as long as the treatment is at least as good as that given to investors from other parts of the country.

[384] Compare VanDuzer et al (2013), p 116

In sum, there is an argument for host states to prefer post-establishment NT obligations that may be limited in one or all of the following ways:[385]

- to specific activities (and not including activities such as establishment, acquisition and expansion)
- to foreign investors 'in like circumstances', whereas the determination thereof shall consider specified criteria that promote sustainable development in this context
- to listed policy areas, sectors and measures (positive list) or at least excluding listed policy areas, sectors and measures (negative list)
- with respect to sub-national governments, to treatment no less favorable than such governments extend to other investors of the host state from outside the jurisdiction of sub-national governments
- subject to general exceptions
- and to *de jure* national treatment, excluding *de facto* national treatment

4.1.8. Most Favored Nation Treatment

As discussed earlier, an MFN commitment in the investment context implies that each state party must treat investors of the other party and their investments no less favorably than it treats investors and investments of any other state. Usually, both *de jure* and *de facto* discrimination are covered by the standard and it is generally not necessary to show discriminatory intent on the part of the state. The main goal of an MFN provision is to ensure equality of competitive opportunity among investors of different nationalities.

The treaty shopping opportunity introduced by an MFN clause basically depends on the scope of the standard as defined in the IIA but also on the doctrine the tribunal follows in this context. Especially where the wording of the clause leaves large space for interpretation, tribunals have developed different understandings of how powerful an MFN clause should be; whether it covers substantive protection standards only or whether it should reach out to dispute settlement provisions or even jurisdictional matters.

Since MFN is a relative standard, it can be both beneficial or harmful for developing countries. Thus, the clause could import benefits from IIAs between the party state and other states with a high bargaining power. On the other side, there is the risk that for example stronger standards of investment protection, investor-friendly time periods or – in the worst case – even the definitions of investor and investment as contained in another IIA could be harnessed to the disadvantage of the state.

[385] Compare VanDuzer et al (2013), pp 119 ff; UNCTAD (2012), p 50

Hence, states may decide that the easiest way to avoid the problems related with MFN provisions is simply not to include such a provision in the agreement. Many IIAs have reduced the scope of MFN to specific aspects of an investment and have incorporated an explicit 'like circumstances' requirement.[386] Although IIA practice has shown that finding the adequate comparator is easier for MFN than for NT, the difficulties in the process of drafting the respective clauses are the same for both standards. Therefore, it is crucial to specify the factors relevant for determining what is an appropriate foreign investment to compare with the foreign investment whose treatment is at issue.

When limiting the scope of the MFN obligation it is of decisive importance to contemplate whether or not it is wise to extend the standard to pre-establishment activities. Mostly, pre-establishment rights are sought in order to achieve some actual liberalization of conditions of entry as well as to obtain a commitment not to change existing rules in ways that restrict entry. I mentioned the danger of pre-establishment commitments earlier and must repeat that warning now in the discussion of the MFN and NT standards, since such provisions can create entry rights for investors and investments in unexpected ways.

Especially developing countries that have limited resources for the regulation of investments in the post-establishment phase should carefully contemplate entry conditions for investments and preserve their right to decide which investments are granted access into the country. In sum, there is a point in not including MFN clauses at all or in including a post-establishment MFN obligation that may be limited in similar ways as the NT obligation:[387]

- limited to specific activities (and not including activities such as establishment, acquisition and expansion)
- limited to foreign investors 'in like circumstances', whereas the determination thereof shall consider specified criteria that promote sustainable development in this context
- limited to listed policy areas, sectors and measures (positive list) or excluding listed policy areas, sectors and measures (negative list)
- limited to international agreements existing at the time the IIA comes into force
- subject to general exceptions
- limited to *de jure* discrimination
- MFN treatment but only subject to domestic law of the host state

The latter option (MFN treatment subject to domestic law) would not commit the host state to grant MFN treatment but only to ensure that any discrimination was authorized by domestic law.

[386] Compare VanDuzer et al (2013), pp 126 ff
[387] Compare VanDuzer et al (2013), pp 132 ff; UNCTAD (2012), p 51

4.1.9. Fair and Equitable Treatment

As discussed earlier, FET shall protect investors against serious abuse and arbitrary or discriminatory actions by host states. If FET is not restricted to the customary international law minimum standard of treatment of aliens, the standard could be understood as an open-ended and unpredictable requirement for a state to act fairly, leaving it to the tribunal to determine what is fair in particular circumstances. When applied responsibly, this could lead to highly fair and equitable arbitral awards in a literal sense. When applied in an extremely investor-friendly way, practically every sovereign measure that has a negative impact to the foreign investment can be qualified as a breach of FET.

Given the rather mild *Neer* standard which is still informing the customary minimum standard to a certain extent[388], there is a good statistical chance that an autonomous understanding of FET will be more beneficial to the investor (and therefore more dangerous for the host state) than the equalization of FET with the customary minimum standard. In any event, neither the customary minimum standard nor an autonomous FET standard provide a great deal of legal certainty.

In order to do away with this uncertainty, an option would be not to include an FET clause but to simply specify prohibited types of state action. Alternatively, one could include an FET obligation and clarify its meaning by specifying its normative content.

In concreto, a sustainable development friendly FET provision could have the following characteristics:[389]

- A link to the customary minimum standard which clarifies that no treatment in addition or beyond that standard is necessary.
- Limitation of FET to specific kinds of state actions. In this sense, a rather high threshold for the finding of a violation of the FET standard can be set by defining those state measures that are manifestly arbitrary, unreasonable or discriminatory, or that are a gross denial of justice and due process. These terms will define the exclusive normative content of the FET provision.
- Clarification that the breach of another IIA provision does not mean that there is also a breach of FET, in order to keep the scope of FET clear and limited.
- The explicit acknowledgement of different levels of development as a relevant factor in the determination of liability. Therefore, the requirements regarding the administrative, legislative and judicial systems will be lower for developing countries.

[388] Compare Newcombe et al (2009), pp 235 ff
[389] Compare VanDuzer et al (2013), pp 147 ff; UNCTAD (2012), p 51

- Moreover, an explicit permission for the tribunal to take case-specific factors into account when assessing compensation will encourage tribunals to reduce the amount of compensation due in accordance with the host state's stage of development.
- An explicit recognition of the host state's freedom to regulate can be realized by clarifying that 'this article shall not be interpreted to preclude the parties from adopting regulatory or other measures that pursue legitimate policy objectives, including measures adopted to comply with other international obligations'.

In any event, states should be aware that their attempts to shape the FET standard could potentially be undermined by an MFN clause that is capable of importing FET provisions from other IIAs.

4.1.10. Expropriation

The concept of expropriation and the relevant distinctions in this context have been thoroughly discussed earlier. The main challenge in drafting expropriation provisions is to define the scope of expropriation and the remedies available in a way that safeguards the host state's right to regulate without the duty to pay compensation while protecting foreign investors against true expropriations without compensation. A sustainable development friendly expropriation clause could be designed according to the following principles:[390]

- Clarifications regarding what is to be considered an indirect expropriation:
  - The determination of whether an indirect expropriation has occurred shall follow either a balancing approach involving both considerations of the economic impact and of the purpose of the state measure at issue or a police powers approach as applied by the *Methanex* tribunal. In order to freshen up our minds, the famous *Methanex* formula in this context states that 'a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process … is not deemed expropriatory and compensable unless specific commitments had been given' to the foreign investor.[391] This formula is crucial for distinguishing legitimate non-compensable regulatory measures from expropriations and has gained significant prominence in IIA practice. By all means, the 'sole effects' approach must be declined.
  - In any event, an indirect expropriation of a foreign investment can occur only when a state measure has an effect equivalent to a direct expropriation. This provision shall basically remind tribunals of the requirement that the interference with an investor's

[390] Compare VanDuzer et al (2013), pp 169 ff; UNCTAD (2012), p 52
[391] *Methanex v United States*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, Part IV, Chapter D, page 4, para 7

property rights has to reach an intensity that can actually be compared with the economic effects of a direct expropriation in order to constitute an expropriation.

- Limiting the interests protected against expropriation to tangible or intangible property rights, which is narrower than investment as defined in the IIA. Excluding the protection of intangible property rights will prevent expropriation claims that are based exclusively on contractual rights.
- Exclusion of partial expropriation by requiring that all aspects of an investor's investment be assessed in determining whether there has been an expropriation, rather than looking separately at any distinct interest that could qualify as an investment under the IIA definition.
- Inclusion of exceptions:
  - Exceptions specific to the expropriation obligation such as a provision that excludes a compulsory license of intellectual property rights from the scope of the expropriation provision. Clauses excluding compulsory licensing usually condition the exception on compliance with international obligations under applicable international agreements on intellectual property rights such as the WTO TRIPs Agreement.
  - Alternatively, general exceptions for measures to protect health, the environment and other policy priorities can be included. We discussed the potential problems caused by general exceptions earlier.
- Limitations on compensation:
  - Limiting the basic standard to compensation that is 'appropriate', 'just' or 'equitable' rather than 'prompt, adequate and effective'. In the absence of more detailed definitions of compensation, these terms indicate the possibility for the tribunal to go below the fair market value when determining compensation.
  - Limiting compensation to direct losses, not including loss of future profits, and prohibiting the calculation on compensation based on the discounted value of cash flows. Such limitations shall avoid the uncertainties inherent to the estimation of future profits or cash flows and shall particularly exclude the DCF method.
  - Allowing tribunals to reduce the amount of compensation or damages based on considerations of fairness, equity and justice that account for the host state's development situation, the investment's contribution to host state development, the investor's conduct and legal compliance and good faith as well as its failure to mitigate its damages. This is another crucial provision for accommodating sustainable development considerations in investment arbitration. Whenever sustainable development arguments cannot exclude the host state's liability, they can still reduce the amount of compensation or damages due.
  - Prohibiting the award of punitive and moral damages. Given the essentially economic nature of investment disputes, those types of damages would be rare anyway in this context. However, states may wish to exclude these unpredictable and highly discretionary categories of damages.

- Giving the host state and the investor a time period to negotiate compensation prior to the arbitral award of damages. Such an agreement would be possible even in the absence of the respective treaty requirement. However, the tribunal's duty to provide an opportunity for states to negotiate compensation prior to an award would ensure that the tribunal permitted such an opportunity by not awarding damages until the expiry of some period of time after it found the host state to be liable.
- Specifying situations in which payment of compensation by the state may be delayed. Such a concession could help developing countries in various situations, e.g. in a financial crisis.

Although parts of the recommended provisions above have a customary basis and are reflected in IIA and arbitral practice anyway, a clear wording in the IIA text is a strong tool to ensure the effective integration of sustainable development considerations into investment arbitration.

4.1.11. Performance requirements

Performance requirements are another effective tool to ensure that the investment is beneficial to the host state, its population and eco-systems. As discussed earlier, performance requirements are '[o]bligations imposed by the host state on the investor to conduct its business in a prescribed manner'[392]. Such requirements can be made a condition of admission of an investment or could be related to the operation thereof. They can be mandatory or designed as non-mandatory conditions to certain advantages (e.g. fiscal benefits or subsidies). Such provisions could oblige the foreign investor, for example, to use local materials for production, hire local personnel or export a certain amount of products.[393] Therefore, host states may wish to affirm their right to impose performance requirements.

However, WTO members should be aware of the prohibition of performance requirements resulting from the TRIMs Agreement and GATS ('General Agreement on Trade in Services'). Trade related investment measures that are inconsistent with National Treatment (Art III GATT) include investor obligations related to the mandatory purchase or use of products of domestic origin and requirements that an investor's purchase or use of imported products is limited to an amount related to the volume or value of domestic products that it exports. TRIMs

[392] Dolzer/Schreuer (2012), p 90

[393] Compare Dolzer/Schreuer (2012), p 90; Other performance requirements could be: Obligations to engage in training programs for the workforce or build the capacities of suppliers of goods and services; carry out a given level of research and development activity in the country; transfer technology to the country; carry out environmental and social actions; form a joint venture with national partners to make the investment; have a minimum level of domestic shares in the company's capital; establish the investment activities or the decision-making center in a given region; limit itself to a certain volume or quantity of sales of goods or services on the national market. (Compare IISD, *Performance Requirements in Investment Treaties*, Best Practices Series, December 2014, p 2 f)

inconsistent with the general elimination of quantitative restrictions (Art XI GATT) include restrictions on the importation of products used in domestic production, restrictions of access to foreign exchange in order to limit the importation of products used in domestic production and quantitative restrictions on the export of products. While the TRIMs Agreement applies to trade in goods only, the GATS focuses on services. Prohibited investor obligations in this respect could be, for example, requirements for an investor to use only domestic suppliers of construction services as a condition of granting approval for the investment (provided construction services are listed in the host state's national schedule of commitments).[394]

It is, however, beneficial to the host state not to reaffirm those WTO obligations in the IIA, since otherwise those obligations could become enforceable by the investor-state dispute settlement mechanism.[395]

4.1.12. Host state participation in management, share in profits and partnerships

These issues are closely related to the imposition of performance requirements. Subject to a comprehensive assessment of costs and benefits, the host state could make its participation in the management of the investment, its share in the investment's profits as well as certain forms of partnership or even co-ownership between the investor and the host state conditions to the approval of the investment. Therefore, it is necessary for the host state not to give up its right to establish an approval process for (individual) foreign investments. Hence, IIA tools like an explicit right to establishment, the extension of certain substantive protection standards to the pre-establishment phase but also the inclusion of an unrestricted MFN clause could frustrate the imposition of individual requirements for the permission of an investment.

Individual agreements between the home state and the foreign investor could include creative forms of 'Public-Private-Partnership' (PPP), tailored to the character of the investment, and investor obligations to transfer ownership of the (assets of the) investment to the host state after a specified period of time ('Build-Operate-Transfer'). Moreover, creative forms of project financing can be integrated in such agreements. A fair design of the (re-)payment conditions will be important in this context.[396]

[394] Compare VanDuzer et al (2013), pp 196 ff; UNCTAD (2012), p 54
[395] Alternatively, those WTO obligations could be exempted from the scope of the dispute settlement mechanism.
[396] Compare Viñuales (2012), pp 42 ff

4.1.13. Transparency

Transparency in the investment context can relate to the applicability and actual application of norms governing foreign investments as well as to dispute settlement processes. Concerning transparency of the norms governing foreign investments, IIA obligations can be designed to require the host state to publish certain norms (laws, regulations as well as decisions of administrative and judicial bodies), consult with the home state or the investor on questions of interpretation or application of the IIA, exchange information on the foreign investment policies, laws and regulations that may affect new investments and otherwise cooperate in promoting transparency in respect of investment issues.

No question that a large degree of transparency will enhance clarity and predictability and in effect benefit all parties. Nevertheless, the host state should be aware of the administrative effort and expenses necessary for establishing and maintaining the systems, institutions and processes required for complying with transparency commitments. Therefore, IIAs can provide for various degrees of transparency. Transparency provisions could be mandatory or bound to the host state's 'best efforts'. Different levels of interaction between host state, investor and home state can be stipulated (passive provision of information, active exchange, consultation). Moreover, the obligations can extend to different types of norms (existing laws and regulations, administrative procedures and rulings, judicial decisions, international agreements).[397]

4.2. New provisions addressing sustainable development

Next to the adjustment of common existing IIA provisions, another effective method of addressing sustainable development concerns within IIAs is the inclusion of provisions the very purpose of which is the promotion of sustainable development. This chapter presents some sustainable development 'core provisions' which:

- include a sustainability assessment process into the IIA;
- impose obligations on investors to respect the environment, human rights, labor rights and the rights of indigenous people;
- create civil and criminal liability for investors that harm the environment or violate human rights;

[397] Compare VanDuzer et al (2013), pp 2013 ff; UNCTAD (2012), p 53

- create liability in the home state in order to hold investors accountable for harms caused in host states;
- prohibit bribery and other forms of corruption;
- modify the investor-state dispute settlement process in order to strengthen the host state's procedural rights.

4.2.1. Inclusion of a sustainability impact assessment process into the IIA

One effective way of ensuring that the foreign investment is harnessed for (or at least compatible with) sustainable development purposes is to require the foreign investor to conduct a comprehensive sustainability assessment prior to the investment's realization in the host state. Accordingly, a sustainability assessment process should be designed to effectively evaluate the investment's environmental, social and human rights impact to the host state, applying sound principles of risk management and evidence-based evaluation methods to achieve goals of environmental protection, community participation and human rights protection. Sustainability assessments should consider social factors like distributive justice, labor conditions, culture, the community's way of life, indigenous people and structures, the political system, people's health and well-being; environmental factors like the regenerative capacity of regional and international ecological systems, biodiversity, amount of available natural resources; civil, political, economic, social and cultural human rights and solidarity rights.[398]

The inclusion of investor obligations to conduct sustainability assessments into an IIA has significant advantages for the host state over the sole creation of respective obligations on the level of domestic host state law. It lifts those obligations to the international level. Therefore, the requirement of sustainability assessments cannot be qualified as a breach of the IIA. Rather, such assessments become a treaty objective which must be taken into account in the interpretation and application of the IIA. Furthermore, if the IIA is designed accordingly, assessment requirements can be subject to treaty-based enforcement mechanisms that can support and supplement domestic mechanisms. Moreover, non-performance of sustainability assessments could be qualified as contributory fault by the investor or even be the basis for a counter claim or other treaty based challenges initiated by the host state. In addition, sustainability assessment requirements in treaties encourage policy makers to implement their obligations under environmental law, human rights law and other fields of international law.[399]

Apart from model IIAs like the IISD Model Agreement[400], no existing IIA requires states to enact domestic laws to implement sustainability assessments. However, there are prominent

[398] Compare VanDuzer et al (2013), pp 267 ff
[399] Compare VanDuzer et al (2013), pp 263 ff
[400] Article 12 of the IISD Model Agreement

calls on states to require such assessments. In this sense, the UN released the 'Guiding Principles on Business and Human Rights' in March 2011, based on the report of the Secretary General's Special Representative John Ruggie. These Guiding Principles reiterate states' duty to respect, protect and fulfill human rights under the catchphrase 'Protect, Respect and Remedy', thereby calling upon states to ensure that business enterprises avoid causing or contributing to human rights violations. Therefore, the Guiding Principles suggest that business enterprises should be obliged to carry out 'human rights due diligence' by assessing 'actual and potential human rights impacts' of their activities.[401] In addition, states should ensure that victims of human rights violations have adequate access to effective judicial and non-judicial remedies.[402] This new focus on human rights accountability in the business context revitalizes existing environmental and human rights due diligence obligations grounded in customary international law and treaty law. It nourishes the development of effective assessment tools covering environmental, social and human rights aspects.

An effective sustainability assessment strategy involves several features. First, there is need to identify those activities of the investment that are likely to produce impacts that could conflict with sustainable development purposes. At the same time, all host state systems (i.e. systems that are relevant from economic, environmental and social perspectives) and stakeholders (i.e. all individuals like e.g. workers, groups like e.g. indigenous peoples and actors like e.g. the host state and its population as a whole, the environment as a whole and other companies) potentially affected by the investment as well as the antipodal interests at play (e.g. national vs alien, developed vs developing, rich vs poor, big vs small, city vs countryside, men vs women, young vs old, immigrants vs indigenous, fit vs disabled, majority vs minority, permanent vs temporary, resident vs commuting) should be identified.

The most critical part of the assessment is the assessment standard. While it is undisputed that scientific data and methods should play as much a role in the assessment as possible, there is much room for debate on the question of what is sustainable. The meaning of the term 'sustainable' depends very much on the values of the interpreter (e.g. the relative importance attached to different – economic, ecological and social – purposes) as well as the beliefs of how these values can and should be realized (e.g. neo-liberal vs eco-social economic approaches). If a sustainability assessment shall have any regulatory effects, it is necessary to define clearly and in detail the benchmark for the sustainability assessment, i.e. the relationship between economic, environmental and social priorities that is deemed to be 'sustainable'.[403]

[401] UN *Guiding Principles on Business and Human Rights*, 2011, A/HRC/17/31, principle 17
[402] Ibid, principle 25
[403] To my opinion, the ultimate benchmark for the sustainability assessment should be a fair balance of give and take between the investor and its home state on the one side and the host state and its systems and stakeholders (including employees) on the other side. Real sustainability requires a fair balance between all systems and stakeholders. This is more than just a numerical comparison of the overall costs and benefits between the side of the investor and the side of the host state. It involves a qualitative confrontation and balancing between economic,

The starting point for the creation of the benchmark should be the host state's existing international environmental, social and human rights obligations, including important principles of the respective fields of law.[404] Once such a benchmark for sustainability is determined and all relevant scientific data is collected, potential impacts to host state systems and stakeholders should be identified and their likelihood assessed. In this context, the IFC has developed performance standards for assessing social and environmental impacts of an investment in an integrated way.[405] Furthermore, the International Organization for Standardization has released standards for managing environmental assessments (ISO 14001) and for the implementation of best practices in the field of social responsibility (ISO 26000). Moreover, the International Center for Human Rights and Democratic Development provides standards for assessing the impact of an investment on human rights.[406]

Another relevant issue is that all potentially affected stakeholders and civil society groups should be able to participate meaningfully in the assessment process. To this end, effective communication between investors and affected stakeholders about the investment's risks is required. Another important step in an effective sustainability assessment strategy is the inclusion of the outcomes of the assessment into the management plan and the business processes of the planned investment. In addition, corporate compliance with the measures that can be derived from the assessment, should be monitored. Finally, the assessment system should include an effective enforcement mechanism to counter a company's failure to comply with the management plan.[407]

As for the inclusion of an investor obligation to conduct a sustainability assessment into an IIA, various options exist on a technical level. The minimum version would be to specify in the IIA that a sustainability assessment does not violate the agreement. Another version is to make the sustainability assessment a condition for both the approval of the investment and the applicability of the investment protection standards in the IIA. The maximum version would make the sustainability assessment a condition of the investment and would add effective enforcement mechanisms to counter non-compliance by the investor with the assessment obligations. In this sense, the investor's access to the investor-state dispute settlement process

ecological and social purposes in a way that respects the different indicators of success inherent to these purposes and that allows each aspect to prosper in its own way. The mindset needed in this respect is an eco-centric set of values (hierarchy of values: 1. ecology, 2. social purposes, 3. economy) combined with the belief that ecological sustainability and social justice call for a fundamental eco-social change of our global economic system. With such a mindset, the outcome of the sustainability assessment will probably be different from the results of a 'mainstream' sustainability assessment.

[404] E.g. environmental law principles like the precautionary principle, the principle of common but differentiated responsibilities and the polluter pays principle, but also universally recognized human rights.

[405] See International Finance Corporation, *IFC Performance Standards on Environmental and Social Sustainability*, January 2012, available at http://www.ifc.org/wps/wcm/connect/c8f524004a73daeca09afdf998895a12/IFC_Performance_Standards.pdf?MOD=AJPERES (accessed 8 August 2016, 10:00 P.M.)

[406] Compare VanDuzer et al (2013), p 277

[407] Ibid, pp 275 f

could be limited in case of non-compliance. The host state, affected stakeholders and the investor's home state could be allowed to sue investors that harm the environment, human rights, labor rights or rights of indigenous peoples. Alternatively, domestic complaint and investigation procedures could be created. In addition to all of this, ongoing monitoring of the sustainability situation of the investment can be required as well as involvement or even consent of all affected stakeholders in the approval process. All of these options require the host state to define the content and the procedures of the sustainability assessment on the level of domestic law. This ensures a certain flexibility for adapting the assessment parameters if necessary. However, nothing prevents the IIA parties from including substantial characteristics of the sustainability assessment into the IIA itself.[408]

In the present context, it must be mentioned that not only planned investments, but also IIAs themselves, can be subject to a sustainability assessment. For this purpose, the UN have released the 'Guiding Principles on Human Rights Impact Assessments of Trade and Investment Agreements' in December 2011.[409] Moreover, the OECD has developed a methodology for the assessment of the environmental impacts of international trade agreements. Various OECD members such as the USA, the EU and Canada have evaluated the environmental impacts of free trade agreements and IIAs.[410] It may, however, be questioned how much the assessment efforts of these industrialized nations have contributed to achieving goals of sustainable development in effect.

4.2.2. Investor obligations to comply with the laws of the host state

Reiterating in the IIA the investor's general obligation to comply with all domestic law of the host state has two main advantages for the host state. First, such an IIA obligation clarifies the expectations investors may legitimately have. Raising the obligation to the international level encourages the arbitral tribunal to balance the investor duty to obey host state law with the investor protection induced by the IIA protection standards. Second, including such an obligation into the IIA creates a straightforward way for the host state to use a variety of treaty-based enforcement tools beyond the usual domestic mechanisms available. Subject to according IIA provisions, the breach of a sustainable development related domestic norm could be the initial point for a civil (counter) claim against the investor.

[408] Ibid, pp 272 ff
[409] United Nations, *Report of the Special Rapporteur on the Right to Food, Olivier De Schutter: Guiding Principles on Human Rights Impact Assessments of Trade and Investment Agreements*, December 2011, A/HRC/19/59/Add.5
[410] Compare Gehring, Markus W, *Impact Assessments of Investment Treaties*, 2011, cited in Cordonier Segger et al. (2011), p. 155

The importance of such an IIA obligation is emphasized by the OECD Guidelines for Multinational Enterprises[411] and UNCTAD's Investment Policy Framework for Sustainable Development[412]. Both the COMESA Investment Agreement[413] and the IISD Model Agreement[414] contain provisions requiring investors to comply with the domestic law of the host state. One way of drafting such a provision is to state that 'Investors of a party and their investments are subject to and shall respect all laws and regulations of the other party, including, but not limited to its laws, regulations and standards for the protection of human rights, labor rights, the rights of indigenous peoples and the environment'. The explicit reference to the fields of law specifically relevant for the promotion of sustainable development strengthens the validity and lawfulness of correlating host state measures.[415]

4.2.3. Investor obligation to respect internationally recognized human rights and to undertake human rights due diligence

The UN Guiding Principles on Business and Human Rights are probably the most prominent and professional compendium about the realization of a sound human rights culture in the international business context.[416] When referring to human rights, the Guidelines mean – at minimum – the human rights expressed in the International Bill of Human Rights[417] and the principles concerning fundamental rights as set out in the International Labour Organization's Declaration on Fundamental Principles and Rights at work.[418] As explained earlier, the Guiding principles call upon home states to require business actors to respect human rights by effectively integrating human rights concerns into the corporate psyche. In Principle 15, the Guidelines demand that:

> 'In order to meet their responsibility to respect human rights, business enterprises should have in place policies and processes appropriate to their size and circumstances, including:
>
> a. A policy commitment to meet their responsibility to respect human rights;

[411] OECD, *OECD Guidelines for Multinational Enterprises*, 2011, at 15
[412] UNCTAD (2012), p 58
[413] COMESA Investment Agreement, Art 13
[414] IISD Model Agreement, Art 11
[415] Compare VanDuzer et al (2013), pp 302 ff; UNCTAD (2012), p 58
[416] The Guiding Principles were unanimously endorsed by the UN Human Rights Council. The core provisions of the Guiding Principles have also been reiterated in the OECD Guidelines for Multinational Enterprises and the ISO 26000 standards.
[417] I.e. the UDHR (Universal Declaration of Human Rights of 1948) together with the ICCPR (International Covenant on Civil and Political Rights of 1976) and the ICESCR (International Covenant on Economic, Social and Cultural Rights of 1976)
[418] Compare *UN Guiding Principles on Business and Human Rights*, A/HRC/17/31, 2011, Principle 12

b. A human rights due-diligence process to identify, prevent, mitigate and account for how they address their impacts on human rights;

c. Processes to enable the remediation of any adverse human rights impacts they cause or to which they contribute.'

According to the Guidelines, a comprehensive human rights due diligence process shall constitute the heart piece of a company's strategy to respect human rights. In this context, a due diligence is a comprehensive assessment of an investment's human rights impacts, meant to ensure that companies have all the information necessary to avoid human rights violations in their business activities. Principles 17 to 21 of the Guidelines lay down detailed minimum requirements for the due diligence process. These requirements demand, among others, the involvement of human rights experts, meaningful consultation with stakeholders affected by the investment, the integration of the results of the human rights impact assessment into the management processes, accurate reports to the home state about how the company addresses its human rights impacts as well as the provision of remediation to victims of adverse human rights impacts.

To date, no existing IIA includes an investor obligation to engage in a process of human rights diligence. However, there is some human rights language in the Norwegian draft APPI, which affirms the parties' commitment to human rights and fundamental freedoms and references the principles set out in the UN Charter and the Universal Declaration of Human Rights. In the EU-Russia Cooperation and Partnership Agreement, the parties have agreed to engage in a regular political dialogue to ensure observance of the principles of democracy and human rights.[419]

More recently, some states have started to include into IIAs provisions that deal with CSR and contain references to human rights or to standards that address human rights.[420] Hence, the Canada-Colombia FTA includes a non-binding recommendation that party states encourage foreign investors to 'voluntarily incorporate internationally recognized standards of corporate social responsibility in their internal policies' relating to human rights, labor rights, environmental issues, anti-corruption and community relations.[421] The Canada-Peru FTA contains a similar provision.[422] The Norwegian draft APPI imposes an obligation on party states 'to encourage investors to conduct their investment activities in compliance with the OECD Guidelines for Multinational Enterprises and to participate in the United Nations Global Compact'.[423]

[419] Compare Compare VanDuzer et al (2013), p 300
[420] Compare Hepburn/Kuuya, *Corporate Social Responsibility and Investment Treaties*, in Cordonier Segger et al (2011), pp 599 ff
[421] Canada-Colombia FTA, 2008, Art 816
[422] Canada-Peru FTA, 2008, Art 810
[423] Norwegian draft APPI, Art 32

As for the technical integration into an IIA of an investor obligation to respect human rights and to engage in human rights due diligence, I may refer to the respective remarks in the Chapter about the inclusion of a sustainability impact assessment process into IIAs in large parts. Therefore, an IIA could simply specify that the respective investor obligation does not violate the agreement. Alternatively, the state can make compliance by the investor a condition for the approval of the investment and for investment protection. Furthermore, monitoring, consulting and reporting requirements as well as enforcement mechanisms could be added. Non-compliance could be made the initial point for claims, counter-claims, set-offs or other remedies against the foreign investor, initiated by the host state, home state or affected stakeholders.

The advantages of lifting the obligation to the international level – again – are a certain immunization of host state regulations or measures against investor challenges as well as access to IIA-based enforcement mechanisms, provided the agreement contains according provisions. Moreover, such an IIA obligation encourages the host state to implement its international human rights obligations, since a substantive human rights basis needs to be established and a couple of procedural features of the due diligence process must be determined by domestic host state law. In this context, references to domestic fundamental rights and international human rights documents and treaties are highly useful.

Since the majority of transnational litigation against corporate actors relates to allegations of grave human rights violations[424], states might wish to include into to IIA an express investor obligation to refrain from the commission of, or complicity in, grave violations of human rights. The biggest benefit of reiterating this general obligation within the IIA is that grave human rights violations could be specified as initial points for treaty-based grievance processes – open to affected individuals – which could be designed to establish not only civil but also criminal liability of the perpetrators. The IIA could also provide that these treaty-based enforcement mechanisms can be used to pursue breaches of domestic laws in the host state that prohibit grave human rights violations.[425]

4.2.4. Investor obligation to comply with core labor standards

High labor standards have traditionally been viewed as likely to discourage foreign investment, since high standards may translate into higher production costs. Recent empirical studies, however, have shown that a high level of labor standards does not in fact discourage investment. To the contrary: Violations of labor rights have the effect of even discouraging foreign investment. The same is true for human rights and environmental standards. In fact, 'it is

[424] Compare Compare VanDuzer et al (2013), p 320
[425] Compare VanDuzer et al (2013), pp 318 ff; UNCTAD (2012), p 58

conceivable that the observance of core standards would strengthen the long-term economic performance of all countries'.[426]

Substantially speaking, the most important labor standards refer to equality of opportunity and treatment in employment (non-discrimination), freedom of association and workers' right to organize and collectively bargain as well as to child labor and economic exploitation of children. The most important codifications in this respect are the non-binding 1998 ILO Declaration on Fundamental Principles and Rights at Work, the eight ILO core conventions[427], the 1999 Convention on the Rights of the Child as well as the 2008 ILO Declaration on Social Justice for a Fair Globalization[428].

Technically speaking, the integration of labor standards into an IIA can be realized through: language in the preamble; provisions in the substantive body of the IIA or in a side agreement to address the problem of 'race to the bottom' of labor standards; exceptions for labor laws and regulations; an obligation on states to cooperate to ensure investor compliance with labor standards; and through an investor obligation to comply with (core) labor standards.

Language in the preamble: The preamble could state that the protection of labor standards is at the same level of importance as investor protection. In some aspects, the preamble could even demand precedence in interpretation for non-investment priorities like labor conditions. This would be a stronger approach than present in existing IIAs, such as the US-Uruguay BIT and the EC-CARIFORUM EPA[429] which require that treaty objectives shall be accomplished in a manner consistent with purposes like health, safety, the environment and international labor rights.[430]

Provisions in the substantive body of the IIA or in a side agreement to address the problem of 'race to the bottom' of labor standards: Parties could reaffirm their commitments to international labor law instruments. They could establish obligations on state parties 'not to relax domestic labor laws and regulations in order to attract or retain investment and not to

[426] Compare OECD, *Trade, Employment and Labour Standards: A Study of Core Worker's Rights and International Trade*, OECD, 1996, Paris, at 105; Busse/Nunnenkamp/Spatareanu (2011), *Foreign Direct Investment and Labour Rights: A Panel Analysis of Bilateral FDI Flows*, 18 Applied Economics Letters 149; Blume/Voigt (2004), *The Economic Effects of Human Rights*, University of Kassel Working Paper 66/04, University of Kassel, at 3, 30, 37; all these sources cited in VanDuzer et al (2013), pp 303, 323

[427] I.e. ILO Convention (No. 100) concerning Equal Remuneration for Men and Women Workers for Work of Equal Value, 1951; ILO Convention (No. 111) concerning Discrimination in Respect of Employment and Occupation, 1958; ILO Convention (No. 87) concerning Freedom of Association and Protection of the Right to Organize, 1948; ILO Convention (No. 98) concerning the Application of the Principles of the Right to Organise and Collective Bargaining, 1949; ILO Convention (No. 138) concerning Minimum Age for Admission to Employment, 1973; ILO Convention (No. 182) concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour, 1999; ILO Convention (No. 29) concerning Forced or Compulsory Labour, 1930; ILO Convention (No. 105) concerning the Abolition of Forced Labour, 1957

[428] The ILO Declaration on Social Justice for a Fair Globalization calls for the promotion of employment in which individual and collective development, social protection and fundamental labor rights can be realized.

[429] Economic Partnership Agreement between the European Community and the Caribbean Forum of 1994

[430] Compare Compare VanDuzer et al (2013), p 324

enforce such standards' as well as 'to either maintain high levels of labor standards or endeavor to ensure that domestic labor standards are consistent with certain listed international labor standards and require parties to strive to improve such standards'.

Generally, the ostracism of a 'race to the bottom', as can be found e.g. in the EC-CARIFORUM EPA, the 2012 US Model BIT, some US FTAs, EU-Korea FTA and the Austrian Model BIT, is becoming common in IIAs.[431] The EU-CARIFORUM EPA, for example, requires parties to ensure that their domestic laws 'provide for and encourage high levels of social and labour standards' in line with listed international labor standards but also recognizes the host state's right 'to regulate in order to establish their own social regulations and labour standards in line with their own social development priorities and to adopt or modify accordingly their relevant laws and policies'.[432]

Exceptions for labor laws and regulations: An exception for labor measures – the various types and forms of exceptions have been broadly discussed – expresses the parties' intention to carve out this area from the IIA's scope of protection. An exception for labor concerns can be found in the US-Uruguay BIT:

> 'Nothing in this Treaty shall be construed to prevent a Party from adopting or maintaining, or enforcing any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to labor concerns.'[433]

The term 'that it considers appropriate' has self-judging character and grants some regulatory discretion to the host state. The term 'otherwise consistent with this Treaty', however, takes away a large portion of that discretion, since it requires any host state measure to be consistent with the standards of investment protection in the IIA.

An obligation on states to cooperate to ensure investor compliance with labor standards: An obligation of the party states to cooperate harnesses the home state's regulatory capacity, investigation resources and enforcement power for the host state's policy goals. Comprehensive cooperation between states can overcome the territorial limits of one state's jurisdiction to a certain extent and can pave the way for an extraterritorial application of domestic norms.

[431] Compare VanDuzer et al (2013), p 325
[432] Art 191 f
[433] US-Uruguay BIT, 2005, Art 13 (3)

In present IIA practice, cooperation focusses on the enforcement of labor standards against investors (e.g. in the EC-CARIFORUM EPA[434]) and on the exchange of information, educational activities and technical cooperation (e.g. in US FTAs[435]).

Investor obligation to comply with (core) labor standards: This is the place to include substantive labor standards and references to existing international labor documents. The combination of 1. exceptions, 2. the articulation of the host state's right to regulate and 3. investor obligations to respect specific standards is likely to constitute a strong shield for host state regulations and measures against investment claims. This is true for every policy field, including labor issues.

In effect, the advantages of including investor obligations to respect labor standards into the IIA itself are two-fold: First, it overcomes the danger of a potential investor challenge. The protection of labor standards becomes a treaty objective and therefore gains weight in relation to the objective of investment protection. Second, the respect of labor standards becomes an international obligation the violation of which can give rise to treaty-based enforcement mechanisms, provided the treaty states so (e.g. grievance procedure, civil liability, criminal sanctions, counter claims, set-offs).[436]

4.2.5. Other provisions

In a similar manner, other investor obligations can be included into the IIA:

- An investor obligation to refrain from acts, or complicity in acts, of bribery and corruption. Such an investor obligation is contained in the IISD Model Agreement.[437] Other IIAs, such as the EC-CARIFORUM EPA, oblige state parties to 'take the necessary legislative and administrative measures to comply with international standards, including those laid down in the United Nations Convention against Corruption' and to cooperate in order to prohibit and punish bribery or corruption.[438]
- An obligation to encourage compliance with voluntary mechanisms on environmental performance. The Australia- US FTA, for example, contains an obligation on state parties to promote the development of voluntary, market-based mechanisms that 'encourage the protection of natural resources and the environment'.[439]

[434] Art 72 (b) and (c)
[435] E.g. Art 18.5 of the Australia-US FTA of 2004, Art 16.5 and Annex 16.5 of the US-CAFTA FTA of 2004, Art 18.5 and Annex 18.5 of the US-Chile FTA of 2003
[436] Compare VanDuzer et al (2013), pp 329 ff; UNCTAD (2012), p 58
[437] Art 13 of the IISD Model Agreement
[438] Art 237 and 72 of the EC-CARIFORUM EPA
[439] Art 19.4 of the Australia-US FTA of 2004

- Cooperation between parties on environmental issues. Some US FTAs recognize the importance of capacity building for the purpose of environmental protection and incorporate provisions on the sharing of information relating to the environmental effects of trade agreements and policies.[440] The US-Chile FTA provides an indicative list of cooperative activities. These include, for example, the establishment of a database of chemicals that have been released into the environment, the reduction of the pollution from mining projects, the protection of wildlife and the reduction of ozone-depleting substances.[441] By contrast, the EC-CARIFORUM EPA focuses on the enforcement of environmental protection standards against investors. The IISD Model Agreement goes the furthest in this respect. It reiterates state obligations under international human rights and environmental agreements[442] and states that the aim of this provision is to put the parties on notice that these 'obligations are not superseded by the present Agreement'.[443] Furthermore, the IISD Model recognizes the state parties' right to establish their own levels of environmental protection and requires the parties to establish high levels of human rights, labor rights and environmental protection appropriate to their level of development.[444]
- Obligations on state parties and investors to respect the rights of indigenous peoples. To date, no international instrument specifically articulates the rights of indigenous peoples and corresponding responsibilities of states, corporations and individuals in relation to investment. However, there are pertinent international documents dealing with the rights of indigenous peoples, such as the non-binding UN Declaration on the Rights of Indigenous Peoples (UNDRIP) and the ILO Convention No. 169 concerning Indigenous and Tribal Peoples in Independent Countries of 1989. The most important issue when drafting IIA clauses in this respect is to articulate that none of the host state's obligations in relation to investors limits the state's ability to adopt and enforce laws, regulations or policies that implement its international obligations towards indigenous peoples or that secure their rights. Moreover, it is important to specify that in certain human rights relevant situations[445], the free, prior and informed consent of indigenous peoples must be obtained. In other situations, obligations to consult with indigenous peoples would be appropriate.[446]
- Obligation on states to provide for criminal enforcement of prohibitions on bribery and corruption and grave violations of human rights and to cooperate with respect to

[440] Art 19.6 of the Australia-US FTA of 2006; Art 18.6 of the US-Singapore FTA of 2003
[441] Annex 19.3, Art 2 of the US-Chile FTA of 2003
[442] Important environmental treaties are e.g.: Convention on International Trade in Endangered Species of Wild Fauna and Flora (1973); Framework Convention on Climate Change (1992); Kyoto Protocol to the Framework Convention on Climate Change (1997); Convention on Biological Diversity (1992); Cartegna Protocol on Biosafety (2000); Vienna Convention for the Protection of the Ozone Layer (1988); Montreal Protocol on Substances that Deplete the Ozone Layer (1987); Stockholm Convention on Persistent Organic Pollutants (2001); Convention on the Law of the Seas (1982); Convention to Combat Desertification (1994)
[443] Art 34 of the IISD Model Agreement
[444] Compare VanDuzer et al (2013), p 354
[445] E.g. removal of indigenous peoples from their lands, waste-storage, large-scale projects
[446] Compare VanDuzer et al (2013), pp 345 ff

enforcement. In this context, it is important to make sure that criminal liability extends to both natural and legal persons.

4.2.6. Civil liability of investors

Another way to facilitate investor compliance with its obligations under IIAs and host state law is the imposition of civil liability on investors and their investments. Traditionally, there are various jurisdictional, procedural, evidentiary and other legal obstacles to bringing successful civil suits against an investor in the host state or the investor's home state. One hurdle could be, that in many common law jurisdictions, there is no specific cause of action for violations of human rights, labor rights or indigenous peoples' rights that may result from investments in other countries. Another hurdle could be judicial doctrines like *forum non conveniens*. A third issue is related to the complex organization of transnational business. A transnational corporation typically involves various kinds of entities spread all over the world, each possessing separate legal personality. Transnational corporations can easily restructure, and even if a company's liability can be established, the corporation would mostly be flexible enough to transfer their assets and financial resources. Courts are often reticent to pierce the veil of corporate groups to impose liability on parent companies for acts of their subsidiaries.[447]

Therefore, the challenge in this context is to hold liable an appropriate entity in a corporate group that has sufficient assets. There are basically three ways to do so: 1. States can establish enterprise liability for investors and their investments; 2. States can create investor obligations to take out liability insurance for violations of human rights, labor rights, indigenous peoples' rights and environmental damage, as a condition of permitting the investment; and 3. States can require the foreign investor to post a bond as a condition of permitting the investment.

Enterprise liability (1) goes beyond piercing the corporate veil, by allowing courts not only to find a parent corporation liable for the acts of a subsidiary, but also to find a sister entity (i.e. a corporation that is under the common control of the parent) liable. This holistic approach reflects the economic reality of transnational business groups (which often operate as an integrated whole) and reallocates the liability risk to the international actor in its entirety. Such an approach is already applied by the US, Germany, India and Albania in certain circumstances. In this sense, the Albanian company law, for example, focuses on the flow of money rather than on legal control, thereby attaching liability to the whole corporate group. This concept is flexible enough to even cover relationships such as franchising and other outsourcing

[447] Compare VanDuzer et al (2013), pp 387 f

constructions.[448] However, an IIA obligation establishing enterprise liability should be formulated to cover all forms of economic partnerships and entities that are connected in terms of financial flows and effective risk sharing.

Other ways of ensuring that investors cannot evade civil liability is to require (2) liability insurance or (3) the payment of a deposit. In this case, it may be useful to link the sum insured or deposited to the outcome of a sustainability assessment. The right to sue could be granted to a variety of – directly or even indirectly – affected stakeholders, including the host state, individuals, indigenous peoples, groups and organizations as well as to special interest groups, NGOs and other actors of the civil society.[449]

There are no existing IIAs that include provisions requiring parties to establish civil liability for investor violations of human rights, labor rights, indigenous peoples' rights, for environmental damage or for harm caused by corruption.[450] However, the IISD Model Agreement contains such a provision. Moreover, the IISD Model provides that an investor may be held civilly liable in its home state[451] and that victims may pursue a claim in the state where the investor is likely to hold more assets. In addition, home states must make sure that bringing an action is not prevented just because the impugned acts occurred in the host state.[452]

4.2.7. Counter claims by states in investor-state arbitration

As discussed earlier, another tool for enforcing investor obligations under an IIA and holding investors civilly liable is the establishment of a counter claim mechanism, which allows the host state to hold the investor liable for breaches of its IIA obligations, once the investor has initiated an investor-sate arbitration procedure. The advantages of a counter claim mechanism for the host state are obvious: It strengthens the state's position in investor-state arbitration, reallocates risk, deters investors from bringing investor-state claims, encourages the investor to comply with its obligations and hence supports sustainable development. Moreover, compensation or damages granted by an arbitral award enjoy the benefits of the efficient and widespread enforcement regimes established by the ICSID Convention or the New York Convention.[453]

[448] Compare VanDuzer et al (2013), p 390; Dine, J (2012), *Jurisdictional Arbitrage by Multinational Companies: A National Law Solution?*, 3 Journal of Human Rights and the Environment 44 at 66-67, cited in VanDuzer et al (2013), p 390
[449] Compare VanDuzer et al (2013), p 39
[450] Ibid, 392
[451] Art 31 of the IISD Model Agreement
[452] Compare VanDuzer et al (2013), p 393
[453] Ibid, pp 401 ff

According to the COMESA Investment Agreement, a host state may bring a counter claim for breaches of the investor obligations contained in the Agreement and allows a host state to raise non-fulfilment by the investor of its obligations as defense or set-off.[454] In a similar vein, the IISD Model Agreement contemplates a right of counter claim as well as a right of set-off where an investor persistently fails to comply with its obligations under the Agreement, provided the breach is materially relevant to the issues of the proceeding.[455] However, in the case of ICSID arbitration[456] or the use of the full UNCITRAL rules[457], additional requirements will have to be observed.

4.2.8. Additional options for strengthening the host state's position

Let me now give a brief overview of additional options for strengthening the host state's position in investment arbitration:[458]

- Limitation of investor-state arbitration to disputes about the amount of compensation for an expropriation or to the main investor protection obligations of the IIA.
- Inclusion of a procedure for having the parties make binding interpretations or allow the host state to declare unilaterally that an exception is available.
- Requiring consultations between the investor and the host state prior to the formal commencement of an arbitration (e.g. a six-month 'cooling off' period) or requiring the investor to file a notice of intent to bring a claim 90 days prior to the submission of the claim itself.
- Inclusion of asymmetrical obligations ('Special and Differential Treatment'), allowing for:
  - Reduction of normative intensity: Binding obligations could be replaced with best-endeavor obligations for less developed countries;
  - Delayed implementation of obligations while introducing a timetable for implementation of IIA obligations with longer time frames for developing countries;
  - Development specific reservations which benefit the developing party;
  - Provisions requiring a development-friendly interpretation of IIA provisions, taking into account the different levels of development.
- Requiring the exhaustion of local remedies before international investor-state dispute settlement mechanisms are engaged. Advantages for the host state in this context are: Domestic courts have a chance to correct mistakes of the host state by providing relief in

[454] Art 28.9 of the COMESA Investment Agreement
[455] Art 18 (D) and (E) of the IISD Model Agreement
[456] Art 46 of the ICSID Convention provides that counter claims must arise 'directly out of the subject matter of dispute' that is the basis of the claim brought by the foreign investor.
[457] In 2010, the UNCITRAL rules were amended to state that a counter claim is permitted any time the tribunal has jurisdiction over it.
[458] Compare VanDuzer et al (2013), pp 493 ff; UNCTAD (2012), pp 48 ff

obvious cases; Domestic courts can sort out claims without obvious merit; Domestic dispute resolution is typically less costly than international arbitration; The host state is encouraged to further develop domestic investment rules and institutions; Decisions in accordance with democratically determined domestic laws and constitutional requirements contributes to the public perception of a legitimate outcome; Domestic courts' interpretations of local law will help international tribunals to apply local law. Disadvantages for the host state are the possible deterrence of investment and the possible need for the host state to defend its position in both domestic and international proceedings.

- Avoiding multiple remedial possibilities for investors. 'Waiver': The IIA could provide that a choice by an investor to initiate arbitration means that the investor must give up ('waive') all other claims to relief. 'Fork in the road': The IIA could also provide that the investor must choose to pursue its claim either in domestic courts or through investor-state arbitration under an IIA and that such choice is final and irrevocable.
- Including a provision into the IIA which gives the host state and the investor a certain period of time to negotiate the amount of compensation prior to an award by the tribunal after a finding of liability.
- Providing for situations in which payment of compensation by the host state may be delayed, including a financial crises.
- An IIA could expressly require that the investor must prove all elements of its claim, including damages suffered, and that the investor must show the losses were sustained by reason of the host state's breach of its IIA obligations. Alternatively: Requiring that a claimant must have suffered damage by reason of, or arising out of, a breach of a protection standard as a condition for the host state's duty to pay damages.
- Allowing the arbitral tribunal to reduce the amount of compensation or damages for various reasons, including:
  (1) 'Contributory fault' – situations where the investor has contributed to the loss it suffered;
  (2) Situations in which the host state' action has breached a rule that the tribunal determines were unclear or subject to conflicting interpretation in some way that is relevant to the finding of liability;
  (3) Situations where the investor has not taken reasonable steps to mitigate its losses;
  (4) The preclusion of damages where the breach by the host state does not surpass some minimum threshold of seriousness.
  (5) Reductions for developing countries with limited financial resources and other reasons of fairness and equity;

Reasons (1) to (4) are either generally accepted in international law or have already been taken into account be investment tribunals. Reason (5) (reduction for developing reasons and other reasons of fairness and equity) earns a great deal of further research and – to my opinion – is among the most promising tools for making decisions of investment tribunals more just.

5. Excursus: Financial products as investments under investment treaties

This chapter examines the readiness of international investment tribunals to grant investment protection to financial products. The related question in this regard is, if financial products qualify as 'investment' in the sense of investment treaties and Article 25 (1) of the ICSID Convention.

By today, just about a handful of investment treaty arbitrations have been based on investments consisting in financial products such as loans, bonds and derivatives. In this context, the most relevant cases are *Fedax v Venezuela*[459], *CSOB v Slovakia*[460], *Abaclat v Argentina*[461], *Ambiente Ufficio v Argentina*[462], and *Deutsche Bank v Sri Lanka*[463].

These five cases are ICSID arbitration cases and show that ICSID tribunals are willing to construe the notion of 'investment' broadly enough in order to encompass financial instruments acquired on the primary or even on the secondary market.[464]

As mentioned earlier, ICSID arbitration requires the existence of an 'investment' both in the sense of the agreement containing the consent for arbitration as well as in the sense of Article 25 (1) of the ICSID Convention. There are basically two schools concerning the interpretation of 'investment' in Art 25: the *subjectivist* and the *objectivist* school. While the subjectivist school tends to read Art 25 as leaving it exclusively to the parties of the agreement to define 'investment', the objectivist school recognizes that 'investment' in Art 25 has its own normative content which sets objective limits ('outer limits') to what can be deemed an 'investment' valid for ICSID arbitration.[465]

Many investment treaties explicitly mention financial products such as loans, bonds, and other financial instruments in their definitions of 'investment'. But even without explicit references,

[459] *Fedax NV v The Republic of Venezuela*, Decision of the Tribunal on Objections to Jurisdiction, 11 July 1997
[460] *Ceskoslovenska Obchodni Banka, AS v The Slovak Republic*, Decision of the Tribunal on Objections to Jurisdiction, 24 May 1999
[461] *Abaclat and Others v Argentine Republic* (formerly *Giovanna a Beccara and Others v The Argentine Republic*), Decision on Jurisdiction and Admissibility, 4 August 2011
[462] *Ambiente Ufficio SpA and others v Argentine Republic* (formerly *Giordano Alpi and others v Argentine Republic*), Decision on Jurisdiction and Admissibility, 8 February 2013
[463] *Deutsche Bank AG v Democratic Socialist Republic of Sri Lanka*, Award, 31 October 2012
[464] Compare Jeffrey Golden/Carolyn Lamm, *International Financial Disputes – Arbitration and Mediation*, Oxford University Press, 2015, p 117
[465] Compare Golden/Lamm (2015), p 113; This two-step examination of whether the alleged investment fulfills the normative requirements of an 'investment' in the sense of the agreement invoked for arbitration as well as of Article 25 (1) of the ICSID Convention is referred to as 'double-keyhole' or 'double-barrelled' test.

terms like 'claims to money', will presumable cover debt obligations which may be reflected in loans and bonds.[466] Given the broad definitions of 'investment' contained in the investment treaties at issue in the five cases mentioned above, the respective tribunals did not have troubles to conclude that the financial instruments under discussion constituted investments in the sense of these investment treaties. Since all these cases have arisen within the ICSID framework, tribunals entered furthermore into thorough examinations whether financial products meet the requirements of Art 25 ICSID Convention.

In these examinations, the traditional distinction between investments (only investments are the object of investment treaties) and ordinary commercial transactions became relevant. In this context, the *Fedax* tribunal explicitly distinguished the promissory notes at issue from 'ordinary' loans, stating that 'the transactions involved in this case are not ordinary commercial transactions'.[467] In a similar vein, the tribunal in *Deutsche Bank* rejected the respondent's argument on the commercial nature of the transactions, since it found that the involvement of financial products in the sales agreement at issue would prevent a qualification of the latter as an ordinary commercial transaction.[468]

Concerning debt instruments, the tribunals in *Fedax* and *CSOB* have qualified loans as investments both in the sense of the applicable BITs and in the sense of the ICSID Convention.

In *Fedax*, the question was whether promissory notes issued by the government of Venezuela to a Venezuelan corporation and then endorsed to a Dutch entity could qualify as an investment in the sense of Art 25. The tribunal explained its affirmative decision by reference to a statement of commentator Georges Delaume who underlined that 'the characterization of transnational loans as "investments" has not raised difficulty' because 'it has been assumed from the origin of the [ICSID] Convention that loans, or more precisely those of a certain duration as opposed to rapidly concluded commercial financial facilities, were included in the term "investment"'.[469] Citing this statement and other commentaries and referring to the 'broad scope' of Article 25 (1), the tribunal held that in general 'loans qualify as an investment within ICSID's jurisdiction'. The tribunal went on to hold that '[s]ince promissory notes are evidence of a loan and a rather typical financial credit instrument, there is nothing to prevent their purchase from qualifying as an investment under the [ICSID] Convention …'.[470]

Moreover, the tribunal held that the fact that the financial instrument was acquired on a secondary market was not a bar to the qualification of the product as investment: '[A]lthough

[466] Compare 2008 German Model BIT, Art 1 (1) (c): 'claims to money which has been used to create an economic value or claims to any performance having an economic value'; Netherlands-Indonesia BIT, Art 1 (c): 'claims to money or to any performance having a financial value'.
[467] *Fedax v Venezuela*, Decision of the Tribunal on Objections to Jurisdiction, 11 July 1997, para 42
[468] Compare Golden/Lamm (2015), p 120
[469] *Fedax v Venezuela*, Decision of the Tribunal on Objections to Jurisdiction, 11 July 1997, para 23, quoting Georges R Delaume, *ICSID and the Transnational Financial Community*, 1 ICSID Rev 237, 242 (1986)
[470] *Fedax v Venezuela*, Decision of the Tribunal on Objections to Jurisdiction, 11 July 1997, para 29

the identity of the investor will change with every endorsement, the investment itself will remain constant, while the issuer will enjoy a continuous credit benefit until the time the notes become due'.[471]

Citing Professor Schreuer's ICSID Commentary, the tribunal laid out a proto version of the *Salini* test and concluded that each element of the test (duration, regularity of profit and return, substantial commitment, element of risk, contribution to host state development) was met:[472]

> 'The duration of the investment in this case meets the requirement of the [Public Credit] Law as to contracts needing to extend beyond the fiscal year in which they are made. The regularity of profit and return is also met by the scheduling of interest payments through a period of several years. The amount of capital committed is also relatively substantial. Risk is also involved as has been explained. And most importantly, there is clearly a significant relationship between the transaction and the development of the host State, as specifically required under the [Public Credit] Law for issuing the pertinent financial instrument.'[473]

The tribunal affirmed its jurisdiction unanimously, thereby laying the foundation for future cases concerning financial instruments.

Two years after *Fedax v Venezuela*, the tribunal in *CSOB v Slovakia* was confronted with a dispute in the context of Czechoslovakia's separation into two independent republics. In order to ease the privatization of the bank CSOB, the respective financial ministries of the Czech and Slovak Republics and CSOB agreed on the creation of so-called 'Collection Companies' in both the Czech and Slovak Republic, to which some of the bank's non-performing loan portfolio receivables should be transferred. After its establishment, the Slovak Collection Company signed a loan agreement with CSOB whereas the Slovak Republic promised to guarantee for the repayment of the loan given to the Collection Company by CSOB.

The dispute arose when the Slovak Collection Company went bankrupt and the Slovak Republic refused to pay in violation of its guarantee. Challenging the jurisdiction of the ICSID tribunal, Slovakia argued that CSOB's loan to the Slovak Collection Company did not qualify as an investment, since it was 'an element of the inter-governmental restructuring and division of CSOB, necessitated by the dissolution of [Czechoslovakia], and not an operation from which either party to the dispute was intended to receive a benefit'.[474]

[471] *Fedax v Venezuela*, Decision of the Tribunal on Objections to Jurisdiction, 11 July 1997, para 40
[472] Compare Golden/Lamm (2015), p 122
[473] *Fedax v Venezuela*, Decision of the Tribunal on Objections to Jurisdiction, 11 July 1997, para 43, citing Christoph Schreuer, *Commentary on the ICSID Convention*, 11 ICSID Rev 316, 372 (1996)
[474] *CSOB v Slovakia*, Decision of the Tribunal on Objections to Jurisdiction, 24 May 1999, paras 12, 62

In analyzing the jurisdictional objections, the tribunal cited the broad language on the promotion of economic development contained in ICSID's preamble and emphasized that this language 'permits an inference that an international transaction which contributes to cooperation designed to promote the economic development of a Contracting State may be deemed to be an investment as that term is understood in the Convention'.[475] Furthermore, the tribunal underlined the importance of party consent in this context.[476] Moreover, it held that even a single transaction can be an investment if 'that particular transaction forms an integral part of an overall operation that qualifies as an investment'.[477]

In effect, the tribunal decided that 'CSOB's claim and the related loan facility made available to the Slovak Collection Company are closely connected to the development of CSOB's banking activity in the Slovak Republic and that they qualify as investment within the meaning of the [ICSID] Convention and the BIT'.[478]

In the context of sovereign debt – sovereign bonds in particular – *Abaclat* and *Ambiente Ufficio* are relevant flagship cases. The most interesting issue about *Abaclat* is the subjectivist approach the tribunal applied when determining that the respective bonds qualified as 'investment' in the sense on Article 25 (1) of the ICSID Convention.[479] Therefore, the tribunal confined its substantial analyzation to examining if the financial instruments at issue (i.e. the sovereign bonds and the security entitlements therein) satisfied the BIT definition of investment. This was an easy task, since the BIT specifically addressed financial instruments.

The *Abaclat* decision was, however, not uncontested. One of the arbitrators, Georges Abi-Saab, issued a scathing dissent from the decision. Hence, he rejected the subjectivist approach just mentioned, since 'words have an intrinsic meaning, hence a limited and limiting one, however large and vague it may be'. Moreover, he emphasized that, on a proper examination of the meaning of 'investment' in Article 25 (1) of the ICSID Convention 'widely dispersed off-the-shelf financial products, with their high velocity of circulation and their remoteness as to their holders, from the State in whose territory the investment is supposed to take place … seem at first blush to be worlds apart from the direct foreign investment model, which is usually long negotiated and extensively embedded in the legal environment of the State'.[480] In addition, he criticized that the majority had wrongly failed to 'distinguish between purchases on the primary market, involving the issuer (Argentina) and the first buyers of the issue (the [bank] underwriters), and the secondary market, where previously issued securities are traded, without

[475] *CSOB v Slovakia*, Decision of the Tribunal on Objections to Jurisdiction, 24 May 1999, para 64
[476] *CSOB v Slovakia*, Decision of the Tribunal on Objections to Jurisdiction, 24 May 1999, para 66
[477] *CSOB v Slovakia*, Decision of the Tribunal on Objections to Jurisdiction, 24 May 1999, para 72
[478] *CSOB v Slovakia*, Decision of the Tribunal on Objections to Jurisdiction, 24 May 1999, para 91
[479] *Abaclat v Argentina*, Decision on Jurisdiction and Admissibility, 4 August 2011, para 364
[480] *Abaclat*, Dissenting Opinion of Georges Abi-Saab on the Decision on Jurisdiction and Admissibility, 28 October 2011, para 57

any involvement of the sovereign debtor'.[481] This would make a difference, since Argentina received funds only from the initial sale of the bonds to the underwriting banks and not from the secondary market buyers. The latter had instituted claims that would not have arisen directly out of an investment as required by Article 25 of the ICSID Convention.

Finally, one main point of criticism advanced by Abi-Saab was the missing link between the financial instruments at issue and a specific underlying project that could be qualified as an investment. In his words, the purported investment 'is totally free-standing and unhinged, without any anchorage, however remote, into an underlying economic project, enterprise or activity in the territory of the host State' and he added that '[a] simple loan in itself is merely an "ordinary commercial transaction"'.[482] Abi-Saab emphasized that it should not be ICSID's goal to take virtually all capital market transactions – ranging from shares and bonds to structured and derivative products, such as hedges and credit default swaps – under its umbrella.[483]

Nevertheless, the *Ambiente Ufficio* tribunal, following the *Abaclat* decision, qualified bonds and related security entitlements as investments in the sense of Article 25 ICSID Convention, noting that this provision 'is rather susceptible to include those financial instruments'.[484] Just as the *Abaclat* decision, the *Ambiente Ufficio* decision was subject to criticism. In his dissenting opinion, arbitrator Torres Bernández – largely agreeing with arbitrator Abi-Saab – noted that the bonds and security entitlements were 'mere portfolio investments' lacking 'the objective elements of investments'.[485] In his opinion, Argentina had 'participated in the transactions concerning the selling of its sovereign bonds … as a commercial actor', and it was therefore '"hosting" nothing as a result of the transactions considered, but making a commercial dealing of a financial product of its own outside the Republic in international markets'.[486]

Concerning derivatives, *Deutsche Bank v Sri Lanka* provides a case in which the claimant asserted that an oil hedging agreement signed with the state-owned Ceylon Petroleum Corporation qualified as an investment under the Germany-Sri Lanka BIT and the ICSID Convention.[487] In its 'objective' analysis, the *Deutsche Bank* tribunal held that only three of the *Salini* criteria (contribution, duration and risk) should be relevant for the determination of 'investment' in the sense of Article 25 (1) of the ICSID Convention.

[481] *Abaclat*, Dissenting Opinion of Georges Abi-Saab on the Decision on Jurisdiction and Admissibility, 28 October 2011, para 70
[482] *Abaclat*, Dissenting Opinion of Georges Abi-Saab on the Decision on Jurisdiction and Admissibility, 28 October 2011, paras 109, 112
[483] Compare Golden/Lamm, p 131
[484] *Abaclat v Argentina*, Decision on Jurisdiction and Admissibility, 4 August 2011, para 456
[485] *Ambiente Ufficio*, Dissenting Opinion of Santiago Torres Bernández, 2 May 2013, paras 158, 207
[486] *Ambiente Ufficio*, Dissenting Opinion of Santiago Torres Bernández, 2 May 2013, paras 186-188
[487] Compare Golden/Lamm, p 134

On *contribution*, the tribunal noted that '[a] contribution can take any form'. It is not limited to financial terms but also includes know-how, equipment, personnel and services'.[488] On *risk*, the tribunal cited Professor Schreuer's comment that 'the very existence of the dispute is an indication of risk'.[489] On *duration*, the tribunal noted that duration 'is a very flexible term' which 'could be anything from a couple of months to many years'.[490] Moreover, the tribunal deemed not only the actual but also the intended duration of a contribution relevant.[491] Concerning the missing *Salini* criterion (*contribution to host state development*), the tribunal underlined the importance of the 'commitment of the investor and not whether he positively contributed to the economic social development of the host state'.[492] The tribunal decided that the hedging agreement at hand qualified as an investment in the sense of the ICSID Convention.[493]

Similar to *Abaclat* and *Ambiente Ufficio*, the *Deutsche Bank* decision was accompanied by a sharp dissent. The dissenting arbitrator Ali Khan argued that neither the subjective nor the objective criteria had been fulfilled, since the claim to money under the BIT had not been used to create economic value and was not associated with a separate investment. He added his concerns that the qualification of the hedging agreement at issue would imply that practically all financial instruments could be qualified as investments.[494]

In conclusion, the five ICID cases discussed show that ICSID tribunals are inclined to qualify financial products like loans, bonds and derivatives as investments both in the sense of investment treaties and Article 25 (1) of the ICSID Convention. There are, fortunately, arbitrators who want to see financial products anchored in real economy projects. Given the complexity of many financial instruments and the fact that a reasonable link to investments in the traditional sense is often missing, investment tribunals should be cautious about generalizations and decide on a case-by-case basis which financial instrument ultimately earns protection by investment treaties.

[488] *Deutsche Bank v Sri Lanka*, Award, 31 October 2012, para 297
[489] *Deutsche Bank v Sri Lanka*, Award, 31 October 2012, para 301, citing Schreuer et al (2009), p 131
[490] *Deutsche Bank v Sri Lanka*, Award, 31 October 2012, para 303
[491] *Deutsche Bank v Sri Lanka*, Award, 31 October 2012, para 304
[492] *Deutsche Bank v Sri Lanka*, Award, 31 October 2012, para 307
[493] *Deutsche Bank v Sri Lanka*, Award, 31 October 2012, para 310
[494] Compare Golden/Lamm, p 137

6. Conclusion and the way forward:

Apart from presenting existing and new IIA provisions which promote sustainable development, this thesis has shown that the integration of sustainable development considerations into IIAs is both a matter of IIA drafting and interpretation.

There are entry points for sustainable development concerns both at the procedural (including jurisdiction) and substantive levels; be it development requirements in the definition of 'investment', the police powers doctrine for expropriation, the level of diligence for FET, the level of protection for FPS or the definition of 'like circumstances' in the context of non-discrimination standards.

The common denominator among the numerous ways of taking non-investment priorities into account is a careful balancing between investor and host state interests, whereas it is in particular the multi-facetted nature of the public interest which makes these weighing and balancing endeavors so complex. Technically speaking, international courts and tribunals have developed various frameworks for balancing opposing interests.[495] The most significant dividing line within the common balancing methods seems to be between those tests that require 'sharp proportionality'[496] between the state measures taken and the genuine public purpose pursued and those tests that are content with a 'reasonable nexus' between means and aims. Let me speak out in favor of the latter approach at this point.

There are other tools in this context – like the margin of appreciation doctrine – that lend themselves to a certain deference of sovereign measures. However, more important than the scales used for balancing is the mindset of the arbitrators. An arbitration is only as good as the arbitrators involved. It is ultimately the interpreters' values as well as their beliefs about the realization of these values that will be decisive for giving the common good its appropriate place within a legal framework that sometimes seems to blank out a variety of systems, stakeholders and priorities affected by the investment. Just as general international law is the larger framework that functions as a glue for various legal disciplines, investment is embedded in ecological, social and a multiplicity of other systems of real life.

I am convinced that the proper consideration of environmental and social factors in a broader sense will be the substantive key challenge for international investment law within the next

[495] E.g. ECtHR, ECJ, WTO Appellate Body, US Supreme Court and investment tribunals
[496] That is the requirement that the host state measure taken be the least infringing on the foreign investor among all suitable options.

centuries. And, again, values and beliefs will be the most decisive variables for determining the direction of this utterly fragmented field of international law.

Sustainable development is not just one of many purposes within investment agreements, it is the world's major contemporary challenge throughout all disciplines. The proclamation of the Sustainable Development Goals and the Paris Agreement on climate change are prominent calls on all states to ensure the primacy for sustainable development as an overarching goal within the international agenda. The role of global investment policymaking in this international agenda has recently been rearticulated on the occasion of the G20 Ministerial Meeting held on 9 and 10 July 2016 in Shanghai. Hence, the new 'G20 Guiding Principles for Global Investment Policymaking' particularly stress the role of sustainable development and the host state's right to regulate for legitimate public policy purposes.[497]

However, in order to live up to these agendas, the current hierarchy of values in IIL – that disproportionately favors investment protection – must be changed in order to reflect the reality that economic efforts are meant to support and shall be subordinated to social wellbeing and that a healthy environment is an indispensable basis for both these purposes. The relation between these three priorities in investment law should reflect this reality and should accordingly be observed by investment tribunals.[498]

If we take sustainable development seriously, we should be utmost critical about the very fundaments of our current global economic system and its legal underpinnings. We should fundamentally revise the way we generate and share wealth and reconsider our blatant disregard of our planet's ecological borders. Recent studies show that the gap between poor and rich is growing and that many eco-systems, which we all depend on, are shortly before collapse. The number of economists who believe that these problems are the result of a deep-rooting misconstruction of our global economic system is rising. Criticism of capitalism, globalization and neo-liberal doctrines is not any longer a domain of eco-nerds, NGOs, left-wing idealists and dreamers far from reality.

Sustainable development stands for a balance between economic, ecologic and social priorities. This balance requires an economic system that ensures a fair distribution of wealth while keeping resource consumption and environmental pollution on a level that preserves our eco-systems for future times. I am convinced that our current economic system – based on the paradigms of profit maximization, competition and infinite growth – does not allow such a balance to come into being. On the contrary: Capitalism incentivizes brutal competition

[497] Compare *G20 Guiding Principles for Global Investment Policymaking*, July 2016, preamble and para VI, available at http://investmentpolicyhub.unctad.org/Upload/Documents/Annex%20III%20G20%20Guiding%20Principles%20for%20Global%20Investment%20Policymaking.pdf (accessed 8 August 2016, 10:00 PM)

[498] The eco-centric hierarchy of values required should be: 1. ecological sustainability, 2. social wellbeing, 3. economic activity

between economic actors on the back of the poor and the environment while liberalization ensures that obstacles for international trade and investment streams fall, thereby guaranteeing the right of the stronger.

It seems to me that – in the relation between developed and developing countries – the positive development effects induced by responsible investments is consumed by the large scale economic exploitation of the global South concerning its resources and workforce – exploitation that is guaranteed by international economic law; be it WTO law, the law of international financial organizations or international investment law. Therefore, after a critical evaluation of all costs and benefits of IIAs for host states, a developing country might come to the conclusion that it is the most beneficial option not to conclude IIAs at all.

The fundamental change of our global economic system (i.e. the global economic-, monetary-, financial- and banking-system) towards a more solidary and ecologically sustainable economic system is the precondition for achieving sustainable development on a global scale.[499] It is this fundamental change of the economy and a mindset filled with eco-social values that must provide the basis for an investment regime that appropriately defers to the environment and social issues. Fortunately, many grass-root-movements with promising ideas in this respect have appeared within the last two centuries.

Although my conclusion in the first hand is that there is need for radical change in the economic system and the entire economic law in order to live up to the requirements of sustainable development, I gladly recognize that both treaty drafters and interpreters have indeed already taken a variety of little steps in the right direction.

In particular, I like the idea of reducing compensation or damages for reasons of development, fairness, equity and justice. In any event, these notions should get the attention of future research. The main question should be, how justice can be operationalized (maybe as the most fundamental norm and measure for positive law) in order to compensate for systematic legal and factual imbalances in the investment context. However, making fair decisions in investment arbitration is not only a scientific issue but also a matter of taking fairness more important than the treaty text whenever justice so requires.

[499] Compare Greil, Christoph, *Change the Economy – Save the World*, Capital Finance International, January 2015, available at http://cfi.co/finance/2015/01/change-the-economy-save-the-world/ (accessed 8 August 2016, 09:00 PM); Greil, Christoph, *Quantitative Easing: Another Shot for the Caffeine Junkie*, Capital Finance International, June 2015, available at http://cfi.co/europe/2015/06/quantitative-easing-another-shot-for-the-caffeine-junkie/ (accessed 8 August 2016, 09:00 PM)

7. Summary

This thesis examines how investment tribunals have included sustainable development considerations in the interpretation of common standards of investment protection found in international investment agreements ('IIAs') and presents options for a sustainable development friendly drafting of IIAs.

In the Brundtland Report, sustainable development was defined as 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs'.[500] The notion of sustainable development encompasses a balance between three 'interdependent and mutually reinforcing' pillars: economic development, social development and environmental protection.[501]

Even if investment tribunals – due to lack of party consent – rarely have jurisdiction over sustainable development related disputes such as environmental or human rights claims as independent heads of claim, sustainable development related norms can be relevant as external rules according to customary principles of treaty interpretation. Therefore, these external rules can inform the meaning of generic or relative terms and can become relevant via Article 31 (3) (c) of the Vienna Convention on the Law of Treaties as 'relevant rules of international law applicable in the relations between the parties'.

The progress of investment arbitration concerning the integration of sustainable development is evidenced by the growing importance of transparency and *amicus curiae* participation in arbitral proceedings as well as by a growing inclination of tribunals to consider non-investment priorities in the interpretation of common substantive IIA standards of investment protection.

A willing tribunal can channel sustainable development considerations through various substantive entry points. In the context of the expropriation standard, the 'police powers' doctrine is both method and attitude for safeguarding an appropriate portion of regulatory space for the host state. Regarding 'fair and equitable treatment', tribunals have started to search for a balance between the foreign investor's legitimate expectations and the public interest. Concerning 'full protection and security', tribunals can take the host state's stage of development into account when determining the proper level of protection of investments against physical violence. In the context of non-discrimination standards like 'most favoured

[500] *Our Common Future: Report of the World Commission on Environment and Development*, Oslo, 20 March 1987, Chapter 2, para 1, available at http://www.un-documents.net/our-common-future.pdf (accessed 07 August 2016, 02:00 PM)
[501] *UN General Assembly Resolution S-19/2*, 19 September 1997, para 23, available at http://www.un.org/documents/ga/res/spec/aress19-2.htm (accessed 07 August 2016, 02:00 PM)

nation treatment' and 'national treatment', the definition of 'like circumstances' is a valuable tool to ensure that socially or environmentally irresponsible investor behavior is a category that matters when determining the relevant comparator.

Apart from the level of liability, sustainable development considerations can be taken into account on the level of calculating the amount of compensation or damages due. Hence, not only factors such as the investor's contributory fault or failure to mitigate damages, vague formulation of IIA obligations or the non-passage of a minimum threshold of seriousness, but also the level of development and the financial capabilities of the host state can be harnessed to reduce the amount of payment to be awarded.

Drafting sustainable development friendly IIAs involves a careful calculation of the costs and benefits of single IIA provisions and their combination – on political, economic and eco-social levels. The inclusion of sustainable development into IIAs follows three basic technical ratios. First, common existing IIA provisions can be adjusted by using hortatory language, clarifications and carve-outs. Second, new provisions can be introduced which enhance host state rights, include investor obligations and ensure support by the investor's home state to the host state. Third, 'Special and Differential Treatment' can be achieved by including asymmetrical obligations, lowering the level of obligation for the developing party and requiring development friendly interpretation.

Concerns for the common good can be reflected in practically all parts and provisions of an investment agreement. Substantively speaking, capital importing development countries should be utmost careful about the integration of extensive 'most favoured nation treatment' and umbrella clauses, since these provisions can extend host state obligations in unexpected ways. Moreover, host states should be cautious about granting foreign investors a right of establishment in a liberal manner. Rather, it is recommendable to require thorough ecological, social and human rights impact assessments before an investment gets approval. Host states should preserve their sovereign right to impose conditions and performance requirements on the foreign investment in order to ensure a fair host state participation in the management and in the gains of the investment.

Technically speaking, the definition of the scope of investment protection should be defined with great care. Definitions of 'investor' and 'investment', particular scope provisions but also exceptions and reservations should be used wisely. In this context, treaty drafters should bear in mind the normative uncertainties introduced by general exceptions as well as the advantages of precisely defining the scope of the protection standards. In any event, clear treaty language is in the interest of legal certainty and can avoid that vague terms receive their meaning by reference to certain standards of international law or to unsuitable jurisprudence. Drafters should also be aware that the inclusion of obligations into the treaty will raise the obligation to

the international level, thereby creating priorities for interpretation and protecting host state measures from challenges under the investor-state dispute settlement mechanism.

Finally, it is advisable for host states to strive for the creation of treaty-based mechanisms to hold transnational corporations effectively liable for misconduct – both civil and criminal. In this context, the creation of enterprise liability would be capable of piercing the corporate veil and holding the entire globally acting corporation liable for damages caused by the entity installed in the host state. To sum up, the combination of carve-outs, positive and detailed affirmations of the host state's right to regulate, clear investor obligations and effective enforcement mechanisms will be a strong agenda for strengthening the host state's position as well as the public interest.

Integrating sustainable development into investment arbitration is both a matter of IIA drafting and interpretation. Interpreting IIAs in the light of sustainable development purposes will always involve a careful balancing between investor and host state interests while taking into account the position of all affected systems and stakeholders. The decisive variable in this balancing endeavor is the mindset of the interpreter. It is a matter of the interpreter's values where he or she finds the balance between economic, social and ecological priorities with respect to the case at hand.

Sustainable development is not just a purpose to be considered in the context of investment arbitration but also an overarching priority within all disciplines of the international agenda. If the Sustainable Development Goals shall be realized, strong social and ecological state commitments and effective global implementation measures will be necessary. In this respect, the main question is whether our neo-liberal global economic system provides a valid basis for the degree of international solidarity and deference to our planet's ecologic borders necessary to achieve the balance required by the concept of sustainable development. It is this international economic background, the implications of globalized capitalism to social justice and environmental sustainability in the relations between the global North and South against which international investment law has to be applied. In order to compensate for the systemic imbalances stipulated in IIAs, it seems important to take considerations of fairness and equity more important than the treaty text whenever justice so requires.

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10. Annex: Abstract

This Master Thesis presents options for a sustainable development friendly drafting of international investment agreements (IIAs) and possible avenues for accommodating sustainable development considerations in the interpretation of IIAs.
The first part of the thesis examines under which circumstances investment tribunals have jurisdiction over disputes with an environmental or human rights emphasis and to what extent environmental and human rights norms can qualify as applicable law within investment arbitration. Furthermore, the first part presents different lines of arbitral adjudication in relation to the sustainable development relevant interpretation of common IIA standards of investment protection such as the prohibition of expropriation without compensation, 'fair and equitable treatment' and non-discrimination obligations.
The second part of the thesis outlines options for designing IIAs in line with sustainable development objectives. Therefore, possibilities for accordingly adapting typical IIA provisions will be presented as well as new provisions which specifically aim at promoting sustainable development. In this context, special attention will be payed to safeguarding the host state's regulatory flexibility, the furtherance of the public interest as well as the creation of civil and criminal liability on the side of the foreign investor.
Finally, the thesis critically questions whether the ecological and social goals inherent to the concept of sustainable development can be achieved within the current global capitalist economic system. In addition, for the context of investment arbitration, this thesis suggests that tribunals should take considerations of fairness and equity more important than the treaty text whenever justice so requires.

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Diese Master These präsentiert Optionen für eine nachhaltige und entwicklungsförderliche Ausgestaltung von internationalen Investitionsabkommen sowie Möglichkeiten, in solchen Verträgen enthaltene Investitionsschutzstandards im Lichte von Prinzipien der nachhaltigen Entwicklung zu interpretieren.
Im ersten Teil der Arbeit wird hinterfragt, unter welchen Voraussetzungen Investitionsschiedsgerichte über Streitigkeiten mit Umwelt- und Menschenrechts-Schwerpunkten Gerichtsbarkeit ausüben dürfen und inwieweit Umwelt- und Menschenrechtsnormen als anwendbares Sachrecht infrage kommen. Danach werden anhand unterschiedlicher schiedsgerichtlicher Judikaturlinien Optionen aufgezeigt, Aspekte der nachhaltigen Entwicklung bei der Auslegung klassischer vertraglicher Investitionsschutzstandards – wie dem Verbot entschädigungsloser Enteignung, dem Versprechen „gerechter und billiger" Behandlung und Diskriminierungsverboten – zu berücksichtigen.
Im zweiten Teil der Arbeit werden Gestaltungsvarianten für nachhaltige und entwicklungsförderliche Investitionsabkommen vorgestellt. In diesem Zuge werden Ideen für eine entsprechende Anpassung herkömmlicher Klauseln präsentiert sowie Vertragsbestimmungen, die spezifisch auf die Förderung nachhaltiger Entwicklung abzielen. Besonderes Augenmerk wird dabei auf die Sicherstellung des Regulierungsfreiraums des Aufnahmestaates, die Förderung öffentlicher Interessen sowie die Schaffung von zivil- und strafrechtlicher Investorenverantwortlichkeit gelegt.
Zuletzt wird kritisch hinterfragt, ob die dem Konzept der nachhaltigen Entwicklung inhärenten ökologischen und sozialen Zielsetzungen im bestehenden kapitalistischen Weltwirtschaftssystem überhaupt erreicht werden können. Zudem wird im Kontext der Auslegung von Investitionsverträgen vorgeschlagen, Fairness- und Billigkeitserwägungen wichtiger zu nehmen als den Vertragstext, wenn die Gerechtigkeit danach verlangt.