

ARBITRATING CLIMATE CHANGE: REGULATORY REGIMES AND INVESTOR-STATE DISPUTES

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Climate change already regularly features in the courts. The challenges created by climate change, and the domestic and international measures designed to mitigate its effects, are generating issues over which an array of disputes are occurring.¹ They are manifesting in global-scale questions of climate change causation and liability.² Matters of administrative law have been raised in the European Union concerning the scope of governance and authority in the determination of National Allocation Plans (NAPs).³ Challenges to the operation of the European Union Emissions Trading Scheme⁴ have been filed with the European Court of Justice.⁵ Inter-state non-compliance procedures have been established under the Kyoto Protocol.⁶ The potential for conflict between international trade rules and climate change mitigation activity has been identified.⁷ Domestic development applications are challenged on

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¹ Brian Preston, 'Avenues for Litigating the Effects of Climate Change' (2009) November *New South Wales Law Society Journal* 49.

² See for example, claims brought in the United States against carbon-intensive industries in *Connecticut v American Electric* WL 2996729 (CA 2 (NY), 2009); see also claims brought by Inuit peoples against oil and coal companies for the erosion of their territories as a result of climate change in *Kilvalina v ExxonMobil*, WL 295157 (CD Cal, 2008).

³ *United Kingdom v Commission*, Case T-143/05 (joined with Case T-178/05 *United Kingdom v Commission*) [2005] ECR II 4807; *Germany v Commission*, Case T-374/04 [2007] ECR II 4431; *Poland v Commission*, Case T-183/07 [2007] ECR II 152; see the discussion in Navraj Singh Ghaleigh, 'Emissions Trading Before the European Court of Justice: Market Making in Luxembourg' in David Freestone and Charlotte Streck (eds), *Legal Aspects of Carbon Trading: Kyoto, Copenhagen and Beyond* (2009 forthcoming).

⁴ Council Directive 2003/87/EC, Establishing a Scheme for Greenhouse Gas Emission Allowance Trading with the Community and Amending Council Directive 96/61/EC, 2003 O.J. (L 275) 32.

⁵ *Société Arcelor Atlantique et Lorraine and others v Premier Ministre, Ministre de l'Économie, des Finances et de l'Industrie, Ministre de l'Écologie et du Développement Durable*, Case C-127/07, *Official Journal of the European Union*, 26/5/2007, C117/8; *Arcelor S.A. v European Parliament and Council* (2004) Case T-16/04.

⁶ *Kyoto Protocol to the United Nations Framework Convention on Climate Change*, opened for signature 11 December 1997, (1998) 37 ILM 22 (entered into force 16 February 2005); see further the discussion in Catherine Redgwell, 'Non-Compliance Procedures and the Climate Change Convention' in W Bradnee Chambers, *Inter-Linkages: The Kyoto Protocol and the International Trade and Investment Regimes* (2001) 43.

⁷ Andrew Green, 'Climate Change, Regulatory Policy and the WTO: How Constraining Are Trade Rules?' (2005) 8 *Journal of International Economic Law* 143; see also the recent climate change-related controversies over whether Chinese subsidies for the manufacture of solar panels may amount to a breach of international trade agreements in Keith Bradsher, 'China racing Ahead of U.S. in the Drive to go Solar', *The New York Times*, 24 August 2009, <http://www.nytimes.com/2009/08/25/business/energy-environment/25solar.html?_r=1&em> at 6

the grounds that a project will result in excessive carbon emissions.⁸ Courts and tribunals have determined coastal planning consents on the basis of future sea level rises and increases in extreme storm events due to climate change.⁹ And there will undoubtedly be a raft of ordinary commercial disputes arising out of contracts related to renewable energy projects, low-carbon technology development, carbon trading arrangements, and Clean Development Mechanism (CDM) projects.¹⁰ These trends are likely to continue.¹¹ It is also probable that they will eventually emerge in investor-state arbitration as well. This paper examines that likelihood.

International investment law provides a range of investor protection guarantees to foreign investment activity, including prohibitions on uncompensated expropriation, guarantees of national treatment, and requirements to adhere to the fair and equitable treatment standard.¹² These guarantees are contained in a network of investment treaties and rules of customary international law, but their impacts can also be felt across a wide range of policy issues, in their intersect with other fields of international law, and in their interaction with domestic regulatory regimes.¹³ In particular, there has recently been a series of investor challenges to host state environmental regulation, raising the spectre of possible climate change-related disputes.¹⁴ As

November 2009; see also the controversy over local content requirements introduced in Ontario, Canada for grid-connected solar projects in Tyler Hamilton, 'Germany Fuming Over Solar Policy', *The Star* (Canada), 24 October 2009, <<http://www.thestar.com/business/article/715515--germany-fuming-over-solar-policy>> at 8 November 2009.

⁸ See for example, *Gray v Minister for Planning* (2006) 152 LGERA 258 regarding a coal mine proposal.

⁹ See for example, *Northcape Properties Pty Ltd v District Council of Yorke Peninsula* [2008] SASC 57; *Gippsland Coastal Board v South Gippsland Shire Council (No 2)* [2008] VCAT 1545.

¹⁰ Chester Brown, 'The Settlement of Disputes Arising in Flexibility Mechanism Transactions under the Kyoto Protocol' (2005) 21: 3 *Arbitration International* 361; Dane Ratcliff, 'Arbitration in 'Flexible-Mechanism' Contracts' in David Freestone and Charlotte Streck (eds), *Legal Aspects of Implementing the Kyoto Protocol: Making Kyoto Work* (2005) 377.

¹¹ Preston, above n 1, 52.

¹² See generally Campbell McLachlan, Laurence Shore, Matthew Weiniger, *International Investment Arbitration: Substantive Principles* (2007); see also Rudolph Dolzer and Christoph Schreuer, *Principles of International Investment Law* (2008).

¹³ McLachlan, Shore and Weiniger, above n 12, 15; Dolzer and Schreuer, above n 12, 3–10; see also Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (2009); see also the discussion on interacting principles in Philippe Sands, 'Treaty, Custom and the Cross-Fertilization of International Law' (1998) 1 *Yale Human Rights and Development Law Journal* 85.

¹⁴ See for example, *Dow Agro Sciences LLC v Government of Canada*, Notice of Arbitration Under the UNCITRAL Rules and the North American Free Trade Agreement, 31 March 2009, <<http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/DowAgroSciencesLLC-2.pdf>> at 6 November 2009; *Methanex Corporation v United States of America*, (2005) 44 *International Legal Materials* 1345; *S.D. Myers, Inc v Canada*, Partial Award (Decision on the Merits), November 2000, (2001) 40 *International Legal Materials* 1408; *Ethyl Corporation v Canada*, Jurisdiction Phase, (1999) 38 *International*

such, this paper examines the way in which climate change issues are likely to be engaged by the protections provided under international investment law.

Part I of this paper considers the investment protection guarantees that have been implicated in environment-related investor-state disputes. It observes that although recent interpretations of investment treaties have the potential to constrain host state policy space to a significant degree, insufficient consideration of non-investment issues is often a feature of arbitral awards involving environmental matters.¹⁵ Part II examines the implications of this investment treaty jurisprudence for the implementation of climate change mitigation measures. It argues that international investment law has the potential to frustrate such programmes.¹⁶ In particular, it is likely that the fair and equitable treatment standard and national treatment requirements will be invoked by investors in carbon-intensive operations on the enactment of more stringent energy use regulation or the setting of more restrictive permit conditions.¹⁷

This paper also makes the point, however, that investment law does not make moral judgements on the type of investment pursued or the individual policies an investment might be seeking to advance — its focus is directed towards protecting the investor. As such, in some instances, investment law has the potential to frustrate domestic and international climate change mitigation

Legal Materials 708; *Metalclad Corporation v The United States of Mexico*, Award, 25 August 2000, (2001) 40 *International Legal Materials* 35.

¹⁵ Julie Soloway, ‘Environmental Regulation as Expropriation: The Case of NAFTA’s Chapter 11’ (2000) 33 *Canadian Business Law Journal* 92, 119; see the discussion on incorporating principles from environmental law or human rights law into investment law in August Reinisch, “‘Investment and ...’ — The Broader Picture of Investment Law’ in August Reinisch and Christina Knahr (eds), *International Investment Law in Context* (2008) 201, 201–202; see also Moshe Hirsch, ‘Interactions between Investment and Non-Investment Obligations in International Investment Law’ in Peter Muchlinski, Federico Ortino and Christoph Schreuer, *The Oxford Handbook of International Investment Law* (2008) 154; see for a discussion on the concept of reduction of ‘policy space’, Albert H Cho and Navroz K Dubash, *Will Investment Rules Shrink Policy Space for Sustainable Development? Evidence from the Electricity Sector*, World Resources Institute Working Paper (2003) <http://www.iisd.org/pdf/2003/trade_investment_rules.pdf> at 5 September 2009.

¹⁶ Jacob Werksman, Kevin A Baumert and Navroz K Dubash, ‘Will International Investment Rules Obstruct Climate Protection Policies? An Examination of the Clean Development Mechanism’ (2003) 3 *International Environmental Agreements: Politics, Law and Economics* 59; Kate Miles, ‘International Investment Law and Climate Change: Issues in the Transition to a Low Carbon World’ (July 2008) *Society of International Economic Law, Inaugural Conference*, <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1154588> at 6 November 2009.

¹⁷ Miles, above n 16; Fiona Marshall and Deborah Murphy, *Climate Change and International Investment Agreements: Obstacles or Opportunities?* (2009) International Institute for Sustainable Development, 21–34, <http://www.iisd.org/pdf/2009/bali_2_copenhagen_iias.pdf> at 3 November 2009; see further the advice given by leading Australian law firm to its clients in Mallesons Stephen Jaques, ‘The Impact of Climate Change Regulation on Bilateral Investment Treaties’, *Mallesons International Commercial Arbitration Update* (November 2008) <<http://www.mallesons.com/publications/update-combine.cfm?id=1551305>> at 6 November 2009.

initiatives. On other occasions, investor protection guarantees will shield investors in projects that advance climate change mitigation objectives.¹⁸ Both eventualities, however, point to climate change featuring in investment arbitration and expanding on current trends in the emergence of climate change-related disputes.

I. INVESTOR PROTECTION AND THE ENVIRONMENT

The characterisation of environmental regulation as a violation of investment treaties is a recent trend. It has found form in allegations that host state decision-making and regulation on environmental matters have violated treaty guarantees against uncompensated expropriation, the fair and equitable treatment standard, and national treatment requirements. These complaints have, for example, challenged regulations introduced to prevent contamination of ground water with chemicals,¹⁹ measures prohibiting the export of hazardous waste in compliance with international environmental obligations,²⁰ the denial of a permit to operate a hazardous waste facility,²¹ warnings not to drink water contaminated with toxic bacteria,²² regulation prohibiting the use of certain pesticides,²³ and a ban on a fuel additive to protect human health and the environment.²⁴ The nature of these disputes illustrates the way in which investor protection guarantees can interfere in domestic decision-making on environmental matters.²⁵ It also points to the potential for climate change-related disputes in the future.²⁶ As such, this next section

¹⁸ Anatole Boute, 'The Potential Contribution of International Investment Protection Law to Combat Climate Change' (2009) 27 *Journal of Energy and Natural Resources Law* 333.

¹⁹ *Methanex Corporation v United States of America*, (2005) 44 *International Legal Materials* 1345.

²⁰ *S.D. Myers, Inc v Canada*, Partial Award (Decision on the Merits), November 2000, (2001) 40 *International Legal Materials* 1408. It was argued that the measure was made in compliance with the *Convention on the Control of Transboundary Movement of Hazardous Wastes and their Disposal*, opened for signature 22 March 1989, (1989) 28 ILM 657 (entered into force 1992) (Basel Convention).

²¹ *Metalclad Corporation v The United States of Mexico*, Award, 25 August 2000, 40 *International Legal Materials* 35 (2001).

²² *Azurix Corp. v Republic of Argentina* (Award) (2006) ICSID Case No. ARB/01/12.

²³ *Dow Agro Sciences LLC v Government of Canada*, Notice of Arbitration Under the UNCITRAL Rules and the North American Free Trade Agreement, 31 March 2009, <<http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/DowAgroSciencesLLC-2.pdf>> at 6 November 2009.

²⁴ *Ethyl Corporation v Canada*, Jurisdiction Phase, (1999) 38 *International Legal Materials* 708.

²⁵ Soloway, above n 15; Philippe Sands, 'Searching for Balance: Concluding Remarks' in 'The Colloquium on Regulatory Expropriations in International Law' (2002) 11 *New York University School of Law Environmental Law Journal* 198.

²⁶ Werksman, Baumert and Dubash, above n 16, 77; Miles, above n 16; Marshall and Murphy, above n 17; Nathalie Bernasconi, *Background Paper on Vattenfall v. Germany Arbitration* (July 2009) 6.

analyses the way in which investor protection standards have been interpreted in awards implicating environmental issues.

A. *Investment Treaty Protection*

1. *Indirect Expropriation*

Indirect expropriation featured controversially in early environment-related investor-state disputes. Notable examples were *Metalclad Corporation v The United States of Mexico*,²⁷ *S.D. Myers, Inc v Canada*,²⁸ *Pope & Talbot Inc v Canada*,²⁹ and *Methanex Corporation v United States of America*.³⁰ Indirect expropriation takes the form of a diminution in property rights or interference with property interests without a formal transfer of ownership.³¹ However, encapsulating its precise boundaries has proven elusive.³² In discussing the concept, Been and Beauvais refer to the terms ‘indirect expropriation’, ‘measures tantamount to expropriation’, ‘constructive takings’, ‘creeping expropriation’, and ‘disguised expropriation’, and make the following comment:³³

These terms collectively refer to the notion that governments, by means of regulatory or other measures, effectively can deprive an investor of the use and benefit of an investment without direct physical occupation or transfer of title.

Traditionally, the rules on international expropriation do not classify certain kinds of governmental action that merely reduce the value of an investment as a compensable taking.³⁴ This includes the imposition of taxation, devaluation in currency, or changes to inheritance,

²⁷ *Metalclad Corporation v The United States of Mexico*, Award, 25 August 2000, 40 *International Legal Materials* 35 (2001).

²⁸ *S.D. Myers, Inc v Canada*, Partial Award (Decision on the Merits), November 2000, (2001) 40 *International Legal Materials* 1408.

²⁹ *Pope & Talbot Inc v Canada* (2002) 41 *International Legal Materials* 1347.

³⁰ *Methanex Corporation v United States of America*, (2005) 44 *International Legal Materials* 1345.

³¹ M Sornarajah, *The International Law on Foreign Investment* (2nd ed., 2004) 349–350; G C Christie, ‘What Constitutes a Taking of Property Under International Law?’ (1964) 38 *British Yearbook of International Law* 307, 309; Burns H Weston, ‘“Constructive Takings” under International Law: A Modest Foray into the Problem of “Creeping Expropriation”’ (1975) 16 *Virginia Journal of International Law* 103.

³² McLachlan, Shore and Weiniger, above n 12, 298.

³³ Vicki Been and Joel C Beauvais, ‘The Global Fifth Amendment? NAFTA’s Investment Protections and the Misguided Quest for an International “Regulatory Takings” Doctrine’ (2003) 78 *New York University Law Review* 30, 54.

³⁴ Ian Brownlie, *Principles of Public International Law* (7th edition, 2008) 536; B A Wortley, *Expropriation in Public International Law* (1959) 50–51.

health and safety, and planning regulations.³⁵ It is often difficult, however, to ascertain where the legitimate exercise of governmental regulatory authority ends and compensable expropriation has occurred.³⁶ Although the authorities take a case-by-case approach to this assessment, which renders it more difficult to predict outcomes in individual instances,³⁷ inferences for the treatment of environmental issues can be drawn from the jurisprudence.

(a) *The Effects Doctrine*

The effect of governmental action on the investment will play a substantial role in a tribunal's assessment of whether or not it constitutes indirect expropriation.³⁸ The purpose of the regulation, on the other hand, is a much less significant factor, even to the point of not impacting at all on the decision.³⁹ A series of awards have adopted this approach and their characterisation of the relationship between the legitimate motivation for the measures taken and their effect on the investment points to the likelihood of continued controversy surrounding environmental regulation. For example, legitimate purpose did not alter the expropriatory nature of governmental action for the Iran–US Claims Tribunal in *Phelps Dodge Corp. et al v Iran*:⁴⁰

... the Tribunal understands the financial, economic and social concerns that inspired the law pursuant to which it acted, but those reasons and concerns cannot relieve the Respondent of the obligation to compensate Phelps Dodge for its loss.

This approach has also been reflected in the more recent decisions of *Compañía del Desarrollo de Santa Elena, S.A. v The Republic of Costa Rica (Santa Elena)*,⁴¹ *Tecnicas Medioambientales Tecmed, SA v United Mexican States (Tecmed)*,⁴² and *Azurix Corp. v Republic of Argentina (Azurix)*.⁴³ For example, in determining that the non-renewal of an operating licence constituted

³⁵ Brownlie, above n 34, 538; Wortley, above n 34, 50–51.

³⁶ Wortley, above n 34, 51; Been and Beauvais, above n 33, 54; Alexander Fachiri, 'Expropriation and International Law' (1925) 6 *British Year Book of International Law* 159, 170.

³⁷ McLachlan, Shore and Weiniger, above n 12, 298.

³⁸ August Reinisch, 'Expropriation' in Peter Muchlinski, Federico Ortino and Christoph Schreuer, *The Oxford Handbook of International Investment Law* (2008) 407, 444; Rudolph Dolzer, 'Indirect Expropriations: New Developments?' (2002) 11 *New York University Environmental Law Journal* 64, 65.

³⁹ See the discussion in Reinisch, above n 38, 444–447; Dolzer, above n 38, 65.

⁴⁰ *Phelps Dodge Corp. et al v Iran*, 10 Iran–US CTR 121, 130 (1986-I); see also the discussion in Reinisch, above n 38, 445.

⁴¹ *Compañía del Desarrollo de Santa Elena, S.A. v The Republic of Costa Rica* (2000) 39 *International Legal Materials* 1317.

⁴² *Tecnicas Medioambientales Tecmed, SA v United Mexican States* (2004) 43 *International Legal Materials* 133.

⁴³ *Azurix Corp. v Republic of Argentina* (Award) (2006) ICSID Case No. ARB/01/12.

an expropriation of the investment, the *Tecmed* tribunal reemphasised that the primary concern in questions of indirect expropriation is with the effect of the governmental measure rather than its object, stating that:⁴⁴

The government's intention is less important than the effects of the measures on the owner of the assets or on the benefits arising from such assets affected by the measures; and the form of the deprivation measure is less important than its actual effects.

As such, this focus on effects led the tribunal to conclude that legitimate regulation enacted to further environmental protection objectives did not shield those measures from scrutiny as a violation of investment treaties.⁴⁵

... we find no principle stating that regulatory administrative actions are *per se* excluded from the scope of the Agreement, even if they are beneficial to society as a whole — such as environmental protection —, particularly if the negative or economic impact of such actions on the financial position of the investor is sufficient to neutralize in full the value, or economic or commercial use of its investment without receiving any compensation whatsoever.

The *Azurix* tribunal adopted a similar approach, again reiterating that assessment of the effect of the measure on the investment was the determining factor in whether or not indirect expropriation had occurred, stating:⁴⁶

For the Tribunal, the issue is not so much whether the measure concerned is legitimate and serves a public purpose, but whether it is a measure that, being legitimate and serving a public purpose, should give rise to a compensation claim.

In *Azurix*, the tribunal then turned to the extent of the effect on the investment, considering whether the investor had been deprived in whole or in significant part of the use or reasonably-to-be-expected economic benefit of its investment.⁴⁷ The local authorities were held to have breached their contractual obligations to the investor, but not so as to amount to an expropriation of the investment.⁴⁸ This framing of the criteria for consideration as including the 'reasonably-to-be-expected' economic benefit of the investment had also been asserted earlier in *Metalclad Corporation v The United States of Mexico (Metalclad)*.⁴⁹ The tribunal in *Metalclad* adopted the

⁴⁴ *Tecnicas Medioambientales Tecmed, SA v United Mexican States* (2004) 43 *International Legal Materials* 133.

⁴⁵ *Ibid* 164; see also the discussion in Reinisch, above n 38, 436–437; see further the discussion in Miles, above n 16.

⁴⁶ *Azurix Corp. v Republic of Argentina* (Award) (2006) ICSID Case No. ARB/01/12, para, 310.

⁴⁷ *Ibid* para. 311–322.

⁴⁸ *Ibid* para. 319–322.

⁴⁹ *Metalclad Corporation v The United States of Mexico*, Award, 25 August 2000, 40 *International Legal Materials* 35 (2001).

effects-based analysis and combined this with the expectations of the investor, resulting in a particularly expansive form of investor protection.⁵⁰

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

The reasoning embodied in these awards represents one stream of thinking on indirect expropriation and the scope of a state's regulatory authority — regulating in the public interest may constitute a compensable expropriation if it impacts significantly on the activities of foreign investors.⁵¹ There is, however, a divergence of approaches to the relationship between environmental regulation and expropriation amongst arbitral awards in investor-state disputes. A separate mode of analysis has also emerged in which legitimate public welfare regulation is excluded from the scope of investment treaties, exemplified in the decisions in *Saluka Investments BV (The Netherlands) v The Czech Republic (Saluka)*⁵² and *Methanex*, which provides that:⁵³

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

Contrary to the approach in *Metalclad*, *Santa Elena*, *Tecmed*, and *Azurix*, the awards in *Methanex* and *Saluka* remove non-discriminatory environmental regulation from the reach of investment treaties. If the *Methanex* reasoning is consistently adopted in future awards, the risk of inappropriate constraints being placed on host state policy space via allegations of indirect expropriation will be greatly lessened. However, there is no assurance that investment jurisprudence will develop along such lines, as illustrated in the approach taken in *Azurix*, an award subsequent to the *Methanex* decision, which instead preferred the reasoning of *Tecmed*.⁵⁴ As such, the availability of such different approaches, combined with the difficulties in predicting which stream of case law a tribunal will prefer, means that environmental regulation

⁵⁰ Ibid para 103; see also the discussion in Been and Beauvais, above n 33, 33–37.

⁵¹ Reinisch, above n 38, 436–437.

⁵² *Saluka Investments BV (The Netherlands) v The Czech Republic*, UNCITRAL Partial Award, 2006, para. 263.

⁵³ *Methanex Corporation v United States of America*, (2005) 44 *International Legal Materials* 1345, 1456; see also the discussion in Reinisch, above n 38, 433, 436–438; see also Miles, above n 16.

⁵⁴ *Azurix Corp. v Republic of Argentina* (Award) (2006) ICSID Case No. ARB/01/12, para. 309–310.

remains exposed to investor challenges as indirect expropriation.⁵⁵ The high level of interference required for an expropriation, however, has seen such claims often falter in the allegations that the measures have amounted to an expropriation, but then succeed under other heads of claim, such as breach of the fair and equitable treatment standard and national treatment requirements.⁵⁶ This tendency has directed recent attention towards the more controversial application of these treatment standards.⁵⁷ As such, although it is likely that indirect expropriation will be pleaded in an investor-state dispute involving climate change-related issues, the main thrust of the claim will be grounded in fair and equitable treatment and national treatment.

2. *Fair and Equitable Treatment*

In the environmental context, allegations of a breach of the fair and equitable treatment standard arise in investor challenges to administrative decision-making, prohibitions on certain activities, and the introduction of new regulation.⁵⁸ Arbitral awards have clarified the meaning of the term 'fair and equitable treatment', the most significant elements of which comprise adherence to the legitimate expectations of the investor, due process, and maintenance of a stable legal and business environment.⁵⁹ Tribunals go beyond the consideration of specific representations made to the investor and examine the law in existence at the time of entering into the investment. The challenged regulatory changes are then assessed in light of the original state of the law to ascertain whether or not the legitimate expectations of the investor have been met.⁶⁰ This requirement to maintain a stable legal and business environment, in particular, has the potential to constrain host state policy space. It has been described as an essential element of meeting the

⁵⁵ Reinisch, above n 38, 437–438; Miles, above n 16.

⁵⁶ See for example *Azurix Corp. v Republic of Argentina* (Award) (2006) ICSID Case No. ARB/01/12.

⁵⁷ See for example the discussion in Gus Van Harten, *Investment Treaty Arbitration and Public Law* (2007) 88–90; M Sornarajah, 'The Fair and Equitable Standard of Treatment: Whose Fairness? Whose Equity?' in Federico Ortino, Lahra Liberti, Audley Sheppard and Hugo Warner (eds) *Investment Treaty Law, Current Issues II: Nationality and Investment Treaty Claims; Fair and Equitable Treatment in Investment Treaty Law* (2007) 165; Fiona Marshall, *Fair and Equitable Treatment in International Investment Agreements*, 10, International Institute for Sustainable Development (2007) <http://www.iisd.org/pdf/2007/inv_fair_treatment.pdf> at 2 October 2009.

⁵⁸ McLachlan, Shore and Weiniger, above n 12, 226, 233–234; Dolzer and Schreuer, above n 12, 133–135, 142.

⁵⁹ McLachlan, Shore and Weiniger, above n 12, 234–238; Dolzer and Schreuer, above n 12, 134; Ioana Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (2008) 163–172.

⁶⁰ Dolzer and Schreuer, above n 12, 134; McLachlan, Shore and Weiniger, above n 12, 234–238; Tudor, above n 59, 163–172.

fair and equitable treatment standard⁶¹ and its scope has a particularly expansive reach, as illustrated by the award in *Tecmed*:⁶²

The Arbitral Tribunal considers that this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations.

Together with this characterisation of knowing 'beforehand any and all rules and regulations that will govern its investments',⁶³ the positive obligations assumed by the host state to adopt a favourable approach towards foreign investment were emphasised by the tribunal in *Azuriz*:⁶⁴

A third element is the frustration of expectations that the investor may have legitimately taken into account when it made the investment. The standards of conduct agreed by the parties to a BIT presuppose a favorable disposition towards foreign investment, in fact, a pro-active behavior of the State to encourage and protect it. To encourage and protect investment is the purpose of the BIT. It would be incoherent with such a purpose and the expectation created by such a document to consider that a party to the BIT has breached the obligation of fair and equitable treatment only when it has acted in bad faith or its conduct can be qualified as outrageous or egregious.

The combination of these factors points to a particularly favourable framework in which the consideration of investors' expectations occurs.⁶⁵ And it is the emergence of this approach in investor-state arbitral jurisprudence that causes concern for the implementation of new environmental protection measures. As host states seek to respond to changing environmental conditions, to implement international environmental obligations, and to pursue domestic sustainable development objectives, the enactment of new regulation, the prioritising of certain sectors or projects, and the introduction of new policies is inevitable — and in the course of that process, they may also fundamentally change the legal and political landscape in which established investors are required to operate in a manner that could not have been foreseen at the

⁶¹ *Occidental Exploration and Production Co v Republic of Ecuador* (Award) Case No UN3467 (UNCITRAL, 2004) para. 183.

⁶² *Tecnicas Medioambientales Tecmed, SA v United Mexican States* (2004) 43 *International Legal Materials* 133, 173. This approach has been adopted in a number of subsequent awards, such as, *MTD Equity Sdn Bhd & anor v Republic of Chile* (Award) (2005) 44 *International Legal Materials* 91, 105–106; *CMS Gas Transmission Co v Argentine Republic* (2005) 44 *International Legal Materials* 1205, 1235; *Azurix Corp. v Argentine Republic* (Award) (2006) ICSID Case No. ARB/01/12, para. 360–361, 372, 392, 408.

⁶³ *Tecnicas Medioambientales Tecmed, SA v United Mexican States* (2004) 43 *International Legal Materials* 133, 173.

⁶⁴ *Azurix Corp. v Argentine Republic* (Award) (2006) ICSID Case No. ARB/01/12, para. 372.

⁶⁵ Marshall, above n 57; Van Harten, above n 57, 88–90; Miles, above n 16.

time of the original investment.⁶⁶ In this way, legitimate environmental regulation and decision-making can be exposed to allegations of violating the fair and equitable treatment standard. This possibility also points to future investor-state arbitration on the implementation of new climate change-related measures, alleging a failure to maintain a stable legal and business environment for established carbon-intensive investments.⁶⁷

3. *National Treatment*

Allegations of discrimination in violation of the national treatment standard are also a feature of investor-state challenges to environmental regulation.⁶⁸ Guarantees of national treatment within investment treaties accord foreign investors and their investments 'treatment no less favourable than that which the host state accords to its own investors'.⁶⁹

(a) *Like Circumstances*

The assessment of whether a host state has actually breached this standard first requires a consideration of whether or not the foreign and domestic investors and their investments are in 'like circumstances', as if they are not, differential treatment does not violate national treatment obligations.⁷⁰ As such, the determination on the question of 'like circumstances' is a central component in national treatment challenges to domestic measures. The criteria by which such assessments are made are, therefore, hugely significant for the outcome of determinations of 'like circumstances', a process which in itself involves the making of value judgements as to the appropriate comparators.⁷¹ And, on the whole, the chosen criteria have been limited to commercial considerations, framing the assessment in terms of the same business or economic

⁶⁶ Van Harten, above n 57, 93–94; Konrad von Moltke, *An International Investment Regime? Issues of Sustainability*, International Institute for Sustainable Development (2000) 50 <<http://www.iisd.org/pdf/investment.pdf>> at 6 September 2009; see also the discussion in Marie-Claire Cordonier Segger, 'From Protest to Proposal: Options for an Americas Investment Regime?' in Marie-Claire Cordonier Segger and Maria Lechner Reynal (eds), *Beyond the Barricades: The Americas Trade and Sustainable Development Agenda* (2005) 146, 155.

⁶⁷ The form such challenges might take is examined in Part II of this paper; see also Miles, above n 16; Marshall, above n 57.

⁶⁸ See for example *S.D. Myers, Inc v Canada*, Partial Award (Decision on the Merits), November 2000, (2001) 40 *International Legal Materials* 1408; *Ethyl Corporation v Canada*, Jurisdiction Phase, (1999) 38 *International Legal Materials* 708; *Metalclad Corporation v The United States of Mexico*, Award, 25 August 2000, (2001) 40 *International Legal Materials* 35.

⁶⁹ Dolzer and Schreuer, above n 12, 178.

⁷⁰ McLachlan, Shore and Weiniger, above n 12, 251; Dolzer and Schreuer, above n 12, 179–180.

⁷¹ Van Harten, above n 57, 82–85.

sector.⁷² This approach does not encompass social and environmental impacts as distinguishing factors, rendering domestic and foreign investors in 'like circumstances' if the sole difference is in their sustainability impacts. And, as such, a host state's attempt to differentiate through regulation or decision-making on these grounds so as to support sustainable development objectives would be at risk of challenge as a breach of national treatment obligations.⁷³

One recent award has broken with this traditional approach to the consideration of 'like circumstances' and adopted a more encouraging line of reasoning. The award in *Parkerings-Compagniet AS v Republic of Lithuania (Parkerings)* considered cultural heritage and environmental impacts as a component of the criteria for 'like circumstances'.⁷⁴ And, in so doing, held that the difference in the archaeological and environmental impacts between two otherwise very similar investment projects rendered them not in 'like circumstances'. As such, the local authority's decision to approve one project over the other on the grounds of archaeological preservation and environmental protection was not in violation of national treatment obligations.⁷⁵ If this approach were adopted in future environment-related investor-state disputes, the potential for national treatment requirements to constrain legitimate host state policy space would be significantly reduced.

(b) *Effects and Justification*

As with indirect expropriation, the focus in a national treatment claim will be on the effect of the domestic measure on the investment rather than the need for any intent to discriminate against

⁷² McLachlan, Shore and Weiniger, above n 12, 253; Werksman, Baumert and Dubash, above n 16, 75; Victor R Salgado, 'The Case Against Adopting BIT Law in the FTA Framework' (2006) *Wisconsin Law Review* 1025, 1061; Center for International Environmental Law, *Foreign Investment and Sustainable Development: Brief for the World Summit on Sustainable Development* (2002) <<http://www.ciel.org/Publications/investment.pdf>> at 6 September 2009.

⁷³ Werksman, Baumert and Dubash, above n 16, 75; Kate Miles, 'Sustainable Development, National Treatment and Like Circumstances in Investment Law' in Marie-Claire Cordonier Segger, Markus W Gehring and Andrew Newcombe (eds), *Sustainable Development in International Investment Law* (forthcoming); see also Aaron Cosbey et al, *Investment and Sustainable Development: A Guide to the Use and Potential of International Investment Agreements* (2004), 6, International Institute for Sustainable Development <http://www.iisd.org/pdf/2004/investment_invest_and_sd.pdf> at 15 October 2009; Howard Mann et al, *IISD Model International Agreement on Investment for Sustainable Development* (2nd ed) (2006) International Institute for Sustainable Development <http://www.iisd.org/pdf/2005/investment_model_int_handbook.pdf> at 15 October 2009.

⁷⁴ *Parkerings-Compagniet AS v Republic of Lithuania*, ICSID Arbitration Case No. ARB/05/8, Award, 11 September 2007, para. 375, 392 <<http://ita.law.uvic.ca/documents/Pakerings.pdf>> at 21 October 2008.

⁷⁵ *Ibid* para 51–52, 375.

the foreign investor.⁷⁶ This *de facto* form of discrimination is significant for the implementation of new environmental regulation. It means that regulation of general application can breach national treatment obligations if it affects a foreign investor to a greater degree than domestic investors.⁷⁷ Within the assessment of an alleged breach of national treatment, there is scope to consider whether there are any applicable 'rational grounds' on which the host state action can be justified.⁷⁸ However, arbitral practice is inconsistent and tribunals only refer to this aspect on occasion. It also remains unclear the grounds that would be sufficient to justify differential treatment.⁷⁹ The sparse jurisprudence that does exist suggests that the 'rational grounds' justification may not readily be relied upon to exempt environmental regulation. For example, the tribunal in *Pope & Talbot v Canada*, significantly limited the scope of the exception, providing that there must be:⁸⁰

a reasonable nexus to rational government policies that (1) do not distinguish, on their face or *de facto*, between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the investment liberalizing objectives of NAFTA.

And the tribunal in *S.D. Myers v Canada* was not swayed by the justification argument, even although the regulation was enacted to implement Canada's obligations under a multilateral environmental agreement.⁸¹ As such, if the current approach to its application continues, the 'rational grounds' justification is unlikely to provide much assistance to host states seeking to enact new environmental regulation that also impacts significantly on foreign-owned investments.

The central concern raised by the way in which investor protections are often applied is that they can constrain host states in the development of legitimate environmental protection policies and in the design of regulatory responses to environmental challenges, such as climate change. It is

⁷⁶ McLachlan, Shore and Weiniger, above n 12, 251; Dolzer and Schreuer, above n 12, 181; see for example, *S.D. Myers, Inc v Canada*, Partial Award (Decision on the Merits), November 2000, (2001) 40 *International Legal Materials* 1408.

⁷⁷ Van Harten, above n 57, 85–86; Miles, above n 73.

⁷⁸ Dolzer and Schreuer, above n 12, 181–183; McLachlan, Shore and Weiniger, above n 12, 251; see also the comments in *S.D. Myers, Inc v Canada*, Partial Award (Decision on the Merits), November 2000, (2001) 40 *International Legal Materials* 1408, para. 250.

⁷⁹ Dolzer and Schreuer, above n 12, 181–183.

⁸⁰ *Pope & Talbot v Canada*, Award on the Merits of Phase II, 10 April 2001, para. 78.

⁸¹ *S.D. Myers, Inc v Canada*, Partial Award (Decision on the Merits), November 2000, (2001) 40 *International Legal Materials* 1408. It was argued that the measure was made in compliance with the *Convention on the Control of Transboundary Movement of Hazardous Wastes and their Disposal*, opened for signature 22 March 1989, (1989) 28 ILM 657 (entered into force 1992) (Basel Convention).

clear that when new environmental measures are introduced that impact on foreign-owned investments, those measures are open to challenge under investment treaties.

B. *Engaging with Non-Investment Issues*

The mode of interaction between domestic environmental regulation and international investment law occurs within a wider context of engagement with non-investment issues. Traditionally, there has been very limited engagement with wider policy issues in the text of investment treaties or in investor-state disputes. For example, traditional bilateral investment treaties have not contained express references to environmental protection, human rights, or concepts such as sustainable development.⁸² They have not integrated principles from other areas of international law nor even referred to non-investment issues. They still do not incorporate non-investment principles into the substantive body of treaty texts. And there has been a notable failure to incorporate sustainability considerations into interpretations given to investor protections in arbitral awards.⁸³

There have, however, been some recent developments in investment treaties designed to introduce a level of engagement with non-investment issues. Although still limited in scope, these may point to the possibility of more substantial reforms in the future. ‘New generation BITs’,⁸⁴ have included express references to sustainable development, protection of the environment, and the health and safety of the public.⁸⁵ These developments have been driven by the experiences of Canada and the United States as Respondents under the North American Free

⁸² Andrew Newcombe, ‘Sustainable Development and Investment Treaty Law’ (2007) 8 *The Journal of World Investment & Trade* 357.

⁸³ See the discussion on the treatment of public interest issues in Barnali Choudhury, ‘Recapturing Public Power: Is Investment Arbitration’s Engagement of the Public Interest Contributing to the Democratic Deficit?’ (2008) 41 *Vanderbilt Journal of Transnational Law* 775, 788, 831–832.

⁸⁴ Wenhua Shan, ‘From “North–South Divide” to “Private–Public Debate”’: Revival of the Calvo Doctrine and the Changing Landscape in International Investment Law’ (2007) 27 *Northwestern Journal of International Law & Business* 631, 652, 656.

⁸⁵ *Ibid*; Newcombe, above n 82, 399; see for example the United States–Uruguay BIT, *Treaty between the United States of America and the Oriental Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment* (2005) <http://www.unctad.org/sections/dite/ia/docs/bits/US_Uruguay.pdf> at 15 March 2009; see also the Canada–Peru BIT, *Agreement between Canada and the Republic of Peru for the Promotion and Protection of Investments* (2006) <<http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/Canada-Peru10nov06-en.pdf>> at 4 October 2009.

Trade Agreement (NAFTA).⁸⁶ Both these states have had investor claims filed against them, challenging public welfare regulation,⁸⁷ and this experience has led them to revisit their approach to bilateral investment treaties.⁸⁸ Even so, despite these moves to refer to wider issues and other areas of international law in the preambles of new generation BITs, the interaction between investment law and non-investment issues still remains a contentious relationship. And in the context of climate change, the way in which investor-state tribunals have approached competing international obligations and the use of principles from other areas of international law is particularly significant.

1. *Host State International Environmental Obligations*

Several investor-state awards have had reason to refer to aspects of public international law beyond the investment treaty in question.⁸⁹ Although some tribunals have expressly emphasised that investment treaties fall within the wider international law framework,⁹⁰ they have also, on the whole, been very selective in the particular rules that have been considered, effectively ‘cherry-picking’ some rules and discounting others.⁹¹ Conflicting host state obligations under

⁸⁶ North American Free Trade Agreement (NAFTA) (1992) 32 *International Legal Materials* 612; Van Harten, above n 57, 146; Philippe Sands, *Lawless World: America and the Making and Breaking of Global Rules* (2003) 121–122, 139–141.

⁸⁷ Notable examples include *Methanex Corporation v United States of America*, (2005) 44 *International Legal Materials* 1345; *S.D. Myers, Inc v Canada*, Partial Award (Decision on the Merits), November 2000; *Ethyl Corporation v Canada*, Jurisdiction Phase, (1999) 38 *International Legal Materials* 708.

⁸⁸ Shan, above n 84, 650–653; James McIlroy, ‘Canada’s New Foreign Investment Protection and Promotion Agreement: Two Steps Forward, One Step back?’ (2004) 5 *The Journal of World Investment & Trade* 621, 646; Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (2009) 61.

⁸⁹ See for example, *Marvin Roy Feldman Karpa v United Mexican States* (2001) 40 *International Legal Materials* 615; *Pope & Talbot Inc v Canada* (2002) 41 *International Legal Materials* 1347; *MTD Equity Sdn Bhd v Chile* (Decision on Annulment) (2007) ICSID Case No. ARB/01/7; *Compañía del Desarrollo de Santa Elena, S A v The Republic of Costa Rica*, (2000) 39 *International Legal Materials* 1317; *CMS Gas Transmission Co v Argentina* (Award) (2005) 44 *International Legal Materials* 1205; *LG&E Energy Corp v Argentina* (Award) (2006) ICSID Case No. ARB/02/1; *CMS Gas Transmission Co v Argentina* (Decision on Annulment) (2007) ICSID Case No. ARB/01/8.

⁹⁰ See for example, *Asian Agricultural Products Ltd v Republic of Sri Lanka* (1990) 4 ICSID Rep 245, 257: ... [a BIT] is not a self-contained closed legal system limited to provide for substantive material rules of direct applicability, but it has to be envisaged within a wider juridical context in which rules from other sources are integrated through implied incorporation methods, or by direct reference to certain supplementary rules, whether of international law character or of domestic law nature.

See also *MTD Equity Sdn Bhd v Chile* (Decision on Annulment) (2007) ICSID Case No. ARB/01/7:

... the Tribunal had to apply international law as a whole to the claim, and not the provisions of the BIT in isolation.

⁹¹ See for example the treatment given to international environmental principles in *Compañía del Desarrollo de Santa Elena, S A v The Republic of Costa Rica*, (2000) 39 *International Legal Materials* 1317 and in *S.D. Myers, Inc v Canada*, Jurisdiction Phase (1999) 38 *International Legal Materials* 708.

non-investment treaties do not fair well in their treatment by arbitrators in investor-state disputes. Despite the lack of a formal hierarchy as amongst treaties to which a state has consented, the obligations under international investment agreements are effectively given priority by arbitral tribunals in investment disputes. Two cases, in particular, illustrate this approach in the context of obligations under international environmental agreements, *Compañía del Desarrollo de Santa Elena, S.A. v The Republic of Costa Rica (Santa Elena)*⁹² and *S.D. Myers, Inc v Canada (S.D. Myers)*.⁹³

(a) *Santa Elena*

In *Santa Elena*, Costa Rica raised the argument that its international environmental obligations ought to have a bearing on the methodology used for calculating the compensation due to the investor following an expropriation of property.⁹⁴ Costa Rica argued⁹⁵ that as the property constituted a unique ecological site, it was under an obligation to preserve the area pursuant to several international environmental agreements, including the Convention Concerning the Protection of the World Natural and Cultural Heritage,⁹⁶ the Ramsar Convention on Wetlands of International Importance especially as Waterfowl Habitat,⁹⁷ the Convention on Biological Diversity,⁹⁸ and the Central American Regional Convention for the Management and Conservation of Natural Forest Ecosystems. And, as such, Costa Rica reasoned, the methodology for determining compensation should take the environmental objective of the expropriation into account and adopt an ‘appropriate’ valuation as opposed to the ‘full

⁹² *Compañía del Desarrollo de Santa Elena, S.A. v The Republic of Costa Rica* (2000) 39 *International Legal Materials* 1317.

⁹³ *S.D. Myers, Inc v Canada*, Partial Award (Decision on the Merits) (2001) 40 *International Legal Materials* 1408.

⁹⁴ *Compañía del Desarrollo de Santa Elena, S.A. v Costa Rica* (2000) 39 *International Legal Materials* 1317, 1323.

⁹⁵ In its Counter Memorial (not publicly available on ICSID’s website), an account of which is set out in Todd Weiler, *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (2005) 763–764.

⁹⁶ *Convention for the Protection of the World Cultural and Natural Heritage*, opened for signature 16 November 1972, (1972) 11 ILM 1358 (entered into force 17 December 1975).

⁹⁷ *Ramsar Convention on Wetlands of International Importance especially as Waterfowl Habitat*, opened for signature 2 February 1971, 996 UNTS 245 (entered into force 21 December 1975).

⁹⁸ *United Nations Convention on Biological Diversity*, opened for signature 5 June 1992, 31 ILM 822 (entered into force 29 December 1993).

compensation’ at a ‘market’ valuation sought by the investor.⁹⁹ The Tribunal, however, stated that:¹⁰⁰

While an expropriation or taking for environmental reasons may be classified as a taking for a public purpose, and thus may be legitimate, the fact that the Property was taken for this reason does not affect either the nature or the measure of the compensation to be paid for the taking. That is, the purpose of protecting the environment for which the Property was taken does not alter the legal character of the taking for which adequate compensation must be paid. The international source of the obligation to protect the environment makes no difference.

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

As such, in ascertaining the amount of compensation due to the investor, the tribunal did not give any weight to Costa Rica’s competing international environmental obligations, did not modify the application of the investment obligations, nor contextualise the investment principles. In prioritising investment rules in this way, the tribunal deprived those non-investment obligations of meaningful effect.¹⁰¹

(b) *S.D. Myers*

In *S. D. Myers*, Canada also pointed to its international environmental obligations in seeking to justify the introduction of a new measure prohibiting the export of a hazardous chemical product, polychlorinated biphenyl (PCBs).¹⁰² Canada argued that the measure was made in compliance with the *Convention on the Control of Transboundary Movement of Hazardous Wastes and their Disposal* (Basel Convention).¹⁰³ Despite Canada being a party to the Basel Convention, however, the tribunal found that there was ‘no legitimate environmental reason for introducing the ban’.¹⁰⁴ The tribunal went on to state that even where there are genuine environmental protection concerns, if there is a variety of methods through which those environmental

⁹⁹ *Compañía del Desarrollo de Santa Elena, S.A. v Costa Rica* (2000) 39 *International Legal Materials* 1317, 1322–1323.

¹⁰⁰ *Ibid* 1329.

¹⁰¹ See the discussion in Sands, above n 25, 204.

¹⁰² *S.D. Myers, Inc v Canada*, Partial Award (Decision on the Merits) (2001) 40 *International Legal Materials* 1408; *Interim Order Respecting the PCB Waste Export Production Regulations* (Canada, 20 November 1995). This Interim Order was converted into a Final Order on 26 February 1996.

¹⁰³ *Convention on the Control of Transboundary Movement of Hazardous Wastes and their Disposal*, opened for signature 22 March 1989, (1989) 28 *ILM* 657 (entered into force 5 May 1992).

¹⁰⁴ *S.D. Myers, Inc v Canada*, Partial Award (Decision on the Merits) (2001) 40 *International Legal Materials* 1408, 1428.

objectives can be achieved, host states must implement those measures in a manner that is ‘most consistent with open trade’¹⁰⁵ — and in adopting a blanket prohibition on the export of PCB waste products, Canada had not met this requirement.¹⁰⁶

Again, although the host state’s international obligations under a multilateral environmental agreement were briefly acknowledged by the investment arbitral tribunal, they were also then treated dismissively. The tribunals in both *Santa Elena* and *S.D. Myers* refer to the existence of environmental obligations but then render those obligations ineffectual through the unmodified prioritising of investment protection guarantees. This approach reflects the general reluctance of arbitral tribunals in investor-state disputes to contextualise investor rights, interpret them against a background of non-investment obligations, or integrate principles from international environmental law into investment treaties.¹⁰⁷

2. *Human Rights Jurisprudence*

Awards in investor-state arbitration have certainly referred to human rights jurisprudence.¹⁰⁸ However, the interesting aspect is the way in which investor-state arbitral tribunals have utilised principles from international human rights law — not, as might be expected, to alleviate the impacts of investor activities on affected local communities within host states, but to bolster investor claims.¹⁰⁹ In particular, tribunals have looked to the extensive body of jurisprudence generated in the European Court of Human Rights and the Inter-American Court of Human Rights regarding an individual’s right to private property and the right to peaceful enjoyment of possessions to frame investors’ claims as violations of human rights.¹¹⁰

¹⁰⁵ Ibid 1431.

¹⁰⁶ Ibid 1437.

¹⁰⁷ Campbell McLachlan, ‘Investment Treaties and General International Law’ (2008) 57 *International and Comparative Law Quarterly* 361, 376 August Reinisch, “‘Investment and ...’ — The Broader Picture of Investment Law’ in August Reinisch and Christina Knahr (eds), *International Investment Law in Context* (2008) 201, 201–202.

¹⁰⁸ See for example *In the Matter of a UNCITRAL Arbitration between Ronald S Lauder v the Czech Republic*, Final Award, 3 September 2001; *Tecnicas Medioambientales Tecmed, SA v United Mexican States* (2004) 43 *International Legal Materials* 133; *Azurix Corp. v Republic of Argentina* (Award) (2006) ICSID Case No. ARB/01/12..

¹⁰⁹ Luke Eric Peterson, *Human Rights and Bilateral Investment Treaties: Mapping the Role of Human Rights Law within Investor-State Arbitration*, International Centre for Human Rights and Democratic Development, 23–26, (2009) <http://www.dd-rd.ca/site/_PDF/publications/globalization/HIRA-volume3-ENG.pdf> at 2 October 2009.

¹¹⁰ See for example *In the Matter of a UNCITRAL Arbitration between Ronald S Lauder v the Czech Republic*, Final Award, 3 September 2001; *Tecnicas Medioambientales Tecmed, SA v United Mexican States* (2004) 43

Engagement of this kind with human rights principles is illustrated by, for example, the tribunals in *Ronald S Lauder v the Czech Republic*¹¹¹ and *Tecnicas Medioambientales Tecmed, SA v United Mexican States (Tecmed)*.¹¹² Case law from both the Inter-American Court of Human Rights and the European Court of Human Rights was used in these cases to determine the scope of obligations owed under bilateral investment treaties regarding expropriation.¹¹³ Framing investor claims as human rights claims was also given extensive treatment in the separate opinion of Wälde in *International Thunderbird Gaming Corp v United Mexican States*.¹¹⁴ Wälde gives the impression that the investor-state relationship is akin to ‘David and Goliath’, characterising it as one of innate inequality. And, as such, he argues, the rationale for investor-state arbitration is analogous to that of judicial review functions seen in the European Court of Human Rights, European Court of Justice, or Inter-American Human Rights Court — to protect the rights of the individual:¹¹⁵

International commercial arbitration assumes roughly equal parties engaging in sophisticated transnational commercial transactions. Investment arbitration is fundamentally different from international commercial arbitration. It governs the situation of a foreign investor exposed to the sovereignty, the regulatory, administrative and other governmental powers of a state. The investor is frequently, if not mostly, in a position of structural weakness, exacerbated often by inexperience (in particular in the case of smaller, entrepreneurial investors). Investment arbitration does not therefore set up a system of resolving disputes between presumed equals as in commercial arbitration, but a system of protection of foreign investors that are, by exposure to political risk, lack of familiarity with and integration into, an alien political, social, cultural, commercial, institutional and legal system, at a disadvantage.

... more appropriate for investor-state arbitration are analogies with judicial review relating to governmental conduct — be it international judicial review (as carried out by WTO dispute

International Legal Materials 133; *Azurix Corp. v Republic of Argentina* (Award) (2006) ICSID Case No. ARB/01/12. For example, these awards have referred to, amongst others, *Mellacher v Austria* (1989) 169 European Court of Human Rights (ser. A); *Matos e Silva, Lda v Portugal* 1996–IV European Court of Human Rights; *Baruch Ivcher Bronstein v Peru* (2001) Inter-American Court of Human Rights (ser. C) No. 74; *James v United Kingdom* (1986) 98 European Court of Human Rights (ser. A).

¹¹¹ *In the Matter of a UNCITRAL Arbitration between Ronald S Lauder v the Czech Republic*, Final Award, 3 September 2001.

¹¹² *Tecnicas Medioambientales Tecmed, SA v United Mexican States* (2004) 43 *International Legal Materials* 133.

¹¹³ *In the Matter of a UNCITRAL Arbitration between Ronald S Lauder v the Czech Republic*, Final Award, 3 September 2001; *Tecnicas Medioambientales Tecmed, SA v United Mexican States* (2004) 43 *International Legal Materials* 133, 162–163. These awards referred to *Mellacher v Austria* (1989) 169 European Court of Human Rights (ser. A); *Baruch Ivcher Bronstein v Peru* (2001) Inter-American Court of Human Rights (ser. C) No. 74; *James v United Kingdom* (1986) 98 European Court of Human Rights (ser. A); see also the discussion in Peterson, above n 109, 23.

¹¹⁴ *In the Matter of a NAFTA Arbitration under UNCITRAL Arbitration Rules between International Thunderbird Gaming Corp v United Mexican States*, Award, 26 January 2006 <<http://ita.law.uvic.ca/documents/ThunderbirdSeparateOpinion.pdf>> at 27 October 2009.

¹¹⁵ *Ibid* para. 12–13.

panels and Appellate Body, by the European– or Inter-American Human Rights Courts, or European Court of Justice) or national administrative courts judging the disputes of individual citizens over alleged abuse by public bodies of their governmental powers.

On this basis, Wälde draws on human rights principles, importing jurisprudence from the European Court of Justice and the European Court of Human Rights into the investment treaty standard of fair and equitable treatment.¹¹⁶ He argues that within the human rights context, ‘legitimate expectation’ is a fundamental principle governing relations between the individual and the state, and that, as such, it is appropriate to incorporate this concept into the investment treaty standard of fair and equitable treatment.¹¹⁷ In this way, through the appropriation of the language and principles of human rights, Wälde elevates the commercial grievance of an investor to a fundamental human right.

In the course of his enquiry, Wälde also traverses a wide array of non-investment sources of law to bolster his claim to the existence of a general principle of legitimate expectation, conflating ‘legitimate expectation’ with the substantive international law principle of ‘good faith’ and the treaty interpretation principle set out in Article 31 of the Vienna Convention on the Law of Treaties.¹¹⁸ In addition to human rights jurisprudence, he also refers to comparative contract law, a variety of domestic administrative law systems, and jurisprudence from the World Trade Organisation.¹¹⁹ Wälde clearly approaches investment treaties as embedded within general international law and was comfortable using non-investment principles to construct a particular reading of guaranteed investor protections. However, this was for the purpose of supporting foreign investment protection. It is troubling that the same willingness to import principles from other areas of international law has not been prevalent in arbitral awards when the issue is the constraining of investor activity in accordance with international environmental or human rights

¹¹⁶ Ibid para. 27.

¹¹⁷ Ibid; see also the discussion in James D Fry, ‘International Human Rights Law in Investment Arbitration: Evidence of International Law’s Unity’ (2007) 17 *Duke Journal of Comparative & International Law* 77, 83–89. Fry makes the error of answering the critique that investment awards do not adequately address human rights concerns by discussing awards that frame investor claims in terms of human rights violations, and, in so doing, conflates the human rights of investors with those of local communities within host states.

¹¹⁸ *Vienna Convention on the Law of Treaties*, opened for signature 23 May 1969, 1155 UNTS 331, art. 31 (entered into force 27 January 1980); *In the Matter of a NAFTA Arbitration under UNCITRAL Arbitration Rules between International Thunderbird Gaming Corp v United Mexican States*, Award, 26 January 2006, para. 25, <<http://ita.law.uvic.ca/documents/ThunderbirdSeparateOpinion.pdf>> at 20 October 2009.

¹¹⁹ *In the Matter of a NAFTA Arbitration under UNCITRAL Arbitration Rules between International Thunderbird Gaming Corp v United Mexican States*, Award, 26 January 2006, para. 27–30, <<http://ita.law.uvic.ca/documents/ThunderbirdSeparateOpinion.pdf>> at 20 October 2009.

law. This selectivity in the methodology of interpretation in investor-state arbitration reflects a predilection for investor-friendly constructions of treaty obligations. It also suggests, of course, that investors in eco-technology or environment-friendly projects can expect the import of supportive principles from other areas of international law to assist with claims of investment treaty violation, while at the same time incidentally benefiting environmental protection objectives.

II. CLIMATE CHANGE IN INVESTOR-STATE ARBITRATION

Climate change has different implications for separate categories of investors — opportunity, on the one hand, for those investing in low carbon technology and renewable energy projects; restrictions and cost, on the other, for investors in carbon-intensive industries. International investment law protects both sets of investors. As such, climate change issues will almost certainly appear in investor-state arbitration in one form or another. Within that framework, the focus for this paper is on the potential barriers posed by investor protections to the implementation of new climate change-related regulation and asks the question: what do the recent investor challenges to environmental regulation mean for future climate change mitigation measures? In essence, this paper takes the view that it is inevitable that, at some point, climate change-related regulation will feature in investor-state disputes.

A. *Operating in a Carbon-Constrained Economy*

Climate change mitigation strategies are centred on the reduction of carbon emissions at the national level. The United Nations Framework Convention on Climate Change (UNFCCC)¹²⁰ and its Kyoto Protocol¹²¹ establish the international legal regime to govern that process. The Kyoto Protocol provides the specifics of the system, setting out quantified emissions reduction targets in Annex B for Annex I parties to the UNFCCC. It obligates Annex I parties (designated developing states) to ensure that their carbon emissions do not exceed their assigned amounts.¹²² A variety of methods are envisaged to facilitate the reduction of carbon emissions, some of

¹²⁰ *United Nations Framework Convention on Climate Change*, opened for signature 9 May 1992, 31 ILM 849 (entered into force 24 March 1994). See the discussion on the international climate change regime in Philippe Sands, *Principles of International Environmental Law* (2nd ed., 2003) 357–381.

¹²¹ *Kyoto Protocol to the United Nations Framework Convention on Climate Change*, opened for signature 11 December 1997, (1998) 37 ILM 22 (entered into force 16 February 2005).

¹²² *Ibid* art 3.

which focus on the promotion of renewable energy projects and investment in low-carbon technology, others of which embody the imposition of more stringent restrictions on carbon-intensive activities.¹²³

New domestic regulatory conditions to advance the reduction of carbon emissions may take the form of prohibitions on the use of certain products or constrain particular activities. States may adopt mandatory energy efficiency standards on production processes.¹²⁴ The new carbon-constrained environment will certainly involve the withdrawal of rights presently held by sectors of the economy and individual facilities to emit carbon at current levels.¹²⁵ It may also include an emissions trading scheme with free permit allocations to particular sectors or operations, and it may introduce mandatory quotas to source electricity from renewable energy generators.¹²⁶ States may change tax structures, exemptions, and subsidies in fundamental ways, and may instead provide incentives to invest in renewable energy.¹²⁷ They may also adopt new measures to support CDM projects under the Kyoto Protocol.¹²⁸

Domestic emissions-reduction responses that adopt a number of these strategies will dramatically alter the legal and business environment in which carbon-intensive facilities will be required to operate. And they will certainly impose greater costs on individual operators and particular sectors of the economy.¹²⁹ The concern is that such measures, and their method of implementation, may be challenged by foreign investors, framing new climate change-related regulation as indirect expropriation, a violation of national treatment requirements, and a breach

¹²³ Ibid art 2; Green, above n 7, 148–149.

¹²⁴ Green, above n 7, 148–149.

¹²⁵ Herbert Posser and Stefan Altenschmidt, ‘European Union Emissions Trading Directive’ (2005) 23:1 *Journal of Energy and Natural Resources* 60, 67–68.

¹²⁶ Green, above n 7, 148–151.

¹²⁷ Bradford S Gentry and Jennifer Ronk, ‘International Investment Agreements and Investments in Renewable Energy’ in Leslie Parker, Jennifer Ronk, Bradford Gentry et al, *From Barriers to Opportunities: Renewable Energy Issues in Law and Policy* (2007) 25, 59–64.

¹²⁸ Jacob Werksman and Claudia Santoro, ‘Investing in Sustainable Development: The Potential Interaction between the Kyoto Protocol and the Multilateral Agreement on Investment’ in W Bradnee Chambers, *Inter-Linkages: The Kyoto Protocol and the International Trade and Investment Regimes* (2001) 191, 204; *Kyoto Protocol to the United Nations Framework Convention on Climate Change*, opened for signature 11 December 1997, (1998) 37 ILM 22, art 2, 6 and 17 (entered into force 16 February 2005).

¹²⁹ Green, above n 7, 143–144; Nicolas Stern, *The Economics of Climate Change: The Stern Review* (2007).

of the fair and equitable treatment standard.¹³⁰ The implications of investor challenges of this nature are extensive. They have the potential to frustrate climate change mitigation initiatives, to constrain governments in their decision-making on climate change law and policy, and to hinder the development of more sustainable energy sources.

B. *Compensation Demands*

Compensation demands and claims of discriminatory treatment have already emerged on the introduction of climate change-related regulation. For example, following the introduction of the European Emissions Trading Scheme (EETS),¹³¹ court action was taken by a major steel manufacturer, Arcelor, alleging discrimination in the design of the EETS as between the steel sector and other comparable industries.¹³² Compensation demands and exemption requests from established carbon-intensive facilities are also intensifying in the lead-up to the introduction of an emissions trading scheme in Australia (AETS).¹³³ This section considers the implications of these developments for future investor-state disputes.

1. *Arcelor and the European Emissions Trading Scheme*

Prior to the introduction of the EETS, Arcelor had operated under conditions in which its carbon emissions were virtually unrestricted. The constraints imposed by the EETS amounted to a significant shift in the legal and financial conditions under which the investments in the company

¹³⁰ Werksman, Baumert and Dubash, above n 16, 75–77; Miles, above n 16; Werksman and Santoro, above n 128, 204; Gentry and Ronk, above n 127, 65–70; Brown, above n 10, 372–373, 380–381; Marshall and Murphy, above n 17; see also Stephan W Schill, ‘Do Investment Treaties Chill Unilateral State Regulation to Mitigate Climate Change?’ (2007) 24:5 *Journal of International Arbitration* 469, 371. Schill considers that investment treaties are unlikely to preclude the introduction of climate change mitigation measures as long as they comply with investor protection guarantees.

¹³¹ Council Directive 2003/87/EC, Establishing a Scheme for Greenhouse Gas Emission Allowance Trading with the Community and Amending Council Directive 96/61/EC, 2003 O.J. (L 275) 32.

¹³² *Arcelor S.A. v European Parliament and Council* (2004) Case T-16/04; Belgian Arbitration Court, Arrest No. 92/2006, 7 June 2007; French Council of State, Arrest No. 287110, 8 February 2007; see the discussion in Anatole Boute, ‘Combating Climate Change and Securing Electricity Supply: The Role of Investment Protection Law’ (2007) 16 *European Environmental Law Review* 227, 231–233.

¹³³ Australian Associated Press, ‘Coal Industry Presses for More ETS Compo’, *Sydney Morning Herald*, 20 October 2009, <<http://news.smh.com.au/breaking-news-business/coal-industry-presses-for-more-ets-compo-20091020-h656.html>> at 9 November 2009; Sid Maher, ‘Mining Boss Lashes Rudd Over ETS’, *The Australian*, 9 November 2009, <<http://www.theaustralian.com.au/news/nation/mining-boss-lashes-rudd-over-ets/story-e6frg6nf-1225795565585>> at 10 November 2009; Marian Wilkinson and Flint Duxfield, ‘Revealed: Polluters’ Fear Tactics on Climate’, *Sydney Morning Herald*, 6 November 2009, <<http://www.smh.com.au/environment/climate-change/revealed-polluters-fear-tactics-on-climate-20091105-i091.html>> at 9 November 2009.

had originally been made.¹³⁴ As such, Arcelor objected to its inclusion within the EETS in circumstances where other comparable sectors, such as the aluminium, chemical, and plastics industries, were not subject to similar restrictions. It argued that its emissions allocation amounted to discriminatory treatment of its operations as compared to other competing sectors.¹³⁵

The European Court of Justice handed down its decision in December 2008 upholding the EETS and supporting its incremental approach of including some sectors, but not others.¹³⁶ As Boute had commented earlier, it would have been politically difficult for the European Court of Justice to have ruled in any other way.¹³⁷ However, the reasoning adopted by the Court is of interest in its implications for investor-state disputes. The Court held that the various industrial sectors were comparable sources of carbon emissions on the grounds that all emissions contribute to dangerous interference with the global climate system and all economic sectors could potentially participate in an ETS.¹³⁸ The Court then determined that the EETS was subjecting comparable sectors to differential treatment through its application to the steel industry without the inclusion of the chemical and aluminium sectors.¹³⁹ The differential treatment was, however, justified because of the novelty and complexity of the scheme, which meant that a 'step-by-step' approach to its introduction was appropriate. Furthermore, the exclusion of the chemical sector was appropriate because the large number of installations would have made the scheme difficult to administer. The different levels of carbon emissions between the non-ferrous metal sector and the steel industry also meant that the differential treatment could be justified.¹⁴⁰

¹³⁴ Boute, above n 132, 231.

¹³⁵ *Arcelor S.A. v European Parliament and Council* (2004) Case T-16/04; Belgian Arbitration Court, Arrest No. 92/2006, 7 June 2007; French Council of State, Arrest No. 287110, 8 February 2007.

¹³⁶ *Société Arcelor Atlantique et Lorraine and others v Premier Ministre, Ministre de l'Économie, des Finances et de l'Industrie, Ministre de l'Écologie et du Développement Durable*, Case C-127/07, *Official Journal of the European Union*, 26/5/2007, C117/8; Judgment of the Court of Justice, 16 December 2008.

¹³⁷ Boute, above n 132, 232.

¹³⁸ *Société Arcelor Atlantique et Lorraine and others v Premier Ministre, Ministre de l'Économie, des Finances et de l'Industrie, Ministre de l'Écologie et du Développement Durable*, Case C-127/07, *Official Journal of the European Union*, 26/5/2007, C117/8; Judgment of the Court of Justice, 16 December 2008.

¹³⁹ *Ibid*; see also the discussion in J.A.W van Zeben, 'The European Emissions Trading Scheme Case Law' (2009) *Amsterdam Center for Law & Economics Working Paper No. 2009-12*, <<http://ssrn.com/abstract=1462651>> at 4 November 2009.

¹⁴⁰ *Société Arcelor Atlantique et Lorraine and others v Premier Ministre, Ministre de l'Économie, des Finances et de l'Industrie, Ministre de l'Écologie et du Développement Durable*, Case C-127/07, *Official Journal of the European Union*, 26/5/2007, C117/8; Judgment of the Court of Justice, 16 December 2008.

The Court did not refer to the underlying objectives of the climate change mitigation measures embodied within the EETS in justifying the differential treatment. Rather, it was the functional requirements of the scheme that rendered the discrimination permissible. In much the same way, a central aspect in an investor-state complaint is often not the policy behind the regulation, but in the detail of its form, implementation, or effect. As such, it is unlikely that an investor will challenge the rationale behind carbon emissions reductions measures, but their application to particular facilities. The Court's reasoning is helpful for investors in that it establishes a *prima facie* comparability between carbon emitters. Whether or not foreign investor claims of discriminatory treatment or breaches of fair and equitable treatment obligations are successful will turn on questions of the method of application of new schemes, the effects of the measures on the investment, the legitimate expectations of the investor, and the interpretation of requirements to maintain a stable legal and business environment. The outcome will largely depend on the line of reasoning adopted by tribunals in the future. If the *Methanex* and *Saluka* approach is followed, climate change-related regulation will most likely be beyond the reach of investment treaties. If, on the other hand, the *Santa Elena*, *Metalclad*, *Tecmed*, and *Azurix* reasoning is preferred, the outcome is less certain.

2. *Compensation: The Australian Emissions Trading Scheme*

There will, of course, be no difficulties in the interaction between international investment law and domestic climate change initiatives if compensation is paid to affected carbon-intensive facilities. The issue of compensation for the energy sector is already the subject of intense scrutiny and has resulted in industry lobbying for ever-increasing forms of compensation and for less-restrictive legislation.¹⁴¹ There is also ample scope for allegations of violations of investment treaties in the implementation of new regulatory systems, such as an ETS, and in the decision-making processes on compensation. In a cap-and-trade system, for example, allocations to one facility reduce the pool available to other operations, including competitors, and, as such, the decisions taken on permit distribution will impact substantially on business and industry

¹⁴¹ Wilkinson and Duxfield, above n 133; Dallas Burtraw and Karen Palmer, *Compensation Rules for Climate Policy in the Electricity Sector*, Resources for the Future (2007) SSRN, <<http://ssrn.com/abstract=1005680>> at 3 October 2009; Lisa Murray, 'Companies Brace for the Low-Carb Economy', *The Sydney Morning Herald*, 21 June 2008, 41; see also the discussion in Marjan Peeters, Stefan Weishaar and Javier de Cendra de Larragan, 'EU ETS: A Governance Perspective on the Choice between "Cap and Trade" and "Credit and Trade" for an Emissions Trading Regime' (2007) 16:7 *European Environmental Law Review* 191; WWF-Australia, 'No Compensation for Electricity Generators under ETS', *WWF-Australia*, 2 July 2008, <<http://www.wwf.org.au/news/no-compensation-for-electricity-generators-under-ets/>> at 8 November 2009.

costs and value.¹⁴² Within the Australian context, particular sectors and individual corporations have engaged in substantial lobbying to frame their own positions as ‘emissions-intensive’ or ‘trade-exposed’ so as to receive higher emissions allocations in the distribution process.¹⁴³ The allocation process itself means that ‘the Government will inevitably be forced to favour some companies and sectors over others.’¹⁴⁴ The prospect of difficult governmental decisions points to the potential for foreign investor claims alleging less favourable treatment than their domestic competitors.¹⁴⁵

Australia has chosen to throw money at the problem. In so doing, it acknowledges the substantial additional costs its proposed AETS will place on carbon-intensive industries and has opted to provide compensation funds and free emission permits to those facilities qualifying as ‘carbon-intensive’ and ‘trade-exposed’.¹⁴⁶ It does send a signal, however, that compensable takings have been generated by the regulatory changes. And, despite the already extensive compensation measures, the calls continue from industry to lift the level of available compensation again and to exclude a raft of sectors from emissions restrictions altogether.¹⁴⁷ This approach to compensation has attracted criticism from Ross Garnaut, the Australian government’s former climate change advisor, for its potential to discriminate amongst operators. He argues that the payment of compensation and free permit allocations are protectionist, potentially breach international trade rules, and could lead Australia into a trade war.¹⁴⁸ Future investor-state disputes over climate change-related measures are unlikely to be framed in such dramatic terms. It is entirely possible that these will instead take on a form more like the

¹⁴² Burtraw and Palmer, above n 141, 1, 3; Murray, above n 141.

¹⁴³ See the discussion in Murray, above n 141; see also Wilkinson and Duxfield, above n 133.

¹⁴⁴ Murray, above n 141.

¹⁴⁵ Brown, above n 10, 372–373, 380–381; see also for a discussion of potential investor claims in respect of electricity restructuring in Canada ‘International Legal Expert says Ontario’s Electricity Program Violates NAFTA’, *Canada Newswire*, 14 February 2005, IATP, Trade Observatory <<http://www.iatp.org/tradeobservatory/headlines.cfm?refID=48594>> at 23 June 2008; see also the website of Appleton & Associates describing the firm’s areas of expertise as including investor-state arbitration, international investment law, and international environmental agreements such as the Kyoto Protocol, and stating specifically that ‘we provide advice on the unique challenges associated with the issuance and trading of Greenhouse Gas Emission credits’ <<http://www.appletonlaw.com/index.htm>> at 23 October 2009.

¹⁴⁶ *Carbon Pollution Reduction Scheme* (Cth).

¹⁴⁷ Jennifer Macey, ‘Investors Demand End to Emissions Trading Handouts’, *Australian Broadcasting Corporation News*, 22 October 2009, <www.abc.net.au/news/stories/2009/10/22/2720964.htm> at 8 November 2009.

¹⁴⁸ Tom Arup, ‘Coal Funding Under Fire’, *Sydney Morning Herald*, 15 September 2009, <<http://www.smh.com.au/environment/coal-funding-under-fire-20090914-fny0.html>> at 9 November 2009.

planning disputes already regularly filed in domestic courts and tribunals where the issues involve restrictions initiated by the changing climate, such as permits for carbon emissions, water use restrictions, or coastal development prohibitions.¹⁴⁹ Indeed, it is likely that versions of the *Vattenfall AB V Federal Republic of Germany (Vattenfall)* dispute over the failure to issue emissions and water use permits for the operation of a coal-fired power plant will occur in which climate change effects are expressly cited.¹⁵⁰ This very issue was recently raised in the European Parliament, questioning the implications of the *Vattenfall* dispute for climate protection measures implemented under European law.¹⁵¹

Investors have not yet invoked bilateral investment treaties in relation to the imposition of new climate change mitigation measures. At this stage, it appears that where new legislation has been enacted, it has not yet reached a level of impact on foreign-owned investments to invoke claims or that compensation is being paid on the introduction of new regulation. It is likely, however, that once compensation funds are not flowing so freely, permit allocations become tighter, and developing states begin to implement new climate change measures, investor challenges to new regulation will occur. And in the long term, it is highly probable that climate change will become a regular feature in investor-state disputes over development applications, activity prohibitions, and permit denials, in much the same way as it has already done so in domestic planning cases.

III. CONCLUSION

Climate change is already a part of national, regional, and international dispute resolution frameworks. It is also highly likely that arbitrating climate change within the investor-state context will occur in the near future. International investment law protects investors, and, as such, it will engage with climate change issues in various forms, reflecting the numerous ways in which the activities of investors also interact with climate change. The incidental effects of that

¹⁴⁹ See for example, *Northcape Properties Pty Ltd v District Council of Yorke Peninsula* [2008] SASC 57; *Gippsland Coastal Board v South Gippsland Shire Council (No 2)* [2008] VCAT 1545; *Gray v Minister for Planning* (2006) 152 LGERA 258 regarding a coal mine proposal.

¹⁵⁰ *Vattenfall AB V Federal Republic of Germany*, Request for Arbitration, 30 March 2009.

¹⁵¹ Rebecca Harms (Verts/Hale) to the Commission, 'Written Question: Investment Protection Proceedings Brought by Vattenfall AB Against the Federal Republic of Germany', *Parliamentary Questions*, 17 September 2009, <<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+WQ+E-2009-4343+0+DOC+XML+V0//EN>> at 9 November 2009.

interaction will, at times, frustrate climate change mitigation objectives, and, on other occasions, it will protect investors in low-carbon technology and renewable energy projects.

The primary concern of this paper has been to explore the potential problems that still exist within the application of investor protection guarantees to environmental protection measures and their implications for host state climate change mitigation measures. This issue implicates the expansive interpretations adopted in investment jurisprudence, the generally problematic approach to engagement with non-investment issues, and the integration of principles from other areas of international law. While there are indications of more balanced approaches developing, such as seen in the *Methanex* and *Parkerings* awards and in the drafting of 'new generation BITs', the jurisprudential trends discussed in this paper also point to continued problems for environmental matters in investor-state disputes — and this suggests that international investment law may also operate so as to frustrate climate change mitigation measures in the future.