CHAPTER - 13

GREEN MULTILATERALISM IN THE INVESTMENT TREATY: A TRIUMPH FOR STATE'S RIGHT TO REGULATE?

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I INTRODUCTION

The evolving landscape of international law on foreign investment has its roots during the tumultuous colonization era. Since then, the protection of foreign investment has evolved over time. The early stage of the expansion of foreign investment took place in the colonies of the States of investors. In this respect, investment protection was integrated within the colonial legal system of the imperial powers, which gave sufficient protection for the investment in those colonies. Even if the investments were made in areas that remained un-colonised, a combination of diplomacy and power ensured that the host countries did not interfere with foreign investors. Therefore, colonial power was the absolute dispute settlement mechanism dealing with the conflict between foreign investors and the host countries in the colonized period.

The ending of colonialization totally changed the condition of foreign investment and its regulations. These newly independent nations grappled not only for freedom from their former colonial power's economic dominance, but also to reclaim their own economic sovereignty as well as to gain inroads of global market. Generated by nationalistic fervour, foreign investment has been the subject of hostility and antagonism by newly independent nations. Nationalism was itself a flagship of anti-colonialist movement, which reverberated across the globe throughout the colonized parts of the world. This resulted in the wave of nationalization policy of foreign properties in the age awash with a fervent nationalism. Various issues in relation with foreign investment such as nationalization or expropriation, rules on compensation and protection of foreign properties made inroads into the international law discourse.

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In the context of conflicts of interest between developed and developing States, new legal principles were introduced as measures of protection. The emergence of the "Calvo"[1] and "Drago Doctrine" severely disrupted the stability of foreign investment in developing host States that adopted these doctrines as it placed foreign investors at risk. Therefore, there was a need to establish an international standard for legality of nationalization that anchor on national treatment or non-discrimination. This serve as safeguard measures regarding specific undertakings that nationalization of foreign properties should be subjected to public interest ground with due process of law and judicial review. As such, a new level playing field was constructed to provide check and balance between the interest of developed and developing States. The "Hull formula"[2] provides further requirements that nationalization must be accompanied by compensation that are prompt, adequate and effective. This conflict was compromised later by referring to the terms such as "just", "full", "reasonable" or "fair and equitable" based on the fair market value or genuine value of the assets expropriated. These terms have formed the best practices usually incorporated in the BITs entered into between host and home States. These new rules seem to contradict the traditional view of

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1 Attempts were made by the developing States to restrain the Great Power's dominance. From the middle of nineteenth century, many Latin American States began to insert the "Calvo Doctrine or Clause" into concession contracts with nationals of foreign countries, chiefly for the exploitation of national resources. It was the Argentine jurist C Calvo (1824-1906) who had argued for this clause. It stipulated that in cases of dispute arising out of contracts, foreigners relinquished the right to request the diplomatic and judicial protection of their national State and agreed to have the dispute settled by ad hoc tribunals. Another important attempt to place restraints on the Great Power's hegemony was made in the early twentieth century by the Foreign Minister of Argentina namely Luis Maria Drago (1859-1921). He argued that the Great Powers must not use military force to seek payment of debts from poor countries. See Antonio Cassese *International Law* (2nd ed, Oxford University Press, 2005) 32-33.

2 The Hull formula outlined the US position on the issue of expropriation and the nature of compensation under international law. It states that:

> The taking of property without compensation is not expropriation. It is confiscation. It is no less confiscation because there may be an expressed intent to pay at some time in the future. If it were permissible for a government to take the private property of the citizens of other countries and pay for it as and when, in the judgment of that government, its economic circumstances and local legislation may perhaps permit, the safeguards which the constitutions of most countries and established international law have sought to provide would be illusory. Governments would be free to take property far beyond their ability or willingness to pay, and the owners thereof would be without recourse. We cannot question the right of a foreign government to treat its own nationals in this fashion if it so desires. This is a matter of domestic concern. But we cannot admit that a foreign government may take the property of American nationals in disregard for the rule of compensation under international law. Nor can we admit that any government unilaterally and through its domestic legislation can, as in this instant case, nullify this universally accepted principle of international law, based as it is on reason, equity and justice. See Letter of the US Secretary of State to Mexican Ambassador to the United States, 21 July 1938, as cited in AF Lowenfeld *International Economic Law* (Oxford University Press, 2002) 398.

developing States, which often relied on domestic law when it comes to nationalization of foreign properties. Nevertheless, the relaxation of the strict Calvo doctrine was justified due to the importance of foreign investment to economic growth of developing States.

In particular, a minimum standard of investor's protection as customary international law emerged out of economic necessity in the early 19th century. Until the Communist Revolution of Russia in 1917, neither State practice nor the commentators of international law had reason to pay special attention to rules protecting foreign investment. Treaty practice in the 19th century protected alien property not on the premise of an autonomous standard, but by reference to domestic laws of the host State. The implicit assumption was that each State would in its national laws protect private property and that the extension of the domestic scheme of protection would lead to sufficient guarantees to the alien investor. The Russian revolution witnessed the expropriation of national enterprises without compensation and attempted to rely on its empty standard of national treatment for the protection or lack of protection of alien property. The ensuing dispute led to the *Lena Goldfields Arbitration*[3] of 1930 in which the tribunal required the Soviet Union to compensate the alien claimant on the ground of unjust enrichment.

A further attack upon the standard of international law was mounted in 1938 by Mexico after the nationalization of US interests in the Mexican agrarian and oil business. The dispute led to a diplomatic exchange in which the US Secretary of State Cordell Hull wrote a significant letter to his Mexican counterpart spelling out that the rules of international law allowed expropriation of foreign property but subject to "prompt, adequate and effective compensation."[4] The Mexican position echoed the tenet of the Calvo doctrine and also foreshadowed harsh disputes between industrialized and developing countries in subsequent decades of post-colonization. The Calvo doctrine, the Russian revolution and the Mexican position have prompted the tightening of an alien investment protection against the unacceptable measures of the host State by rules of international law that is independent of those of host State domestic laws. Eventually, these rules become known as the international minimum standard.

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3 G Hackworth *Digest of International Law* (1942) vol 3 and (1943) vol 5.

4 For analysis of the *Lena Goldfields Arbitration* (1930) see V Veeder "The Lena Goldfields Arbitration: The Historical Roots of Three Ideas" (1998) 47 ICLQ 747.

II RELENTLESS ATTACKS AGAINST THE ISDS: THE STORY SO FAR

Among the opponents, it has been argued that the Investor State Dispute Settlement (ISDS) mechanism tends to favour the investors in their legal action against State. The legal basis of ISDS itself is justified on the ground that the capital-exporting States do not want investors from their countries to be subject to weak or corrupt domestic legal systems and institutions in host States. They prefer tribunals administered by the International Centre for Settlement of Investment Disputes (ICSID), which is an independent international institution in the World Bank Group created by the 1966 Convention on the Settlement of Investment Disputes Between States and Nationals of other States.

There are four main concerns that are being leveraged against the ISDS. Investor-state arbitration regime is based on international commercial arbitration model. It is questionable whether this is appropriate to adjudicate disputes involving sovereign States and public interest. First, the compensation of investor-state arbitration tribunal has come under great scrutiny. The regime features select few individuals to review and evaluate States action even though they are largely unaccountable to the constituency that their decision affect. These arbitrators are widely respected and experience in commercial and other areas of law and might in fact have experience working in and advising governments and international institutions. It might not necessarily be attuned to the domestic public interest and policy concern of the sovereign States in the cases before them. There are also perceived lack of representation among the arbitrators from developing countries including from Asia. Even where there is Asian representation in the ICSID Tribunal, this generally consists of a small group of repeat players.

Second, there is concern with issue conflict. Conflict may arise in various ways. Most notably where the arbitrators concurrently acts as counsel in another case pertaining to similar issues so that the decision made as arbitrator may impact the case in which the arbitrators concerned are counsel. Issue conflict is potentially serious in investor state arbitration context because this often concerns with the interpretation of Bilateral Investment Treaties (BITs) that contain similar provision that give rise to similar legal issues. Third, concern has been raised in regards to the lack of public participation in investor state arbitration. The confidentiality of the investor state arbitration proceedings is rooted from the rules of international commercial arbitration. However, in view of the public interest in investor state arbitration, there has been a push for increased transparency. This is reflected to some degree in the amendment of ISCID arbitration rules and the introduction of transparency enhanced procedure in new investment treaty such as the US-

Singapore Free Trade Agreement (FTA) as well as the recently announced EU-Canada Comprehensive Economic and Trade Agreement (CETA).

Another set of concern relates to the substantive law. Investment treaty started as *lex specialis* instrument that emerged at the time of ideological divergence between the developed and developing world. Such treaties were skeletal because of the conscious desire not to hamstring the development of a system for investor state dispute settlement by arguing over the contentious issue of what the substantive law ought to be. But the consequences of having the system that rest of bare bone provision that are left to be flesh out by individual appointed to hear disputes when they arise are that, first many disputes can and will arise because they are not obviously excluded given the way which the obligation have been framed. Second, a great deal of law is going to be made by those entrusted to decide these cases as and when they arise. This also means that some of the traditional concept that underneath investment treaty might be stretched beyond what the parties themselves might have contemplated them to mean. For instance the concept of expropriation was historically concerned with the physical seizure or transfer of tangible property or nationalization of foreign owned assets. But it has in fact been extended to a broad range of economic assets including contractual rights. Another example relates to Most Favoured Nation (MFN) clauses. Such clauses were originally intended for the host State not to discriminate in terms of the competitive opportunity offered to treaties partners. But the tribunals have interpreted the MFN clause broadly seemingly allowing investors to be able to pick and choose from provisions present in the BITs between the host State and third party States. This sometime enables the investors to construct the cause of action that might not have been in the contemplation of the contracting States.

The obligation of the contracting States might therefore come to be defined by a patchwork of the most favourable provisions contained in the treaties linked by the MFN clauses potentially undermining sometime the calibrated result of inter State negotiation. Moreover, there is no single body that has the capacity of competence to rationalize, reconcile, review or moderate the emerging jurisprudence of these ad hoc tribunals. There is no avenue for appeals to strip away some of the errors incoherence or inconsistency in the arbitral jurisprudence. Critics even argue that international arbitration framework maybe inherently unsuited to handling issues involving sovereign and public interest and perhaps this matters should be carved out as being unarbitrable.[5]

5 The recent development shows that some States have attempted to recapture the authority to interpret their treaties. For example, under the Singapore-USA FTA joint committee of government official may issue binding interpretation of the agreement. The Malaysia-New

III DEBUNKING THE MYTH OF REGULATORY CHILL

There has been assertion among the critics that investment treaties could result in an "environmental chill" by obstructing State's measures to mitigate climate change. Opponents of the ISDS system claim that it does not and cannot strike a balance between the State's right to regulate in the public interest and the protection of investors. It is argued that these critics failed to consider the new wave of BITs/Multilateral Investment Treaties (MITs) and the evolving jurisprudence of investment arbitration. It seems that such critics are still trapped in a time warp. In fact, the system is already recalibrating to meet these challenges in the environmental context.

This is due to the fact that the new generations of BITs/MITs increasingly consider environmental issues at the outset of drafting investment chapters. This has been considered in a more detailed fashion than the early bilateral treaties. In this regards, critics seems to base their claims on the peculiar context of investment treaties during its infancy stage where the world was a different place than it is now. The United Nations Conference on Trade and Development (UNCTAD) has also identified that BITs are increasingly incorporating sustainable development-oriented features, such as those identified in its Investment Policy Framework for Sustainable Development.[6] The IBA's Report provides a comprehensive coverage of these new wave pro-environment clauses included in these investment chapters.[7]

It has been argued that in practice some treaties are negotiated too hastily and without detailed considerations of their implications. Typically, capital-exporting States have formulated a model treaty for their own purpose.[8] Moreover, they have

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Zealand FTA and the ASEAN-Australia and New Zealand FTA also incorporate express provisions for tribunal to request joint decision for the parties declaring their interpretation of disputed provisions. Under the CETA, the EU and Canada may issue binding interpretation of what originally meant in their provisions and to participate in the arbitration in relation to question of interpretation.

6 United Nations Conference on Trade and Development *Investment Policy Framework for Sustainable Development* (2014) 116.

7 These new waves of pro-environment clauses includes (i) obligations explicitly supporting environmental measures (ii) obligations to promote foreign direct investment in environmental goods and services (iii) requirements not to derogate from existing environmental laws when seeking to attract investment; and (iv) explicit exceptions for environmental measures from trade obligations. See International Bar Association Climate Change Justice and Human Rights Task Force Report: Achieving Justice and Human Rights in an Era of Climate Disruption 2014.

8 Most capital-exporting countries have drawn up their own model investment agreements. Also, the Asian-African Legal Consultative Organisation (AALCO) has produced a model treaty for its members in 1984, with two variants. See Asian-African Legal Consultative Committee: Models for Bilateral Agreements on promotion and Protection of Investments, reprinted in (1984) 23 ILM 237.

presented these informal documents to the capital-importing States at the beginning of the negotiations as a basis for the subsequent negotiations. Developing States have also gradually negotiated treaties between them. As more treaties have been concluded, and as the international discussion on the nature and the details of these treaties has progressed, including the contours and substance of individual clauses, any argument pointed to host States have accepted the investment obligation without proper understanding of its scope and repercussion become less convincing. By the same token, investment treaties are regarded as an admission ticket to international investment market by creating investment-friendly environment.

There was a major confrontation regarding the status of customary international law between the newly independent developing States and capital-exporting State during the 1945 and 1990 period. These were often triggered by the ideological view which insisted on the strict notion of permanent sovereignty over natural resources.[9] In addition, there was a strong motivation for economic decolonization. However, this confrontation ended in 1962 with a compromise through the GA Resolution 1803 which stated that in the case of expropriation, "appropriate compensation" had to be paid. Furthermore, a consensus existed then that foreign investment agreements concluded by a government must be observed in good faith. [10] The ideological battle was taken to another level by the developing countries in 1974. This is largely motivated by the success of oil-producing countries in boycotting Western States and sharp oil prices increases as well as by the prevailing spirit of independence in Latin America. Several resolutions were passed that introduced a New International Economic Order, which called for the abolition of rules of international law governing the expropriation of alien property. Alternatively, reference to the domestic laws of host State as determined by the national authorities was put in place.[11]

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9 R Dolzer "Permanent Sovereignty over Natural resources and Economic Decolonization" (1986) 7 Human Rights Law Journal 217; K Gess "Permanent Sovereignty over Natural Resources: An Analytical Review of the United nations Declaration and its Genesis" (1964) 13 ICLQ 398; S M Schwebel "The Story of the UN's Declaration on Permanent Sovereignty over Natural resources" (1963) 49 American Bar Association Journal 463.

10 See UNGA Resolution 1803 (14 December 1962) para 8. It says that "foreign investment agreements freely entered into by or between sovereign States shall be observed in good faith."

11 See UNGA No 3281 (12 December 1974) ("Charter of Economic Rights and Duties of States"). It reads that:

> Each State has the right: …(c) To nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulation and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it

This period of Western resistance came to a halt following the fall of the communism. It becomes obvious that the Socialist paradigm of property had collapsed due to the disintegration of Soviet Union. Moreover, the call for economic independence has led to a financial crisis in Latin America. As a result, Latin American countries started to conclude BITs whose spirit was opposed to the Calvo doctrine and all the concern about permanent sovereignty notion in the United Nations General Assembly (UNGA) had died down. There was a growing international consensus that economic liberalism promised more growth than economic protectionism within closed national or regional borders. In this regard, the Washington Consensus provides the wind of change.[12] National financial institutions revised their position on the role of private investment with new emphasis on the private sector in the process of development and its concomitant positive view of private foreign investment. Within this new environment, the fight of previous decades against customary rules protecting foreign investment had abruptly become anachronistic and obsolete. The pendulum has swung in favour of the foreign investment. The penchant for opposition against classical customary law among capital-importing States came to an end. Instead, more protection was granted to foreign investment than traditional international law could ever offer on the basis of treaties negotiated to attract additional foreign investment for development. Developing countries started to conclude investment treaties among themselves, which do not significantly deviate from the characteristics of treaties from those concluded with developed States.[13]

3.1 Indirect Expropriation: A Tool for State to Regulate Climate Change?

Foreign investors could argue that certain States' measures to mitigate climate change violate the protected investment under the treaties. For example, the introduction of stricter emission standards or ban on producing certain products could have significant economic effects for affected industries. This may be the cause for concern among the investors even though the measures aim at reducing greenhouse gas emissions and thus pursue a legitimate public purpose. The

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shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principal of free choice of means.

12 See J Williamson "From Reform Agenda to Damaged brand name-A Short History of the Washington Consensus and Suggestions for What to do Next" (2003) Finance and Development 10.

13 See UNCTAD *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking* (2007).

jurisprudence of investment arbitration has demonstrated a positive sign that favour States' right to regulate matters related to public interest. The tribunal in *Metalclad v Mexico* has endorsed the effect doctrine in the following words:[14]

> Expropriation under NAFTA includes not only open, deliberate and acknowledged taking of property, such as 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 effect doctrine adopted in this case should not be viewed as an indication of how the concept of indirect expropriation limits a government's power to pass environmental measures through legislation. This is due to the facts that *Metalclad* involved a case of state responsibility for governmental assurances but not a regulatory takings case. What was rather at the crux of Mexico's liability was the fact that the investor had relied on an assurance given by Mexico's federal government that the investor had all the permits necessary for constructing and operating the landfill.

The vast majority of tribunals also adopt the police power doctrine in deciding whether a general measure entitles an investor to compensation due to indirect expropriation. The police power doctrine allows the host State to restrict private property rights without compensation in pursuance of a legitimate purpose. This doctrine is subject to such purpose that is reasonably balanced in relation to the regulation's effect on the investment.[15] The tribunal in *Tecmed v Mexico* held that a police power formed part of the international law of expropriation. It held that "the principle that the State's exercise of its sovereign powers within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling to any compensation whatsoever is undisputable."[16]

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14 *Metalclad Corp v United Mexican States* ICSID case No ARB (AF)/97/1, Award of 30 August 2000, para 103.

15 See *Sedco Inc v Iran* 9 Iran-US Cl Trib Rep 248, where the tribunal has stressed that "the principle of international law that a state is not liable for economic injury which is a consequence of bona fide 'regulation' within the accepted police power of States." Similarly, the tribunal in *Emanuel Too v Greater Modesto Insurance Associates & United States* 23 Iran-US Cl Trib rep 378, 387 held that "a State is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation or any other action that is commonly accepted as within the police power of States, provided it is not discriminatory and is not designed to cause the alien to abandon the property to the State or to sell it at a distress price."

16 *Technicas Medioambientales Tecmed SA v United Mexican States* ICSID case No ARB (AF)/00/02, Award of 29 May 2003, para 119.

Similarly in *Methanex v United States*, the tribunal noted that:[17]

> 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 compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.

The tribunal in *LG&E v Argentina* reiterated that an indirect expropriation does not occur "where the investment continues to operate, even if profits are diminished. The impact must be substantial in order that compensation may be claimed for the expropriation."[18] It is necessary to demonstrate that the business activity had "disappeared ie the economic value of the use, enjoyment or disposition of the assets or rights affected … have been neutralized or destroyed."[19]

3.2 Fair and Equitable Treatment: An Absolute or Restrictive Legitimate Expectation?

In the context of regulatory measures exercised by State to mitigate climate change, the Fair and Equitable Treatment (FET) requires that the host State accord sufficient consideration to the "legitimate expectation" of foreign investors in the continuation of the existing domestic emissions regime. As the tribunal in *International Thunderbird Gaming v Mexico* explained, "the concept of legitimate expectation relates … to a situation where a contracting party's conduct creates reasonable and justifiable expectations on the part of the investor (or investment) to act in reliance on said conduct, such that a failure by the State to honour those expectations could cause the investor (or investment) to suffer damages."[20] Legitimate expectation therefore presupposes that the host State induced investors to adjust their behaviour to a certain regulatory framework and made them believe that this framework was going to apply for a significant time.

The protection of the investor's legitimate expectation, nevertheless, does not make the regulatory framework unchangeable. In addition, it is also not necessarily a subject that any change to be accompanied by compensation. As noted by the

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17 *Methanex Corp v United States* UNCITRAL/NAFTA, Final Award of 3 August 2005, Pt IC, ch D, para 7.

18 *LG&E v Argentine Republic* ICSID Case No ARB/02/01, para 191.

19 *Technicas Medioambientales Tecmed SA v United Mexican States* (n 16) para 116.

20 *Int'l Thurderbird Gaming Corp v United Mexican States* UNCITRAL/NAFTA, Arbitral Award of 26 January 2006, para 127.

tribunal in *Saluka v Czech Republic*, the test as to whether the FET is in breached required "a weighing of the Claimant's legitimate and reasonable expectations on the one hand and the Respondent's legitimate regulatory interests on the other."[21] The tribunal did not deem the protection of the investor's expectation as absolute. Instead, it considered that the host State was merely required to 'implement its policies bona fide by conduct that is, as far as it affects the investors' investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and non-discrimination.'[22] Essentially, the FET only protects the investor's expectations in the continued and unchanged validity of regulatory framework against disproportionate measure. Proportionality further requires that a reasonable balance be struck between the purposes of regulatory change, the benefits resulting from it and the burden imposed on the investors. In the context of climate change, the FET merely prevents States from unreasonably changing emission standards or unforeseeably changing production standards contrary to the host State's earlier representation or should have known that investor would reasonably infer certain stability from an existing regulation.[23]

IV GREEN MULTILATERALISM IN THE TPP: A TRIUMPH FOR STATE'S RIGHT TO REGULATE THE ENVIRONMENT?

The Trans-Pacific Partnership (TPP) is an agreement on trade and investment recently negotiated and concluded among a diverse group of twelve Pacific Rim countries that are Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam and the United States. Proponents of the TPP emphasize its prospective economic benefits, with economic growth increasing due to rising trade volumes and investment. Furthermore, the TPP will generate higher economic growth throughout the area by eliminating tariffs and other barriers to international trade and investment. By contrast, the opponents of the TPP argue that, among others, the TPP will produce undesired repercussions on state sovereignty to regulate. In particular, existence of the ISDS system has a chilling effect on the state's regulatory prerogative, dissuading states from enacting legislation that would tackle environmental concerns. The ISDS now is so common that there has been a backlash against it in the last few years. This is largely as a result of public perceptions that ISDS allows foreign corporations the power to sue government for changes in law that are otherwise necessary to safeguard the public

21 *Saluka Investments BV v Czech Republic* UNCITRAL Partial Award of 17 March 2006, para 306.

22 Ibid para 307.

23 Stephan W Schill "Do Investment Treaties Chill Unilateral State Regulation to Mitigate Climate Change?" (2007) 24(5) Journal of International Arbitration 469-477, 476.

interest. These concerns are reflected in the new generation of MITs and FTAs, which tend to contain more detailed conditions for access to ISDS. A good example of this trend is the TPP itself. The following section analyses the environment chapter of the TPP. This is to address the dichotomy between investors' right for protected investment and the power of State to protect public interest.

The TPP contains trinity of regulatory powers. Such provisions designed to protect TPP States' freedom to act in pursuit of environmental and other regulatory bodies. The relevant provisions are the carve-outs and regulatory exceptions to the TPP's substantive investment protections. These includes first, the fair and equitable treatment/FET (Article 9.6); second, expropriation (Article 9.8 and fn 17, Annex 9-B, paragraph 3(b), fn 37) and third, the balancing provision (Article 9.16). Each of these regulatory powers is discussed in the following section.

Paragraph 9 of the TPP Preamble encompasses:

> The Parties to this Agreement, resolving to:
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> Recognise their inherent right to regulate and resolve to preserve the flexibility of the Parties to set legislative and regulatory priorities, safeguard public welfare, and protect legitimate public welfare objectives, such as public health, safety, the environment, the conservation of living or non-living exhaustible natural resources, the integrity and stability of the financial system and public morals.

4.1 Article 9.6 on the FET

> Article 9.6: Minimum Standard of Treatment
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> Each Party shall accord to covered investments treatment in accordance with applicable customary international law principles, including fair and equitable treatment and full protection and security.

However, one should bear in mind that Article 9.6 must be interpreted based on Annex 9-A: Customary International Law. It says:

> The Parties confirm their shared understanding that "customary international law" generally and as specifically referenced in Article 9.6 (Minimum Standard of Treatment) results from a general and consistent practice of States that they follow from a sense of legal obligation. The customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the investments of aliens.

A question arises on the FET as to whether it is based on customary international law or independent treaty-based standard. When interpreted as an autonomous standard (not linked to customary international law), FET may include

wide-ranging obligations on the host State. First, prohibition of manifest arbitrariness in decision-making, that is, measures taken purely on the basis of prejudice or bias without a legitimate purpose or rational explanation. Second, prohibition of the denial of justice and disregard of the fundamental principles of due process. Third, prohibition of targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief. Fourth, prohibition of abusive treatment of investors, including coercion, duress and harassment. Finally, protection of the legitimate expectations of investors arising from a government's specific representations or investment inducing measures.

When linked to the minimum standard of treatment of aliens under customary international law, FET may include the *Neer*[24] standard:

> Without attempting to announce a precise formula, it is in the opinion of the Commission possible to […] hold (first) that the propriety of governmental acts should be put to the test of international standards, and (second) that 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.

The FET standard and customary international law giving the States the ability to argue that the *Neer* standard shall apply. *Neer* is rather outdated due to the fact that it did not concern an investment treaty and was not decided under an investment treaty. However, the *Neer* case still has relevance. The ISDS tribunals have applied the *Neer* standard in *Glamis Gold v United States*.[25] The Glamis claim rested on a series of regulatory measures imposed by federal and state agencies in response to concerns over the environmental and cultural impacts of its mining project (the Imperial Project). The open pit mining project was controversial in California, drawing particular opposition from the Quenchan Indian Nation due to its location in an area sacred to the Native American tribe. Glamis argued that federal mining agencies departed from well-established precedent when they declined to approve Glamis' plan of operation. Glamis also objected to measures introduced by the State of California in 2003, which it claimed were arbitrary and

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24 *Neer Claim* (*United States v Mexico*) 4 RIAA 60 (1926), Mexico-United States General Claims Commission. In this case, Mr Neer a national of the United States was working in Mexico when he was stopped by armed men and shot. It was claimed that the Mexican authorities were not diligent in their investigations into the murder and that they should pay damages to Neer's family. The claim was rejected by the Commission on the grounds stated above.

25 The *Neer* test has been applied in some investor-state cases such as *Glamis Gold v USA* (2009). See *Mondev International v USA* (2002) where the court has rejected the *Neer* test.

discriminatory, designed to block the Imperial Project rather than genuinely address environmental and cultural concerns associated with mining activities generally. Glamis Gold claimed "measures tantamount to expropriation". Claims rejected on the grounds that "State's measures not sufficiently egregious and shocking."

The TPP reflects State concerns that "legitimate expectations" jurisprudence expanded the FET standard into the areas of legislative and regulatory action. Article 9.6 (4) sets out:

> For greater certainty, the mere fact that a Party takes or fails to take an action that may be inconsistent with an investor's expectations does not constitute a breach of this Article, even if there is loss or damage to the covered investment as a result.

It should be noted that this wording originates from an interpretative note that the US, Canada and Mexico issued under North American Free Trade Agreement (NAFTA). With regards to investor's burden, Article 9.23 (7) states:

> For greater certainty, if an investor of a Party submits a claim under this Section, including a claim alleging that a party breached Article 9.6 (Minimum Standard of Treatment), the investor has the burden of proving all elements of its claims, consistent with general principles of international law applicable to international arbitration.

4.2 Expropriation: Article 9.8 of the TPP

Article 9.8 (1): Expropriation and Compensation:[26]

> No party shall expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization (expropriation), except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment of prompt, adequate and effective compensation in accordance with paragraphs 2,3 and 4; and (d) in accordance with due process of law.

The second situation addressed by Article 9.8.1 (Expropriation and Compensation) is indirect expropriation, in which an action or series of actions by a party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure. Annex 9-B 3 (b) reads:

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26 See footnote 17 of the TPP Chapter 9. It says 'For greater certainty, for the purpose of this Article, the term "public purpose" refers to a concept in customary international law. Domestic law may express this or a similar concept by using different terms, such as "public necessity", "public interest" or "public use".'

> 9-B.3(b): Non-discriminatory regulatory actions by a party that are designed and applied to protect legitimate public welfare objectives, such as public health,[27] safety and the environment, do not constitute indirect expropriations, except in rare circumstances.

The text of Annex 9-B of the TPP makes expropriation materially less prospective as a cause of action for investors aggrieved by regulation. This applies to the following circumstances. First, adverse effect on the economic value of an investment does not, standing alone, constitute an indirect expropriation. Second, account shall be taken of "the extent to which the government action interferes with distinct, reasonable investment backed-expectations". Third, the character of government measures shall be considered. Finally, 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, except in rare circumstances. Taking these elements together, non-discriminatory government action of a legislative nature in a policy-sensitive field would not qualify as an indirect expropriation, absence evidence of government representations or evidence that the action is disproportionate.

4.3 The Balancing Provision in Article 9.16.

Article 9.16: Investment and environmental, health and other regulatory objectives

> 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, health or other regulatory objectives.

There are some criticisms against Article 9.16 of the TPP. Where does the wording come from and what does it mean? According to the Columbia Centre for Sustainable Development,[28] the words "otherwise consistent with this Chapter" serve to "negate protections otherwise purported to be given under Article 9.16". Thus, on this reading, Article 19.6 is self-defeating, circular, and worthless as a

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27 See footnote 37 of the TPP Chapter 9. It mentions "for greater certainty and without limiting the scope of this subparagraph, regulatory actions to protect public health include, among others, such measures with respect to the regulation, pricing and supply of, and reimbursement for, pharmaceuticals (including biological products), diagnostics, vaccines, medical devices, gene therapies and technologies, health related aids and appliances and blood-related products."

28 Lise Johnson and Lisa Sachs "The TPP's Investment Chapter: Entrenching, Rather than Reforming, a Flawed System" (*Columbia Center on Sustainable Investment Policy Paper*, November 2015) available at <http://ccsi.columbia.edu/files/2015/11/TPP-entrenching-flaws-21-Nov-FINAL.pdf.>.

protector of the State's regulatory prerogatives. Article 12 (5) of the US Model BIT says "nothing in this Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Treaty…" Article 19.6 of the TPP comes from a wealthy, capital-exporting country with an advanced and stable political and legal system. It has originated in a country where the rule of law is strong and the most likely source of ISDS claims is adverse regulation rather than direct expropriation or nationalization. The US would not insert this type of provision in its treaties unless it thought it was in their best interest to do so.

What is the meaning of "consistent" in Article 9.16? For a positive investment protection obligation, "consistent" means the measure does not breach that positive obligation. For a carve-out or exception to one of the substantive standards/protections/obligations under the Investment Chapter, "consistent" means the measure falls within that carve out or exception. The notion of consistency is as much about the exceptions and carve-out as it is about the standards and protections. To adopt the interpretation of the critics (that Article 9.16 'negates itself') would go against *effect utile*[29] principle of interpretation, which requires that a treaty provision must be read in a way that gives it effect rather than deprives it of its effect.

Apart from the meaning of "consistent" discussed above, the meaning of "otherwise" contained in Article 9.16 has also been the subject of debate. The meaning of "otherwise" is crucial and may be debatable. From the standpoint of pro-State, "otherwise" signifies the provision as a Non-Precluded Measures Clause (NPM). It gives the State maximum regulatory freedom. If not, it has no effective function. For pro-investor perspective, Article 9.16 and NPM clause would make all of the health and environment exceptions and carve-outs in the rest of the investment Chapter redundant. This to a significant degree effectively invalidates the protections offered under Chapter 9. The middle ground argument would indicate that Article 9.16 is an NPM clause if the word "prevent" means a non-exclusion of damages liability. The state is free to regulate in its policy areas, but if it does so and another provision of the investment chapter makes it liable to pay compensation to an investor, the State shall pay such compensation in accordance with the TPP.

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29 In public international law the concept of *effect utile* is applied by a judge when he is confronted with two possible interpretations of a legal provision, one which confers some meaning on it, and the other which makes it devoid of any significance. In this scenario, he will give priority to the former. See Case C-437/97 *Evangelischer Krankenhausverein Wien v Abgabenberufungs kommission Wien and Wein & Co HandelsgesmbH, formerly Ikera Warenhandelsgesellschaft mbH v Oberösterreichische Landesregierung* [2000] ECR 1-1157.

V INCREASED TRANSPARENCY IN CLIMATE CHANGE RELATED ARBITRATION

As noted above, one of the key concerns in investment arbitration is the lack of transparency and participation from the affected third party in climate change related disputes. Of late, there is a growth of transparency and inclusion. In climate change related disputes, it does not make any sense for the party to accept arbitration unless express transparency provisions are guaranteed at the outset. This situation is even precarious where the ISDS decisions have a detrimental impact on the third parties' interests particularly regarding investment affecting sustainable development. A system that obstructed the affected party rights to be heard is subject to serious criticism. The role of NGOs and civil society organisations will be important in representing the interests of climate-vulnerable populations. Because the award will eventually be paid from a public treasury, participation of the affected party is crucial to ensure compliance with the award. Greater transparency will promote the rule of law.

On this basis, the UN General Assembly has adopted the UN Convention on Transparency in Treaty-based Arbitration,[30] which would apply to all arbitrations concluded under existing investment treaties. The United Nations Commission on International Trade Law (UNCITRAL) 2014 Transparency Rules on Transparency in Treaty-based Investor-State Arbitration [31] provides greater transparency for investor-State disputes. It empowers the tribunals to invite third-party submissions, publication of information at the commencement of the proceedings, publication of documents related to the proceedings including the awards, allows submission by a third person, submission by a non-disputing party to the treaty and requires all hearings under the future BITs to be open to the public.[32]

In this regards, arbitration could be an effective means to enforce international human rights standards in the context of disputes arising from climate change. In the same vein, arbitration can also fill the enforcement lacuna in the United Nations Framework Convention on Climate Change 1992 (UNFCC) as a means of resolving disputes arising from climate change. The UNFCC as it currently stands does not specifically endorse arbitration or any international forum as a means of

30 General Assembly resolution 68/109 (16 December 2013).

31 The Rules will apply by default to disputes arising out of treaties concluded on or after 1 April 2014, when investor-State arbitration is initiated under the UNCITRAL Arbitration rules (unless the parties otherwise agree). And also to investor-State arbitrations initiated under rules other than the UNCITRAL Arbitration Rules and in ad hoc proceedings.

32 UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration (2014), art 1 (5), 2, 3, 4, 5 and 6.

settling climate change related disputes. The key feature of the UNFCC is negotiation as being a peaceful means of resolving disputes. Therefore, arbitration is an attractive proposition to resolve disputes involving climate change. In light of this, investment arbitrations may serve to create a uniform standard of sovereign behaviour towards investors as well as providing a forum for vulnerable communities to seek climate justice.

Other options such as national court are a not viable for climate change related disputes. This is due to the facts that parties come from multiple jurisdictions and the potential political fall-out as judgment of a national court may not be recognized and enforceable by another State's court. Therefore, international forums are better equipped to arbitrate such disputes for example, the Permanent Court of Arbitration (the PCA), ICSID or arbitrations under the UNCITRAL Rules.

VI CONCLUSION

Article 9.16 is a quasi-declaratory provision. It communicates to investors that TPP States place great importance in health and the environment and reserve their rights to regulate in these areas. It signals to incoming investors that these public policy considerations may inform the way in which the host State administers covered investments. The words "otherwise consistent" work to ensure that the statement of regulatory priorities and prerogatives cannot negate the standards of investor protection set out in the TPP. However, the words of Article 9.16 also have a general interpretative function, which is to emphasize that ISDS tribunals need to take into account environmental and public health considerations when they interpret the other provisions of the TPP Investment Chapter. Overall, investment treaties neither obstruct nor chill State regulation that aims at mitigating climate change. The new wave towards green multilateralism and transparency would provide greater rule of law to overcome the challenges of climate change. The move towards pro-environment clauses as being reflected by these new waves of investment treaties has pushed for a State's right to regulate in triumph.