

Climate Change and International Investment Agreements

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Abstract

This article analyzes how International Investment Agreements (IIAs) might constrain the ability of governments to adopt climate change measures. This article will consider how climate change measures can either escape the application of IIA obligations or be justified under exceptions. First, this article considers the role of treaty structure in preserving regulatory autonomy. Then, it analyzes the role that general scope provisions can play in excluding environmental regulation from the scope of application of IIAs. Next, this article will consider how the limited incorporation of environmental exceptions into IIAs affects their interpretation and application in cases involving environmental regulation. The article then analyzes non-discrimination obligations, the minimum standard of treatment for foreign investors and obligations regarding compensation for expropriation. This analysis shows that tribunals can exclude environmental regulation from the scope of application of specific obligations as well.

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I. Introduction

International technology diffusion plays a key role in both climate change mitigation and adaptation. International investment, international trade in goods and services,

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intellectual property rights and international finance all play a key role in international technology diffusion. Since these flows can be affected by the manner in which International Investment Agreements (IIAs) address climate change measures, IIAs may affect a broad range of measures that are essential to address climate change.¹ This article focuses on how IIAs might constrain the ability of governments to adopt climate change measures.

There are four ways to save climate change measures from violating an IIA: (1) by finding that the measure does not fall within the scope of application of the treaty as a whole; (2) by finding that the measure does not fall within the scope of application of a specific obligation; (3) by finding that the relevant treaty obligation has not been violated; or (4) by justifying a violation of an obligation under an exception. Such exceptions may fall into three categories: exceptions whose application is limited to the specific obligations, general exceptions set out in the treaty or exceptions that form part of customary international law (such as those regarding necessity and countermeasures). In the first two situations the treaty or the obligation does not apply, so there is no need to determine whether there is a violation of an obligation or whether a violation can be justified under an exception. In the third situation, the treaty and the obligation apply, but there is no violation of the obligation. In the fourth situation, the treaty and obligation apply, there is a violation of an obligation, but there is an exception that justifies the violation. Thus, tribunals can find *bona fide* climate change regulations consistent with State obligations in IIAs at different points in these treaties. A key difference in these approaches is that the burden of proof falls on the complainant to show that the treaty and obligation apply and that an obligation is violated, whereas it

¹ Of course, IIAs are not the only relevant law with respect to such measures. Foreign investors can challenge climate change measures in domestic legal systems as well, or persuade their governments to challenge trade-related investment measures under WTO law or relevant Free Trade Agreements. However, such issues regarding choice of forum are beyond the scope of this article.

falls on the defending State to demonstrate compliance with an exception. Thus, the structure of IIAs affects the allocation of the burden of proof.

IIAs impose three principal types of obligations on governments with respect to their treatment of foreign investors: (1) non-discrimination between domestic and foreign investors (national treatment), and between foreign investors from different countries (most-favoured-nation treatment); (2) a minimum standard of fair and equitable treatment for foreign investors; and (3) an obligation to pay compensation for expropriation. However, not all government regulation is subject to these obligations. This article will consider how environmental measures can either escape the application of the foregoing obligations or be justified under exceptions. First, this article considers the role of treaty structure in preserving regulatory autonomy. Then, it analyzes the extent to which environmental regulation that affects foreign investors can be considered as measures that 'relate to' foreign investment and foreign investors. This analysis illustrates the role that general scope provisions can play in excluding environmental regulation from the scope of application of IIAs. Next, this article will consider how the limited incorporation of environmental exceptions into IIAs affects their interpretation and application in cases involving environmental regulation, using the example of NAFTA Articles 1106 and 1114. The article then analyzes non-discrimination obligations, the minimum standard of treatment for foreign investors and obligations regarding compensation for expropriation. This analysis shows that tribunals can exclude environmental regulation from the scope of application of specific obligations as well.

International investment flows are an important conduit for the international diffusion of climate change technology and expertise, together with trade in goods and

services.² Thus, it is important to create adequate incentives for foreign investors to transfer best practices and technologies that can address climate change adaptation and mitigation. IIAs can lower regulatory and political risks for foreign investors, and thus lower the cost of and create incentives for foreign investment in clean energy or in carbon mitigation technologies.³ Thus, adequately addressing climate change measures in IIAs is important not only to preserve regulatory autonomy, but also to enhance the financial and technological capacity of countries to address climate change.

II. The Role of Treaty Structure and the Burden of Proof

The structure of a treaty—the manner in which its provisions limit the general scope of the treaty’s application, limit the scope of positive obligations, establish positive obligations, or establish general or specific exceptions to positive obligations—has important implications for the allocation of the burden of proof between the complainant and the respondent and, subsequently, for regulatory autonomy.

Particularly in cases that involve complex factual or scientific issues, the allocation of

² Bernard Hoekman and Beata Smarzynska Javorcik, eds, *Global Integration and Technology Transfer* (Palgrave Macmillan and the World Bank, Washington 2006); Keith E. Maskus and Jerome H. Reichman, eds, *International Public Goods and Transfer of Technology under a Globalized Intellectual Property Regime* (Cambridge University Press, Cambridge 2005); Gill Wilkins, *Technology Transfer for Renewable Energy* (The Royal Institute of International Affairs and Earthscan Publications, Oxford 2002); Stephen O. Andersen, K. Madhava Sarma and Kristen N. Taddonio, *Technology Transfer for the Ozone Layer: Lessons for Climate Change* (Global Environment Facility and Earthscan Publications, Oxford 2007).

³ Anatole Boute, ‘Combating Climate Change through Investment Arbitration’ (2012) 35 *Fordham International Law Journal* 613; UNCTAD, *World Investment Report 2010: Investing in a Low-Carbon Economy* (United Nations, Geneva 2010) <http://unctad.org/en/Docs/wir2010_en.pdf> (Accessed 2 November 2012). Also see Marie-Claire Cordonier Segger, Markus W Gehring & Andrew Newcombe, eds, *Sustainable Development in World Investment Law* (Kluwer Law International, 2010); Marie-Claire Cordonier Segger & Markus Gehring, ‘Trade and Investment Implication of Carbon Trading for Sustainable Development’ in David Freestone and Charlotte Streck (eds), *Legal Aspects of Carbon Trading: Kyoto, Copenhagen, and Beyond* (Oxford University Press, Oxford 2009); Lise Johnson, ‘International Investment Agreements and Climate Change: The Potential for Investor-State Conflicts and Possible Strategies for Minimizing It’ (2009) 39 *Environmental Law Reporter* 11147; Stephan W. Schill, ‘Do Investment Treaties Chill Unilateral State Regulation to Mitigate Climate Change?’ (2007) 24 *Journal of International Arbitration* 469; Jacob Werksman, Kevin A. Baumert, and Navroz K. Dubash, *Will international investment rules obstruct climate protection policies?* (World Resources Institute, Washington 2001); Kate Miles, ‘International Investment Law and Climate Change: Issues in the Transition to a Low Carbon World’ (2008). Society of International Economic Law (SIEL) Inaugural Conference 2008 <<http://ssrn.com/abstract=1154588>> (accessed 15 October 2012).

the burden of proof can play a pivotal role, since unclear or insufficient evidence can lead to a ruling against the party who bears the burden of proof. In the case of climate change, where the science can only identify a range of probabilities and potential risks, the burden of proof is likely to take on greater significance.

Based on treaty structure, we can categorize the allocation of the burden of proof according to five types of argument. The complainant bears the burden of proving: (1) the treaty applies to a measure (general scope of application); (2) a specific obligation applies to a measure (scope of obligation); and (3) the measure violates the applicable obligation. The respondent bears the burden of proving: (4) a specific exception applies to a measure (scope of exception) and (5) the requirements of the exception have been met.⁴

The approach that a tribunal takes in a given case will be dictated by the facts of the case and the structure of the particular IIA. Treaty negotiators and drafters need to keep this in mind when they decide whether to limit the scope of IIAs in general scope provisions, the language of obligations, specific exceptions to obligations or general exceptions. In the case of climate change regulation, it may be preferable to limit the application of IIAs in general scope provisions, so that the burden of proof rests with the complainant. In existing IIAs that lack general exceptions, limiting the scope of application of the treaty or its specific obligations may be the only approach that tribunals can use to preserve regulatory autonomy.

There are several reasons why States should adopt an approach to climate change measures in IIAs that allocates the burden of proof to the complainants. First, the complexity and uncertainty of the science of climate change means that the burden of proof is likely to play an important role in international investment litigation

⁴ Bradley J. Condon, "Treaty Structure and Public Interest Regulation in International Economic Law", 17:2 *Journal of International Economic Law* 333-353 (2014).

regarding climate change measures. Second, the political economy of climate change regulation means that it will likely involve measures that combine the pursuit of the public interest with elements that serve private interests, rather than purely public interest measures, in order to marshal political support for the measures. These mixed-motive measures will raise issues regarding the primary purpose of climate change measures and the extent to which they serve the public interest, on the one hand, and the extent to which they serve private interests, on the other. Since regulatory capture has the potential to distort climate change regulation to serve private interests, these are important issues. Third, foreign investors have direct access to the dispute settlement mechanisms in IIAs, unlike international trade agreements that limit standing to governments themselves. Fourth, IIAs have the potential to cause regulatory chill. Climate change is a serious threat, and requires urgent action on both mitigation and adaptation. Litigation risk can create disincentives to regulation, particularly in countries where the responsible government officials are unsure of the scope of their obligations to foreign investors. Finally, States should exclude *bona fide* measures to combat climate change from the scope of application of IIAs in order to maintain the political legitimacy of the international investment regime itself. If IIAs are perceived to create an obstacle to effective action on climate change, it will call into question the political legitimacy of IIAs, and undermine the international investment regime.

The practice with respect to the structure of IIAs varies considerably.⁵ Unlike many trade agreements, notably GATT and GATS, most IIAs do not contain comprehensive exceptions for environmental measures. However, recent IIAs have incorporated such general exceptions, based on GATT Article XX and GATS Article

⁵ Marie-France Houde, 'Novel Features in Recent OECD Bilateral Investment Treaties', in *International Investment Perspectives: 2006 Edition* (OECD, 2006), 143-181.

XIV.⁶ The insertion of GATT exceptions into IIAs creates several interpretative difficulties. For example, how can arbitrary discrimination that violates the standard of fair and equitable treatment be justified in the chapeau of GATT Article XX? How can a denial of justice in national courts qualify as necessary? Moreover, a limited enumeration of public interest categories might prove less flexible than simply excluding legitimate regulatory distinctions from the scope of IIA obligations.⁷ Finally, in addition to allocating the burden of proof to the respondent, exceptions are interpreted more narrowly than scope provisions or obligations.

Several IIAs, including NAFTA Chapter 11 and the Canadian and US Model Bilateral Investment Treaties (BITs), contain a general scope provision that limits their application to measures ‘relating to’ foreign investors and investments.⁸ Article 10.1 of the Canadian Model BIT also contains a general public interest exception, similar to GATT Article XX, paragraphs (b), (d) and (g).⁹ Article 8(2)(c) of the 2012 US Model BIT has a similar exception that is limited to certain provisions regarding performance

⁶ Andrew Newcombe, ‘General Exceptions in International Investment Agreements’ in *Sustainable Development in World Investment Law*, Marie-Claire Cordonier Segger, Markus W. Gehring, Andrew Paul Newcombe, eds (Kluwer Law International, 2011) 351-70. These IIA provisions include Article 10, *Agreement between Canada and the Republic of Peru for the Promotion and Protection of Investments*, 14 November 2006, <<http://www.treaty-accord.gc.ca/text-texte.aspx?id=105078>> (accessed 23 February 2014); Article 83, *Agreement between Japan and the Republic of Singapore for a New-Age Economic Partnership*, <<http://www.mofa.go.jp/region/asia-paci/singapore/jsepa.html>> (accessed 23 February 2014); Article 200, *Free Trade Agreement Between The Government of New Zealand And The Government of the People’s Republic of China*, <<http://www.chinafta.govt.nz/1-The-agreement/2-Text-of-the-agreement/index.php>> (accessed 23 February 2014); Article 22.1(3), *Korea-Australia Free Trade Agreement*, initialled by Chief Negotiators on 10 February 2014, <<http://www.dfat.gov.au/fta/kafta/>> (accessed 23 February 2014).

⁷ Andrew Newcombe, ‘The Use of General Exceptions in IIAs: Increasing Legitimacy or Uncertainty’, in *Improving International Investment Agreements*, A. De Mestral & C. Lévesque, eds, (Routledge, 2012).

⁸ See, for example, NAFTA Article 1101; 2004 Model US BIT, Article 2.1 <<http://www.state.gov/documents/organization/117601.pdf>> (accessed 23 February 2014); 2012 Model US BIT, Article 2.1 <<http://www.italaw.com/sites/default/files/archive/ita1028.pdf>> (accessed 23 February 2014); 2004 Model Canadian FIPA, Article 2.1 <<http://italaw.com/documents/Canadian2004-FIPA-model-en.pdf>> (accessed 23 February 2014).

⁹ 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 or investment, nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures necessary:

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

requirements, and is similar to NAFTA Article 1106. In addition to the scope provision and the general public interest exception, Article 11 of the 2004 Canadian Model BIT contains a provision similar to NAFTA Article 1114 that applies to ‘Health, Safety and Environmental Measures. Article 12 of the 2012 US Model BIT also contains a provision that is similar to NAFTA Article 1114, but it has evolved differently from Article 11 of the 2004 Canadian Model BIT; for example, it adds a reference to multilateral environmental agreements.

Several other model BITs do not contain a general scope provision that limits their application to measures ‘relating to’ foreign investors and investments.¹⁰ Of those that do not, some use language to limit the scope of specific obligations. For example, Article 3(2) of the 2008 German Model BIT applies the national treatment and MFN standards to investors only ‘as regards their activity in connection with investments’ and adds a further clarification that, ‘Measures that have to be taken for reasons of public security and order shall not be deemed treatment less favourable within the meaning of this Article.’ Similarly, Article 4 of the 2006 Model French BIT applies the national treatment and MFN standards to investors only ‘activities related to the investments’. Article VI(2)(c) of the Colombian Model BIT excludes good faith, non-discriminatory public interest measures from the scope of application of the expropriation provision. Article VIII of the 2007 Colombia Model BIT also contains a provision that is similar to NAFTA Article 1114(1).

In an OECD working paper, Gordon and Pohl have surveyed environmental references in Free Trade Agreements (FTAs) with investment chapters and in BITs.

¹⁰ See, for example, 2006 Model French BIT <<http://italaw.com/documents/ModelTreatyFrance2006.pdf>> (accessed 23 February 2014); 2008 Model German BIT <<http://www.italaw.com/sites/default/files/archive/ita1025.pdf>> (accessed 23 February 2014); 2007 Colombia Model BIT <http://italaw.com/documents/inv_model_bit_colombia.pdf> (accessed 23 February 2014); 2003 India Model BIT <<http://www.italaw.com/sites/default/files/archive/ita1026.pdf>> (accessed 23 February 2014).

They found that references to environmental concerns are common in FTAs with investment chapters (100% of 30 FTAs surveyed) while they are rare in BITs (6.5% of 1,593 BITs surveyed).¹¹ These references are either general references to environmental concerns or specific references to sanitary and phytosanitary objectives and conservation objectives.¹² The latter are often expressed as human, animal and plant life or health and conservation of living or non-living exhaustible natural resources,¹³ using the language of paragraphs (b) and (g) of GATT Article XX. Gordon and Pohl note the need for analysis on the effect of including environmental language in IIAs.¹⁴

The Gordon and Pohl study raises some important legal issues, including: (1) whether the inclusion of references to environmental concerns in international investment agreements facilitates reconciling potential conflicts between foreign investment protection and environmental protection and (2) which approach provides treaty parties with the most appropriate balance between predictability and flexibility with respect to the relationship between environmental and investment norms. The language of international investment agreements should be sufficiently flexible to accommodate climate change regulation. However, the diversity of approaches to addressing environmental issues in IIAs creates confusion regarding the intended effect of different treaty structures on regulatory autonomy.

III. Connection between Measure and Investment

Measures may be excluded from the scope of application of an IIA by (1) a general scope of application provision, (2) a provision that excludes certain measures from its

¹¹ Kathryn Gordon and Joachim Pohl, 'Environmental Concerns in International Investment Agreements: a survey' (2011) OECD Working Papers on International Investment, No. 2011/1, OECD Investment Division <www.oecd.org/daf/investment> (accessed 24 November 2012).

¹² Ibid 25-26.

¹³ Ibid 27.

¹⁴ Ibid 27.

application, such as a clause regarding ‘essential security interests’, or (3) by characterizing the measure as legitimate regulatory action that does not give rise to any breach of the IIA substantive obligations. This section examines the first situation. The third situation is examined in the context of specific obligations. The literature has addressed the second situation, as well as the customary international defense of necessity, in the context of financial crises.¹⁵ It is worth raising the issue as to whether the reasoning applied in the context of financial crises might also apply in the climate change context.¹⁶ Opinion is divided between two approaches in the context of financial crises: that crises are precisely when foreign investors are most in need of protection or that crises are precisely when the public interest is most endangered and a government’s right to regulate in the public interest should prevail.¹⁷ This is essentially the issue that arises more generally in IIA disputes: the contest between the rights of investors and the rights of governments to regulate in the public interest. This article asks which point in the treaty text is the best place to address this tension between state and investor rights in the case of climate change measures. Excluding measures from the general scope of application of an IIA means that the tribunal does not have jurisdiction to apply substantive obligations or exceptions.¹⁸

NAFTA Article 1101 limits the general scope of application of NAFTA Chapter 11 to measures ‘relating to’ foreign investors and investments. NAFTA Chapter 11

¹⁵ Giorgio Sacerdoti, ‘BIT Protections and Economic Crises: Limits to Their Coverage, the Impact of Multilateral Financial Regulation and the Defense of Necessity’ (2013) 28 ICSID Review 351; Anne van Aaken and Jürgen Kurtz, ‘Prudence or Discrimination? Emergency Measures, The Global Financial Crisis and International Economic Law’ (2009) 12 JIEL 859; Jürgen Kurtz, ‘Adjudging the Exceptional at International Investment Law: Security, Public Order and Financial Crisis’ (2010) 59 ICLQ 325.

¹⁶ For example, one can imagine the following excerpt being applied to climate change in the future: ‘The protection of essential security interests... does not require that... a “catastrophic situation” [has] already occurred before responsible national authorities may have recourse to [the protection of an essential interests clause]... There is no point in having such protection if there is nothing left to protect.’ Continental Casualty Company v Argentine Republic, ICSID Case No. ARB/03/09, Award (5 September 2008), paras 180, 181, cited in Sacerdoti, above n 15, at 352.

¹⁷ Sacerdoti, above n 15, at 360.

¹⁸ Ibid, at 368. Also see *Methanex Corporation v United States*, NAFTA/UNCITRAL, Award of the Tribunal on Jurisdiction and Merits (3 August 2005), 19- 20, 22.

tribunals have considered the extent to which WTO jurisprudence on the term ‘relating to’ in GATT Article XX(g) is relevant to interpret NAFTA Article 1101. The general exception in GATT Article XX(g) permits measures ‘relating to’ the conservation of exhaustible natural resources. GATT and WTO jurisprudence has interpreted ‘relating to’ to mean ‘primarily aimed at’, which requires a close and genuine relationship of ends and means.¹⁹ NAFTA tribunals have held that the term ‘relating to’ requires a ‘legally significant connection’ between a measure and an investor or an investment.

In *Pope & Talbot v Canada*, Canada contended that a measure could only relate to an investment if it was ‘primarily directed’ at that investment. The tribunal did not reject Canada’s argument that it was insufficient that a measure affects an investor, but did reject the contention that the measure must be primarily directed at the investment.²⁰ In *Methanex v United States*, the tribunal noted that the WTO interpretation of the term ‘relating to’ in GATT Article XX(g) was quite different from the interpretation in the *Pope & Talbot* case, which confirms the need to interpret a term in accordance with the particular context, object and purpose.²¹

In *Methanex v United States*, California banned the use of methanol as a gasoline additive (MTBE), for environmental reasons. The tribunal held that the methanol ban was a non-discriminatory environmental measure and thus not a measure ‘relating to’ foreign investment or foreign investors under NAFTA Article 1101. Thus, it was not subject to NAFTA Chapter 11. The *Methanex* tribunal found that Article 1101(1) requires ‘something more than the mere effect of a measure on an investor or

¹⁹ GATT Panel Report, *Canada – Measures Affecting Exports of Unprocessed Salmon and Herring (Canada – Salmon and Herring)*, L/6268 - 35S/98, adopted 22 March 1988; Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline (US – Gasoline)*, WT/DS2/AB/R, adopted 20 May 1996, p 18; Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products (US – Shrimp)*, WT/DS58/AB/R, adopted 6 November 1998, para 141-142.

²⁰ *Pope & Talbot Inc. v. Government of Canada* NAFTA/UNCITRAL (2000) (Award in relation to Preliminary Motion by Government of Canada to dismiss the claim because it falls outside the scope and coverage of NAFTA Chapter 11 ‘measures relating to investment’ motion) 33-34
<<http://italaw.com/sites/default/files/case-documents/ita0672.pdf>> (accessed 9 April 2013).

²¹ *Methanex Corporation v United States*, NAFTA/UNCITRAL, First Partial Award (7 August 2002).

an investment’ and that the term ‘relating to’ requires a ‘legally significant connection’ between a measure and an investor or an investment.²² The scientific and administrative record established that California acted with a view to protecting the environmental interests of its citizens, and not with the intent to harm foreign methanol producers. California ordered a careful assessment of the environmental problem and responded reasonably to independent findings that large volumes of the state’s ground and surface water had become polluted by MTBE and that preventative measures were required. Thus, on the facts of this case, there was no legally significant connection between the measures, Methanex and its investments. As such, the measures did not ‘relate to’ Methanex or its investments as required by Article 1101(1).²³

Other tribunals also have used the same test as in *Methanex* to require a legally significant connection between the investor and the measure, in order to exclude claims that measures in one party affected investments in a different party.²⁴ However, other tribunals have not used Article 1101 to exclude environmental measures from the general scope of application of NAFTA Chapter 11. In *Glamis Gold v. United States*, the Tribunal did not follow the *Methanex* approach to addressing environmental measures, instead simply finding that they did not violate substantive obligations because they did not constitute expropriation or violate the minimum standard of fair and equitable treatment.²⁵

In contrast to the *Methanex* case, in *S. D. Myers v Canada*, in which Canada introduced a ban on the export of PCBs to protect the Canadian PCB disposal industry from US competition, the Tribunal concluded that there was no legitimate

²² Ibid, para 4.

²³ *Methanex Corporation v United States*, NAFTA/UNCITRAL, Award of the Tribunal on Jurisdiction and Merits (3 August 2005),19- 20, 22.

²⁴ Jorge E. Viñuales, *Foreign Investment and the Environment in International Law* (Cambridge University Press, 2012).

²⁵ *Glamis Gold Ltd. v. United States of America*, NAFTA/UNCITRAL, Award (8 June 2009).

environmental reason for introducing the ban. The *Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal* discourages transboundary movements of hazardous wastes and encourages the creation of domestic capacity for their disposal.²⁶ However, in this case it was better, from an environmental perspective, to ship hazardous wastes from Central Canada to Ohio than to Canada's only PCB disposal facility in Alberta, due to Ohio's much closer proximity. The tribunal held that the requirement in Article 1101 that the import ban relate to S. D. Myers and its investment was 'easily satisfied', because the 'specific inspiration for the export ban' was the prospect that S. D. Myers would carry through with its plans to expand its Canadian operations.²⁷

Addressing environmental measures in the general scope provision of NAFTA Article 1101 may not be the most appropriate approach, since public interest measures also can be addressed in the substantive obligations. Indeed, there is a limit to this approach, since the term 'relating to' should not be stretched in order to address issues that arise regarding non-discrimination obligations, regarding expropriation, or regarding the minimum standard of fair and equitable treatment. For example, in BITS there is an obligation to pay compensation for expropriation, even when it is for domestic or international environmental purposes.²⁸ Indeed, in addition to other requirements, including the obligation to pay compensation, NAFTA Article 1110 requires that expropriation be for a public purpose. This is a clear indication that Article 1110 should apply to environmental measures. To interpret NAFTA Article 1101 to exclude environmental measures from the scope of Chapter 11 would be difficult to

²⁶ Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, done at Basel, 22 March 1989, in force 5 May 1992, No. 28911, 1673 UNTS 57.

²⁷ *S. D. Myers v Government of Canada*, NAFTA/UNCITRAL, Partial Award (13 November 2000), para 234.

²⁸ *Técnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award, (9 May 2003), para 121; *Compañía del Desarrollo de Santa Elena v Republic of Costa Rica* ICSID Case No. ARB/96/1, Award (17 February 2000), p. 192.

reconcile with the public purpose requirement of Article 1110. Moreover, IIA tribunals have addressed public interest measures by limiting the scope of specific obligations, particularly those regarding non-discrimination, fair and equitable treatment and expropriation. The flexibility that IIA tribunals have to limit the scope of these obligations obviates the need to rely on a general scope provision to preserve regulatory autonomy.

To what extent can WTO jurisprudence regarding the term ‘relating to’ in GATT Article XX(g) be applied to interpret NAFTA Article 1101? On the one hand, the ordinary meaning of the term ‘relating to’ should be the same, since the wording is identical. Moreover, the purpose of the term ‘relating to’ is to determine the nature of the measure, in both GATT Article XX(g) and NAFTA Article 1101. These two factors suggest that the interpretation of this term should not be significantly different and that WTO jurisprudence should be relevant to the interpretation of NAFTA Article 1101. On the other hand, there are significant differences in the contexts of the two provisions. Unlike GATT Article XX(g), NAFTA Article 1101 is not an exception. In addition, to justify a measure in GATT Article XX(g), the measure must relate to the conservation of exhaustible natural resources, meet a requirement of evenhandedness through the application of restrictions on domestic production or consumption, and the application of the measure must comply with the non-discrimination requirements of the Article XX chapeau. The measure in *Methanex* likely would meet these requirements.

However, interpreting the term ‘relating to’ in IIA general scope provisions to incorporate requirements from the GATT Article XX chapeau is likely to raise several objections. First, the incorporation of GATT Article XX into NAFTA Chapter 3, and the decision to not do so in NAFTA Chapter 11, suggests that this interpretation is inconsistent with the intention of the NAFTA Parties. Second, there is no obvious

textual basis for such an expansive interpretation. Third, the NAFTA Parties did incorporate more limited exceptions for environmental measures, which also suggests that this interpretation would be inconsistent with the context of NAFTA Chapter 11. Fourth, the introduction of general environmental exceptions in later BITs, notably the Canadian Model BIT, and the contrasting absence of such exceptions in other recent BITs, notable the 2012 US Model BIT, suggests that the absence of such general exceptions may be an intentional result of the lack of agreement regarding the treatment of environmental regulation in IIAs.

Nevertheless, these arguments would not necessarily prevent a tribunal from using this type of general scope provision to maintain consistency between IIAs and WTO law with respect to the treatment of *bona fide* environmental measures, as the *Methanex* decision demonstrates. Moreover, recent WTO jurisprudence also demonstrates the willingness of international tribunals to take treaty interpretation in this direction. The Panel in *EC – Seal Products* interpreted the term ‘less favourable treatment’ in Article 2.1 of the TBT Agreement to incorporate the requirements of the GATT Article XX chapeau into a provision, whose text does not provide any obvious support for this approach, in an agreement that lacks a general environmental exception.²⁹ Thus, this approach to treaty interpretation is not outside the realm of possibilities in IIAs that lack general environmental exceptions.

If a measure qualifies as ‘relating to’ conservation in Article XX(g), and otherwise complies with Article XX, it should not qualify as ‘relating to’ investors or investments in Article 1101. For example, if a WTO Member implements its obligations under a multilateral environmental agreement (MEA) on climate change in a non-

²⁹ WTO Panel Reports, *European Communities – Measures Prohibiting the Importation and Marketing of Seal Products (EC – Seal Products)*, WT/DS400/R, WT/DS401/R, 25 November 2013, para 7.173-7.258 and footnote 413. Panel Report under appeal on 24 January 2014.

discriminatory manner, the measure likely to qualify under GATT Article XX(g).³⁰ The same measure should be excluded from the scope of application of Article 1101. The MEA would provide evidence that the measure is an environmental measure, not an investment measure. The presumption against conflicts in international law would favour an interpretation of Article 1101 that avoids a conflict between the treaty obligations in Chapter 11 and the treaty obligations in the MEA. If the MEA requires the measure and the provisions of Chapter 11 prohibit the measure, there would be a conflict. Similarly, if GATT Article XX(g) permits the measure, then NAFTA Chapter 11 should too. In *S. D. Myers v. Canada*, there was no conflict with the Basel Convention and there was evidence that the government had banned the export of PCBs to protect domestic industry, not the environment. The same type of evidence would disqualify a measure under the Article XX chapeau. The mere existence of a MEA is not sufficient to justify a measure where its implementation has the effect of defeating the purported environmental goal.³¹

A key issue is the legitimacy of the disputed environmental measure. One way to define legitimacy is by asking whether the measure serves the public interest or a private interest. In *Methanex* the measure served the former. In *S. D. Myers* the measure served the latter. Of course, a measure can simultaneously serve both public and private interests. The real question here is whether the evidence demonstrates bad faith, protectionist intent or intent to harm foreign investors on the part of the legislator or the judiciary. NAFTA Chapter 11 has been criticized as lacking legitimacy, due to the pressure it places on governments to ensure that laws are consistent with its

³⁰ Bradley J. Condon, *Environmental Sovereignty and the WTO: Trade Sanctions and International Law* (Ardsley NY, Transnational Publishers 2006) Chapter 7.

³¹ WTO Appellate Body Report, *Brazil – Measures Affecting Imports of Retreaded Tyres (Brazil – Retreaded Tyres)*, WT/DS332/AB/R, adopted 17 December 2007.

provisions.³² However, NAFTA Chapter 11 is far from unique, in a universe of thousands of BITs and dozens of investment chapters in FTAs. Moreover, as far as environmental regulation is concerned, the legitimacy of environmental measures is the real issue. With respect to climate change regulation, as with other areas of environmental regulation, where national regulation is based on a multilateral agreement, the agreement provides evidence of the legitimacy of the regulation. However, a multilateral agreement is not required to prove legitimacy.

Scope provisions like Article 1101 also can be interpreted in a manner that is consistent with customary international law. In *Maffezini v Spain*, Spain's application of environmental impact assessment requirements was held to be consistent with the bilateral investment treaty between Argentina and Spain. The Tribunal noted that the environmental impact assessment procedure is basic for the adequate protection of the environment and the application of appropriate preventive measures, not only under Spanish and EEC law, but also increasingly so under international law.³³ The claimant had sought compensation for the additional costs resulting from the environmental impact assessment, claiming that it had been pressured to go ahead with the investment before that process was finalized. The tribunal found that both Mr. Maffezini and his employees were aware that the project required an environmental impact assessment. Spain had done no more than insist on the strict observance of the EEC and Spanish law applicable to the industry in question. Therefore, the tribunal held that Spain could not be held responsible for the decisions taken by the claimant with regard to the environmental impact assessment. Furthermore, Spain's action was fully consistent with

³² José E. Alvarez, 'Critical Theory and The North American Free Trade Agreement's Chapter Eleven' (1997) 28 University of Miami Inter-American Law Review 303; Charles H. Brower, II, 'Structure, Legitimacy, and NAFTA's Investment Chapter' (2003) 36 Vanderbilt Journal of Transnational Law 37; Jeffery Atik, 'Repenser NAFTA Chapter 11: A Catalogue of Legitimacy Critiques' (2004) 3 Asper Review of International Business and Trade Law <<http://ssrn.com/abstract=470141>>

³³ *Maffezini v Spain*, Award, para 67

Article 2(1) of the Argentine-Spain Bilateral Investment Treaty, which calls for the promotion of investment in compliance with national legislation.³⁴ While the provision of the investment treaty in this case was different from NAFTA Article 1101(1), the same logic applies under the latter type of provision, since an environmental requirement that applies in general to industries, regardless of whether they are national or foreign investment, is not a measure relating to investment. In addition, while the environmental law in this case was national and regional, the same logic should apply where the source of the environmental law is international. In *Pulp Mills on the River Uruguay (Argentina v Uruguay)*, the International Court of Justice held that environmental impact assessment is required under customary international law.³⁵

The term ‘relating to’, in NAFTA Article 1101 and other IIAs with this type of scope provision, should be subject to evolutionary interpretation and be interpreted to exclude legitimate climate change regulation from their scope of application. In *US – Shrimp*, the WTO Appellate Body held that the definition of measures relating to ‘exhaustible natural resources’ in GATT Article XX(g) is subject to evolutionary interpretation.³⁶ One must be cautious about importing interpretations from trade law to investment law, but evolutionary treaty interpretation is not limited to international trade agreements. When the issue is whether a measure relates to environmental protection or to investment, evolutionary treaty interpretation provides tribunals with an additional means to take into account the evolution of environmental concerns in international relations.

However, the usefulness of general scope provisions in excluding public interest regulation depends on the wording and context of the provision, as well as the allocation

³⁴ Ibid, paras 65-71.

³⁵ *Pulp Mills on the River Uruguay (Argentina v Uruguay)* (2010) (Judgment) ICJ Reports 2010 paras 203-219.

³⁶ Appellate Body Report, *US – Shrimp*, above n 19.

of the burden of proof. For example, in *Philip Morris v. Uruguay*, the Tribunal held that the scope provision in the Switzerland-Uruguay BIT did not exclude post-establishment public interest regulation from the scope of application, because the relevant Article dealt with promotion and admission of investments. Article 2(1) provides that the ‘Contracting Parties recognize each other’s right not to allow economic activities for reasons of public security and order, public health or morality....’ This reference immediately follows the duty of each State to admit investments, and operates as an exception to that duty at the pre-establishment stage. It did not create an exception to substantive obligations with respect to investments that had already been admitted in accordance with Uruguayan law.³⁷ Thus, this scope provision did not exclude post-establishment regulation and, as an exception to the general rule regarding admission of investments, would place the burden of proof on the respondent, even at that stage.

NAFTA Chapter 11 has no general exception for environmental measures that is comparable to GATT Article XX. NAFTA Chapter 3 incorporates GATT Article XX by reference. However, Article XX cannot be invoked to justify a violation of Chapter 11. Instead, Chapter 11 contains two limited environmental exceptions, which are examined below. Article 1106 contains environmental exceptions that only apply to certain provisions in that article. Article 1114 contains a more general exception for environmental measures, but its scope is limited. However, the host government can argue that Chapter 11 does not apply to an environmental measure, because the measure does not relate to investors or investments according to Article 1101. Thus, the interpretation and application of general scope provisions like Article 1101 can play an important role of the analysis of the relationship between environmental law and

³⁷ *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, Decision on Jurisdiction, ICSID Case No. ARB/10/7, 2 July 2013, para 167-174.

investment law. Moreover, in contrast to exceptions, general scope provisions place the burden of proof on the claimant.

IV. Limited Environmental Exceptions

In NAFTA Chapter 11, one could argue that Article 1101 is not intended to avoid or to resolve conflicts between investment law and environmental law. Rather, such conflicts should be resolved according to the specific environmental exceptions, such as those in Article 1106 and 1114. However, the limited scope of those environmental exceptions mean that many legitimate environmental measures would not be subject to those exceptions. In such a case, one way to avoid the conflict would be through the interpretation and application of Article 1101. Moreover, Article 1114 supports the view that legitimate environmental regulation is beyond the scope of Chapter 11, by confirming the right of parties to protect the environment and recognizing that, far from discouraging environmental regulation, Chapter 11 discourages the relaxation of environmental regulation in order to attract investment. As exceptions, the burden of proof is on the respondent to show compliance with these exceptions.

1. NAFTA Article 1114

Article 1114 provides as follows:

Article 1114: Environmental Measures

1. Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter

that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.

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

In *Metalclad v Mexico*, Metalclad invested in a hazardous waste plant. The Mexican state of San Luis Potosi declared the area where the plant was located to be an ecological zone, which prevented Metalclad from operating the plant. Both the NAFTA tribunal and the British Columbia Supreme Court held that this ecological decree was a measure equivalent to expropriation that required Mexico to pay compensation. Mexico raised Article 1114(1) as a defense. The tribunal rejected this argument because Mexico had taken steps to satisfy itself that Metalclad's investment would be undertaken in a manner consistent with and sensitive to environmental concerns, through an agreement

with Metalclad and federal permits.³⁸ On judicial review to the British Columbia Supreme Court, the Court held that this conclusion was not unreasonable.³⁹

The ruling in the Metalclad case suggests that Article 1114(1) can only justify environmental regulations that are in force prior to an investment being made. Many existing investments could be affected by future climate change regulation. If one accepts the reasoning in *Methanex*, such post-investment regulations would not relate to investment and thus would not have to be justified under Article 1114(1). NAFTA Article 1114(1) is the most common type of environmental provision in IIAs, appearing in eighty-two of the treaties surveyed by Gordon and Pohl.

In forty-nine of the treaties Gordon and Pohl surveyed, provisions discourage lowering environmental regulation for the purpose of attracting investment, in the same manner as NAFTA Article 1114(2). This provision was inserted to address concerns that NAFTA would create ‘pollution havens’— the relaxation of environmental regulations in order to attract investment. This type of provision generally is not subject to arbitration and does not prevent changes to environmental regulations.⁴⁰

2. NAFTA Article 1106(6)

NAFTA Article 1106 prohibits the imposition of performance requirements on investments of an investor of a Party or of a non-Party. The prohibited performance requirements include: minimum levels of domestic content; preference for domestic goods or services; and requirements to transfer technology, a production process or other proprietary knowledge. Regarding technology transfer, there is an exception for

³⁸ *Metalclad Corporation v United Mexican States*, NAFTA/ICSID Case No. ARB(AF)/97/1, Award (30 August 2000); a similar case, for which a decision had not been issued at the time of writing, is *Abengoa, S.A. y COFIDES, S.A. v United Mexican States*, ICSID Case No ARB (AF)/09/2), Award not public, <<http://www.italaw.com/cases/1871>> (accessed 27 February 2014); Katia Fach Gómez, ‘ICSID Claim by Spanish Companies against Mexico over the Center for the Integral Management of Industrial Resources’ (2010) <<http://ssrn.com/abstract=1631835>>.

³⁹ *Mexico v Metalclad Corporation* 2001 BCSC 664 para 104.

⁴⁰ Houde, above n 5. See, for example, 2012 US Model BIT, above n 8 Article 12.

measures that require an investment to use a technology to meet generally applicable health, safety or environmental requirements, as long as the measure complies with the non-discrimination obligations in Articles 1102 and 1103.

Regarding domestic content requirements and preferences for domestic goods or services, Article 1106(6) establishes an exception that incorporates language from GATT Article XX:

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

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

The introductory paragraph of Article 1106(6) differs from the language of the GATT Article XX chapeau in three important respects: (1) it eliminates the reference to discrimination between countries where the same conditions prevail; (2) it adds a reference to investment, in addition to the reference to international trade; and (3) it

clarifies that the term ‘measures’ includes environmental measures. The second and third differences are relatively minor. The reference to investment is an understandably necessary adaptation to incorporate the exception into an investment chapter.

Subsequent WTO jurisprudence has applied GATT Article XX to environmental measures, which means that the Article 1106(6) clarification is consistent with WTO jurisprudence. However, the first difference is more significant. In GATT Article XX, the reference to discrimination between countries where the same conditions prevail has been interpreted to require flexibility in the application of environmental measures to take into account differences in prevailing conditions in different countries.⁴¹ The absence of this requirement in Article 1106 suggests that the conditions prevailing in the home State of a foreign investor need not be taken into consideration in the design of environmental measures that may affect the foreign investor in the host State. This makes sense if one assumes that the relevant environmental measures are aimed at protecting the environment of the host State.

Article 1106(6)(c) modifies the language of GATT Article XX(g) in three ways: (1) it replaces the term ‘relating to’ with the stricter necessity requirement; (2) it clarifies that exhaustible natural resources may be living or non-living; and (3) it eliminates the even-handedness requirement of GATT Article XX(g), which requires that conservation measures include restrictions on domestic production or consumption.⁴² Unlike the first and third modifications, the second modification is consistent with the interpretation of the term ‘exhaustible natural resources’ in subsequent WTO jurisprudence regarding GATT Article XX(g). The first modification places a stricter test on environmental measures than GATT Article XX(g), whereas the

⁴¹ Appellate Body Report, *US – Shrimp*, above n 19.

⁴² Article 8(3)(c) of the 2012 US Model BIT, above n 8, is similar to NAFTA Article 1106(6), but uses the term ‘related to’ in Article 8(3)(c)(iii) in reference to ‘the conservation of living or non-living exhaustible natural resources’.

third modification suggests that performance requirements can be applied to foreign investors without being applied to domestic investors. The absence of the GATT Article XX language regarding discrimination in the introductory paragraph of Article 1106(6) confirms this interpretation.

3. General Environmental Exceptions

Gordon and Pohl found several BITs that incorporate general provisions, based on the language of GATT Article XX or based on security interests and sanitary and phytosanitary concerns.⁴³ Their paper includes the following examples:

Provided that such measures are not applied in a discriminatory or arbitrary manner or do not constitute a disguised restriction on foreign investment, nothing in this Agreement shall be construed to prevent a Contracting Party from adopting measures to maintain public order, or to protect public health and safety, including environmental measures necessary to protect human, animal or plant life.⁴⁴

Nothing in this Agreement precludes the host Contracting Party from taking, in accordance with its laws applied reasonably and on a non-discriminatory basis, measures necessary for the protection of its own essential security interests or for the prevention of diseases or pests.⁴⁵

⁴³ Gordon and Pohl, above n 11, 17-18. See also Newcombe, 'General Exceptions in International Investment Agreements', above n 6.

⁴⁴ Gordon and Pohl, above n 11, citing Canada-Egypt BIT (1996); Canada-El Salvador BIT (1999); Canada-Lebanon BIT (1997); Canada-Panama BIT (1996); Canada-Philippines BIT (1995); Canada-South Africa BIT (1995); Canada-Thailand BIT (1997); Canada-Trinidad and Tobago BIT (1995).

⁴⁵ Gordon and Pohl, above n 11, citing Australia-India BIT (1999).

The first example incorporates language from the chapeau and paragraph b of GATT Article XX, *inter alia*. However, the language is adapted to the investment context. Thus, while WTO jurisprudence should be relevant to its interpretation, the differences in terms and context would have to be taken into account. The second example does not borrow as much from GATT Article XX, but does incorporate a necessity test, which also is used in some paragraphs of GATT Article XX. While WTO jurisprudence would be relevant to the interpretation of the term ‘necessary’, the differences in the context, object and purpose would have to be taken into account. In both examples, the use of GATT language is helpful to avoid conflicts or inconsistencies between WTO law and international investment law.

The majority of State practice is consistent with the view that IIAs do not negate the right to regulate climate change, since the overwhelming majority of IIAs do not incorporate explicit exceptions to preserve the right to regulate in the public interest. The term ‘relating to’ (and similar terminology) can be interpreted and applied to exclude *bona fide* environmental regulation from the applications of such agreements. While some recent IIAs have incorporated general environmental exceptions, this should not be viewed as an indication that other IIAs restrict governments’ right to regulate in the public interest. Rather, the incorporation of such exceptions could be viewed as a clarification or a codification of existing customary international law, possibly in response to the unpredictability of international investment tribunals, possibly in response to public concern that these agreements were not addressing environmental concerns explicitly or possibly to avoid conflicts or inconsistencies between WTO law and international investment law. Thus, there are many reasons for incorporating this type of provision that do not suggest that such provisions are essential to preserve the right to regulate climate change and other matters of public interest.

Nevertheless, the introduction of general exceptions in IIAs, borrowing language from the general exceptions of the WTO, apparently without regard as to whether such transplants are appropriate in the IIA context, may well cause confusion.⁴⁶ The presence or absence of general exceptions also influences the manner in which tribunals interpret and apply general scope provisions, specific obligations and autonomous rights, and how tribunals allocate the burden of proof. As a result of the multiplicity of treaty structures, tribunals address public interest regulation in many different ways and at different points in different treaties. Thus, introducing general exceptions may cause more confusion than clarification with respect to how tribunals should address environmental regulation in IIAs.

V. Non-discrimination Obligations

NAFTA Chapter 11 contains the non-discrimination obligations of national treatment (Article 1102) and most-favoured-nation treatment (Article 1103), as well as an obligation to provide the better treatment of the two (Article 1104). These provisions prohibit discrimination between investors and investments in ‘like circumstances’.

Article 1102 prohibits less favourable treatment of foreign investors compared to

⁴⁶ See, for example, 2004 Model Canadian FIPA, above n 8, Article 2.1, Article 10.1; *Agreement between Canada and the Republic of Peru for the Promotion and Protection of Investments*, 14 November 2006, <<http://www.treaty-accord.gc.ca/text-texte.aspx?id=105078>> (accessed 23 February 2014), Article 10; *Agreement between Japan and the Republic of Singapore for a New-Age Economic Partnership*, <<http://www.mofa.go.jp/region/asia-paci/singapore/jsepa.html>> (accessed 23 February 2014), Article 83; *Free Trade Agreement Between The Government of New Zealand And The Government of the People’s Republic of China*, <<http://www.chinafta.govt.nz/1-The-agreement/2-Text-of-the-agreement/index.php>> (accessed 23 February 2014), Article 200; *Korea-Australia Free Trade Agreement*, initialled by Chief Negotiators on 10 February 2014, <<http://www.dfat.gov.au/fta/kafta/>> (accessed 23 February 2014), Article 22.1(3).

domestic investors, while Article 1103 prohibits discrimination between foreign investors from other parties and any non-party. Differences in the impact that investors or investments have on climate change could be relevant to determine whether they are in ‘like circumstances’, to the extent that such differences determine the competitive relationship between investors and investments. However, the different context and terminology in Articles 1102 and 1103 leave open the question of which criteria should be used to make this determination. Moreover, those criteria are likely to vary according to the nature of the investor or the investment. For example, it is unlikely that goods manufacturers and service providers could be subject to the same criteria to determine likeness. Indeed, in the context of the WTO, goods and services are subject to different likeness criteria in the GATT and the GATS non-discrimination provisions, respectively.⁴⁷

Recent WTO jurisprudence on the meaning of ‘less favourable treatment’ in Article 2.1 of the TBT Agreement, which lacks a general environmental exception, could be relevant to the interpretation of non-discrimination obligations in IIAs that also lack such exceptions. The Appellate Body held that ‘less favourable treatment’ requires a determination of whether the contested measure modifies the conditions of competition to the detriment of imported products. However, the existence of such a detrimental effect is not sufficient to demonstrate less favourable treatment if the detrimental impact on imports stems exclusively from a legitimate regulatory distinction

⁴⁷ Mirreille Cossy, ‘Determining ‘likeness’ under the GATS: Squaring the circle?’ (2006) WTO Working Paper ERSD-2006-08 <http://www.wto.org/english/res_e/reser_e/ersd200608_e.pdf>; Nadja Dorothea Ruiz Euler, ‘El Trato Nacional y la Nación Más Favorecida en el Acuerdo General sobre el Comercio de Servicios de la OMC’ (2012) 2 *Revista de Derecho Económico Internacional* 5 <http://dei.itam.mx/archivos/articulo3/primer_articulo_marzo.pdf>.

rather than reflecting discrimination against the group of imported products.⁴⁸ In the context of IIAs, this test could be applied with respect to the differential treatment of domestic and foreign investors or investments. Indeed, this test dovetails nicely with the concept of the right of governments to regulate, which has been discussed in the context of IIA obligations.

In *S. D. Myers v Canada*, the Tribunal interpreted Article 1102 in light of the context of the NAFTA as a whole, the North American Agreement on Environmental Cooperation (NAAEC) and the principles that are affirmed by the NAAEC (including those of the Rio Declaration), including its concern for the environment and the need to avoid trade distortions that are not justified by environmental concerns. The Tribunal also took into account the part of the OECD Declaration on International and Multinational Enterprises of 21 June 1976 regarding national treatment, as well as OECD commentary on the ‘like situation’ test from 1993. Finally, the Tribunal considered Supreme Court of Canada jurisprudence regarding discrimination against individuals. The Tribunal concluded that the assessment of ‘like circumstances’ must take into account whether the foreign and national investors are in the same economic or business sector and circumstances that would justify governmental regulations that treat them differently in order to protect the public interest. The Tribunal compared *S. D. Myers* with Canadian competitors who also provided PCB waste remediation services.⁴⁹ Thus, the determination was in fact based on the comparators providing the same services and being competitors. This approach is consistent with the WTO focus on the competitive relationship between products in the determination of whether they are ‘like’, which has been applied in GATT Article III and TBT Agreement Article 2.1.

⁴⁸ WTO Appellate Body Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products (US – Tuna II (Mexico))*, WT/DS381/AB/R, adopted 13 June 2012, para 215.

⁴⁹ *S. D. Meyers v Canada*, paras 247-251.

Regarding the issue of whether there was less favourable treatment, the *S.D. Meyers* Tribunal based its decision on whether the practical effect of the measure is to create a disproportionate benefit for nationals over non-nationals and whether the measure, on its face, appears to favour nationals over non-nationals. In this regard, the tribunal stated that protectionist intent would only be relevant if the measure produced an adverse effect on the foreign complainant. It held that it was a legitimate goal to want to maintain the ability to process PCBs within Canada, and consistent with the policy objectives of the Basel Convention. However, there were alternative measures that Canada could have taken to achieve this objective that would have been consistent with the NAFTA.⁵⁰ Thus, the tribunal appears to have first interpreted Article 1102 to including *de facto* as well as *de jure* discrimination, and then introduced a test that resembles the least-trade-restrictive test apply to the necessity test of GATT Article XX.

NAFTA Article 1202 on services also uses the term ‘like circumstances’. In the US-Mexico Trucking Services case, the Panel accepted that differential treatment for legitimate regulatory objectives related to safety was a valid consideration. It further stated that ‘such differential treatment should be no greater than necessary for legitimate regulatory reasons such as safety, and that such treatment be equivalent to the treatment accorded to domestic service providers.’ The Panel interpreted Article 1202 in light of Article 2101 of NAFTA, which allows for exceptions for environmental and human health reasons.⁵¹ Since Chapter 11 has no comparable exception for the non-discrimination provisions, one could argue that legitimate regulatory objectives (like legitimate regulatory distinctions test in the TBT Agreement) should be relevant circumstances, to enable a state to establish distinctions between investors on the basis

⁵⁰ Ibid, paras 254-255.

⁵¹ Final report of the Panel, *In The Matter of Cross-Border Trucking Services* (2001) USA-Mex-98-2008-01, paras 257-258.

of the actual impacts and effects of their investments.⁵² This view is consistent with the statement of the *Feldman* Tribunal that ‘the concept of discrimination has been defined to imply unreasonable distinctions between foreign and domestic investors in like circumstances.’⁵³

Public interference with the right of foreign investors to benefit from support schemes for renewable energy or with their right to GHG emission credits can constitute an unjustified difference in treatment. In *Nykomb v Latvia* case, the tribunal held that Latvia had violated the national treatment standard in the Energy Charter Treaty by refusing to honor a promise of support for low-carbon electricity production on the basis of which Nykomb made his investment. The administrator of the support scheme continued to support low-carbon installations operated by domestic investors, while refusing this payment to Nykomb, who was operating in comparable conditions. The tribunal held that the host state had failed to justify on the basis of public policy why it refused to pay the promised support to the foreign investor, while continuing to support national investors.⁵⁴ This case is consistent with the view that differential treatment should have a basis in a legitimate regulatory distinction.

There is jurisprudence to support the proposition that differential treatment based on legitimate regulatory distinctions does not constitute a violation of non-discrimination violations in IIAs that do not contain general exceptions for environmental measures. This jurisprudence is consistent with the approach of the WTO Appellate Body to the issue of no less favourable treatment in Article 2.1 of the TBT Agreement, which also lacks general exceptions for environmental measures. Thus, in

⁵² Howard Mann and Don McRae, International Institute for Sustainable Development, Amicus Curiae Submission, *Methanex v United States* (2004), para 84

<<http://www.iisd.org/publications/pub.aspx?id=608>> (accessed 10 August 2012), paras. 40-44.

⁵³ *Marvin Roy Feldman v United Mexican States*, NAFTA/ICSID Case No. ARB(AF)/99/1, Award (16 December 2002), para 170.

⁵⁴ Stockholm Chamber of Commerce *Nykomb Synergetics Tech. Holding AB v Republic of Latvia* (2001) (Award) SCC Case No. 118/2001.

both areas of international economic law the absence general exceptions for environmental measures has led tribunals to limit the scope of application of non-discrimination obligations in order to preserve regulatory autonomy with respect to environmental regulation in a manner that resemble the approach in the general exceptions of GATT Article XX.

The allocation of the burden of proof in IIAs requires careful consideration. For example, in the context of IIAs, the national treatment obligation focuses on harm to specific investments in IIAs, rather than abstract competitive opportunities.⁵⁵ This influences the test of whether a measure accords less favourable treatment.⁵⁶ As a general rule, in IIAs the claimant bears the burden of proving likeness and less favourable treatment, whereas the respondent bears the burden of proving that differential treatment is justified for a specific reason (other than an absence of likeness).⁵⁷ However, an IIA can explicitly exclude public interest regulation from the scope of application of non-discrimination obligations, thereby shifting the burden of proof to the complainant.⁵⁸ In both trade and investment law, the burden is on the complainant to prove nationality-based discrimination. In trade law, proof of less

⁵⁵ Nicholas DiMascio and Joost Pauwelyn, 'Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?' (2008) 102 AJIL 48, at 61, 70.

⁵⁶ Ibid, at 78-80. Also see Jorge E. Viñuales, *Foreign Investment and the Environment in International Law* (Cambridge University Press, 2012), at 319.

⁵⁷ Viñuales, *ibid*, at 318-19, 332; Andrew Newcombe and L. Paradell, *Law and Practice of Investment Treaties* (Kluwer Law International, 2009), at 20.

⁵⁸ See, for example, Agreement on the Encouragement and Reciprocal Protection of Investments, Protocol, People's Republic of China-Federal Republic of Germany, December 2003, para. 4(a), reproduced in W.W. Burke-White and A. von Staden, 'Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties' (2008) 48 *Virginia Journal of International Law* 307 at 327; Viñuales, *above n 56*, at 334.

favourable treatment may raise a presumption that the treatment is based on nationality, which the respondent can rebut by proving that the discrepant treatment is the by-product of a legitimate government goal not based on national origin. In contrast, investment tribunals should be more reluctant to accord a presumption of nationality-based discrimination, since the focus is on harm to specific investments in IIAs.⁵⁹

VI. Minimum Standard in Customary International Law

International investment law draws upon customary international law to a greater extent than trade law. The claimant bears the burden of proof to establish what customary international law requires in the minimum standard of treatment.⁶⁰ Moreover, the claimant bears the burden of proof to establish a violation of the minimum standard of treatment, and in particular to prove that a public interest regulation is not a normal part of regulatory evolution that is part of the commercial risk assumed by the investor.⁶¹ The claimant also bears the burden of proof to establish that general regulatory changes amount to expropriation. States have a right to regulate and, as a general rule, the adverse effect of general regulation on investors is not compensable, because it does not amount to expropriation.⁶² Customary international law is also a source of defences that can avoid the violation of IIAs by precluding wrongfulness, in which the burden of

⁵⁹ DiMascio and Pauwelyn, above n 55, at 83-86.

⁶⁰ *Glamis Gold Ltd. v. United States of America*, NAFTA/UNCITRAL, Award (8 June 2009), paras 601-2.

⁶¹ *Chemtura Corporation (formerly Crompton Corporation) v. Government of Canada*, UNCITRAL, Award (2 August 2010), para 137; Viñuales, above n 56, at 312, 375.

⁶² Viñuales, above n 56, at 305-7.

proof is on the party invoking the defence.⁶³ Thus, customary international law needs to be borne in mind in any discussion of the structure of IIAs and the subsequent allocation of the burden of proof.

NAFTA Article 1105 requires host governments to treat foreign investors and investments in accordance with the minimum standard of treatment in international law. The NAFTA Commission issued an interpretation of this provision that clarifies that ‘international law’ refers to customary international law, which is developed by the common practices of countries, and thus does not include treaty law (including provisions contained in the NAFTA other than Article 1105 and other provisions of Chapter 11).⁶⁴ There was some debate in the case law regarding whether this constituted an interpretation or an amendment, but the tribunals decided that this did not matter, since they were bound to follow the decision of the NAFTA Commission regardless. In contrast to non-discrimination obligations, Article 1105 is framed in absolute terms. The comparative treatment of other investors is not relevant. Article 1105 establishes a minimum standard, under which a Party may not treat foreign investments worse than this standard irrespective of the manner in which the Party treats other investors and their investments.⁶⁵

Following the NAFTA Commission interpretation, several NAFTA Chapter 11 tribunals have sought to define the customary international law standard in 1105. The

⁶³ Viñuales, above n 56, at 381-87; Giorgio Sacerdoti, ‘BIT Protections and Economic Crises: Limits to Their Coverage, the Impact of Multilateral Financial Regulation and the Defense of Necessity’ (2013) 28 ICSID Review 351; Anne van Aaken and Jürgen Kurtz, ‘Prudence or Discrimination? Emergency Measures, The Global Financial Crisis and International Economic Law’ (2009) 12 JIEL 859; Jürgen Kurtz, ‘Adjudging the Exceptional at International Investment Law: Security, Public Order and Financial Crisis’ (2010) 59 ICLQ 325.

⁶⁴ *Mexico v Metalclad* (BCSC), above n 39, para 62.

⁶⁵ *Ibid*, para 60.

Tribunal in *Mondev v. United States*, for example, emphasized that the application of the customary international law standard does not permit resort to other treaties of the NAFTA Parties or other provisions within NAFTA.⁶⁶ In *ADF Group v. United States*, the Tribunal noted that recourse to customary international law ‘must be disciplined by being based on State practice and judicial or arbitral case law or other sources of customary or general international law’.⁶⁷ However, in *Glamis Gold v. United States*, the Tribunal stated that arbitral awards cannot create or prove customary international law. In particular, arbitral awards based on autonomous treaty standards are not relevant in determining the customary international law standard of NAFTA Article 1105.⁶⁸ In *Loewen v. United States*, the Tribunal observed: ‘Manifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety is enough, even if one applies the Interpretation according to its terms’.⁶⁹ The Tribunal in *Waste Management v. Mexico* attempted to synthesize the post-interpretation jurisprudence of Article 1105, as: ‘[T]he minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety—as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in any administrative process.’⁷⁰

⁶⁶ *Mondev International Ltd. v United States*, NAFTA/ICSID Case No. ARB(AF)/99/2, Award (11 October 2002), paras 120-121.

⁶⁷ *ADF Group Inc. v United States*, NAFTA/ICSID Case No. ARB(AF)/00/1, Award (9 January 2003), para 184.

⁶⁸ *Glamis Gold v. United States*, above n 25, paras 605-609. Also see *Tecmed v. Mexico*, above n 28, para 155.

⁶⁹ *The Loewen Group, Inc. and Raymond L. Loewen v United States*, NAFTA/ICSID Case No. ARB(AF)/98/3, Decision on Hearing of Respondent’s Objection to Competence and Jurisdiction (5 January 2001), para 132.

⁷⁰ *Methanex v United States* (2005), above n 21, IV.C.11-12.

In *Methanex v. United States*, the Tribunal found that Article 1105(1) does not preclude governmental differentiations between nationals and aliens; Article 1105(1) does not refer to discrimination, whereas Article 1105(2) does. The NAFTA Commission interpretation confirms this: ‘A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1)’. The *Methanex* tribunal concluded that, in the absence of a contrary rule of international law binding on the States parties, whether of conventional or customary origin, a State may differentiate in its treatment of nationals and aliens.⁷¹

In *Mobil Investments Canada Inc. & Murphy Oil Corporation v Canada*, after reviewing the NAFTA jurisprudence on Article 1105, the Tribunal summarized the standard of treatment as follows:

- (1) the minimum standard of treatment guaranteed by Article 1105 is that which is reflected in customary international law on the treatment of aliens;
- (2) the fair and equitable treatment standard in customary international law will be infringed by conduct attributable to a NAFTA Party and harmful to a claimant that is arbitrary, grossly unfair, unjust or idiosyncratic, or is discriminatory and exposes a claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety.
- (3) in determining whether that standard has been violated it will be a relevant factor if the treatment is made against the background of

⁷¹ Ibid, paras 14, 17, 25.

- (i) clear and explicit representations made by or attributable to the NAFTA host State in order to induce the investment, and
- (ii) were, by reference to an objective standard, reasonably relied on by the investor, and
- (iii) were subsequently repudiated by the NAFTA host State.⁷²

The *Mobil* tribunal explained that customary international law on the treatment of aliens does not require a State to maintain a stable legal and business environment for investments. NAFTA Article 1105 only protects an investor from changes to the rules governing an investment if those changes may be characterized as arbitrary or grossly unfair or discriminatory, or otherwise inconsistent with the customary international law standard. Article 1105 does not prevent a public authority from changing the regulatory environment to take account of new policies and needs, even if some of those changes may have far-reaching consequences and effects, and even if they impose significant additional burdens on an investor. Article 1105 does not provide a guarantee against regulatory change or entitle an investor to expect no material changes to the regulatory framework within which an investment is made. Governments can change, and policies and rules can change. The rules of customary international law only protect against egregious behavior and do not require a legal and business environment to be ‘set in concrete’.⁷³ Thus, to establish a breach of Article 1105, the Claimants had to establish that (1) clear and explicit representations were made by or attributable to Canada in order to induce the investment, (2) such representations were reasonably relied upon by the Claimants, and (3) these representations were subsequently repudiated by Canada. However, there was no evidence that Canada made representations that there would not

⁷² Ibid, para 152.

⁷³ Ibid, para 153.

be changes to the regulatory regime and no indication of reliance being placed upon such representations. In particular, there was no promise or representation in the underlying regulatory framework to not change an existing benefits plan or to impose a new plan.⁷⁴

Boute notes that support schemes and regulatory frameworks for renewable energy projects and GHG emission reduction projects create incentives that aim to stimulate private investment and that low-carbon investors expect to receive public support in accordance with the schemes existing at the time of investing. Thus, the fair and equitable treatment standard could provide a guarantee of protection against changes to the framework the State has created to attract low-carbon investments.⁷⁵ The fair and equitable treatment standard also requires a tribunal to weigh the investors' legitimate expectations against the legitimate regulatory interests of the host state.⁷⁶ However, it is not possible to generalize regarding how a particular category of cases would be addressed, since it depends on the specific domestic regulatory framework, the provisions of the specific IIA⁷⁷ and the surrounding circumstances of each case.

The *Mobil* tribunal's statement of the standard in customary international law is consistent with the view that States are entitled to maintain their right to regulate, which includes the right to change the regulatory environment. The real question is whether whether an investor's expectations are justifiable in the circumstances of each case. Moreover, a State may be tied to the objective expectations to the extent that it creates those expectations in order to induce investment.⁷⁸

⁷⁴ Ibid, paras 154-159.

⁷⁵ Boute, above n 5, 637-638.

⁷⁶ Ibid, 649.

⁷⁷ For example, some IIAs contain sanctity of contracts clauses, which aim to guarantee by treaty the respect by the host state for the specific contractual obligations it enters into with investors, which could influence the outcome in cases involving contractual claims. Ibid, 644-647.

⁷⁸ Glamis Gold v. United States, above n 25, para 621.

In *Arif v. Moldova*, Article 3 of the France-Moldova BIT established a fair and equitable treatment obligation.⁷⁹ The tribunal found that the illustrative reference in Article 3 to logistical and regulatory obstacles to fair and equitable treatment showed that measures of this nature were expressly contemplated as breaching the standard. Moreover, other tribunals had connected the fair and equitable treatment standard with the concept of a ‘hospitable climate’ for investment.⁸⁰ The tribunal held that the Complainant made his investment in reliance on a legitimate expectation of a secure legal framework for his investment in a duty-free store at an airport, based on a contract entered with a state entity, approval of the contract by a regulatory authority, and an updated licence.⁸¹ The tribunal noted that an investor’s expectation must be recognised and protected in international law.⁸² Moreover, the fair and equitable treatment standard also takes into account ‘the host State’s legitimate right subsequently to regulate domestic matters in the public interest.’⁸³ However, the tribunal stated:

even where the State action has a reasonable basis in public policy, the fair and equitable treatment standard still requires that the State respect the legitimate expectations insofar as the investor should be treated with an appropriate degree of due process and, if possible, the State should seek to ameliorate the effects of the change of policy on the investor.⁸⁴

The tribunal concluded that an investor’s legitimate expectations might be breached not only by a substantive change in policy, but also by inconsistent treatment of the investor

⁷⁹ *Mr. Franck Charles Arif v. Republic of Moldova*, Award, ICSID Case No. ARB/11/23, 8 April 2013.

⁸⁰ *Ibid*, para 530, citing *Pope and Talbot, Inc v. Government of Canada*, Award on the Merits, Phase 2, paragraph 116; *Saluka Investment B.V. v. The Czech Republic*, Partial Award dated March 17, 2006, para. 286.

⁸¹ *Ibid*, para 541.

⁸² *Ibid*, para 536.

⁸³ *Ibid*, para 538, citing *Saluka Investments B.V. v. The Czech Republic*, para. 305.

⁸⁴ *Arif v. Moldova*, para 537.

by different arms of government during the process of changing a policy.⁸⁵ Moreover, the acts of a government organ or official can create legitimate expectations even when acting in accordance with domestic law, because international responsibility of a State is determined by principle of attribution in international law, not by the legality of an act under domestic law.⁸⁶ The Moldovan Airport State Enterprise and the State Administration of Civil Aviation endorsed and encouraged the investment, but the Moldovan courts found the same investment to be illegal. This direct inconsistency amounted to a breach of the fair and equitable treatment standard, as did Moldova's failure to take remedial action to fulfil the investor's legitimate expectation of a secure legal framework for his duty-free store, even though the courts correctly applied Moldovan law.⁸⁷

Several statements of the tribunal in *Arif v. Moldova* are troubling, since they raise the issue of how this approach to legitimate expectations of an investor might affect the responsibility of a State for exercising its right to regulate in the public interest. Moreover, the approach of the tribunal in this case appears to diverge from the approach of the *Mobil* tribunal on the issue of the degree of regulatory autonomy that a State enjoys versus the legitimate expectations of an investor. How should a tribunal balance a State's pursuit of legitimate regulatory objectives and the legitimate expectations of an investor of a secure legal framework for its investment? Voon and Mitchell argue, in the case of tobacco regulation, that public interest regulation should pass the test where (1) the State has a legitimate regulatory interest, (2) there is a rational relationship between the policy and the measure, and (3) given the public interest at stake, the investor cannot reasonably have expected that the regulatory

⁸⁵ Ibid, para 538, citing *Técnicas Medioambientales Tecmed S.A. v. United Mexican States* (2004) 43 ILM 133; *MTD Equity Sdn v. Republic of Chile* (2005) 44 ILM 91.

⁸⁶ *Arif v. Moldova*, para 539, citing *Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt*, ICSID Case ARB/84/3, Award of May 20, 1992, para. 83 and 85.

⁸⁷ *Arif v. Moldova*, para 415-21, 547.

environment would remain frozen.⁸⁸ The same reasoning would apply with respect to climate change regulation.

In *Pulp Mills on the River Uruguay (Argentina v. Uruguay)*, the Court laid out how customary international environmental law had evolved over time.⁸⁹ The Court pointed out that the principle of prevention, as a customary rule, has its origins in the due diligence that is required of a State in its territory. It is ‘every State’s obligation not to allow knowingly its territory to be used for acts contrary to the rights of other States’.⁹⁰ A State is thus obliged to use all the means at its disposal in order to avoid activities which take place in its territory, or in any area under its jurisdiction, causing significant damage to the environment of another State. This obligation ‘is now part of the corpus of international law relating to the environment’.⁹¹ Moreover, ‘there are situations in which the parties’ intention upon conclusion of the treaty was, or may be presumed to have been, to give the terms used or some of them a meaning or content capable of evolving, not one fixed once and for all, so as to make allowance for, among other things, developments in international law’.⁹² As a result, in *Pulp Mills on the River Uruguay* the Court found that a provision, ‘has to be interpreted in accordance with a practice, which in recent years has gained so much acceptance among States that it may now be considered a requirement under general international law to undertake an environmental impact assessment where there is a risk that the proposed industrial activity may have a significant adverse impact in a transboundary context, in particular, on a shared resource’. Thus, the International Court of Justice has confirmed that the ongoing development of customary international environmental law has to be taken into

⁸⁸ Tania Voon and Andrew Mitchell, ‘Time to Quit? Assessing International Investment Claims against Plain Tobacco Packaging in Australia’ (2011) 14 JIEL 515, at 536.

⁸⁹ *Pulp Mills on the River Uruguay (Argentina v. Uruguay)* (Judgment), paras 203-219.

⁹⁰ *Corfu Channel (United Kingdom v. Albania)* (Merits) ICJ Reports 1949, 22.

⁹¹ *Legality of the Threat or Use of Nuclear Weapons* (1996) (Advisory Opinion) ICJ Reports 1996 (I), para 29.

⁹² *Dispute Regarding Navigational and Related Rights (Costa Rica v Nicaragua)* (2009) (Judgment) para 64.

account in the interpretation of treaty provisions that are subject to evolutionary interpretation.

In *Mondev v United States*, the Tribunal stated that the standard of fair and equitable treatment has evolved with the development of international law since the 1920s.⁹³ In *Glamis Gold v. United States*, the Tribunal held that the minimum standard in NAFTA Article 1105 is at least the standard in *Neer*: ‘the treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.’⁹⁴ The Tribunal found that the claimant had not proved that the minimum standard of treatment had evolved beyond this 1926 standard, with the exception that a demonstration of bad faith is no longer required. However, the Tribunal found that the conduct that the international community views as falling below this standard may change over time. Thus, the fair and equitable treatment standard is subject to the evolution of the international view of what is shocking and outrageous.⁹⁵

The opposite also should be true. The fair and equitable treatment standard should evolve with the international view of what is *not* shocking or outrageous. Thus, it should not be considered shocking or outrageous when a State changes the regulatory environment to address climate change. In this regard, the minimum standard of treatment of foreign investors under customary international law has to be interpreted in accordance with evolving customary international environmental law. The obligation to avoid activities causing significant damage to the environment of other States is likely to encompass regulations to address climate change. Thus, climate change regulation

⁹³ *Mondev v United States*, above n 66, para 116.

⁹⁴ *Neer v. Mexico*, 4 R. Int’l Arb. Awards (Oct. 15, 1926), para 4, cited in *Glamis Gold v. United States*, above n 25, para 612.

⁹⁵ *Glamis Gold v. United States*, above n 25, paras 612-616.

would not be inconsistent with the minimum standard of treatment in NAFTA Article 1105, as long as any regulatory distinctions between investors are legitimately connected to climate change mitigation or adaptation and the State has not induced investment by making commitments regarding the regulatory environment in a manner that would create legitimate expectations on the part of the investor. To conclude otherwise would create a conflict between customary international investment law and customary international environmental law, contrary to the presumption against conflicts in international law.

Viñuales argues that conflict norms to avoid conflicts between a multilateral climate change agreement and international investment obligations are scarce and may prove inadequate. UNFCCC Article 3(5) could support limiting the role of international environmental law in trade and investment proceedings, in order to give effect to the principle of mutual supportiveness of the environmental and trade/investment regimes.⁹⁶ While there is a risk that this might occur, the UNFCCC incorporation of language from the chapeau of GATT Article XX should facilitate avoiding conflicts because the principal obligations regarding non-discrimination, fair and equitable treatment and expropriation have been interpreted in a manner that is consistent with the Article XX chapeau and obligations regarding performance requirements may contain specific exceptions to achieve the same result, such as those in NAFTA Article 1106.

VII. Compensation for Expropriation

NAFTA Article 1110 requires host governments to provide compensation for expropriation and measures that are tantamount to expropriation. It also requires that

⁹⁶ Viñuales, above n 56, at 277.

expropriations be made for a public purpose, be non-discriminatory and be in accordance with due process and Article 1105(1).

In *S. D. Myers v Canada*, the tribunal considered that the term ‘expropriation’ in Article 1110 must be interpreted in light of the whole body of state practice, treaties and judicial interpretations of that term in international law cases. The general body of precedent usually does not treat regulatory action as amounting to expropriation, because expropriations tend to involve the deprivation of ownership rights and regulations a lesser interference. Moreover, an expropriation usually amounts to a lasting removal of the owner’s ability to make use of its economic rights. In this case, the trade ban was temporary and there was no expropriation.⁹⁷

International law establishes that the follows types of government actions may constitute expropriation: (1) the taking of title to property, in whole or in part; (2) the use of police, administrative or legal powers to take control of the operation of an investment, or shut the investor out of its rights of control and ownership, without the transfer of title; and (3) creeping expropriation: the use of a series of measures that cumulatively rather than individually accomplish the removal of ownership or control of an investment. A more controversial argument is that the diminution of economic value due to a regulation that protects the public interest can be the basis for a finding of expropriation.⁹⁸

Under customary international law, where economic injury results from *bona fide* regulation within the police powers of a State, compensation is not required. Thus, as a general matter, States are not liable to compensate aliens for economic loss incurred as a result of a nondiscriminatory action to protect the public interest.⁹⁹ However, once

⁹⁷ *S. D. Myers v Canada*, above n 27, paras 280-288.

⁹⁸ Mann and McRae, above n 52, para 82.

⁹⁹ *Ibid*, para 84; Restatement of the Law Third: The Foreign Relations of the United States:

an expropriation has taken place, compensation is due even if it is for an environmental purpose.¹⁰⁰ In the context of NAFTA Article 1110, if there is a finding of expropriation, compensation is required, even if the taking is for a public purpose, non-discriminatory and in accordance with due process of law and Article 1105(1).¹⁰¹ Thus, not all government regulatory activity that makes it difficult or impossible for an investor to carry out a particular business is an expropriation under Article 1110.¹⁰² For example, in *Methanex*, the Tribunal concluded that the California methanol ban was made for a public purpose, was non-discriminatory and was accomplished with due process. Hence, from the standpoint of international law, the California ban was a lawful regulation and not an expropriation.¹⁰³

Twelve of the treaties surveyed by Gordon and Pohl contain provisions that clarify the understanding of the parties that non-discriminatory environmental regulation does not constitute expropriation. These clauses state: ‘The Parties confirm their shared understanding that: [...] Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.’¹⁰⁴ Arguably, this is just a confirmation of existing customary international law and, contrary to the conclusion that Gordon and Pohl draw, does not mean that States that do not include such provisions may thus be exposed to

A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police powers of states, if it is non-discriminatory (cited in *Marvin Roy Feldman v Mexico*, above n 53, para 105.)

¹⁰⁰ *Compañía del Desarrollo de Santa Elena v Republic of Costa Rica* ICSID Case No. ARB/96/1, Award (17 February 2000); *Metalclad v Mexico*, above n 38; *Mexico v Metalclad*, above n 39, para 104.

¹⁰¹ *Marvin Feldman v Mexico*, above n 53, para 98.

¹⁰² *Marvin Feldman v Mexico*, above n 53, para 112.

¹⁰³ *Methanex v United States* (2005), above n 21, IV.D.15.

¹⁰⁴ Gordon and Pohl, above n 11, 22; United States Model BIT 2004 Annex B; Canada Model BIT (2004) Annex B.13(1); Belgium/Luxembourg-Colombia BIT (2009); Canada-Czech Republic BIT (1990); Canada-Jordan BIT (2009); Canada-Latvia BIT (2009); Canada-Peru BIT (2006); Canada-Romania BIT (1996); United States-Rwanda BIT (2008); United States-Uruguay BIT (2005).

compensation claims for expropriation that could discourage modifications of environmental regulation.

Some argue that NAFTA Chapter 11 strikes the right balance between non-compensable exercises of regulatory authority and exercises of regulatory authority that amount to expropriation of an investment, achieving sustainable development through the right balance between environmental protection and economic development.¹⁰⁵ It is difficult to determine where to draw the line between these two objectives, other than on a case-by-case basis. In some cases, environmental protection and economic development may be mutually supportive. However, given the economic and environmental consequences of climate change, it seems that *bona fide* climate change regulation should take precedence over investors' rights, though the correct balance likely will have to be decided on a case-by-case basis. It is also important to protect foreign investors from unfair or arbitrary treatment by governments who are motivated by short-term political interests rather than long-term environmental risks.

Striking the right balance between the regulatory risks that investors face and the litigation risk that governments face is not the same for all markets. Larger markets can have a greater degree of regulatory risk and still attract foreign investors. In contrast, smaller, less economically attractive markets may need to strike a balance that is more in favour of investors' rights and reduces regulatory risk to a greater degree, in order to attract foreign investment. Larger markets are also a greater source of GHG emissions, so the balance should favor climate change regulations over compensation to foreign investors, in order to limit the risk of regulatory chill and to enhance the right to regulate. Their attractiveness to foreign investors means that large markets should seek

¹⁰⁵ Sanford E. Gaines, 'Protecting Investors, Protecting the Environment: The Unexpected Story of NAFTA Chapter 11' in David L. Markell & John H. Knox, eds, *Greening NAFTA: The North American Commission for Environmental Cooperation* (Stanford University Press, Stanford 2003) 173-196, 184, 190-191.

to negotiate IIAs that leave adequate regulatory space to combat climate change. However, there may be limits to how precise the provisions should be in this regard. For example, the negotiating history of NAFTA Chapter 11 indicates that there was no attempt to address directly the problem of how to distinguish legitimate noncompensable regulations having an effect on the economic value of foreign investments, and ‘regulatory takings’ requiring compensation, instead leaving this determination to be made on a case-by-case basis.¹⁰⁶

The NAFTA Preamble is relevant context for interpreting the provisions of Chapter 11. According to the Preamble, the NAFTA Parties seek to ensure a predictable commercial framework for business planning and investment, in a manner consistent with environmental protection and conservation. At the same time, they seek to preserve their flexibility to safeguard the public welfare, promote sustainable development and strengthen the development and enforcement of environmental laws and regulations. These aspects of the Preamble support an interpretation of NAFTA Chapter 11 that gives *bona fide* climate change regulation precedence over investors’ rights.

The *Methanex* case indicates that science-based regulatory decisions are likely to withstand scrutiny in NAFTA Chapter 11.¹⁰⁷ In that case, the science was preliminary, but there was sufficient scientific evidence of the potentially serious health effects of methanol to support the state regulation. The *Methanex* case is of particular relevance to climate change regulation, since it shows that regulation based on the precautionary principle can survive a challenge by foreign investors. There is sufficient scientific evidence of the potentially serious effects of climate change to justify climate change regulation, even if it also has the effect of diminishing the value of some foreign

¹⁰⁶ Daniel M. Price, ‘Chapter 11—Private Party Vs. Government, Investor-State Dispute Settlement: Frankenstein or Safety Valve?’ (2000) 26 Canada-U.S. Law Journal 107.

¹⁰⁷ This stands in contrast to *Ethyl Corporation v Canada*, a case in which the Canadian government agreed to withdraw a trade ban and publicly concede that there was no scientific basis for the ban. Gaines, above n 105, 182-183.

investments. There are sixty-six IIAs with general language in preambles that mentions environmental concerns and establishes protection of the environment as a concern of the parties to the treaty.¹⁰⁸

VIII. Conclusion

International investment law has the potential to have a chilling effect on climate change regulation, by raising issues regarding the risk that climate change regulation will expose host states to claims from foreign investors. However, legitimate climate change regulation should not trigger liability to compensate foreign investors.

Nevertheless, this may not eliminate the chilling effect, since it is costly for States to defend against such claims even if they do not succeed. Awards of costs against investors who file such claims may discourage such claims, but this may not be sufficient to overcome the chilling effect in the short term. Moreover, the lack of a system of precedents for tribunals permits tribunals to reach different conclusions on similar issues, which increases the uncertainty regarding the outcome of litigation.¹⁰⁹ Nevertheless, there is room in international investment law to strike an appropriate balance between the right to regulate climate change and right of foreign investors to seek compensation for arbitrary and discriminatory governmental actions.

The introduction of general environmental exceptions in IIAs may create more problems than it solves. It is possible that tribunals may interpret the presence of such exceptions in some IIAs as a sign of intention to have environmental measures fall within the scope of IIAs, and interpret general scope provisions accordingly. This would be less desirable than excluding *bona fide* environmental measures from the general

¹⁰⁸ Gordon and Pohl, above n 11, 9.

¹⁰⁹ It is not even clear whether arbitral awards qualify as ‘judicial decisions’ under Article 38(d) of the Statute of the International Court of Justice and, if they did, which might qualify as ‘jurisprudence constante’. See *Philip Morris v. Uruguay*, above n 37, para 204.

scope of application, since it would have the effect of reallocating the burden of proof from the complainant to the respondent. The risk of this type of interpretation is particularly significant in IIAs, such as the Canadian Model BIT, that include both general scope provisions and general exceptions. The latter indicate that the former were not intended to exclude environmental measures from the scope of application of the BIT. In other contexts, such as the US Model BITs, the risk is greatly reduced due to the absence of general exceptions.

While it is possible that a tribunal might view the introduction of general exceptions in recent BITs as an indication that environmental measures were not intended to be excluded from the general scope of application of IIAs such as NAFTA and the US Model BITs, this would be wrong. First, there is no basis in Article 31 of the Vienna Convention for reaching such a conclusion, since the later IIAs are not part of the circumstances surrounding the conclusion of the earlier IIAs and would not qualify under VCLT Article 31(3)(c) either, since the parties likely are not the same. Second, there is too much variation in the structure and content of IIAs to support interpretations based on trends in the international practice of IIA design.

Tribunals might support such an interpretative approach under VCLT Article 32, but that would be wrong also. A better approach would be to take recent IIAs with general environmental exceptions into account to interpret older IIAs in an evolutionary fashion. The WTO Appellate Body used this approach to find that the term 'exhaustible natural resources' in GATT Article XX(g) applied to both living and non-living resources, taking into account more recent provisions in multilateral environmental agreements that provided this definition. Similarly, IIA tribunals could consider the recent introduction of general environmental exceptions as favouring an evolutionary interpretation to the the general scope provisions of IIAs that lack such exceptions, to

conclude that they exclude *bona fide* environmental regulation from their scope. The same evolutionary approach is appropriate for customary international law regarding international investment law, since the evolutionary nature of such norms is widely recognized. Even in IIAs that lack such general scope provisions, an evolutionary approach to treaty interpretation can exclude *bona fide* environmental measures from the scope of application of treaty-based obligations and the customary international law standards, such as fair and equitable treatment.

Thus, despite the variety of practice in the design of IIA structure, there is sufficient flexibility for tribunals to reach the correct decision on a case-by-case basis. Nevertheless, IIA parties need to consider the effect of treaty structure on the allocation of burden of proof to ensure that IIAs do not create obstacles to *bona fide* climate change regulation.