

**REGULATORY FREEDOM AND INDIRECT EXPROPRIATION:  
SEEKING COMPATIBILITY WITH SUSTAINABLE DEVELOPMENT IN  
NEW GENERATION BILATERAL INVESTMENT TREATIES**

by  
Anna Kuprieieva

Thesis submitted to  
the University of Ottawa, Faculty of Graduate and Postdoctoral Studies  
in partial fulfillment of the requirements of the degree of

**Master of Laws**

Faculty of Law, University of Ottawa  
Ottawa, Ontario, Canada  
February 2015

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## **ABSTRACT**

One of the most notorious dilemmas of international rules on the protection of foreign investment is how to decrease the tension between a state's regulatory freedom and private property rights in addressing indirect expropriation. Bilateral investment treaties need to achieve a crucial balance: to protect the interests of foreign investors and support rights of states to regulate in pursuit of sustainable development. In dealing with indirect expropriation past tribunals relied on different approaches and adopted mutually inconsistent positions. By demonstrating this incoherence, this thesis reviews the most recent BITs and identifies an archetype of investment treaty provisions and language that may result in the interpretation of indirect expropriation most compatible with states being free to act to achieve sustainable development.

## **EXTRAIT**

En matière de droit des investissements étrangers, l'une des questions récurrente qui se pose concerne le conflit entre la protection des investissements étrangers d'un côté, et la protection des droits de propriété privée soulevée dans le cas d'une expropriation indirecte de l'autre. À cet égard, les Traités Bilatéraux relatifs aux Investissements (TBI) tentent de trouver un équilibre entre la protection des intérêts des investisseurs étrangers et la garantie pour les États de réglementer en matière de politique de développement durable. Aussi, à l'occasion d'affaires impliquant une expropriation indirecte, les tribunaux arbitraux ont pu s'en remettre à différentes approches et adopter des positions parfois divergentes. Ainsi, en démontrant cette incohérence, ce mémoire tente d'examiner les TBI les plus récents et d'identifier un archétype de dispositions relatives aux investissements dans un TBI ainsi que le langage qui pourrait résulter de l'interprétation de l'expropriation indirecte, interprétation qui ne ferait pas obstacle à la liberté des États de légiférer en faveur du développement durable.

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## INTRODUCTION

In the words of Kenneth Vandavelde, the protection of foreign investment by way of treaties is one of the great international legal success stories.<sup>1</sup> Bilateral investment treaties (BITs) constitute the large majority of agreements that fulfill this important mission. To date, around 3,000 such treaties have been signed, covering practically every region of the world. From Germany to Canada, from South Africa to Singapore, virtually every country has concluded one or more BITs, as well as some new negotiating initiatives are under way, thus promising further expansion.<sup>2</sup>

Nonetheless, there are two sides to every story. While almost all states are engaged in the international investment protection framework through their BITs, not many are entirely satisfied with the current regime for several reasons, including growing concerns about the actual effects of BITs in terms of promoting foreign direct investment (FDI)<sup>3</sup> or reducing policy and regulatory space,<sup>4</sup> and increasing exposure to investor-state arbitration.

At the same time, to the extent that the purpose of BITs is to protect foreign investment, one is almost forced to concede their effectiveness when considering their crucial procedural outcomes. For instance, by end of 2013, 98 countries have been respondents in more than 500 known treaty-based cases brought by foreign investors.<sup>5</sup> Not surprisingly, the relationship between investment protection and the proper degree of regulatory autonomy for countries concluding BITs as well as the ways and means to achieve this have become one of the most complicated issues arising from the growing number of investment treaties and investor-state arbitration.

This is particularly evident when looking at the disputes involving so called “indirect expropriation.” States have increasingly found their freedom to act in their own domestic space being “restricted” by the interpretations advanced by tribunals on indirect expropriation under investment

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<sup>1</sup> Kenneth J. Vandavelde, “A Brief History of International Investment Agreements” in Karl P. Sauvant & Lisa E. Sachs, eds, *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (Oxford: Oxford University Press, 2009) 3 at 28.

<sup>2</sup> For instance, in 2014 Canada has agreed with a number of countries, such as Kenya, Kosovo, the United Arab Emirates to begin negotiations towards the Foreign Investment Promotion and Protection Agreements (FIPAs), online: Foreign Affairs, Trade and Development Canada <<http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/index.aspx?lang=eng>>; the European Union has launched negotiations for an investment protection agreement with Myanmar/Burma, online: the European Commission <[http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc\\_152269.pdf](http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152269.pdf)> as well as in 2013 the European Union has launched negotiations for a comprehensive EU-China investment agreement, online: the European Commission <[http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc\\_118238.pdf](http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf)>.

<sup>3</sup> Studies of the link between FDI and economic development have so far been inconclusive. It is argued that increasing foreign investment does not necessarily result in economic growth. These studies have found that the nature of the relationship between foreign investment and economic growth depends on a variety of factors that vary from one host country to the next. See J. A. VanDuzer, P. Simons & G. Mayeda, *Integrating Sustainable Development into International Investment Agreements: A Guide For Developing Countries* (London: Commonwealth Secretariat, 2012).

<sup>4</sup> In this context, many scholars argue that BITs may make it difficult for host States to achieve essential public policy objectives, including their development goals and the maintenance of environmental, human rights and labour standards. Recent empirical studies appear to provide some grounds for such concerns, showing that a significant number of investment disputes, including indirect expropriation, involve conflicts over areas of broad importance such as water, energy, natural resources, air, public health or social security. See Gus Van Harten, *Sovereign Choices and Sovereign Constraints. Judicial Restraint in Investment Treaty Arbitration*, 1<sup>st</sup> ed (Oxford: Oxford University Press, 2013), 87.

<sup>5</sup> United Nations Conference on Trade and Development [UNCTAD], “Recent Developments in Investor – State Dispute Settlement (ISDS)”, IIA Issue Note No. 1, April 2014, online: UNCTAD <[http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d3\\_en.pdf](http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d3_en.pdf)>.

treaties. In this regard, one particular problem is that, relying on provisions of the BITs, tribunals have adopted different, and sometimes contradictory, approaches to determine indirect expropriation<sup>6</sup> in many high-profile cases involving important public policy concerns, such as health, environmental protection, human rights. Because of the vague and open-ended language of many BITs, in some cases tribunals gave too much attention to the interests of foreign investors and too little weight to the environmental and other non-investment considerations invoked by the host States as a justification of their regulatory measures. This resulted in recurrent critiques to BITs in general and the concept of indirect expropriation in particular with respect to the scarce attention they pay to and the detrimental effect they may have on, sustainable development.<sup>7</sup>

A number of countries have made important efforts to address these challenges by recalibrating their international investment treaties. They have started to include non-investment goals and language (which might refer to sustainable development dimensions) in their treaties, which thus would need to be accommodated in the interpretation and application of relevant BITs. As a result, going beyond from their traditional role of investment protection, the evolving new generation of BITs negotiated for the past five years has begun to address health, environment protection and other non-investment concerns with a view to providing for investment promotion and protection that would be conducive to sustainable development. In particular, recent treaties attempt to preserve sufficient policy space and regulatory flexibility for host states to pursue public welfare by setting a specific framework for tribunals' approach to interpretation and application of indirect expropriation.

### **(i) Research Question and Objective of the Study**

The research objective motivating this thesis is to identify an archetype of provisions in recent BITs which would have particular interpretative value for safeguarding host states' ability and flexibility to regulate for public welfare in indirect expropriation cases. A research question that corresponds to the abovementioned objective has been specified as follows:

*- Which treaty provisions and language appearing in recent bilateral investment treaties may result in the interpretation of indirect expropriation most compatible with states being free to act to achieve sustainable development?*

For the purposes of this study, it is also necessary to provide a definition of the concept “*sustainable development*,” underlying this thesis. To date, the concept has taken shape through a

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<sup>6</sup> In order to determine whether indirect expropriation occurred past tribunals employed three different analytical frameworks (tests) – “*sole effects*,” “*police powers*” or “*proportionality*” that contribute to a high degree of inconsistency among the tribunal’s decisions and, in turn, uncertainty for both investors and host States. In the disputes where foreign investors challenged regulatory measures adopted on the environmental grounds, the key question was not how to determine indirect expropriation on its own, rather how to draw a line between indirect expropriation and legitimate government regulation that is not expropriatory and thus do not require compensation.

<sup>7</sup> The concept of sustainable development will be addressed further in this section

number of international documents,<sup>8</sup> international jurisprudence<sup>9</sup> and the wealth of scholarly work dedicated to this topic.<sup>10</sup> The first and most accepted definition of sustainable development comes from the Brundtland Report: “meeting the needs of the present without compromising the ability of future generations to meet their own needs.” The second definition as included in the *Johannesburg Declaration*<sup>11</sup> describes the concept as consisting of three pillars: economic development, social welfare and environmental protection. Furthermore, the 1992 *Rio Declaration* proclaimed twenty-seven principles in the hope of forming an “equitable global partnership” among international stakeholders. The Principle 4 of the *Rio Declaration* (the Principle of Integration) which reads: “In order to achieve sustainable development, environmental protection shall constitute an integral part of the development process and cannot be considered in isolation from it,” is of particular importance in defining sustainable development and addressing the nexus between investment and environment.<sup>12</sup>

While there are different approaches to sustainable development and its role for international law,<sup>13</sup> this study adopts the following framework: in instances where investment protection rules, as economic development norms, intersect with environmental norms, the concept of sustainable development must play a normative role in guiding a balanced, mutually supportive, integrated outcome. This approach implies that investment is essential to sustainable development but must be balanced with environmental protection, where intersects. In this context, the adopted framework relies on what it has been defined as interstitial normativity of sustainable development<sup>14</sup> in the sense that it may assist adjudicators in adopting a “holistic approach” to a resolution of investment disputes on indirect expropriation allowing to consider a wider context and thus address investment and non-investment concerns in a balanced manner.

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<sup>8</sup> *Declaration of the United Nations Conference on the Human Environment*, 5–16 June 1972, UN Doc A/Conf.48/14/Rev. 1(1973); 11 ILM 1416 (1972), United Nations online: <[www.unep.org/Documents.Multilingual/Default.asp?documentid=97&articleid=1503](http://www.unep.org/Documents.Multilingual/Default.asp?documentid=97&articleid=1503)>; *The Future We Want*, UNGA Res. A/66/288, 20–22 June 2012; *Rio Declaration on Environment and Development*, Report of the United Nations Conference on Environment and Development, UN Doc A/Conf.151/26/Rev. 1 (1992) (Vol. 1), Annex I, 3 at 3-8 [*Rio Declaration*]; *Johannesburg Declaration on Sustainable Development*, Report of the World Summit on Sustainable Development, A/CONF.199/20 (2002) 1 at 1-5 [*Johannesburg Declaration*]; *Development and International Economic Co-operation: Environment*, Report of the World Commission on the Environment and Development, UNGAOR, 42<sup>nd</sup> Sess., A/42/427 (1987) [*Report Our Common Future*].

<sup>9</sup> *Award in the Arbitration Regarding the Iron Rhine (“IJzeren Rijn”) Railway between the Kingdom of Belgium and the Kingdom of the Netherlands* (2005), (Permanent Court of Arbitration), (Arbitrators: Rosalyn Higgins, Guy Schrans, Bruno Simma, Alfred H. A. Soons, Peter Tomka), online: The Permanent Court of Arbitration <<http://www.pca-cpa.org/upload/files/BENL%20Award%20corrected%20200905.pdf>> [*Iron Rhine*]; *Case concerning Gabčíkovo-Nagymaros Project (Hungary v Slovakia)*, [1997] ICJ Reports 7 at 78, para.140 [*Gabčíkovo-Nagymaros Project*].

<sup>10</sup> There is extensive body of literature dedicated to the concept of sustainable development. See generally A. Boyle & D. Freestone, eds, *International Law and Sustainable Development. Past Achievements and Future Challenges* (Oxford: Oxford University Press, 1999); Duncan French, *International Law and Policy of Sustainable Development* (Manchester: Manchester University Press, 2005); Nico Schrijver, “The Evolution of Sustainable Development in International Law: Inception, Meaning and Status” (2008) 329 *Recueil des Cours* 217; Christina Voigt, *Sustainable Development as a Principle of International Law: Resolving Conflicts between Climate Measures and WTO Law* (Leiden: Martinus Nijhoff Publishers, 2009).

<sup>11</sup> *Johannesburg Declaration*, *supra* note 8 at 1-5; *Plan of Implementation of the World Summit on Sustainable Development*, [Implementation Plan] online: United Nations Johannesburg Summit 2002 <[http://www.johannesburgsummit.org/html/documents/summit\\_docs/131302\\_wssd\\_report\\_reissued.pdf](http://www.johannesburgsummit.org/html/documents/summit_docs/131302_wssd_report_reissued.pdf)>.

<sup>12</sup> See Principle 4 of the *Rio Declaration*, *supra* note 8.

<sup>13</sup> See Tarcisio Gazzini, “Bilateral Investment Treaties and Sustainable Development” (2014) 15:5-6 *J World Inv & T*, 929 at 932.

<sup>14</sup> Vaughan Lowe, “Sustainable Development and Unsustainable Arguments” in A. Boyle & D. Freestone, eds, *International Law and Sustainable Development: Past Achievements and Future Challenges* (Oxford: Oxford University Press, 1999) 19 at 30.

## (ii) Methodology

The focal point of the study lies within the shift in the practice of recent BITs and their potential to better fulfill their important function of investment protection and liberalization without compromising the host State's right to regulate in the context of indirect expropriation. This, in turn, is closely connected with the interpretation and application of the treaties. As a result, the study will be focused on three important components: a) treaty text; b) interpretation; and c) analytical framework (test) for indirect expropriation.

The methodology involves both theoretical and empirical components. The paper will first explore the concept of indirect expropriation and the analytical frameworks used by tribunals for its determination ("sole effects," "police powers" and "proportionality"). Thus, we will discover both the strengths and weaknesses of the applied approaches. Then, we will examine the legal frameworks for treaty interpretation and the particular interpretative techniques applied by investment tribunals. We will then more closely observe trends in investor-state arbitration in addressing non-investment concerns by means of interpretation of BITs. Keeping this in mind, we will conduct an empirical analysis of recently concluded BITs to illustrate changes in modern investment treaty practice which discloses greater potential to integrate sustainable development goals through interpretation and application of indirect expropriation standards.

The study surveys 61 BITs signed among 63 countries in the period from 2010 until 2013 that have been made public (see Annex A). The analysis will cover selected provisions, which directly or indirectly relate to indirect expropriation and the state's right to regulate: namely, preamble, and expropriation, as well as commitments not to lower environmental standards and other environment-related clauses. The surveyed BITs will be carefully studied and each of the relevant provisions will be mapped as set out in a table (Annex 1) that allows for inter-agreement comparisons and categorization of the provisions.

The sources that dominate this study include negotiated and signed bilateral investment treaties,<sup>15</sup> model treaties of US and Canada, selected decisions of international courts and tribunals and the Vienna Convention on the Law of Treaties (VCLT).<sup>16</sup> The examination of these sources will be supported by the elaborations of prominent researchers in the fields of international law including but not limited to investment law, environmental law and sustainable development law.

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<sup>15</sup> The prevailing majority of treaties' texts are available online in the UNCTAD's international investment agreement database. See UNCTAD: <<http://investmentpolicyhub.unctad.org/IIA/>>. Alternatively, the websites of the ministries of Foreign Affairs or similar authorities that publish official texts of bilateral investment treaties can be consulted, e.g. Indian Treaties Database, online: Ministry of External Affairs <<http://www.mea.gov.in/treaty.htm>>.

<sup>16</sup> *Vienna Convention on the Law of Treaties*, 23 May 1969, UN Doc. A/Conf.39/27, 8 ILM 679 (1969); 1155 UNTS [VCLT] 331.

### **(iii) Structure**

The thesis is divided into three chapters. Chapter I will explore the concept of indirect expropriation and each of the three analytical frameworks (tests) applied by tribunals for its determination. The purpose of the chapter is to explore the methodology offered by these tests and identify which one of them is most compatible with sustainable development, namely, which test allows consideration of both investment and non-investment aspects in a balanced manner. Then, the chapter will attempt to establish the link between the application of tests for indirect expropriation and treaty interpretation.

Chapter II will then examine the rules of interpretation under Articles 31 and 32 of the VCLT with a focus on such interpretative elements as text, context, object and purpose of the treaty as well as non-codified principles of interpretation. The chapter will discuss how the rules and principles of interpretation are used by international courts and tribunals when relying on a textual, contextual or teleological approach. After the framework is established, the chapter will focus on the interpretive approaches and methods employed by investor-state tribunals and discuss their strengths and weaknesses from a sustainable development perspective. Through such examination, we will better understand the particular interpretative choices of investor-state tribunals and the common challenges they face when approaching non-investment concerns. We seek to explore which particular approach and existing means of interpretation ensure the interpretation of indirect expropriation most compatible with states' right to regulate for sustainable development.

Chapter III will review recent BITs signed in the period from 2010 until 2013. It starts from the categorization and analysis of the surveyed provisions, discussing their advantages and limitations for interpretative purposes. The chapter will identify the common patterns of provisions preserving policy space in the context of indirect expropriation and their interpretative significance. Based on the results, the chapter will introduce an archetype of treaty provisions and language that may result in the interpretation of indirect expropriation most compatible with states being free to act to achieve sustainable development.

## CHAPTER I. INDIRECT EXPROPRIATION IN INTERNATIONAL INVESTMENT LAW

### *Introduction*

The past cases where a state forcibly nationalized property of foreign investors are usually clear cases of direct expropriation. In contrast, contemporary cases of indirect takings are inherently more vague. Arbitral tribunals have applied different standards to determine if indirect expropriation has occurred and, as a result, they have given various interpretations of the concept affording stronger protection to either foreign investors or states. In some disputes, arbitrators have found regulatory actions interfering with foreign investments being within the scope of state's police powers and not subject to compensation. While in others, the tribunals have identified the adopted measures as expropriatory actions causing adverse effect on foreign investors and thus requiring compensation. In the third category of cases, arbitral tribunals have strived to avoid an extreme one-sided approach to determination of indirect expropriation taking into account the competing interests – of state and of investor – on an equal footing.

By applying different approaches, the tribunals have looked at different criteria that have given rise to significant controversy surrounding indirect expropriation. Considering this, the Chapter will first, explore the concept of indirect expropriation based on the practice of past tribunals and investment treaties. Then, it will examine three analytical frameworks (tests) used to establish indirect expropriation and various criteria employed by tribunals under these tests. Finally, the Chapter will attempt to determine which of the tests is the most compatible with sustainable development.

### **1.1. Defining Indirect Expropriation and Factors Indicating Its Occurrence**

#### *1.1.1. Scope and Definition*

The standard of investor protection in case of expropriation is considered central to the whole concept of the investor protection.<sup>17</sup> It is a well-established rule in international law that the property of foreign aliens cannot be taken by a state without compensation.<sup>18</sup> This act is often referred to as nationalization or expropriation, although the terms are more or less synonymous. Traditionally, expropriation is described as falling into two categories: direct and indirect. The examples of direct taking include nationalization, the transfer of title and/or outright physical seizure of the property by

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<sup>17</sup> Christoph Schreuer, "Standards of Investment Protection. Introduction. Interrelationship of Standards" in A. Reinisch, ed., *Standards of Investment Protection* (Oxford: Oxford University Press, 2008) 1 at 1.

<sup>18</sup> See August Reinisch, "Expropriation" in Peter Muchlinsky, Federico Ortino & Christoph Schreuer, eds, *The Oxford Handbook of International Investment Law* (Oxford: Oxford University Press, 2008), 407-58; Andrew Newcombe & Luis Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Austin: Kluwer Law International, 2009); Christoph Schreuer, "The Concept of Expropriation under the ECT and Other Investment Protection Treaties" in C. Ribeiro, *Investment Arbitration and the Energy Charter Treaty* (Huntington: JurisNet, 2006), 108 -159; Katia Yannaca-Small, *Arbitration Under International Investment Agreements: A Guide to the Key Issues* (Oxford: Oxford University Press, 2010) at 445.

the state.<sup>19</sup> In addition to the term expropriation, terms such as “dispossession”, “taking”, “deprivation” or “privatization” are also commonly used.<sup>20</sup> While there are different views on the notion of “expropriation”, the general consensus is that:

The term ‘expropriation’ carries with it the connotation of a ‘taking’ by a governmental-type authority of a person’s property with a view to transferring ownership of that property to another person, usually the authority that exercised it de jure or de facto to do the taking.<sup>21</sup>

As one can see, this broad definition obviously does not cover all categories of expropriation. However, two important characteristics of this notion can be extracted from its content: first, it is an action of a governmental-type authority; second, it involves an effect of transferring ownership of the expropriated property. As already mentioned, international law is clear that a seizure of legal title of property constitutes a compensable expropriation. An early statement of this rule was made in 1936 by the U.S. Secretary of State Cordell Hull in response to Mexico’s nationalization of American companies, claiming that international law requires “prompt, adequate and effective” compensation for the expropriation of foreign investments.<sup>22</sup>

Most BITs also provide that a deprivation of a foreign alien’s property should be accompanied by the payment of compensation against the loss suffered by the foreign national. A typical treaty provision on expropriation stipulates that:

Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures tantamount 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; and
- (d) in accordance with due process of law.<sup>23</sup>

According to the interpretation of this provision, the state is allowed to expropriate<sup>24</sup> under the indicated conditions, namely, public purpose, absence of discrimination, due process of law and

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<sup>19</sup> In general, expropriation applies to individual measures taken for a public purpose while nationalisation involves large-scale takings on the basis of an executive or legislative act for the purpose of transferring property or interests into the public domain.

<sup>20</sup> Rudolf Dolzer & Margrete Stevens, *Bilateral Investment Treaties* (The Hague: Martinus Nijhoff Publishers, 1995) at 98.

<sup>21</sup> *S.D. Myers, Inc. v Government of Canada*, UNCITRAL (NAFTA), First Partial Award, 285 (Nov. 13, 2000), 40 ILM 1408, at para. 280, online: <[http://italaw.com/documents/PartialAward\\_Myers\\_000.pdf](http://italaw.com/documents/PartialAward_Myers_000.pdf)> [*S.D. Myers v Canada*]

<sup>22</sup> OECD, “‘Indirect Expropriation’ and the ‘Right to Regulate’ in International Investment Law”, *OECD Working Papers on International Investment 2004/04*, (OECD Publishing, April, 2004) at 1, online: OECD <[http://www.oecd.org/daf/inv/investment-policy/WP-2004\\_4.pdf](http://www.oecd.org/daf/inv/investment-policy/WP-2004_4.pdf)>.

<sup>23</sup> The 2012 U.S. Model Bilateral Investment Treaty Concerning the Encouragement and Reciprocal Protection of Investment [2012 US Model BIT], online: US Department of State <<http://www.state.gov/documents/organization/188371.pdf>>. Similar expropriation clauses can be found in Art. VI of 1990 Canada - Poland BIT, Art.7 of 1995 Australia – Argentina BIT, Art.6 of 1999 Ecuador – Netherlands BIT; Art.4 of 2008 Libya – Russian Federation BIT; Art.4 of 2008 Columbia – China BIT; Art.5 of 2011 India – Lithuania BIT; Art.12 of 2013 Japan – Mozambique BIT.

<sup>24</sup> As recognized by international law, states possess an inherent right to nationalize or expropriate the property of foreign national and local citizens. This principle is reflected in the UN General Assembly Resolution 1803 on Permanent Sovereignty over Natural Resources, which recognizes the right of peoples and nations “to permanent sovereignty over their natural wealth and resources. Paragraph 4 of the Resolution provides: “[N]ationalization, expropriation, requisitioning shall be based on grounds or reasons of public utility, security of national interest which are recognized as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate compensation in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law.” See *Permanent Sovereignty over Natural Resources*, GA Res 1803 (XVII), UNGAOR, 17<sup>th</sup> Sess, Supp. No. 17, UN Doc A/5217 (1962), at 15.

compensation. Hence, the indicated set of criteria constitutes the requirements of *lawful* expropriation.<sup>25</sup> It is clear that expropriation becomes *illegal* or *unlawful* if these requirements are not duly satisfied.<sup>26</sup> The categorization of lawful and unlawful expropriation is important to determine the amount of compensation. In case of unlawful expropriation, the state must pay full compensation or damages; in case of the lawful expropriation, it has to pay a fair market value of the expropriated asset.<sup>27</sup>

In addition to direct expropriation, international instruments dealing with the protection of investments also invariably include a standard of protection against *indirect* expropriation.<sup>28</sup> The concept is often referred to as “regulatory taking”, “compensatory taking”, “*de facto* expropriation”,<sup>29</sup> “creeping expropriation”<sup>30</sup> and “measures tantamount to expropriation” or “having equivalent effect to nationalization or expropriation”. In this context, state action possibly giving rise to expropriation typically covers any law, regulation, procedure, requirement, or practice.<sup>31</sup>

A critical problem with the concept is that there is no clear definition of what exactly constitutes an indirect expropriation. If it is too broadly defined, then it may become difficult for host states to adopt regulations without being sued by foreign investors who believe their property has been expropriated. A too narrow definition, on the other hand, might allow greater freedom to act, but create disincentives for foreign investment.

To date, a prevailing majority of “old-generation” investment treaties contain just a general reference to indirect expropriation without any further elaboration. A good illustration of such a general language is Article III (1) entitled “Expropriation and Compensation” of the 2000 Turkey – Yemen BIT which stipulates that:

Investments shall not be expropriated, nationalized or *subject, directly or indirectly, to measures of similar effects* except for a public purpose, in a non-discriminatory manner, upon payment of prompt, adequate and effective compensation, and in accordance with due

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<sup>25</sup> It should be noted that the first three elements – “public purpose”, “non-discrimination” and “due process” served only as the requirements for the lawfulness of expropriatory measures, and not as factors excluding the basic obligations to pay compensation. See Saverio Di Benedetto, *International Investment Law and the Environment* (Cheltenham: Edward Elgar Publishing, 2013), at 125.

<sup>26</sup> Rudolf Dolzer & Christoph Schreuer, *Principles of International Investment Law* (New York: Oxford University Press, 2008), at 91.

<sup>27</sup> Ursula Kriebaum, “Regulatory Takings: Balancing the Interests of the Investor and the State”, (2007) 8:5 J. World Inv. & Trade 717 at 720.

<sup>28</sup> Among such international documents are the Draft Articles on Responsibility of States for Internationally Wrongful Acts, Adopted by the International Law Commission at its Fifty-Third Session (2001) official Records of the General Assembly, Fifty-Sixth Session, Supplement No. 10 (A/56/10), Chap. IV.E.1); OECD Draft Convention on the Protection of Foreign Property, 12 October 1967, (1968) 7 ILM 117; Draft Convention on the International Responsibility of States for Injuries to Aliens (1961) drafted by Louis B. Sohn & Richard R. Baxter, (1961) 55 AJIL 545, reprinted in FV Garc ía Amador, Louis B. Sohn & Richard R. Baxter, Recent Codification of the Law of State Responsibility for Injuries to Aliens (Dobbs Ferry, New York: Oceana Publications Inc., 1974) [Harvard Draft]; The World Bank Guidelines on Treatment of Foreign Direct Investment, Article IV, (1992) 31 ILM 1379, at 1382, online: ITA Law <<http://ita.law.uvic.ca/otherinvestmentinstruments.htm>>. See also Christoph Schreuer, “The Concept of Expropriation under the ETC and Other Investment Protection Treaties” (Revised 20 May 2005), 6, online: <[http://www.univie.ac.at/intlaw/pdf/csunpublpaper\\_3.pdf](http://www.univie.ac.at/intlaw/pdf/csunpublpaper_3.pdf)>.

<sup>29</sup> Ian Brownlie introduced the idea of *de facto* takings emphasizing that a *de jure* expropriation is not necessarily the only requisite for compensation for deprivation of property. See Ian Brownlie, *Principles of Public International Law*, 6<sup>th</sup> ed (Oxford: Oxford University Press, 2003), 508-509.

<sup>30</sup> The term creeping expropriation refers to a series of separate government measures that, although not expropriatory when considered as separate and distinct measures, are expropriatory when considered cumulatively. See Burns H. Weston, “Constructive Takings under International Law: A Modest Foray into the Problem of Creeping Expropriation” (1975) 16 VJIL 103; The tribunal in *Generation Ukraine Inc. v Ukraine* at para. 20-22 defined creeping expropriation as follows: “Creeping expropriation is a form of indirect expropriation with a distinctive temporal quality in the sense that it encapsulates the situation whereby a series of acts attributable to the State over a period of time culminate in the expropriatory taking of such property.” See *Generation Ukraine, Inc. v Ukraine*, ICSID Case No. ARB/00/9, Award of September 16, 2003, online: <<http://www.asil.org/ilm/Ukraine.pdf>> [*Generation Ukraine*].

<sup>31</sup> As defined, for example, in Art.1 2012 US Model BIT, *supra* note 23.

process of law and the general principles of treatment provided for in Article II of this Agreement.<sup>32</sup>

While the provision above extends treaty protection to cover indirect forms of expropriation (“investments shall not be expropriated...indirectly” or subject to “measures of similar effect”), it does not provide clear guidance for tribunals regarding how such indirect expropriation has to be established. In contrast, there is a growing tendency among recent BITs to provide more detailed clarification of the notion directly in the text or in the annexes. For instance, the 2012 Canada – China BIT includes an annex specifically devoted to the issue of clarification of what constitutes indirect expropriation. It provides that:

Indirect expropriation results from a measure or series of measures of a Contracting Party that have an effect equivalent to direct expropriation without formal transfer of title or outright seizure.<sup>33</sup>

Unlike some treaties, the 2012 Canada – China BIT also sets out the criteria to define indirect expropriation, specifically underlining that such a determination requires a case-by-case, fact-based analysis that considers, among others, a number of factors: the economic impact of the measure or series of measures; the degree of interference with investor’s expectations and the character of such measures.

In this context, the BIT requires taking into account the economic impact of a measure or series of measures, but, in parallel, it makes an important clarification that the decrease in the value of investments in itself does not justify the fact of expropriation.<sup>34</sup> It also requires considering not only the character of measure or series of measures, but also such factors as the purpose of the measures and their proportionality to the public interest.<sup>35</sup> As will be explained later, these criteria correspond to one of the “doctrines” or “approaches” aiming at determining whether an indirect expropriation has occurred.

Importantly, the mentioned provision expressly separates a “measure” from “a series of measures”. This separation, particularly, draws a line between indirect expropriation and its controversial subset – “creeping expropriation” which refers to a series of separate government

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<sup>32</sup> Article III (1) of the 2000 Turkey – Yemen BIT.

<sup>33</sup> See Annex B.10 Expropriation in Canada-China BIT (signed September 9, 2012, brought into force October 1, 2014). Identical [similar not identical] provisions are included in Annex B of the 2012 US Model BIT, *supra* note 23; Annex B.13(1) “Expropriation” of the 2004 Canada Model FIPA, see 2004 Canada’s Model Agreement For the Promotion and Protection of Investments [2004 Canada Model BIT], online: ITA Law <<http://italaw.com/documents/Canadian2004-FIPA-model-en.pdf>>. A number of BITs signed by India also include similar provisions, however, with some variations in wording, e.g. Annex “Interpretation of “Expropriation” in Article 5 (Expropriation)” of the 2010 India – Congo BIT; Protocol “Interpretation of “Expropriation” in Article 6 (Expropriation)” of the 2011 India – Slovenia BIT; Art.5(2) (a) of the 2011 India – Nepal BIT.

<sup>34</sup> Annex B.10 of the 2012 Canada – China BIT. Similar provision can be found in Article 4(2) 2013 Belarus-Lao People’s Democratic Republic BIT; Annex A of the 2010 Canada – Slovakia BIT; Art.10 (5) (a) of the 2013 Canada – Tanzania BIT.

<sup>35</sup> Article 4(2) 2013 Belarus-Lao People’s Democratic Republic BIT (author’s translation). Other BITs also contain different variations regarding the criteria applicable to indirect expropriation. In general, such category of BITs commonly mention the severity of measures, stipulating that the sole fact that a measure or series of measures have an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred, degree of interference with investment – backed expectations and require to consider a character of the measures and their rationale. See, for instance, Annex B of 2009 Canada-Romania BIT.

measures that, although not expropriatory when considered as separate and distinct measures, are expropriatory when considered cumulatively.<sup>36</sup> This has been recognized by investment treaty tribunals, for example in *Generation Ukraine, Inc. v. Ukraine*<sup>37</sup> and in *Burlington Resources v. Republic of Ecuador*.<sup>38</sup> Creeping expropriation has also been largely discussed in scholarly literature.<sup>39</sup>

In general, the approach to indirect expropriation introduced in the 2012 Canada – China BIT seems to reduce the risk of having normal legitimate host state’s regulation considered as expropriatory actions. In fact, it strives to provide clear standards and conditions when the host state can interfere with investor’s property, which is the first step to promote investment.

At the same time, not all of the recently concluded BITs incorporate the detailed clarification of indirect expropriation, specific criteria for tribunals to identify its occurrence and, overall, clear conditions for interference with foreign property. A number of them continue to follow an “old-generation” approach with its traditionally vague language and the broad concept of indirect expropriation.<sup>40</sup> Thus, investment treaty practice today is far from being coherent and unified. However, it is worth noting that past arbitral practice has also not provided for a unified coherent approach to indirect expropriation. As it will be discussed in the next section, tribunals often have referred to different tests to determine whether there is an indirect expropriation in the situation at hand. This has resulted in the absence of general consensus in the determination of the concept of indirect expropriation and generated much debate concerning the issue how to safeguard regulatory space for states to act pursuing the sustainable development objectives, while providing effective investment protection against indirect expropriation.

### 1.1.2. Three Tests for Indirect Expropriation

The analysis of case law as well as the growing body of scholarly works demonstrate that the debates on the concept of indirect expropriation are mainly focused around the critical need to strike a balance between the interests of foreign investors and the state’s inherent right to regulate in the public interest.<sup>41</sup> Against this background, three divergent approaches or tests aimed to determine whether there has been an indirect expropriation have emerged in the practice of arbitral tribunals. These tests

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<sup>36</sup> See B.H. Weston, *supra* note 30, at 103.

<sup>37</sup> In *Generation Ukraine* the tribunal defined a concept of “creeping expropriation” as “a form of indirect expropriation with a distinctive temporal quality in the sense that it encapsulates the situation whereby a series of acts attributable to the State over a period of time culminate in the expropriatory taking of such property.” See *Generation Ukraine, supra* note 30 at para.20.22.

<sup>38</sup> *Burlington Resources v. Republic of Ecuador*, ICSID, Case No. ARB/08/5, Decision on Jurisdiction, 2 June 2010, online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0106.pdf>>. The tribunal held that the correct approach for determining whether one act or a series of acts amounted to an expropriation as a matter of international law was to address each act individually: only when no single act constituted an expropriation was it correct

<sup>39</sup>W. Michael Reisman & Robert D. Sloane, “Indirect Expropriation and Its Valuation in the BIT Generation” (2003) 74 BYIL 115, at 128, 142; Errol P. Mendes, “The Canadian National Energy Program: An Example of Assertion of Economic Sovereignty of Creeping Expropriation in International Law (1981) 14:3 Vand J Transnat’l L, 475-507.

<sup>40</sup> See, for instance, the 2013 Russian Federation – Uzbekistan BIT; 2013 Austria – Nigeria BIT; 2013 Serbia – The United Arab Emirates BIT; 2012 Moldova – Qatar BIT.

<sup>41</sup> Maurizio Brunetti, “Indirect Expropriation in International Law” (2003) 5:3 FORUM 150 at 151.

are known as “sole effects”, “police powers” and “proportionality.” Each of them constitutes an analytical framework developed by courts and tribunals in order to manage legal disputes of a particular structure. Arbitrators deploying these approaches evaluate different elements to determine whether or not a state’s measure is expropriatory and subject to compensation. In combining past jurisprudence with the opinions of legal scholars and modern treaty practice, one can define the following factors used from time to time for the determination of indirect expropriation: a) economic impact of the state’s measure which includes the degree of interference and the loss in economic value of the investments; b) investor’s legitimate expectation; and c) character of regulatory measures. This section will examine these determinants in more detail and analyze which approach to indirect expropriation is most compatible with sustainable development and, as a result, more preferable to balance the competing interests in the process of identification of indirect expropriation.

a) “Sole Effects”

It is commonly asserted that insignificant interference with foreign investment would not amount to indirect expropriation.<sup>42</sup> Therefore, a severity of interference as “substantial loss of control” or “substantial loss in value”<sup>43</sup> of foreign investments is the first element required to identify whether indirect expropriatory measures have actually taken place.

In this context, the first approach for the establishment of indirect expropriation is known as the “*sole effects*” test. It considers the impact of the measure as the only relevant criterion to establish an indirect expropriation. The character and purpose of the measure in question are not relevant to the assessment.<sup>44</sup> Although past jurisprudence deploying this approach reflects some level of inconsistency in the language used to describe the degree of interference sufficient for the effect of a taking, some common themes can be identified.<sup>45</sup>

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<sup>42</sup> Significant interference with foreign property is central for the concept of indirect expropriation. For instance, the Iran-US Claims Tribunal in *Starrett Housing v. Iran* qualified indirect expropriation as a state measure interfering with property rights to the extent of rendering them so useless, that they must be deemed to have been expropriated, even though the legal title to the property formally remains with the original owner. *Starrett Housing Corp. v Islamic Republic of Iran*, (1983) 4 Iran-U.S CTR 122, 154 [*Starrett Housing v Iran*]. Another tribunal in *Ronald S. Lauder v. Czech Republic*, held that indirect expropriation is “a measure that does not involve an overt taking, but that effectively neutralizes the enjoyment of the property.” See *Ronald S. Lauder v The Czech Republic*, UNCITRAL, Final Award (September 3, 2001), para. 200, at. 43 [*Ronald S. Lauder v Czech Republic*].

<sup>43</sup> UNCTAD, *Taking of Property*, UNCTAD Series on Issues in International Investment Agreements, at 41, U.N. Doc. UNCTAD/ITE/IIT/15 (2000). In present context the notions “interference with rights” and “economic loss” should be considered separately, as “a substantial interference with rights may well occur without actually causing any economic damage.” See *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID, Case No ARB/05/22, Award, 24 July 2008, at para. 464, online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0095.pdf>> [*Biwater v. Tanzania*].

<sup>44</sup> Rudolf Dolzer, “Indirect Expropriations: New Developments?” (2002) 11 NYU Envtl LJ 64, 78.

<sup>45</sup> Yves Fortier & Stephen L. Drymer, “Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor” (2004) 19 ICSID REV. FILJ 293, 297; Rahim Moloo & Justin Jacinto, “Environmental and Health Regulation: Assessing Liability under Investment Treaties”, (2011) 29:1 Berkeley J Int'l Law 1 at 12.

Among the most illustrative cases supporting the sole effects approach are the decisions in *Metalclad v. Mexico*<sup>46</sup> and *Santa Elena v. Costa Rica*.<sup>47</sup> In addition to the specific test they applied, a notable point of both cases is the tribunal's refusal to consider, *inter alia*, the environmental purpose of the government measures, when determining whether the measures constituted expropriation and assessing the compensation amount. By doing so, the tribunals proposed a strict interpretation of investment law, oriented exclusively towards the protection of property values and thus leaving no chance for sustainable development concerns.<sup>48</sup>

The NAFTA<sup>49</sup> case *Metalclad v. Mexico* involved two separate government measures: the first one was a set of events that cumulatively denied the company a permit to operate a hazardous waste disposal facility, and the second measure was a state-level act that essentially converted the area, used by the investor as a landfill site for hazardous waste operation, into an ecological reserve.<sup>50</sup> Relying on the sole effects test and giving a broad interpretation of the expropriation, the tribunal found that the both government measures amounted to an indirect expropriation. The Tribunal noted that:

Expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host state, but also covert and 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.<sup>51</sup>

Thus, the tribunal defined the notion of indirect expropriation<sup>52</sup> making a positive contribution to the development of NAFTA practice and investment treaty law. The definition makes a clear separation between direct and indirect expropriation, requires considering the economic impact of the measure, including the “expected economic benefit,” which constitutes another important factor - the loss of economic value of the investments. Also, the tribunal stated that the characteristics of the measure in question are irrelevant. Furthermore, in evaluating the ecological decree, the Tribunal explicitly emphasized that it “need not decide or consider the motivation or intent of the adoption of the Ecological Decree”<sup>53</sup> while holding that the adoption of the Ecological Decree was an expropriatory measure as “[the] Decree had an effect of barring forever the operation of the landfill.”<sup>54</sup>

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<sup>46</sup> *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award (30 August 2000), online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0510.pdf>> [*Metalclad v. Mexico*].

<sup>47</sup> *Compañía del Desarrollo de Santa Elena S.A. v. The Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award (17 February 2000), 15 ICSID REV-FILJ 169 (2000) [*Santa Elena v. Costa Rica*].

<sup>48</sup> See S. Di Benedetto, *supra* note 25, at 138.

<sup>49</sup> *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States*, 17 December 1992, Can TS 1994 No 2, 32 ILM 289 (entered into force 1 January 1994) [NAFTA].

<sup>50</sup> See Nathalie Bernasconi-Osterwalder & Lise Johnson, “International Investment Law and Sustainable Development. Key Cases from 2000-2010”, International Institute for Sustainable Development, at 16, online: IISD <[http://www.iisd.org/pdf/2011/int\\_investment\\_law\\_and\\_sd\\_key\\_cases\\_2010.pdf](http://www.iisd.org/pdf/2011/int_investment_law_and_sd_key_cases_2010.pdf)>.

<sup>51</sup> *Metalclad v. Mexico*, *supra* note 46 at para. 195.

<sup>52</sup> See R. Dolzer *supra* note 43 at 72.

<sup>53</sup> *Metalclad v. Mexico*, *supra* note 46 at para. 111.

<sup>54</sup> *Ibid.*

While it is clear that the impact of a state's action on an investor is a basic factor for the analysis of regulatory takings, the main difficulties are connected with the determination when the effect of the measure is "equivalent to expropriation", if such measure does not result in an actual taking. In other words, the main question is how to determine the concrete "point at which or beyond which either compensation is required..."<sup>55</sup>

In general, in order to pass a threshold of "substantial or severe interference", a regulatory measure should have the same effects on property rights as a direct expropriation, including the deprivation of the investor's fundamental rights or the significant duration of such interference. As Ursula Kriebaum indicates, the wording "measures having equivalent effect to nationalization or expropriation" frequently used in the investment treaties, expressly points to the equivalent effect of the measures as a criterion for characterization of such a measure.<sup>56</sup>

The "effect" criterion is recognized and well-established in arbitral practice. In considering whether the effect of substantial deprivation has taken place, the tribunals usually look at a number of questions, including, *inter alia*: has the measure resulted in a total or near-total decrease of the investment's economic value? Has the investor been deprived of the control over the investment? Along with this, the tribunals, from time to time, also considered the duration of the adverse effect of the measure on the investments. Although different tribunals have employed different approaches, they generally agree that the important aspects for identifying indirect expropriation are the *impact on economic value* and *on the control* of the investments.

In general, it is recognized that substantial deprivation of investments should be such as leading to a total or close to a total elimination of the economic value of the investment. For instance, in *Vivendi v. Argentina*,<sup>57</sup> the Tribunal pointed out that the "weight of authority ... appears to draw a distinction between only a partial deprivation of value (not an expropriation) and a complete or near complete deprivation of value (expropriation)."<sup>58</sup> In its analysis, the Tribunal particularly found that the actions taken by Argentina had a "devastating effect on the economic viability of the concession,"<sup>59</sup> that the measures "taken cumulatively, rendered the concession valueless"<sup>60</sup> and forced the investor to "incur unsustainable losses."<sup>61</sup> Taking these factors into account, the Tribunal concluded that:

[c]laimants were radically deprived of the economic use and enjoyment of their investment, the benefits of which (*ie* the right to be paid for services provided) had been effectively neutralised and rendered useless. Under these circumstances, rescission of the Concession Agreement represented the only rational alternative for Claimants. By leaving Claimants

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<sup>55</sup> See R. Dolzer, *supra* note 43 at 80.

<sup>56</sup> Ursula Kriebaum, "Expropriation" in M. Bungenberg, et al, eds., *International Investment Law* (forthcoming Baden Baden: Nomos, 2013), online: <<http://ssrn.com/abstract=2295979>>.

<sup>57</sup> *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v Argentine Republic*, ICSID Case No. ARB/97/3, Award (20 August 2007), online: ITA Law <<http://ita.law.uvic.ca/documents/VivendiAwardEnglish.pdf>> [*Vivendi v Argentina*].

<sup>58</sup> *Ibid.*, at para. 7.5.11.

<sup>59</sup> *Ibid.*, at para. 7.5.26.

<sup>60</sup> *Ibid.*, at para. 7.5.28.

<sup>61</sup> *Ibid.*

with no other rational choice, we conclude that the Province thus expropriated Claimants' right of use and enjoyment of their investment under the Concession Agreement.<sup>62</sup>

The impact of governmental measure on the control of the investments as another element for determining the indirect expropriation was taken into account in *Pope & Talbot v. Canada*.<sup>63</sup> In this case, a U.S. investor with a Canadian subsidiary filed an expropriation claim alleging that Canada's implementation of the U.S. - Canada Softwood Lumber Agreement violated its obligations under the NAFTA Chapter 11.

In its analysis, the tribunal first expressly referred to the concept of "substantial interference", emphasizing that: "the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been 'taken' from its owner."<sup>64</sup> Second, the tribunal also clarified that the effects equivalent to expropriation can have "the action that is confiscatory or that prevents, unreasonably interferes with or unduly delays effective enjoyment of an alien's property."<sup>65</sup> Finally and most importantly for present analysis, the tribunal ruled that the Canada's regulation did not result in a "substantial deprivation" of investor's business interests because the limitations on exports imposed by Canada did not interfere with the management or operations of Pope & Talbot's investment. It particularly stated:

First of all, there is no allegation that the Investment has been nationalized or that the [export control] Regime is confiscatory.... [T]he investor *remains in control of the Investment*, it directs the day-to-day operations of the Investment, and no officers or employees of the Investment have been detained .... Canada does not supervise the work of the officers or employees of the Investment, does not take any part of the proceeds of company sales ..... does not prevent the Investment from paying dividends to its shareholders, does not interfere with the appointment of directors or management and does not take *any other actions outing the Investor from full ownership and control of his investment*.<sup>66</sup> (emphasis added)

As one can see, the tribunal pointed out that there should be a substantial interference with control of investments to justify the effect of taking. This approach was also followed by the tribunal in *Sempra v. Argentina*,<sup>67</sup> where the tribunal found that there had been adverse effects on the conduct of the business. However, it determined that:

[a] finding of indirect expropriation would require more than adverse effects. It would require that the investor no longer be in control of its business operation, or that the value of the business have been virtually annihilated.<sup>68</sup>

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<sup>62</sup> *Vivendi v Argentina*, *supra* note 57 at para. 7.5.34.

<sup>63</sup> *Pope & Talbot Inc. v Canada*, NAFTA, *Interim Award on Merits* (June 26, 2000), 40 ILM, at para. 102 [*Pope & Talbot v Canada*].

<sup>64</sup> *Ibid.*

<sup>65</sup> *Ibid.*

<sup>66</sup> *Ibid.*, para.100.

<sup>67</sup> *Sempra Energy International v The Argentine Republic*, ICSID, Case No. ARB/02/16, Award (28 September 2007), online: ITA Law <<http://ita.law.uvic.ca/documents/SempraAward.pdf>> [*Sempra v Argentina*].

<sup>68</sup> *Ibid.*, at para 285.

The degree of interference as the impact on control of investments was also a key element in the analysis of *Nycomb v. Latvia*<sup>69</sup> – the first expropriation case considered under the Energy Charter Treaty.<sup>70</sup> In this case, in deciding whether the measures may have an effect equal to expropriation, the tribunal acknowledged that “[t]he decisive factor for drawing the border line towards expropriation must primarily be the degree of possession taking or control over the enterprise the disputed measures entail.”<sup>71</sup> Consequently, the expropriation claim was rejected as the tribunal decided that “there is no possession [or] taking of Windau or its assets, no interference with the shareholder’s rights or with the management’s control over and running of the enterprise – apart from ordinary regulatory provisions laid down in the production license, the off-take agreement, etc.”<sup>72</sup>

In *Chemtura v. Canada*<sup>73</sup> the tribunal also relied on the “substantial deprivation” test in determining whether the government measures amounted to indirect expropriation. However, for this purpose, it considered both – the impact on the value and the impact on control of the investment. In this context, a controversy appeared due to the divergent understanding of both Parties of the criteria applied under the “substantial deprivation” test in *Pope & Talbot*<sup>74</sup> and *Metalclad v. Mexico*<sup>75</sup>, which they both referred to.<sup>76</sup> In assessing the impact of the challenged measures, the Tribunal carefully examined the circumstances of the case and found that the measures did not amount to a substantial deprivation of the Claimant's investment. In summary, the Tribunal gathered from the evidence that (i) the sales of the banned product (lindane) were a relatively small part of the overall sales of the investor at all relevant times; and (ii) a Canada-based subsidiary company of the investor Chemtura Canada – remained operational and its yearly sales, although reduced for a while, continued an ascending trend and the Respondent did not interfere with Chemtura Canada’s management, daily operations, or the payment of dividends, in other words, the Claimant remained at all relevant times in control of its investment.<sup>77</sup> Based on this the tribunal concluded that the challenged measures did not amount to a substantial deprivation of the foreign investment. This case is significant as the approach taken by the tribunal demonstrates that there may be a quantitative and (or) a qualitative impact on the control of foreign investments that can either constitute an indirect expropriation.

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<sup>69</sup> *Nykomb Synergetics Technology Holding AB (Sweden) v Latvia*, SCC, Case No. 118/2001, Award (16 December 2003), online: Energy Charter Treaty <[http://www.encharter.org/fileadmin/user\\_upload/Investor-State\\_Disputes/Nykomb.pdf](http://www.encharter.org/fileadmin/user_upload/Investor-State_Disputes/Nykomb.pdf)> [*Nycomb v Latvia*].

<sup>70</sup> Energy Charter Treaty (1994) 2080 UNTS 95, 34 ILM 360 (1995) [ECT].

<sup>71</sup> *Nycomb v. Latvia*, *supra* note 69 at para. 4.3.1.

<sup>72</sup> *Ibid.*

<sup>73</sup> *Chemtura Corporation v Government of Canada*, Ad Hoc NAFTA Arbitration under UNCITRAL, Award (August 2, 2010), online: ITA Law <[http://www.italaw.com/sites/default/files/case-documents/ita0149\\_0.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0149_0.pdf)> [*Chemtura v Canada*].

<sup>74</sup> *Pope & Talbot*, *supra* note 63.

<sup>75</sup> *Metalclad v Mexico*, *supra* note 46.

<sup>76</sup> *Chemtura v Canada*, *supra* note 73 at para. 246. (The Claimant has argued that the degree of control retained in the investment following an alleged indirect expropriation may be a factor to consider whether a governmental act (or acts) rises to the level of a treaty breach, however it is not “the exclusive or even a necessary factor in this determination (Reply, para. 554).” In turn, the Respondent placed much stronger emphasis on the degree of interference with the investor’s ownership and control of its investment as part of the substantial deprivation test.)

<sup>77</sup> *Ibid.*, at paras. 263-264.

Another important element to consider here is the concept of investor's legitimate expectations - typically an element of fair and equitable treatment standard (FET), but increasingly used also in the context of indirect expropriation.<sup>78</sup> While it is understandable that the purpose of foreign investment is always associated with expectations of certain profit, many governments by using special incentives, subsidies and other mechanisms to attract foreign investors create particular grounds for such expectations. Thus, the concept may encompass expectations resulting from the current host state's regulatory environment as well as the specific assurances given by the host state on which it may have relied making the decision to invest. The frustration of such investor's expectation may be an important factor in determining whether indirect expropriation has occurred, despite some opinions, that it is a rather controversial concept.<sup>79</sup>

Tribunals have frequently referred to investor's legitimate expectations when deciding claims regarding indirect expropriation. For instance, the Tribunal in *LG&E v. Argentina*<sup>80</sup> emphasized that the interference with expectations of an investor should be considered as a kind of economic impact on the investments, when deciding whether certain governmental measures are expropriatory. It stated that:

[i]n evaluating the degree of the measure's interference with the investor's right of ownership, one must analyze the measure's economic impact – its interference with the investor's reasonable expectations – and the measure's duration.<sup>81</sup>

In *Metalclad*, the tribunal also observed that the measures that have the effect of depriving the investor of the reasonably to be expected economic benefit of property may appear expropriatory. As already cited in the above, the tribunal stated that:

... expropriation under NAFTA includes ... 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.<sup>82</sup>

Indeed, this criterion may play a role in defining indirect expropriation. Tribunals may find the regulatory measures amounted to indirect expropriation on the basis of violation of investor's expectation and in the absence of a deprivation of property.<sup>83</sup> In order to rely on the legitimate expectations, the investor should first receive *express* and *specific* representations from the host state

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<sup>78</sup> R. Dolzer *supra* note 43 at 78. For a fuller discussion on this subject see also André von Walter, "The Investor's Expectations in International Investment Arbitration", in A. Reinisch & C. Knahr, eds., *International Investment Law in Context*, (Utrecht: Eleven International, 2008), 173 at 175.

<sup>79</sup> The controversy of the principle of legitimate expectation was also observed by the El Paso tribunal: "There is not always a clear distinction between indirect expropriation and violation of legitimate expectations (...).According to this tribunal, the violation of a legitimate expectation should rather be protected by the fair and equitable treatment standard." See *El Paso Energy Inc. v Argentina*, *supra* note 38.

<sup>80</sup> *LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability (3 October 2006), (2007) 46 ILM 36 [*LG&E v Argentina*].

<sup>81</sup> *Ibid*, at para. 190.

<sup>82</sup> *Metalclad v Mexico*, *supra* note 46, at para. 103.

<sup>83</sup> Ioana Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (Oxford: Oxford University Press, 2008), 164.

with respect of its investment. This may include specific legislation and regulations, any undertakings or guarantees explicitly made by public authorities.<sup>84</sup> While a host state may resort to different mechanisms to attract foreign investors and thus, at first blush, may create a broad basis for investor's expectations, it should be clear that not every promise, representation or assurance given by a host state, in fact, introduce the grounds for such expectations.<sup>85</sup> Thus, in determining the violation of investor's legitimate expectations, the arbitrators usually look at the behaviour of the host state's authorities during their relationship with the investor.

The *Tecmed v. Mexico*<sup>86</sup> case is a clear example in which the tribunal took account of the role of investors' expectations vis-à-vis indirect expropriation. In particular, in establishing whether Mexico's regulatory measures amounted to indirect expropriation, the tribunal considered it important to "determine whether such measures are reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of who suffered such deprivation."<sup>87</sup> In this case, the tribunal resorted to the concept of investor's legitimate expectation within the framework of the proportionality analysis to evaluate the effect on the investor and specified that a finding of indirect expropriation is dependant, *inter alia*, on investment-backed legitimate expectations in conjunction with other criteria, as guided by the proportionality test.

In discussing the issue of legitimate expectations, another tribunal in *Azurix v. Argentina*<sup>88</sup> held that expectations of an investor "are not necessarily based on a contract but on assurances explicit or implicit, or on representations made by the State which the investor took into account in making the investment."<sup>89</sup> Later, in *Grand River v. United States*<sup>90</sup> the tribunal affirmed the relevance of investor's expectations for establishment of indirect expropriation in the NAFTA context stating that it understands the concept as the one that corresponds "with those expectations upon which an investor

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<sup>84</sup> It is clear that express promises of host state that, for example, certain incentives will be implemented to increase or optimize foreign investment in particular sectors of economy or a certain procedure will be followed by government, may give rise to legitimate expectations of an investor. These can be made in the form of explicit representations contained in pamphlets, policy documents, resolutions, specific commitments contained in licenses or in other forms. Obviously, entering into legally binding memorialized commitments with an investor is the clearest form of promise that can be made by a host state. Several tribunals, like *PSEG v Turkey*, have found that where an investor cannot show a sufficiently binding commitment by the state, there can be no legitimate expectations. See *PSEG Global Inc., et al. v Republic of Turkey*, ICSID Case No. ARB/02/5, Award (January 19, 2007) at paras. 241-242, online: ITA Law <<http://www.italaw.com/documents/PSEGGlobal-Turkey-Award.pdf>> [*PSEG v Turkey*]. At the same time, some authors, like Rudolf Dolzer & Christoph Schreuer, also note that legitimate expectations may be based on representation made *explicitly or implicitly* by the host State, or even of a *mixture of these factors*. See R. Dolzer & C. Schreuer, *supra* note 26 at 134.

<sup>85</sup> As summarized and explained by M. Potestà, the requirement that a promise be specific may concern the object (i.e., the content) and the form of the representation. In a different sense, specificity means individualisation, i.e., the promise or representation is addressed to the individual investor, and not to the generality. Such latter distinction assumes particular importance when expectations are grounded in instruments of general application (such as legislation). For a fuller discussion on this issue, see Michele Potestà, "Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept" (2013) 28:1 ICSID Review 88 at 95.

<sup>86</sup> *Tecnicas Medioambientales Tecmed SA v United Mexican States*, ICSID Case No ARB(AF)/00/2 (29 May 2003), 43 ILM 133 [*Tecmed v Mexico*].

<sup>87</sup> *Ibid* at 122.

<sup>88</sup> *Azurix Corp. v The Argentine Republic*, ICSID Case No. ARB/01/12, Award (July 14, 2006), online: ITA Law <<http://italaw.com/documents/AzurixAwardJuly2006.pdf>> [*Azurix v Argentina*].

<sup>89</sup> *Ibid*, at para. 309.

<sup>90</sup> *Grand River Enterprises Six Nations, Ltd., et al. v United States of America*, NAFTA, Arbitration under UNCITRAL Rules, Award (January 12, 2011), online: US Department of State <<http://www.state.gov/documents/organization/156820.pdf>> [*Grand River v United States*].

is entitled to rely as a result of representations or conduct by a state party.”<sup>91</sup> In the next paragraph, similarly to *Azurix*, the tribunals clarified that such expectations normally arise on the basis of “targeted representations or assurances made explicitly or implicitly by a state party.”<sup>92</sup> Thus, the investor’s expectations may be created either from express representations, or in some cases, implicitly - by way of past practice of a host state.

An additional element should be stressed in this regard. In order to receive protection, the expectations of an investor have to be legitimate and reasonable. When deciding to invest in a developing country, it is obvious that an investor cannot expect the same level of stability and administrative efficiency as it could find in a developed country. In this sense, the Tribunal in *El Paso v. Argentina*<sup>93</sup> referred to the *Generation Ukraine Inc. v. Ukraine*<sup>94</sup> which expressly acknowledged that “‘legitimate expectations’ might differ between an economy in transition such as that of Ukraine and a more developed one.”<sup>95</sup> Again, if at the time of investment, the investor failed to take into account a number of factors, such as the economic, historical and socio-political environment in the host state, a claim of legitimate expectations may be unlikely to succeed. This was the case in *Saluka v. Czech Republic*,<sup>96</sup> where a claim of legitimate expectations based on the Claimant’s reliance on representations made by a former Minister of Finance was rejected by the tribunal. The claim was brought under the Netherlands – Czech Republic BIT concerning state financial assistance given by the Czech Republic to a number of banks, but not including Saluka, to overcome the systemic bad loans problems in the Czech banking sector.<sup>97</sup>

The tribunal considered a range of elements to determine whether the Czech Republic had actually failed to ensure a transparent and predictable framework for investment, and thus, frustrated the investor’s legitimate expectations “*without reasonable justification*”.<sup>98</sup> First, in evaluating the claim, the tribunal found that the investor’s expectation that “the Government would not address the bad loan problem” by providing state aid to the banks was “initially said to have been based on an express assurance to that effect given by the then Minister of Finance.”<sup>99</sup> Yet, the tribunal noted:

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<sup>91</sup> *Ibid.*, at para. 140.

<sup>92</sup> *Ibid.*, at para. 141.

<sup>93</sup> *El Paso Energy International Company v The Argentine Republic*, ICSID Case No. ARB/03/15 (31 October 2011), online: ITA Law <[http://italaw.com/documents/El\\_Paso\\_v.\\_Argentina\\_Award\\_ENG.pdf](http://italaw.com/documents/El_Paso_v._Argentina_Award_ENG.pdf)> [*El Paso v Argentina*]. It must be noted that in present case the tribunal considered the concept of legitimate expectations in relation to the FET. However, the reasoning of the tribunal is significant and, theoretically, can be taken into account in the context of indirect expropriation. The same logic also applies to the other two cases cited in this section, namely, *Generation Ukraine supra* note 30, *Saluka v Czech Republic infra* note 95 and *EDF v. Romania, infra* note 105.

<sup>94</sup> *Generation Ukraine, supra* note 30 at para. 20.37.

<sup>95</sup> *El Paso v Argentina, supra* note 93 at para. 360.

<sup>96</sup> *Saluka Investments BV (The Netherlands) v The Czech Republic*, Arbitration under UNCITRAL Rules, Partial Award (17 March 2006), at para. 307, online: Permanent Court of Arbitration <[www.pca-cpa.org/showfile.asp?fil\\_id=105](http://www.pca-cpa.org/showfile.asp?fil_id=105)> [*Saluka v Czech Republic*].

<sup>97</sup> *Ibid.*, at para. 349. In particular, the Claimant argues that Saluka’s legitimate expectations have been frustrated by (i) contradictory and misleading declarations about its policy towards the banking sector in crisis and by justifying the exclusion of the investor’s bank from the State aid granted to save the other banks on the grounds that it had already been fully privatised; (ii) the introduction of more stringent prudential rules for the banks made by the National Bank of the Czech Republic and (iii) by leaving the banks with no effective mechanisms to enforce loan security.

<sup>98</sup> *Ibid.*, para. 348 (emphasis added).

<sup>99</sup> *Ibid.*, para. 351.

“[w]hatever assurance the Minister of Finance may have given, he could not bind future Governments. Especially, he could not give any assurance that the privatisation of the other banks would proceed in the same way as the privatisation of IPB, i.e. without any State financial assistance.”<sup>100</sup>

Thus, the tribunal established that the foreign investor had no reasonable grounds for expecting that there would be no future change in the Czech Republic’s policy towards the bank sector’s bad loan problem, or in state aid policies.

Second, the tribunal stated that the Czech National Bank’s policy of “tightening the regulatory regime” must be seen in the specific context - the Czech Republic’s preparation for accession to the European Union.<sup>101</sup> Also, it observed that it was Czech National Bank’s “declared intention to bring its regulatory regime into line with the norms in the European Union.”<sup>102</sup> Considering this, the foreign investor could not have reasonably expected the Czech Republic to relax its regulatory regime in the related sector. Finally, the tribunal concluded that the longstanding legal problems with respect to enforcement of loan security must have been known to the foreign investor when it made its investment. An expectation that such problems would quickly be fixed by the Czech Republic would have been unfounded.<sup>103</sup> Based on the above, the tribunal rejected the claim that the Czech Republic has frustrated the investor’s legitimate expectations.

Arguably, the main challenges in respect of the investor’s legitimate expectations derive from the fact that such a broad concept may cover “an infinity of situations and become a catch-all concept”.<sup>104</sup> Thus, it is important to consider the decision in *EDF v. Romania*, which is a good illustration of the recent trend to avoid a broad interpretation of the concept of legitimate expectations. In this case, the Tribunal held that “investors may not rely on a bilateral investment treaty as kind of insurance policy against the risk of any changes in the host State’s legal and economic framework”, while underlining that “[s]uch expectations would be neither legitimate nor reasonable.”<sup>105</sup>

The above discussion suggests that application of the concept of legitimate expectations largely depends on the individual circumstances of the case. Neither past case law or treaty practice provide a clear answer regarding its application. Thus, in the context of indirect expropriation, judicial review of government conduct with respect to investor’s legitimate expectations must be carried out in a balanced and thorough manner, bearing in mind that policy changes are actually a standard business risk that can be considered before or at the moment of investment.<sup>106</sup> It must be also noted that to constitute an

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<sup>100</sup> *Ibid.*

<sup>101</sup> *Ibid.*, at para. 357.

<sup>102</sup> *Ibid.*

<sup>103</sup> *Ibid.*, at para. 360.

<sup>104</sup> Ioana Tudor, *supra* note 83 at 166.

<sup>105</sup> *EDF (Services) Limited v Romania*, ICSID case No. ARB/05/13, Award (October 8, 2009) at para. 217, online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0267.pdf>> [*EDF v Romania*].

<sup>106</sup> While the crux of expropriation lies in the financial risks it creates for foreign investor because of the political changes in the host countries, the investor can invoke the expropriation risk insurance products to alleviate the according financial risks posed by expropriations. For instance, the principal American insurer of expropriation risks has been the Overseas Private Investment Corporation (O.P.I.C.), a publicly operated venture carrying out the government-operated expropriation insurance scheme. Similar plans are operated

indirect expropriation, the breach of such expectations should have as much impact as to render the investment valueless.

While no one will seriously doubt that the basic criteria of the sole effects approach - severity of interference with the investments and the loss in their economic value – is a necessary element of an indirect expropriation, a real deficiency of this approach is reflected in its one-dimensional focus on the economic component – the impact on the investor’s rights and interests. This, by definition, excludes any possibility to consider other factors such as the character of the state’s measure and the context in which it has been adopted, its necessity for the purposes of certain legitimate policy, such as public health or environmental objectives.

The approach to indirect expropriation which is focusing exclusively on the “sole effect” on an investor may threaten the promotion of public welfare and create greater risks of regulatory chill.<sup>107</sup> While the foreign investors have the right to protect their property and the states have the right to protect the environment, the key question is the proportionality between the competing interests which could not be achieved if addressing only adverse effect on investment without consideration of the host state’s public interest.

Indeed, from the viewpoint of sustainable development, the sole effects approach, with its “anachronistic focus on ‘deprivation’” alone,<sup>108</sup> is not merely unsatisfactory, but outdated. Having originated at the time when expropriation deemed wrongful merely because something of value had been taken without compensation,<sup>109</sup> its analytical framework is unable to effectively address economic, environmental and social concerns in a balanced way, i.e. on the same footing as required by the concept of sustainable development.

The principle problem of the sole effects test therefore lies in its methodology. By focusing on the criteria whether or not the interference with investments had an extreme effect, it seems to be poorly equipped to distinguish between permissible and impermissible state interferences with adequate consideration of non-economic values – a crucial task to safeguard policy space for state’s measures taken in good faith and for a public welfare purpose. As a result, the sole effects test appears insufficient

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by Canada, Australia, Belgium, Germany, France, Denmark, Switzerland, Japan, Korea, Norway, Poland, Sweden, Netherlands, Turkey, the United Kingdom and others. See Kathryn Gordon, “Investment Guarantees and Political Risk Insurance: Institutions, Incentives and Development”, *Investment Policy Perspectives 2008* (Paris: *OECD, 2008*), online: [OECD <http://www.oecd.org/finance/insurance/44230805.pdf>](http://www.oecd.org/finance/insurance/44230805.pdf).

<sup>107</sup> Some authors, like Kevin R. Gray and Kate Miles are referring to the phenomenon that states refrain from enacting stricter environmental standards in response to fears of losing a competitive edge against other countries in obtaining FDI. See Kevin R. Gray, “Foreign Direct Investment and Environmental Impacts – Is the Debates Over?” (2002) 11:3 *RECIEL* 307 at 310; Kate Miles, “International Investment Law and Climate Change: Issues in the Transition to a Low-Carbon World” (2008) *SIEL Working Paper No. 27/28*, at 22-26, online: <http://ssrn.com/abstract=1154588>. While it is difficult to prove the validity of the “regulatory chill”, some studies demonstrate that negative implications resulted from this phenomenon is not a purely theoretical problem. For instance, as noted by Professor Van Harten, the practical evidence of chilling effect are, *inter alia*, the documented withdrawals by Canada of a proposal to impose cigarette plain-packaging regulations, to establish public auto insurance, and to privatize a water filtration plant following the threat of investor-state arbitration. See Gus Van Harten, “Submission to the Productivity Commission: Bilateral and Regional Trade Agreements Study” (Australian Government Productivity Commission 2010) at 5, online: [The Australian Government <http://www.pc.gov.au/inquiries/completed/trade-agreements/submissions/subdr099.pdf>](http://www.pc.gov.au/inquiries/completed/trade-agreements/submissions/subdr099.pdf).

<sup>108</sup> Mavluda Sattorova, “Investment Treaty Breach as Internationally Proscribed Conduct: Shifting Scope, Evolving Objectives, Recalibrated Remedies?” (2012) *IV:2 TD&L* 321 at 323.

<sup>109</sup> *Ibid*, at 331.

to establish the existence of indirect expropriation when legitimate public interest regulations are at issue.

The modern treaty practice also points to the direction of multi-faceted approaches in assessment of indirect expropriation. The new generation of BITs clearly indicate not one, but a number of factors which go far beyond the narrow economic focus of the substantial deprivation test.<sup>110</sup> Accordingly, the developing state practice reflected by these BITs openly suggests the preferable framework for expropriation analysis leading to a rebalancing of respective rights and responsibilities of both states and investors. This framework leaves no space for the sole effects approach.

b) “Police Powers”

The second test for determining the presence of indirect expropriation relates to the applicability of the “*police powers*” concept<sup>111</sup> according to which certain types of general regulatory measures of host states are not subject to compensation under the international law of expropriation, regardless of their effect on the investor’s property. Although there is no single definition of the police powers concept, it is generally accepted as a matter of customary international law<sup>112</sup> that where economic injury results from a *bona fide* non-discriminatory regulation within the police powers of the State, compensation is not required.<sup>113</sup> Hence, the scope of police powers generally includes measures adopted by a state under its normal function to protect the environment, human health, safety or other legitimate public welfare objectives. In addition to the public purpose requirement, such a measure must be non-discriminatory, taken in good faith and in accordance with due process of law. These criteria are, in fact, identical to those established for a lawful expropriation.<sup>114</sup>

In investment law circles, the concept of state police powers has been recognized by many scholars, who believe that the regulatory conduct of states must carry a presumption of validity. In particular, Professor Vaughan Lowe notes that:

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<sup>110</sup> The approaches to assessment of indirect expropriation contained in newly concluded BITs will be addressed further in more detail.

<sup>111</sup> The origin of the state’s right to regulate in international investment law lies in the customary international law concept of “police powers.” The Black’s Law Dictionary defines the police powers as “the power of a state to place restraints on personal freedom and property rights of persons for the protection of the public safety, health, and morals, or the promotion of the public convenience and general prosperity. . . . The police power is the exercise of the sovereign right of a government to promote order, safety, security, health, morals and general welfare within the constitutional limits and is an essential attribute of government.” See *The Black’s Law Dictionary* 6<sup>th</sup> ed., *sub verbo* “police powers”.

<sup>112</sup> Jorge E. Viñuales, “Sovereignty in Foreign Investment Law” in Z. Douglas, J. Pauwelyn & Jorge E. Viñuales, eds., *The Foundations of International Investment Law: Bringing Theory into Practice* (Oxford: Oxford University Press, 2014), 329.

<sup>113</sup> The specific requirement for the application of the police powers doctrine has been spelled out in Art. 10(5) of the so-called “The 1961 Harvard Draft” See Restatement (Third) of the Foreign Relations Law of the United States, American Law Institute, Volume 1, 1987, Section 712, Comment (g) [Restatement Third]; See also H. Mann & J.A. Soloway, “Untangling the Expropriation and Regulation Relationship: Is There a Way Forward?” Report to the Ad Hoc Expert Group on Investment Rules and the Department of Foreign Affairs and International Trade (March 31, 2002) at 8, online: <<http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/untangle-e.pdf>>; UNCTAD, *Expropriation: UNCTAD Series of Issues on International Investment Agreements II*, (New York: United Nations, 2012), 79, UNCTAD/DIAE/IA/2011/7 (2011); B. Sohn & R.B. Baxter, “Responsibility of States for Injury to the Economic Interests to Aliens”, 55 AJIL (1961), 545; Article 10(5) of the 1961 Harvard Draft.

<sup>114</sup> See J. A. VanDuzer et al., *supra* note 3 at 165. As will be discussed later, recent treaty practice relying on the police powers rule invites to consider the nature, purpose and character of a measure to distinguish between an indirect expropriation and a non-compensation regulatory act. On this subject see also “*Expropriation: UNCTAD Series on Issues in International Investment Agreements II*” *supra* note 114 at 86-90.

The persistence of the regulatory powers of the host State ... is an essential element of the permanent sovereignty of each State over its economy...Nothing in the language of bilateral investment treaties purports to undermine the permanent sovereignty of States over their economies.<sup>115</sup>

Indeed, it is important to recognize the state's right to regulate in the public interest by virtue of police powers. Considering that host states have the right to implement regulatory measures having a legitimate public purpose, investor protection should not come at the expense of the state's role in protecting public welfare.<sup>116</sup> Pointing out the recognition of this principle at the international level, Andrew Newcombe emphasizes that "international authorities have regularly concluded that no right to compensate arises for reasonably necessary regulations passed for the protection of public health, safety, morals or welfare."<sup>117</sup>

To secure an adequate regulatory space for states in the pursuit of environmental policies and the public interest in general, Howard Mann and Konrad von Moltke have argued that:

[u]nder the traditional international law concept of the exercise of police powers, when a state acted in a non-discriminatory manner to protect public goods such as its environment, the health of its people or other public welfare interests, such actions were understood to fall outside the scope of what was meant by expropriation... Such acts are simply not covered by the concept of expropriation, were not a taking of property, and no compensation was payable as a matter of international law."<sup>118</sup>

In broad terms, the police powers test is "not as a criterion which is weighed in the balance with other requirements, but as a controlling element which helps to exempt the government measure from any compensation."<sup>119</sup>

Past case law based on the police powers concept suggests that the character of the governmental measure (i.e. its purpose and the context in which it has been adopted) is a very significant factor of the indirect expropriation analysis. A clear illustration of the "police powers approach" is the case *Methanex v. USA*<sup>120</sup> - one of the first arbitrations initiated against the United States under the investment chapter of the NAFTA. In this case, Methanex Corporation, a Canada-based manufacturer of methanol, claimed \$970 million in compensation from the US for an order adopted by the State of California to ban the use of MTBE of which methanol was a key ingredient.<sup>121</sup> Relying on the approach applied in

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<sup>115</sup> Vaughan Lowe, "Regulation or Expropriation", (2004) 1:3 TDM, at 4.

<sup>116</sup> Similarly, the police powers may not be read as to preventing investors from normal enjoyment of protection against expropriation in environmental-related investment conflicts.

<sup>117</sup> Andrew Newcombe, "The Boundaries of Regulatory Expropriation in International Law" (2005) 20:1 ICSID Rev. 1, at 23.

<sup>118</sup> Howard Mann & Konrad Von Moltke, "Protecting Investor Rights and the Public Good: Assessing NAFTA's Chapter 11" (Winnipeg: IISD, 2003), at 16. Such proposal, often regarded as "radical", has been critically discussed in academia up to now. For instance, some scholars take an opposite view arguing that a certain category of state's regulatory acts cannot be carved out from the expropriation doctrine under the banner of police powers doctrine. For further discussion see Justin R. Mariles, "Public Purpose, Private Losses: Regulatory Expropriation and Environmental Regulation in International Investment Law" (2007) 16:2 J Transnat'l L & Pol'y 275 at 277; Ben Mostafa, "The Sole Effects Doctrine, Police Powers and Indirect Expropriation under International Law" (2008) 15 Australian Int'l L J 267.

<sup>119</sup> OECD, "'Indirect Expropriation' and the 'Right to Regulate' in International Investment Law", *supra* note 22.

<sup>120</sup> *Methanex Corporation v United States of America*, NAFTA, Arbitration under UNCITRAL Rules, Final Award (5 August 2005), online: US Department of State <<http://www.state.gov/documents/organization/51052.pdf>> [*Methanex v USA*].

<sup>121</sup> MTBE is the element in gasoline most likely to contaminate groundwater due to its high degree of solubility, its tendency to move at the same or faster velocity than the water it contaminates, and its failure to biodegrade to the same degree as other gasoline components.

*Metalclad v. Mexico*, Methanex claimed that the imposed regulatory ban amounted to an expropriation that required compensation due to its severe economic impact on the investor.

The Tribunal, however, rejected the “sole effects” approach, and analyzed the claim from the police powers perspective. In particular, it stated that:

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 alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.<sup>122</sup>

Applying a modern regulatory approach, the Tribunal reaffirmed the relevance of the police powers concept for indirect expropriation analysis when dealing with sensitive issues of the environment protection and human health. It held that “the Californian ban was made for a public purpose, was nondiscriminatory, and was accomplished by due process,” and that from the standpoint of international law, it was “a lawful regulation and not an expropriation.”<sup>123</sup> In other words, the Tribunal differentiated the Californian ban from expropriation, qualifying it as a regulatory measure that falls within the state’s right to regulate and is not subject to compensation. Thus, with a single sentence, the Tribunal endorsed a “police powers” exception from the concept of expropriation and excluded the particular state’s *bona fide* regulation for a public welfare purpose from the compensation requirement. At the same time, by using the phrase “unless specific commitments had been given by the regulating government” the Tribunal seems to restrict the exercise of state’s police powers in cases where specific assurances are present.<sup>124</sup> In fact, the lack of a host state’s specific commitments which may create investor’s legitimate expectations appeared not merely relevant for purposes of determination of indirect expropriation, but also decisive in this case.

Nonetheless, the application of this approach by the *Methanex* Tribunal signals that the degree of interference with the investment may not be seen as the only element required establishing an indirect expropriation. This alone is a “critical point in the evolution of NAFTA jurisprudence and that of international investment arbitration generally”.<sup>125</sup> As a result, two essential aspects have been emphasized by this case: first, the purpose of regulation has been affirmed as a proper criterion for identifying non-compensable regulation; second, the public policy concerns that drove Californian

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See United States Environmental Protection Agency, Report No. 420-R-99-021, “Achieving Clean Air And Clean Water: The Report Of The Blue Ribbon Panel On Oxygenates In Gasoline 2” (US EPA, September 15, 1999) at 76, online: US Environmental Protection Agency <<http://www.epa.gov/oms/consumer/fuels/oxypanel/r99021.pdf>>.

<sup>122</sup> *Methanex v USA*, *supra* note 121, Part IV, Chapter D, at para.7.

<sup>123</sup> *Ibid*, at para.15.

<sup>124</sup> Sebastián López Escarcena, *Indirect Expropriation in International Law*, (Cheltenham: Edward Elgar Publishing, 2014) at 170. For further discussion see also Howard Mann, “The Final Decision in *Methanex v. United States: Some New Wine in Some New Bottles*” (IISD, August 2005) at 7, online: IISD <[https://www.international-arbitration-attorney.com/wp-content/uploads/arbitrationlawcommentary\\_methanex.pdf](https://www.international-arbitration-attorney.com/wp-content/uploads/arbitrationlawcommentary_methanex.pdf)>; Jorge E. Viñuales, “Foreign Investment and the Environment in International Law” (Cambridge: Cambridge University Press, 2012), 372.

<sup>125</sup> See H. Mann, *supra* note 125 at 7.

environmental legislation have been elevated to the higher plane than the economic interests of the private investor. This approach does not result in a careful balance between the economic impact of the measure and its character, but, instead, accords a strong focus on the purpose of the measure.<sup>126</sup>

The application of the police powers approach has been confirmed in other arbitration decisions.<sup>127</sup> For instance, in the recent case *Chemtura Corporation v. Canada*<sup>128</sup> the Tribunal declared that the measure challenged by the Claimant constituted a valid exercise of the Respondent's police powers. In particular, the Tribunal concluded, by reference to another award adopted in *Saluka v. Czech Republic*:<sup>129</sup>

As discussed in detail in connection with Article 1105 of NAFTA, the PMRA [Canada's Pest Management Regulatory Agency] took measures within its mandate, in a non-discriminatory manner, motivated by the increasing awareness of the dangers presented by lindane for human health and the environment. A measure adopted under such circumstances is a valid exercise of the State's police powers and, as a result, does not constitute an expropriation.<sup>130</sup>

As one can see, tribunals have expressly relied on the police powers doctrine to justify environmental regulation enacted for a public purpose and excluded it from the scope of expropriation. Thereby, the *Chemtura* case acknowledged the applicability or, as Jorge E. Viñuales calls it - "actionable character"<sup>131</sup> - of the police powers concept as an "expression of states' sovereignty"<sup>132</sup> to adopt important public policy regulation. Ultimately, the tribunal found that no expropriation had occurred.

The above analysis suggests that the application of the police powers approach has been recognized in case law on indirect expropriation involving public interest concerns. Under this approach the arbitrators analyze the aim of the measure, determining whether or not it is discriminatory and falls within the sovereign police powers of the host state. When undertaking such an approach, tribunals have seldom sought to explain what exactly they were doing. In many cases they simply referred to the police powers concept without explaining explicitly how it was used and what were the precise criteria for a measure to be qualified as non-expropriatory. Such an explanation, however, is important as it provides states and foreign investors with predictability so that a measure can be adopted to avoid violations. Better interpretation of the concept itself may, in turn, lead to better compliance

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<sup>126</sup> Many commentators agree that other factors, such as the effects of the government action and the degree and duration of economic harm to the investor, were not even considered by the tribunal in *Methanex v USA*. See for instance, Rashel D. Edshall, "Indirect Expropriation under NAFTA and DR-CAFTA: Potential Inconsistencies in the Treatment of State Public Welfare Regulations" (2006) 86 BU L Rev 952.

<sup>127</sup> The distinction between indirect expropriation and a non-compensable police power measure was recognized in *S.D. Myers v Canada*, *supra* note 21, *CME (Czech Republic) BV v The Czech Republic*, UNCITRAL, Final Award (September 13, 2001) at para. 603, online: ITA Law <[http://italaw.com/documents/CME-2003-Final\\_001.pdf](http://italaw.com/documents/CME-2003-Final_001.pdf)> [*CME v Czech Republic*]; *Azurix v Argentina*, *supra* note 88 at para. 310.

<sup>128</sup> *Chemtura v Canada*, *supra* note 73.

<sup>129</sup> *Saluka v Czech Republic*, *supra* note 103, at para. 262.

<sup>130</sup> *Chemtura v Canada*, *supra* note 73 at 266.

<sup>131</sup> Jorge E. Viñuales, "Sovereignty in Foreign Investment Law" *supra* note 112, at 329.

<sup>132</sup> *Ibid.*

with BITs and decrease controversies with respect to distinguishing indirect expropriation from non-compensable regulation.

Summarising the findings of past arbitration tribunals, the police powers approach can be described as follows: where the conflict arises between a non-economic regulation (e.g. labor rights, health, environmental protection) and interference with foreign investment, the former would “prevail”, if the regulatory measure is non-discriminatory, designed to serve the public interest, in accordance with due process of law, unless specific commitments have been given by the host state to the investor that such measures would not be adopted.<sup>133</sup> In such a situation, no compensation would arise for investors, regardless of the severity of the state’s measure.

From a sustainable development perspective, the police powers approach leaves more room for consideration of important public concerns and thus holds some promise as a basis for defending sustainable development regulatory measures.<sup>134</sup> However, much of the implementation of this exemption depends on the factual circumstances of the case, the government approach to regulation as well as the language of the treaty at hand and its interpretation. Moreover, the strong focus on legitimate regulation in the public interest, with comparatively minor or no consideration of the economic impact on the investor, makes the police powers test unable to ensure a balancing of the competing interests. Considering that international investment plays an increasingly important role for sustainable development,<sup>135</sup> the police powers approach, by failing to take into account investor interests, is inconsistent with sustainable development.

### c) Proportionality

As already mentioned, in some situations it is quite difficult for arbitrators to determine whether an indirect expropriation has occurred based on whether a government measure affecting the foreign investment has been taken for a legitimate public purpose. This is particularly relevant for investment disputes regarding indirect expropriation that involve economic implications for investor’s property and environmental or social implications for the public. In some cases, a proportionality analysis<sup>136</sup> has been employed in the context of indirect expropriation as a suitable test for resolution of these types of conflicts, usually between public and private interests.

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<sup>133</sup> J. Viñuales, *supra* note 124 at 371.

<sup>134</sup> Roland Kläger, “Fair and Equitable Treatment’ and Sustainable Development” in Marie-Claire Cordonier Segger, Markus W. Gehring, & Andrew Newcombe, eds., *Sustainable Development in World Investment Law* (The Hague: Kluwer Law International, 2011) 237 at 241-42.

<sup>135</sup> See, for instance, Nathalie Bernasconi-Osterwalder, et al., “Investment Treaties & Why They Matter to Sustainable Development: Questions & Answers”, International Institute for Sustainable Development (2012) at 1, online: IISD <[http://www.iisd.org/pdf/2011/investment\\_treaties\\_why\\_they\\_matter\\_sd.pdf](http://www.iisd.org/pdf/2011/investment_treaties_why_they_matter_sd.pdf)>.

<sup>136</sup> The proportionality analysis is based on the “principle of proportionality” - a principle to deal with the relationship between end and means, demanding an appropriate relationship between them. In addition, the underlying concept is to balance conflicting benefits. See Xiuli Han, “The Application of the Principle of Proportionality in *Tecmed v. Mexico*”, (2007) 6:3 Chinese JIL 635.

Stemming from German administrative and constitutional law,<sup>137</sup> proportionality analysis has been extensively used in international adjudication in different contexts.<sup>138</sup> The European Court of Human Rights (ECHR) first introduced it in international law. When relying on the proportionality approach the Court explained its function as one aiming to “determine whether a fair balance was struck between the demands of the general interests of the community and the requirements of the protection of the individual’s fundamental rights.”<sup>139</sup> For this purpose, the “fair balance” analysis should involve establishing whether a measure is “both appropriate for achieving its aim and not disproportionate thereto.”<sup>140</sup>

The ECHR tried to apply the “proportionality” approach by using a three-stage test<sup>141</sup> to assess the investor’s interests with the state’s right to regulate so as to determine which should be prioritized. Its traditional European model, as applied by the ECHR, includes the following three analytical stages - suitability, necessity, and proportionality *stricto sensu*, which must be assessed cumulatively.<sup>142</sup> The starting point of the proportionality analysis is an assessment of legitimacy of the regulatory objective, which “aims at filtering out the illegitimate or impermissible purposes.”<sup>143</sup> This stage requires a determination of the *suitability* of the adopted measure’s purpose: a measure must be suitable actually to protect the public interest that requires protection and constitute an effective means of attaining its purpose. Accordingly, there should be a causal relationship between the adopted measure and its purpose.<sup>144</sup>

If the measure meets the first criterion, then the focus turns to whether the measure is *necessary* to achieve the intended public interest objective. This requires a tribunal to determine whether the objective can be achieved causing less interference with the investor’s right or interest.<sup>145</sup> The final stage of review, proportionality *stricto sensu*, includes the evaluation of the effects of the measure in comparison with the investor’s right or interest that has been affected. At this stage the court or tribunal should make a decision regarding whether the economic impact of the state’s measure is proportional to the public aim sought to be realized. It requires the tribunal to consider all relevant factors such as

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<sup>137</sup> See Alec Stone Sweet & J. Mathews “Proportionality Balancing and Global Constitutionalism” (2008) 47 Col JTL 72 at 97.

<sup>138</sup> *Ibid.*

<sup>139</sup> *Case of Sporrong and Lönnroth v Sweden*, (1983) Nos. 7151/75 and 7152/75, Series A no. 52, 5 EHRR 35, para. 69 at p. 26. See also for the proportionality requirement *James and Others v The United Kingdom*, (1986) No. 8793/79, Series A, 8 EHRR 123 [*James and Others v the UK*], at paras. 50, 63.

<sup>140</sup> *James and Others v the UK*, *supra* note 139 at para.50.

<sup>141</sup> Some authors outline four stages of proportionality analysis, instead of three. According to such approach, first is a “legitimacy” stage in which “the judge confirms that the government is constitutionally – authorized to take such a measure”. The next is “suitability” stage in which the judge ensures that “the means adopted by the government are rationally related to the stated policy objectives”. The third is a “necessity” stage, which requires the judge to determine whether the objective could have been achieved through the application of less restrictive measure. Final stage requires application of “balancing *stricto sensu*” in which the judge weighs “the benefits of the acts...against the costs incurred by infringement of the right”. A. Stone Sweet & J. Mathews, *supra* note 140 at 74, cited as in Stephan W. Schill, ed., *International Investment Law and Comparative Public Law* (Oxford: Oxford University Press, 2010). See also Caroline Henckels, “Indirect Expropriation and the Right to Regulate: Revisiting the Proportionality Analysis and the Standard of Review in Investor-State Arbitration” (2012) 15:1 JIEL 226 at 226-227.

<sup>142</sup> Jan H. Jans, “Proportionality Revisited” (2000) 27:3 LIEI 239 at 240 - 241.

<sup>143</sup> C. Henckels, *supra* note 141 at 227.

<sup>144</sup> Jan H. Jans, *supra* note 142 at 240.

<sup>145</sup> Julian Rivers, “Proportionality, Discretion and the Second Law of Balancing” in George Pavlakos, ed, *Law, Rights and Discourse: The Legal Philosophy of Robert Alexy* (Oxford: Hart, 2007) 167 at 171, 177; C. Henckels, *supra* note 141 at 227;

cost-benefit analysis, the importance of the right affected, the importance of the interest protected, the degree and length of interference, the availability of less severe measure and other factors.<sup>146</sup> As some authors note, this final step of the proportionality method is highly important: if the analysis stops at the stage of necessity, it would allow the severe restriction of a right in order to protect public interest.<sup>147</sup>

Presently, the proportionality test has been gaining increasing attention in the practice of investor-state arbitration<sup>148</sup> and in academia.<sup>149</sup> A number of reputable commentators support the ECHR's proportionality approach to indirect expropriation and advocate for its application in investor-state disputes. Many, for example Jasper Krommendijk and John Morijn, consider proportionality as an effective tool which "helps to construe the borders between legitimate government regulation and excessive interference with the rights and obligations [...]".<sup>150</sup> For Anne Hoffman the proportionality test appears to be "a convincing and methodologically clear approach when attempting to balance the interests of both the State and the investor fairly."<sup>151</sup> Similarly, Caroline Henckels outlines the "transparent analytical structure for decision-making"<sup>152</sup> and "more robust methodological framework"<sup>153</sup> as the advantages of the proportionality test in comparison to other legal techniques.

In contrast, other authors are skeptical of the contention that tribunals are moving toward adopting proportionality.<sup>154</sup> Some of them criticize not the approach itself, but its application in investor-state arbitration.<sup>155</sup> In general, the commentators emphasize that past investment tribunals did not follow an established step-by-step procedure, applied a methodologically problematic reasoning or employed a standard of review which differs from the one used by other international dispute settlement bodies.

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<sup>146</sup> See S. Schill, *International Investment Law and Comparative Public Law* (Oxford: Oxford University Press, 2010) at 87.

<sup>147</sup> *Ibid* at 87.

<sup>148</sup> To date, the proportionality approach has been applied in investor-state arbitration in a number of cases, including *Tecmed v. Mexico*, *supra* note 86, *Azurix v. Argentina*, *supra* note 88; *LG&E v. Argentina*, *supra* note 80; *Continental Casualty Company v. The Argentine Republic*, ICSID case no. ARB/03/9A, Award (5 September 2008); and *Señor Tza Yap Shum v. The Republic of Peru*, ICSID Case No. ARB/07/6, Award of 7 July, 2011.

<sup>149</sup> See U. Kriebaum, *supra* note 27 at 720; Jasper Krommendijk & John Morijn, "Proportional' by What Measure(s)? Balancing Investor Interests and Human Rights by Way of Applying the Proportionality Principle in Investor-State Arbitration" in P.M. Dupuy, Ernst-Ulrich Petersmann & Francesco Francioni eds., *Human Rights in International Investment Law and Arbitration* (Oxford: Oxford University Press, 2009) 422; Benedict Kingsbury & S. Schill, "Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality, and the Emerging Global Administrative Law" in Albert Jan Van Den Berg, ed., *50 Years of the New York Convention* (Alphen aan den Rijn: Kluwer, 2009), 6; Benedict Kingsbury & S. Schill, "Public Law Concepts to Balance Investor's Rights with State Regulatory Actions in the Public Interest – the Concept of Proportionality" in S. W. Schill, ed., *International Investment Law and Comparative Public Law* (Oxford: Oxford University Press, 2010) 75; C. Henckels, *supra* note 141 at 224; S. W. Schill, "Cross-Regime Harmonization through Proportionality Analysis: The Case of International Investment Law, the Law of State Immunity and Human Rights" 27 *ICSID Review – FILJ* (2012) 87; S. Escarcena, *Indirect Expropriation in International Law*, *supra* note 124 at 191-194.

<sup>150</sup> Jasper Krommendijk & John Morijn, *supra* note 149.

<sup>151</sup> Anne K. Hoffmann, "Indirect Expropriation" in A. Reinisch, ed., *Standards of Investment Protection* (Oxford: Oxford University Press, 2008) 168.

<sup>152</sup> C. Henckels, *supra* note 141 at 228.

<sup>153</sup> *Ibid*.

<sup>154</sup> See generally Alec Stone Sweet "Investor-State Arbitration: Proportionality's New Frontier" (2010) Faculty Scholarship Series. Paper 69, online: <[http://digitalcommons.law.yale.edu/fss\\_papers/69](http://digitalcommons.law.yale.edu/fss_papers/69)>; Michael Newton & Larry May, *Proportionality in International Law* (Oxford: Oxford University Press, 2014); Edward Guntrip, "International Human Rights Law, Investment Arbitration and Proportionality Analysis: Panacea or Pandora's Box?", online: <<http://www.ejiltalk.org/international-human-rights-law-investment-arbitration-and-proportionality-analysis-panacea-or-pandoras-box/>>.

<sup>155</sup> Michael Newton and Larry May, for instance, noted that "ECHR utilizes a somewhat different logic that ISCID when it comes to the principle of proportionality." They also argue that there is no explanation for invoking proportionality as a rule of decision beyond reference to its common usage in other contexts." Michael Newton & Larry May, *ibid* at 51. See also Alec Stone Sweet, *supra* note 154.

Against this background, Caroline Henckels suggests that investment tribunals “should be more deferential in performing proportionality analysis, mindful of host state authorities’ greater democratic legitimacy and proximity to host state communities, and tribunals’ comparatively weak institutional capacity.”<sup>156</sup> As we can see, the function of the proportionality analysis to a large extent depends upon how it is applied by the adjudicators. Thus, it is necessary first to take a closer look at the practice of investment tribunals using the proportionality test in the expropriation context. The next example illustrates this point.

The proportionality test was applied for the first time in relation to indirect expropriation in *Tecmed v. Mexico*.<sup>157</sup> In this case, the host state had failed to renew a permit to operate the hazardous waste landfill site owned by a foreign investor. The latter claimed that the refusal of the Mexican environmental authority (the Environmental Protection Agency) to renew the permit constituted indirect expropriation of its assets and breached the Spain – Mexico BIT. In response, Mexico contended that its decision did not amount to an expropriation as it was a legitimate regulatory action taken by a government agency consistent with its discretionary authority and in compliance with the “State’s police power...in the highly regulated and extremely sensitive framework of environmental protection and public health.”<sup>158</sup>

The tribunal analyzed in detail the facts of the case and concluded that the claimant indeed was the victim of indirect expropriation without compensation from Mexican authorities as the interests of the Spanish concern Tecmed were seriously affected. What is important here is how the tribunal came to this conclusion identifying, classifying and weighing the competing interests - the investor’s costs and the public policy benefits. For this purpose, the tribunal opted for the proportionality test by drawing partial analytical support from the jurisprudence of the ECHR:

[...] in addition to the negative financial impact of such actions, the Arbitral Tribunal will consider, in order to determine if they are to be characterized as expropriatory, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality.<sup>159</sup>

As one can see, by using the principle of proportionality, the tribunal did not intend to replace the criteria of negative or financial effects, but to balance them against the public interest being pursued by the particular regulatory measure.<sup>160</sup> Despite the fact that the tribunal premised its analysis on the idea that “[u]nder international law . . . the government’s intention is less important than the effects of the measures”,<sup>161</sup> it emphasized the *prima facie* existence of a public interest and stressed the relevance

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<sup>156</sup> C. Henckels, *supra* note 141 at 228.

<sup>157</sup> *Tecmed v Mexico*, *supra* note 86.

<sup>158</sup> *Ibid*, at para. 97.

<sup>159</sup> *Ibid*, at para. 122.

<sup>160</sup> Suzy H. Nikièma, “Best Practices Indirect Expropriation”, The International Institute for Sustainable Development (March 12, 2012), at 16, online: the International Institute for Sustainable Development <[http://www.iisd.org/pdf/2012/best\\_practice\\_indirect\\_expropriation.pdf](http://www.iisd.org/pdf/2012/best_practice_indirect_expropriation.pdf)>.

<sup>161</sup> *Tecmed v Mexico*, *supra* note 86 at para. 116.

of both the measure's adverse effect on the investments and the measure's public purpose as the relevant considerations under the proportionality test.<sup>162</sup>

Following this methodology, the tribunal first looked at the economic impact and burden of the measure imposed on the Spanish investor, analyzing the effects of the measure. It clarified that a measure would only be expropriatory if it “permanent[ly] and irreversib[ly]” “neutralized or destroyed” the “economic value of the use, enjoyment or disposition of [the investor's] assets or rights”.<sup>163</sup> If the measure had the described impact, the tribunal then had to weigh whether the measure was proportional in light of the public interest at stake and the impacts on the protected investment.<sup>164</sup> In this regard, the tribunal took into account that the authority's decision meant that the landfill would be closed permanently and irrevocably. Since the landfill could not be used for a different purpose, it lost its value. Importantly, the tribunal also looked at the measure to verify whether there was an actual public interest behind the measure invoked by the state and whether the adopted measure was the only measure available to achieve the pursued objective. Thus, the tribunal attempted to balance competing interests of both the investor and the host state by applying the principle of proportionality.

In this context, however, the tribunal has concluded that the breaches of both the permit's terms and environmental regulations by the investor were generally minor and did not negatively affect public health or protection of the environment.<sup>165</sup> As a result, despite the initial appeal of proportionality analysis, the tribunal found no true environmental purpose behind the adopted measure and so it was unnecessary to apply it.

Ultimately, the tribunal found that the Environmental Protection Agency's decision to refuse renewal of the permit was a *de facto* indirect expropriation as the investment was permanently deprived of economic value and could not be exploited, despite the fact that the legal ownership of the assets did not pass to the Mexican government or any third parties. Importantly, the character of the measure played an essential role in the assessment of indirect expropriation in the present context. As noted by Professor Viñuales, if the tribunal considered, instead, that had the measure genuinely pursued an environmental objective (e.g. cessation of operations of the investor due to its grave breaches of environmental standards), the expropriation claim could have been decided differently.<sup>166</sup>

To sum, the proportionality test is distinguished from the sole effect and police powers tests in a number of ways, which makes it an effective method to decide cases involved competing interests, such as indirect expropriation. In particular, it is a more structured form of analysis than the other two approaches. It includes concrete steps to determine whether indirect expropriation has taken place by

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<sup>162</sup> As noted by Jorge E. Viñuales, the purpose of the measure was introduced in *Tecmed v. Mexico* as one of the terms of “reasonable relationship between the means employed and the aims sought to be realized [by the measure].” See J. Viñuales, *supra* note 124 at 314.

<sup>163</sup> *Tecmed v Mexico*, *supra* note 86, at para. 116.

<sup>164</sup> *Ibid*, at para. 116. On this issue see Nathalie Bernasconi-Osterwalder & Lise Johnson *supra* note 50 at 141.

<sup>165</sup> *Tecmed v Mexico*, *supra* note 86, at paras. 124, 127, 130–32. See also Nathalie Bernasconi-Osterwalder & Lise Johnson *supra* note 50 at 142.

<sup>166</sup> J. Viñuales, *supra* note 124 at 314.

evaluating an economic impact on investment, legitimate expectations of an investor, a purpose, character of state measure, and its proportionality.<sup>167</sup> Thus, it allows addressing different factors relevant for either investor or state, and requires a tribunal to pay attention to each of them separately. So far, some investment tribunals have attempted to apply the proportionality test as a technique for determining the occurrence of indirect expropriation. In adopting the approach of ECHR, these investment tribunals only partially followed the three-step proportionality test employed in the European human rights system, which is problematic. The use of methodology that skips some steps of the proportionality analysis decreases the functionality of the test and may result in inconsistent interpretation of indirect expropriation. Nevertheless, if applied appropriately, that means following all three stages as introduced by the ECHR, the proportionality test has the potential to respond to the criticism that BITs do not balance investment protection with regulation in the public interest. Among three approaches, it is the only test that offers a balancing framework, which, as it will be argued in the next section, is the most compatible with sustainable development.

## **1.2. Approach to Indirect Expropriation Most Compatible with Sustainable Development**

The complex interaction between investment protection and sustainable development is not limited to indirect expropriation. However, it is particularly evident when looking at this issue. On the one hand, foreign investment, being a driver for sustainable development,<sup>168</sup> requires strong guarantees of investment protection as offered by investment treaties. On the other, host states require policy space to adopt regulations in pursuit of sustainable development, which may result in interference with foreign investments. This poses an important question - whether or not existing tests for indirect expropriation are compatible with sustainable development considering the specific concerns both investors and host states face in the shifting investment protection landscape of the 21st Century. The answer to this question is particularly crucial, since depending on the approach taken, the outcome for both investment protection and sustainable development may be very different.

Based on the analysis introduced in the above sections, the “sole effects” test is clearly inappropriate from a sustainable development perspective. As already discussed, it does not require taking account of other concerns, such as a host state’s intention and particular purpose of regulatory

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<sup>167</sup> The proportionality test does not have any fixed form. It is used differently in many countries (for instance, in Germany, Australia, U.S. and Canada) and many different areas of law (including human rights, administrative and constitutional law). For instance, the ECHR used a three-step proportionality analysis, while some other courts and tribunals (e.g. investor-state tribunals) sometimes deviate from this structure. More on the application of the proportionality test in constitutional and administrative law see Gregory S. Alexander, *The Global Debate Over Constitutional Property: Lessons for American Takings Jurisprudence* (Chicago: The University of Chicago Press, 2008) at 200.

<sup>168</sup> According to the Johannesburg Plan of Implementation and the UNCTAD Investment Policy Framework for Sustainable Development, foreign direct investment in itself is being considered as a key driver for pursuing sustainable development, it is important to maintain a proper balance between the guaranteed by the regime adequate protection of foreign investments and important non-investment public policy concerns. See Johannesburg Plan of Implementation, *supra* note 11; Investment Policy Framework for Sustainable Development, UNCTAD (New York: United Nations, 2012), online: UNCTAD <[http://unctad.org/en/publicationslibrary/webdiaepcb2012d6\\_en.pdf](http://unctad.org/en/publicationslibrary/webdiaepcb2012d6_en.pdf)>.

measure. Such a single-minded focus on interference with investments holds no promise for defending sound sustainable development policies that were fairly applied, but affect foreign investor's property. Considering this imbalance, the "sole effects" test should not be seen as relevant in establishing whether an indirect expropriation has occurred, while the economic impact on the investments remains to be a significant criterion.

Unlike the above approach, the "police powers" test is more favorable to sustainable development. It does not merely consider the public purpose of regulation, but provides exclusive safeguards for the sovereign right of the state to regulate in the public interest. There is no doubt that this approach is important for achieving sustainable development objectives: considering the complexity and variety of disputes on indirect expropriation, which require an individual fact-based inquiry, the police powers test can play a significant role in a particular category of disputes, like *Chemtura*. In such cases, it may well serve as a basis for defending *bona fide* non-discriminatory regulation pursuing sustainable development objectives.

On the other hand, a practical implementation of the test may face some challenges. Very often, it is difficult to determine the precise boundaries for its application. As a result, the police powers approach seems to leave considerable discretion to investment tribunals to decide in each particular case whether the governmental measure is to be withdrawn from the scope of expropriation. In terms of methodology, this approach requires prioritization of the specific purposes of regulation, rather than measuring and balancing them against other interests.<sup>169</sup> Thus, upon closer look, the "police powers" test does not seem to accommodate the required balance between all three components of sustainable development to address economic, environmental and social concerns on an equal basis. Considering this, the approach may be viewed as clearly favorable to sustainable development, but not the most compatible with it.

Given the importance of protecting the investor's interests for the promotion of economic development through foreign investment and public interest regulation of the host state – neither should theoretically "prevail" over each other.<sup>170</sup> Here, the proportionality test is considered as a suitable method to ensure the balance between different concerns (e.g. environmental, social and economic issues) in the indirect expropriation context.

As noted by some scholars, there should be a reasonable balance between public and individual interests, when restricting the individual rights or legitimate public interests.<sup>171</sup> In this regard, the proportionality test suggests a multifaceted analytical framework setting specific criteria to resolve a

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<sup>169</sup> The main feature of the test is that the severity of interference with investor's property is irrelevant for the analysis. What is typically considered is whether the state action constitutes *bona fide* non-discriminatory measure adopted in the sound public interest. As a result, the focus is solely on the state's measure and its context, without consideration of the investor's concerns. This does not reflect a balance of interests as required by the sustainable development concept.

<sup>170</sup> Andreas Kulick, *Global Public Interest in International Investment Law* (Cambridge: Cambridge University Press, 2012) 193.

<sup>171</sup> Janis Brizga, "How Well Sustainable Development Is Integrated into Environmental Policies? Case Study: Latvia" (2012) 2 *Safety of Technogenic Environment*, 30.

conflict between private and public interests. What is particularly important here is that such a framework aims to evaluate whether the regulatory action in question caused an excessive, disproportional effect to the investor, rather than to determine any hierarchy of the competing interests. To put it differently, the proportionality analysis does not consider which interests – a host state’s or a foreign investor’s - should be granted “higher” status. Instead, it measures whether the regulation adopted in the particular context is reasonable and proportionate given its adverse impact on the investor’s property. Its framework is flexible enough to consider the interests of both parties, whether of economic, social or environmental nature, thus the proportionality test is able to ensure the necessary balance from the standpoint of sustainable development. As it will be seen in more detail later, some recent BITs have clearly adopted this approach in clarifying the steps for assessment of indirect expropriation based on the proportionality framework, incorporated directly in the treaty text or its interpretative annexes.

Beyond that, it is argued that the proportionality test offers a more precise and transparent structure, than the “police powers” and “sole effects” techniques. As a result, it may potentially produce better reasoning, clearer assessment and accountability of the tribunals, and ultimately - provide more predictability than other two approaches.<sup>172</sup> On the other hand, it has been criticized for various reasons, one of which is that the tribunals perform the balancing analysis “on a legally unsound basis.”<sup>173</sup> Other concerns, *inter alia*, are related to the risks that the proportionality test leaves much space for tribunal’s discretion. Some even consider it as a “highly subjective decision-making that is influenced by tribunals’ own political, ideological and economic beliefs and assumptions.”<sup>174</sup> To some extent, this questions the application of the test in further investor-state disputes.

Investment tribunals might respond to such criticism in many different ways. As a starting point, it must be clarified that the issue of how the proportionality test will be employed by the tribunals ultimately depends on a number of factors. The first element is the text of the investment treaty that establishes the rules to determine the indirect expropriation as well as other treaties applicable between the parties. As noted by Jonathan Bonnitcha, any meaningful discussion of what balance or proportionality requires is possible only after the primary norms that need to be balanced have been specified.<sup>175</sup> However, if such norms, like in most traditional BITs, are not clearly articulated in the treaty or simply absent, the tribunal’s reasoning would likely lack a sound basis for balanced determination of indirect expropriation and legal argumentation of the applied method. To avoid this risk along with the risk of excessive discretion of the tribunals, investment treaties should incorporate

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<sup>172</sup> B. Kingsbury & S. Schill, “Public Law Concepts to Balance Investor’s Rights with State Regulatory Actions in the Public Interest – the Concept of Proportionality” *supra* note 146 at 103.

<sup>173</sup> Erlend M. Leonhardsen, “Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration” (2012) 3:1 J Int’l Disp Settlement, 119.

<sup>174</sup> C. Henckels, *supra* note 141 at 250 (with further references).

<sup>175</sup> Jonathan Bonnitcha, *Substantive Protection Under Investment Treaties: A Legal and Economic Analysis* (Cambridge: Cambridge University Press, 2014) at 48.

provisions and language specifically designed to address indirect expropriation within the framework of proportionality and proper consideration of state's right to regulate. This may assist tribunals to produce a well-reasoned judgment to justify the outcome of the dispute.

Another important step to counter the criticism to the proportionality test consists in adopting interpretative methods and strategies that better suit the task which is assigned to the interpreter – to balance the competing interests.<sup>176</sup> In that sense, clear interpretative guidance for the proportionality analysis may limit the tribunal's discretion in implementing the approach to indirect expropriation which has been intended by the parties. In expanding the interpretation of treaty provisions in the sustainable development context, there may be the need to ensure the balance between environmental, social and economic interests in the adjudication process. In this regard, the exceptions, strong affirmations of non-economic values in preambles and operative provisions of the treaty might leave tribunals room for interpretation that effectively addresses sustainable development concerns.

Considering the above discussion, the proportionality approach seems preferable as a test for determining an indirect expropriation and can be viewed as the most compatible with sustainable development.

### **1.3. Establishing the Link between the Applicable Tests for Indirect Expropriation and Treaty Interpretation**

Arbitral practice with its conflicting decisions reflects the uncertainty surrounding indirect expropriation.<sup>177</sup> Broadly speaking, three different tests applied by tribunals in order to define an occurrence of indirect expropriation can be identified: namely, the sole effects,<sup>178</sup> police powers and proportionality. The application of these tests often appears insufficiently clear and consistent. As already mentioned, the tribunals rarely explain what exactly they are doing from the view point of the adopted approach and some examples of the decisions discussed in the previous section demonstrate this deficiency. For this reason, the employment of the sole effects, proportionality and the police powers tests in the indirect expropriation context continues to pose questions and doubts for legal scholars and professionals.

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<sup>176</sup> Interestingly, the proportionality analysis itself is viewed by some commentators as a necessary element of investment treaty interpretation. In particular, B. Kingsbury and S. Schill argued that it “can be accommodated – and by some tribunals has already been employed - as an interpretation technique.” In the authors' view, the proportionality analysis can be appropriately accommodated within the concept of indirect expropriation as well as other concepts “whenever the restriction of the state's regulatory leeway is at play.” See Benedict Kingsbury & S. Schill, “Public Law Concepts to Balance Investor's Rights with State Regulatory Actions in the Public Interest – the Concept of Proportionality” *supra* note 149 at 77-78. While the test as a legal construct can hardly present an alternative to the customary rules of treaty interpretation, one may agree with the authors that the proportionality may be helpful in informing the exercise of interpreting of a treaty with a view to resolving conflicts in connection with indirect expropriation.

<sup>177</sup> Markus Perkams, “The Concept of Indirect Expropriation in Comparative Public Law – Searching for Light in the Dark” in Stephan W. Schill, ed., *International Investment Law and Comparative Public Law* (Oxford: Oxford University Press, 2010) 107 at 110;

<sup>178</sup> Although, it is argued that this approach is outdated due to its inconsistency with the emerging sustainable development concept and less developed framework than, for instance, the proportionality test (and thus it is excluded from the present analysis), we cannot argue that it will not be adopted in any further arbitration.

While there are many factors that cause this problem, it is overall true that the legal reasoning of past investment decisions often lacks clarity. The failure of tribunals to consider sustainable development is another deficiency that can be observed in the legal reasoning of investment tribunals. These problems can be partially explained by the broad language and lack of express textual provisions in the old-generation investment treaties.<sup>179</sup>

Taking this into account, it is argued that a new generation of international investment treaties can open new possibilities for interpretation of indirect expropriation. A number of innovative provisions (not just an expropriation clause itself) could assist arbitrators and provide them with “legal windows”, as Marie-Claire Cordonier-Segger and Avidan Kent call them,<sup>180</sup> for a) better differentiation between legitimate regulation in the public interest and indirect expropriation; and b) inclusion of sustainable development goals in investment decisions and awards through appropriate interpretation of the treaty provisions, when deciding the disputes of indirect expropriation. While the ultimate purpose of the present study is to identify the provisions in the BITs which can provide such “legal windows”, an interrelation between the discussed tests for indirect expropriation and treaty interpretation should first be established.

When resolving the conflicts of competing rights and interests in indirect expropriation cases, the tribunal’s aim is to determine whether the government actions resulted in expropriation and violated the treaty provisions. For this purpose, the arbitrators usually rely on the tests to determine a regulatory taking and the treaty interpretation - to delineate the scope of rights and obligations in BITs and thereby to distinguish between those acts that constitute an interference with investors’ rights as set out in a BIT and those that fall within a state’s legitimate right to regulate as recognized in international law.<sup>181</sup> As a result, three important components come into play: a) treaty text; b) interpretation and c) analytical framework (test) for indirect expropriation.

At first glance, a link between these three elements may seem unclear, however, their interrelation can be explained as follows. A starting point for determining the test for indirect expropriation is the text of investment treaty as the main source of its meaning, which requires that meaning to be applied to the facts in case. In turn, through interpretation the tribunal gives meaning to the relevant treaty text. As a result, the first two elements – text and the interpretation form a basis for the determination of the third one - the particular analytical framework to identify an indirect expropriation.

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<sup>179</sup> In general, old-generation treaties often contain a vague language, having no references to sustainable development, environment protection, human health or other sensitive public policy issues. Some BITs contain more precise language of the expropriation clause than others. Some of them also employ general exception clauses to safeguard a wide variety of policy objectives. Thus, the room allowing for different interpretations of the content of indirect expropriation standard may vary significantly among the agreements.

<sup>180</sup> Marie-Claire Cordonier Segger & Avidan Kent, “Promoting Sustainable Investment through International Law” in Marie-Claire Cordonier Segger, Markus W. Gehring & Andrew P. Newcombe, *Sustainable Development in World Investment Law* (The Hague: Kluwer Law International, 2011) 771 at 791.

<sup>181</sup> UNCTAD, “Interpretation of IIAs: What States Can Do”, IIA Issues Note No.3, December 2011 at 2, online: UNCTAD <[http://unctad.org/en/Docs/webdiaeia2011d10\\_en.pdf](http://unctad.org/en/Docs/webdiaeia2011d10_en.pdf)>.

Moreover, another important aspect here is the question of the relationship of the discussed tests to the applicable law, including international law.<sup>182</sup> In the process of assessing whether an indirect expropriation has occurred there might be a need to rely on a specific rule of international law applicable between the parties, such as, for instance, particular provisions of international environmental treaty or general principles of international law. In this case the tribunal would likely resort to the rules of treaty interpretation of customary international law – the 1969 Vienna Convention on the Law of Treaties (VCLT).<sup>183</sup> Thus, interpretation performs a critical function. It connects the two elements – the text of investment treaty and the analytical framework applied to establish the indirect expropriation. An appropriate approach to interpretation may help to arrive at pro-sustainable development reasoning based on the proportionality analysis even in old generation treaty, while express provisions in new generation BITs, make the consistent adoption of such an approach more likely.

To conclude, the effectiveness of differentiation between indirect expropriation and legitimate regulation in the public interest depends, *inter alia*, on the effectiveness of each of the mentioned elements - the language of the investment treaty, the methods of its interpretation and the applicable test for expropriation. For the purpose of ensuring that indirect expropriation provisions are applied in a manner consistent with sustainable development, any of these components including interpretation, can be a part of the problem, but also a part of the solution. To some extent, any of them can provide a gateway for non-investment values to enter into the argumentative framework of investment tribunals and thereby minimize potential controversies for which cases on regulatory expropriation has been largely criticized.

## CONCLUSIONS

Indirect expropriation as an investment protection standard is mirrored in substance in virtually all BITs and constitutes the most frequent form of expropriation in present times.<sup>184</sup> The debates on the concept of indirect expropriation are mainly focused around the need to strike a balance between the interests of foreign investors and the state's right to regulate in the public interest on the path to sustainable development.

Considering claims of indirect expropriation past tribunals, from time to time, relied on three different analytical frameworks – “sole effects”, “police powers” or “proportionality.” If a regulatory measure is viewed through the lens of direct expropriation, then tribunals usually look at the effect of the measure, applying the first approach. Thus, the “sole effects” test, as its name indicates, has a strong

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<sup>182</sup> Benedict Kingsbury & S. Schill, “Public Law Concepts to Balance Investor’s Rights with State Regulatory Actions in the Public Interest – the Concept of Proportionality” *supra* note 149 at 88;

<sup>183</sup> *Vienna Convention on the Law of Treaties supra* note 16 at 331.

<sup>184</sup> See W.M. Reisman & R. D. Sloane, *supra* note 39 at 118.

one-dimensional focus on the adverse effect of the governmental regulation on investments, leaving little or no room for tribunals to consider the purpose of, or public interests underlying, challenged measure. Based on the analysis introduced in this Chapter, the “sole effects” test is viewed as clearly inappropriate from a sustainable development perspective as it is unable to effectively address economic, environmental and social concerns on the same footing as required by the concept.

In contrast, the police powers test goes beyond the sole effects of the governmental measure and requires interpreters of the treaty to consider its aim while determining whether it is not discriminatory and falls within the sovereign police powers of the state. In fact, this test carves out *bona fide* non-discriminatory state measures from the scope of expropriation and therefore exempts them from compensation, regardless of their effect on the investor’s property. As opposite to the sole effects test, the police powers approach leaves enough space to consider public interest factors, although the economic impact of the measure on the investor plays no role. In a particular category of cases it may well serve as a basis for defending *bona fide* non-discriminatory regulation pursuing sustainable development objectives. However, it does not seem to accommodate the required balance between all three components of sustainable development. Considering this, the approach may be viewed as clearly favorable to sustainable development, but not the most compatible with it.

The third approach applied by the tribunals in the indirect expropriation context is proportionality - a suitable test for resolution of conflicts between public and private interests. In comparison to the first two approaches, the proportionality test has a more developed methodological framework which includes a three-stage assessment (suitability, necessity and proportionality *stricto sensu*). In the process of such an assessment, the test does not determine which interests – a host state’s or a foreign investor’s - should be granted a “higher” status. Instead, it aims to ensure that tribunals equally consider the competing interests and balance them under an established framework of proportionality. Against this background, the proportionality approach certainly seems preferable as a test for determining an indirect expropriation, the most compatible with sustainable development.

It must be noted that so far, none of the three approaches has been significantly dominant over others. Moreover, each of them has been a subject of much debate in the investment law circles. Many scholars underline that past arbitration practice does not exhibit a sophisticated understanding regarding the application of these tests. Instead, the practice in the field is commonly characterized as insufficiently clear and consistent: in a number of cases tribunals did not follow previous decisions, but adopt different solutions without clear explanation what exactly they were doing from the view point of the particular test. Thus, the lack of disciplined interpretation, inconsistency, and as a result, unpredictability, appears among the main deficiencies of the practice of indirect expropriation standard. The failure of tribunals to consider sustainable development is another deficiency that can be observed in investor-state arbitration.

At the conclusion of this Chapter, it seems reasonable to suggest that the effectiveness of differentiation between indirect expropriation and legitimate governmental regulation in pursuit of sustainable development depends on the effectiveness of not one particular element, but a combination of elements which, *inter alia*, includes the applicable test for expropriation, the language of the investment treaty, and the methods of its interpretation.

## SECOND CHAPTER: ACHIEVING SUSTAINABLE DEVELOPMENT THROUGH INTERPRETATION OF BITs: A FOCUS ON INDIRECT EXPROPRIATION

### *Introduction*

As noted earlier, a treaty is a legal text, while interpretation is an activity to come to the meaning of that legal text. Thus, in cases where the text itself is vague and does not provide a clear answer, tribunals translate the text into workable legal rules so that they can be applied in the particular case in question. Although the terms “interpretation” and “application” are often used as having the same meaning, in scholarly literature they are differentiated: “interpretation” concerns the determination of the meaning of particular treaty provisions, while “application” concerns whether particular actions or measures taken by a treaty party violate the treaty’s requirements.<sup>185</sup> In practice, both elements often occur simultaneously.

There are discernable tendencies among different scholars—and even among different tribunals—to rely on one type of consideration over others in arriving at the final interpretation of a treaty provision. There are distinct “schools” or approaches to treaty interpretation- textualist, intentionalist and teleological, which correspond to methods of construction of any legal text. The first - textual school - contends that the text of the document should be the focus.<sup>186</sup> However, it does not ignore the value of negotiating history, the intention of parties, nor the object and purpose of the treaty. Instead, these elements are viewed to confirm or support a textual analysis.<sup>187</sup> The intentionalist school prioritizes the intention of the parties and defends a more flexible method of approaching treaty texts, but with the risk of negating the words of that text.<sup>188</sup> In turn, a third school contends that the object and purpose of the treaty should determine the meaning of the treaty in a way that gives scope to the fundamental reason or objective it was supposed to address.<sup>189</sup> As noted by Isabelle Van Damme and accepted by this study, these three approaches “are not opposed to each other; instead, they compete for significance rather than relevance of different interpretive means.”<sup>190</sup>

The use of interpretive approaches and methods vary according to the category of rules to be interpreted. The focus of this study is on international investment law, particularly, on indirect

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<sup>185</sup> Anthea Roberts, “State-to-State Investment Treaty Arbitration: A Hybrid Theory of Interdependent Rights and Shared Interpretive Authority” (2014) 55 Harv Int'l LJ 1 at 6.

<sup>186</sup> Isabelle Van Damme, “Treaty Interpretation Revisited, Not Revised”, International Labour Organization Distinguished Scholar Series (30 October 2008) 3, online: <[http://www.ilo.org/public/english/bureau/leg/include/home/van\\_damme.pdf](http://www.ilo.org/public/english/bureau/leg/include/home/van_damme.pdf)>. The first school of interpretation (textualist or objective) starts from the presumption that the intention of the parties are reflected in the text of the treaty which they have drawn up, and therefore the primary goal of interpretation is to ascertain the meaning of this text. See Ian Sinclair, *The Vienna Convention on the Law of Treaties*, 2<sup>nd</sup> ed (Manchester: Manchester University Press, 1984), 114-115.

<sup>187</sup> *Ibid*, at 3.

<sup>188</sup> *Ibid*. The intentionalist (subjective) approach is based on the belief that interpretation “is the search for the real intention of the contracting parties in using the language employed by them.” See Arnold D. McNair, *The Law of Treaties*, 2<sup>nd</sup> ed (Oxford: Clarendon Press, 1961), at 366.

<sup>189</sup> The teleological school asserts that the practitioner “must first ascertain the object and purpose of a treaty and then interpret it so as to give effect to that object and purpose.” Ian Sinclair, *The Vienna Convention on the Law of Treaties*, *supra* note 186 at 115.

<sup>190</sup> Isabelle Van Damme, “Treaty Interpretation by the WTO Appellate Body”, (2010) 21:3 EJIL 605 at 618.

expropriation with a focus on “new-generation” investment treaties, which may provide new opportunities for better interpretation in line with sustainable development. Accordingly, the interpretive approaches and methods relevant to investment treaty law are discussed below with the aim to explore which of existing means may be implemented to ensure the interpretation of indirect expropriation most compatible with states’ right to regulate to achieve sustainable development. Having set this framework, we will be able to identify specific types of provisions in the new-generation BITs, which may result in such interpretations.

This Chapter will be divided into two parts. The first part will discuss the customary rules of interpretation contained in Articles 31 - 32 of the VCLT as well as other non-codified principles, tracking their application in the jurisprudence of international courts and tribunals, such as the ICJ, the PCA, the WTO AB, and the ECHR. The second part will focus specifically on the practice of investor-state tribunals with the aim of identifying how the tribunals deal with the rules and principles of interpretation under the VCLT and beyond. It will also explore the approaches, which have been adopted in respect of “new-generation” BITs to ensure the interpretation of indirect expropriation which is most compatible with sustainable development objectives. Based on the conclusions from the previous Chapter, the present analysis suggests that the tribunal’s chosen approach and method of interpretation may influence the outcome of a case.<sup>191</sup>

## **2.1. Framework for Treaty Interpretation under the 1969 Vienna Convention**

### *2.1.1. Article 31 of VCLT and the Interpretive Elements: Text, Context and Purpose*

#### (a) Interpretive Element: Text

The rules of customary international law codified in Articles 31 and 32 of the Vienna Convention on the Law of Treaties (VCLT) provide the starting point for the interpretation of treaties under international law and introduces the *text, context, object and purpose* of the treaty as relevant elements for its interpretation.<sup>192</sup> This means, whatever the dispute about the interpretation or application of a treaty is, focusing on these three elements, it will be guided by the principles and rules of Articles 31 and 32:

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<sup>191</sup> Following the approach of J. Pauwelyn and M. Elsig, it is viewed that hypothetically the chosen approach and method of interpretation may have an impact on the outcome of the case, however, it is not argued that interpretation is always the crucial factor for the result of the case as well as it is not excluded that means and factors other than interpretation can also influence it. For further discussion on how a choice of interpretive method may influence the outcome in the case see Joost Pauwelyn & Manfred Elsig, “The Politics of Treaty Interpretation: Variations and Explanations Across International Tribunals” in J. Dunoff & M. Pollack, eds, *Interdisciplinary Perspectives on International Law and International Relations. The State of the Art* (New York: Cambridge University Press, 2013) 445.

<sup>192</sup> *Case Concerning the Territorial Dispute (Libyan Arab Jamahiriya v Chad)*, [1994] ICJ Rep 6 at para. 41 [*Territorial Dispute*]; Kerstin Mechlem, “Treaty Bodies and the Interpretation of Human Rights” (2009) 42:905 Vand J Transnat’l L 905 at 911.

### Article 31 – General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
  - (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
  - (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. There shall be taken into account, together with the context:
  - (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
  - (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
  - (c) any relevant rules of international law applicable in the relations between the Parties.
4. A special meaning shall be given to a term if it is established that the parties so intended.

### Article 32 - Supplementary means of interpretation

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

- (a) leaves the meaning ambiguous or obscure; or
- (b) leads to a result which is manifestly absurd or unreasonable.

The first rule established by Article 31(1) of VCLT is that a treaty shall be interpreted “in *good faith*.” By virtue of this rule, the states are bound by what they have agreed to observe reflected in the ordinary meaning of the terms of the treaty (textual interpretation).<sup>193</sup> As explained by Anthony Aust, the process of interpretation forms a part of the performance of the treaty, and therefore it must be done in good faith.<sup>194</sup>

Traditionally, international tribunals that are associated with the textual school of interpretation are the International Court of Justice and the Appellate Body (AB) of the World Trade Organization<sup>195</sup> although there are also some who believe that the approach of these judicial bodies falls somewhere in between the textual and teleological ones.<sup>196</sup> In its judgment *Territorial Dispute*,<sup>197</sup> the ICJ applied Article 31 of the VCLT, heavily relying on the textual approach. The dispute was focused on Article 3

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<sup>193</sup> M. Magdalena Sepúlveda, *The Nature of the Obligations under the International Covenant on Economic, Social and Cultural Rights* (Antwerpen: Intersentia NV, 2003) at 75.

<sup>194</sup> Anthony Aust determines the principle of good faith through the link with another principle - *pacta sunt servanda* enshrined in Article 26 of VCLT (the rule that treaties are binding on the parties and must be performed in good faith). Analogously, the ILC justified the inclusion of the “good faith” by stating that this principle “flows directly from *pacta sunt servanda*”. See : Reports of the International Law Commission on the second part of its seventeenth session and on its eighteenth session, Doc. A/6309/Rev.I, YBILC 1966, Vol.I, para.12 at 221. See Anthony Aust, *Modern Treaty Law and Practice*, 2<sup>nd</sup> ed (Cambridge University Press 2007) at 234.

<sup>195</sup> J. Pauwelyn & M. Elsig, *supra* note 191, at 1, 9, 18.

<sup>196</sup> G. Nolte, “Second Report for the ILC Study Group on Treaties over Time: Jurisprudence under Special Regimes Relating to the Subsequent Agreements and Subsequent Practice” in G. Nolte, ed, *Treaties and Subsequent Practice* (Oxford University Press, 2013); I. Van Damme, *Treaty Interpretation by the WTO Appellate Body*, *supra* note 190 at 210.

<sup>197</sup> *Territorial Dispute*, *supra* note 192.

of 1955 Treaty of Friendship and Good Neighborliness between the French Republic and the United Kingdom of Libya (the Treaty). In order to interpret Article 3 of the Treaty, the ICJ stated:

The Court would recall that, in accordance with customary international law, reflected in Article 31 of the 1969 Vienna Convention on the Law of Treaties a treaty must be interpreted in good faith in accordance with the ordinary meaning to be given to its terms in their context and in the light of its object and purpose. *Interpretation must be based above all upon the text of the treaty.* As a supplementary measure recourse may be had to means of interpretation such as the preparatory work of the treaty and the circumstances of its conclusion (*emphasis added*).<sup>198</sup>

Following the rules of Article 31 of VCLT, the ICJ interpreted Article 3 of the Treaty, saying that “the parties ‘recognize that the frontiers...are those that result’ from certain international instruments. The word ‘recognize’ used in the Treaty indicates that a legal obligation is undertaken. To recognize a frontier is essentially to ‘accept’ that frontier, to draw legal consequences from its existence, to respect it and to renounce the right to contest it in future.”<sup>199</sup> The ICJ explicitly relied on the textual approach when providing interpretation of the treaty provision in question as well as made a reference to the Article 31 of VCLT as to the “customary international law.” Also, the ICJ fully or partially resorted to textual interpretation in *Anglo-Iranian Oil Co Case (United Kingdom v. Iran)*,<sup>200</sup> and the *Legality of Use of Force Case (Serbia and Montenegro v. Belgium)*.<sup>201</sup> Among other international forums which heavily rely on the Article 31(1) of VCLT are the Inter-American Court of Human Rights<sup>202</sup> and the Court of Arbitration.<sup>203</sup>

Similarly, the AB recognized that the general rule of interpretation contained in Article 31 of VCLT constitutes part of the “customary rules of interpretation of public international law.”<sup>204</sup> Also, in many cases the judicial bodies of the WTO favored the textual approach, generally recognizing the “holistic” nature of that interpretative task.<sup>205</sup> In particular, the AB observed that:

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<sup>198</sup> *Ibid*, at para. 41

<sup>199</sup> *Ibid*, at para. 42.

<sup>200</sup> *Anglo-Iranian Oil Co (United Kingdom v Iran)* (Preliminary Objection) (1952) ICJ Rep 93 at 105.

<sup>201</sup> *Legality of Use of Force (Serbia and Montenegro v Belgium)* (Preliminary Objection), [2004] ICJ Reports 1059. In this case the ICJ again considered that interpretation must be based above all upon the text of the treaty.

<sup>202</sup> Past practice suggests and many scholars observed that the Inter-American Court of Human Rights often solely invoked the Article 31(1) of VCLT when interpreting treaties. See, for instance, *Proposed Amendments to the Naturalization Provisions of the Constitution of Costa Rica*, Advisory Opinion, (1984) 5 HRLJ 161, 79 ILR 282, para. 22 at 292; *Character and Scope of the Right to Reply or Correction Recognized in the American Convention*, Advisory Opinion, (1986) 7 HRLJ 231 at 342. See also Mark E. Villiger, “The Rules on Interpretation: Misgivings, Misunderstandings, Miscarriage? The ‘Crucible’ Intended by the International Law Commission” in Enzo Cannizzaro, ed., *The Law of Treaties Beyond the Vienna Convention* (New York: Oxford University Press, 2011) 105 at 116.

<sup>203</sup> In the *1977 Beagle Channel Arbitration*, the Court of Arbitration resorted “in the first place (to) an analysis of the text.” However, in the 1985 *Maritime Delimitation Arbitral Award* the Court of Arbitration noted that: “(the text) must be interpreted in good faith with each word being giving its ordinary meaning within the context and in light of the object and purpose of the Convention.” See *Beagle Channel Arbitration (Argentina v Chile)* (1977) 52 ILR 93 at 127; *Maritime Delimitation Arbitral Award (Guinea v Guinea-Bissau)* (1988) 77 ILR 635, para. 46 at 658.

<sup>204</sup> *United States - Standards for Reformulated and Conventional Gasoline (Complaint by Brazil and Venezuela)*, (1996), WTO Doc. WT/DS2/AB/R (Appellate Body Report), online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/2-9.pdf](http://www.wto.org/english/tratop_e/dispu_e/2-9.pdf)> [*US – Reformulated Gasoline*].

<sup>205</sup> See *United States - Sections 301-310 of the Trade Act of 1974 (Complaint by European Communities)* (2000) WT/DS152/R (WTO Panel Report), 2 YBILC (1966), at para. 7.22. A similar conclusion was reached by the Panel in *EC – Asbestos*: “To the extent that Article 31 of the Vienna Convention contains a single rule of interpretation and not a number of alternative rules, the various criteria in the article should be considered as forming part of a whole.” *European Communities – Measures Affecting Asbestos and Asbestos Containing Products (Complaint by Canada)* (2000) WT/DS135/R (WTO Panel Report), at para. 8.46, online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds135\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds135_e.htm)> [*EC - Asbestos*].

Article 31 of the Vienna Convention provides that the words of the treaty form the foundation for the interpretative process: “interpretation must be based above all on the text of the treaty”.<sup>206</sup>

This interpretive approach has been further developed in subsequent WTO jurisprudence, providing as a general rule that “a treaty interpreter must begin with, and focus upon, the text of the particular provision to be interpreted...”<sup>207</sup> while also clarifying: “where the meaning imparted by the text itself is equivocal or inconclusive, or where confirmation of the correctness of the reading of the text itself is desired, light from the object and purpose of the treaty as a whole may usually be sought.”<sup>208</sup>

#### (b) Interpretive Element: Context

Under the Vienna Convention it is required to take into account the systematic view of the whole treaty by looking at the context in which the treaty is applied (so-called “contextual interpretation”).<sup>209</sup> The second and third paragraphs of Article 31 clarify the concept of “context” for the purpose of interpretation so as to include “in addition to the text, including its preamble and annexes”: (i) any agreement relating in relation to the conclusion of the treaty and related to it (Art. 31(2) of the VCLT); (ii) any subsequent agreement between the parties or relevant subsequent practice regarding the interpretation of the treaty (Article 31(a), (b) of the VCLT); and iii) any relevant rules of international law applicable in relations between the parties (Article 31(3)(c) of the VCLT). Lastly, paragraph four of Article 31 of the VCLT provides that if states agree to give a special meaning to a term that meaning shall prevail.<sup>210</sup>

When describing the interpretative choices of the WTO, Isabelle Van Damme notes that the Appellate Body (AB) rarely considered the ordinary meaning of the treaty provisions in isolation from the broader context of its language and other interpretative elements mentioned in the Vienna Convention.<sup>211</sup> In general, although with some variations, the approach taken by the AB has been first

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<sup>206</sup> *Japan – Taxes on Alcoholic Beverages (Complaint by European Communities; Canada; the United States)* (1996) WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R (Appellate Body Report) [*Japan – Alcoholic Beverages*], para. 105 at 97. For a comprehensive analysis of the techniques employed by the WTO for the interpretation of the WTO Agreements see Michael Lennard, “Navigating by the Stars: Interpreting the WTO Agreements” (2002) 5 J Int'l Econ L 17 at 22.

<sup>207</sup> *United States – Import Prohibition of Certain Shrimp and Shrimp Products (Complaint by India; Malaysia; Pakistan; Thailand)* (1998) WT/DS58/AB/R (Appellate Body Report) online: WTO <[http://docsonline.wto.org/imrd/gen\\_searchResult.asp?RN=0&searchtype=browse&q1=%28%40meta%5FSymbol+WT%FCDS58%FCAB%FCR%2A+and+not+RW%2A%29&language=1](http://docsonline.wto.org/imrd/gen_searchResult.asp?RN=0&searchtype=browse&q1=%28%40meta%5FSymbol+WT%FCDS58%FCAB%FCR%2A+and+not+RW%2A%29&language=1)> [*US—Shrimp*] at para 114.

<sup>208</sup> *Ibid.*

<sup>209</sup> One should differ a contextual interpretation that is based on the intent of the parties (the approach of the contextual school of interpretation) from the term “contextual interpretation” adopted in this paper. The latter means the approach which considers the context of the treaty as an interpretative element in addition to other elements such as text, object and purpose. It is based on the contextual arguments which may go from the preamble, annexes, footnotes, protocols, any agreement or instrument in connection with the conclusion of the treaty and any subsequent agreement and practice regarding its interpretation. In addition, it must be noted that contextual interpretation may exist as an independent method of interpretation according to which a treaty provision in question should not be perceived as a single abstract but as an integral part of the whole.

<sup>210</sup> Article 31(4) of the VCLT: “A special meaning shall be given to a term if it is established that the parties so intended.”

<sup>211</sup> See Isabelle Van Damme, “The Contextual Interpretation of the WTO Covered Agreements” in I. Van Damme, ed., *Treaty Interpretation by the WTO Appellate Body* (Oxford: Oxford University Press, 2009), 223.

to examine the literal meaning of the particular term, and then proceed to examine the context of the particular agreement and the provision in which the term is found.

For instance, in the *Canada – Aircraft* case the AB resorted to several dictionaries to interpret the term “benefit” in Article 1.1(b) of the Subsidies and Countervailing Measures Agreement.<sup>212</sup> However, it found that literal meanings of the terms as provided by dictionaries were often insufficient because they “leave many interpretative questions open”, and the word “benefit” did “not exist in abstract”.<sup>213</sup> In *US – Gambling*,<sup>214</sup> both the Panel and Appellate Body considered the context in which the relevant terms from sector 10 of the US Schedule to the General Agreement on Services are situated, when they found that the text appears to be inconclusive.<sup>215</sup> In the *EC – Asbestos* case<sup>216</sup> the Appellate Body followed the same approach. It first consulted several dictionaries to identify the common public understanding of the wording “like products.”<sup>217</sup> Then, stressing once again that a dictionary meaning alone may be insufficient for the interpretation,<sup>218</sup> it examined the “like products” in the context of all the paragraphs of Art. III in order to determine the meaning of the same provision as it was used specifically in Article III:4 of the GATT.<sup>219</sup>

Under Article 31 of VCLT the “context” includes the preamble to a treaty (as in the *Golder Case*<sup>220</sup> and the *1977 Beagle Channel Arbitration*<sup>221</sup>) as well as the subsequent agreements between the parties and subsequent state practice in connection with the treaty. Because of their growing significance, these elements are closely discussed in the next sections.

### (c) Interpretive Elements: Object and Purpose

In addition to the text and context, the third element to take into account is the object and purpose of either the treaty or the particular article of the treaty (teleological interpretation), introduced in the final words of paragraph 1 of Article 31 of VCLT.<sup>222</sup> This interpretive element requires that “the terms

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<sup>212</sup> *Canada – Measures Affecting the Export of Civilian Aircraft (Complaint by Canada; Brazil)* (1999) WT/DS70/AB/R (Appellate Body Report), online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds70\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds70_e.htm)>, at para 153 citing the Panel Report, at para 9.112 [*Canada – Export of Civilian Aircraft*].

<sup>213</sup> *Ibid*, at paras. 153-154.

<sup>214</sup> *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services (Complaint by Antigua and Barbuda)* (2004) WT/DS 285/R (WTO Panel Report), online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds285\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds285_e.htm)>; *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services (Complaint by Antigua and Barbuda)*, (2004) WT/DS285/AB/R (Appellate Body Report), online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds285\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds285_e.htm)>; [*US - Gambling*].

<sup>215</sup> In particular, among the contextual elements considered were the remainder of the US Schedule, the provisions of the GATS and of other covered agreements, and the GATS Schedules of other Members. See WTO Panel Report, *US – Gambling*, *supra* note 281. For a detailed discussion see Federico Ortino, “Treaty Interpretation and the WTO Appellate Body Report in *US – Gambling*: A Critique” (2006) 9 *J Int'l Econ L* 117 at 9.

<sup>216</sup> *EC - Asbestos*, *supra* note 205 at paras. 113, 126.

<sup>217</sup> Use of dictionaries is a common technique of determining the ordinary meaning of a particular term or phrase, however, the textual approach is not limited to establishing of the dictionary meaning of the term in question.

<sup>218</sup> *EC – Asbestos*, *supra* note 205 at para. 92

<sup>219</sup> *Ibid* at paras. 93 – 100; 101-108

<sup>220</sup> *Golder v United Kingdom*, (1975), 18 ECHR (Ser. A) 1, 1 EHRR 524, at para. 34 [*Golder v United Kingdom*].

<sup>221</sup> The ICJ noted that it is generally accepted that the preambles of the treaties “may be relevant and important as guides to the manner in which the Treaty should be interpreted, and in order, as it were, to “situate” it in respect of its object and purpose.” See *Beagle Channel Arbitration*, *supra* note 204, para.19 at 89.

<sup>222</sup> Article 31(1) of the VCLT: “A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and *in the light of its object and purpose*.” (Emphasis added).

of a treaty are to be interpreted in a way that advances the latter's aim"<sup>223</sup> and thereby brings an important principle, *the principle of effectiveness*,<sup>224</sup> into the general rule of interpretation under the VCLT. Although many treaties have multiple different objectives, the Vienna Convention mentions the "the object and purpose" of a treaty as a singular form which clearly means "to refer as a single overarching notion to the *telos* of the treaty as a whole."<sup>225</sup>

The consideration of the object and purpose of the treaty has certain limitations. Firstly, the object and purpose of the treaty cannot prevail over its text. Instead, as noted by Gardiner, they are "modifiers of the ordinary meaning of a term which is being interpreted in the sense that the ordinary meaning is to be identified in their light."<sup>226</sup> Secondly, the object and purpose of the treaty may be used to identify only one possible ordinary meaning of the term. They cannot be used so as to alter the meaning of the term, which is already clear. This rule was well established by the *US – Iran Claims* Tribunal, which stated:

Even when one is dealing with the object and purpose of a treaty, which is the most important part of the context, the object and purpose does not constitute an element independent of that context. The object and purpose is not to be considered in isolation from the terms of a treaty; it is intrinsic to its text. It follows that, under Article 31 of the Vienna Convention, a treaty's object and purpose is to be used only to clarify the text, not to provide independent sources of meaning that contradict the clear text.<sup>227</sup>

This statement also emphasizes a close connection between the object and purpose of the treaty and its text. Indeed, while a starting point for determining the object and purpose of the treaty is its preamble, it is not the only important source for this exercise. Along with the preamble, it is necessary to read the whole text of the treaty, where the substantive provisions could provide the fuller indication of the treaty's object and purpose.<sup>228</sup> The WTO case law provides an interesting illustration in this regard. In *US - Reformulated Gasoline* the AB relied on a set of principles which determines its approach to the contextual interpretation. Following the rule contained in Article 31 of the VCLT, the AB looked at the phrase "relating to the conservation of exhaustible natural resources" contained in Article XX (g) of the GATT<sup>229</sup> in its context and in a way to give effect to the object and purpose of the GATT. The AB, in particular, stated that:

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<sup>223</sup> Oliver Dörr & Kirsten Schmalenbach, *Vienna Convention on the Law of Treaties: A Commentary* (Berlin: Springer, 2012), 545.

<sup>224</sup> As explained by Engelen, under the principle of effectiveness, the treaty should be interpreted in such a manner as to give the fullest possible expression to its object and purpose. See Frank A. Engelen, *Interpretation of Tax Treaties under International Law* (Amsterdam: IBFD Publication BV, 2004) at 179.

<sup>225</sup> O. Dörr & K. Schmalenbach, *supra* note 223 at 546. J. Klabbbers, "Treaties, Object and Purpose" in R. Wolfrum, ed., *The Max Planck Encyclopedia of Public International Law* (Oxford University Press, 2008), online: <www.mpepil.com> at 6-7.

<sup>226</sup> Richard K. Gardiner, *Treaty Interpretation* (Oxford: Oxford University Press, 2008) at 190.

<sup>227</sup> *Bank Markazi Iran v Federal Reserve Bank of New York (Islamic Republic of Iran v the United States of America)* [2000] Case A 28 36 Iran-US CTR 5 at para. 70.

<sup>228</sup> R. Gardiner, *supra* note 226 at 196-197.

<sup>229</sup> The text of GATT Article XX:

"Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement [the GATT] shall be construed to prevent the adoption or enforcement by any contracting party of measures:

(b) necessary to protect human, animal or plant life or health; [...]

...Articles I, III and IX and the policies and interests embodied in the ‘General Exceptions’ listed in Article XX, can be given meaning within the framework of *the General Agreement* and its object and purpose by a treaty interpreter only on a case-by-case basis, by careful scrutiny of the factual and legal context of given dispute, without disregarding words actually used by the WTO Members [...] <sup>230</sup>

Thus, the AB established the rule according to which the interpretation of the object and purpose of the treaty cannot be premised on a universal formula. Instead, it should be made on a case-by-case basis with due consideration of individual facts in close connection between the context and the *telos* of the treaty. In addition, by adding the phrase “without disregarding words,” the AB underlined the significance of textual interpretation to be applied in conjunction with the treaty’s context and objectives.

Other important insights for the role of the object and purpose of the treaty in the interpretive process may be gained from *US - Shrimp Case*.<sup>231</sup> Similar to *Reformulated Gasoline*, the case concerned the interpretation of Article XX GATT with a focus on the concept of “arbitrary or unjustifiable discrimination,” contained in its preamble (the “chapeau”). Importantly, the AB criticized the panel’s approach to the object and purpose test:

[T]he Panel did not look at the object and purpose of the *chapeau of Article XX*. Rather, the Panel looked into the object and purpose of *the whole of the GATT 1994* and the *WTO Agreement* which object and purpose it described in an overly broad manner. Thus, the panel arrived at the very broad formulation that measures which ‘undermine the WTO multilateral trading system’ must be regarded as ‘not within the scope of measures permitted under the chapeau of Article XX’.<sup>232</sup>

From this statement one can make an important observation as to the interpretive value of the object and purpose: if taken into account, they can influence the meaning of the provision. Hence, their role in the interpretative process cannot be diminished. Also, according to the AB’s approach, in some cases, it is necessary to look not only at a treaty’s object and purpose contained in its preamble, but also at the object and purpose of the specific provision.<sup>233</sup>

In its analysis the AB made yet another fundamental statement:

...the preamble attached to the WTO Agreement *shows* that the signatories to that agreement were, in 1994, fully aware of the importance and legitimacy of environmental protection as a goal of national and international policy. The preamble of the WTO Agreement – which *informs* not only the GATT 1994, but also the other covered agreements – explicitly acknowledges the ‘objective of sustainable development’...<sup>234</sup> (Emphasis added)

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(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption. ...”

<sup>230</sup> *US - Reformulated Gasoline*, Appellate Body Report, *supra* note 204 at 17.

<sup>231</sup> *US - Shrimp*, Appellate Body Report, *supra* note 207.

<sup>232</sup> *Ibid*, at para 116.

<sup>233</sup> In addition to *Reformulated Gasoline* and *US-Shrimp*, the AB also referred to the object and purpose of specific provisions in a number of other cases. See, for instance, *Japan - Alcoholic Beverages*, Appellate Body Report, *supra* note 206 Section H.

<sup>234</sup> *US-Shrimp*, Appellate Body Report, *supra* note 207 at para.129

As we can see, this statement expressly points to the “function” of the preamble (“preamble shows” and “preamble informs”) on which the AB relied in order to justify its reasoning. An interesting question arises in this regard: would the AB be able to arrive at the same conclusion if the preamble of the WTO Agreement had not included the objective of sustainable development? While we cannot answer this question since it is not the object of this study, it is interesting to observe how the AB further concluded on the scope of the concept of “exhaustible natural resources”:

...recalling the explicit recognition by WTO Members of the objective of sustainable development in the preamble of the WTO Agreement, we believe it is too late in the day to suppose that Article XX(g) of the GATT 1994 may be read as referring only to the conservation of exhaustible mineral or other non-living natural resources.<sup>235</sup>

Arguably, the intention of the AB to expand the meaning of Article XX (g) of the GATT to include a broader range of natural resources, both living and non-living ones, is a clear signal that sustainable development principles will be carefully considered in the WTO decisions. Ultimately, the AB acknowledged that sustainable development, as an element of preambular language of the WTO Agreement, plays a role in the interpretive process, stating that:

We note once more that this [preambular] language demonstrates a recognition by WTO negotiators that optimal use of the world’s resources should be made in accordance with the objective of sustainable development. As this preambular language reflects the intentions of negotiators of the WTO Agreement, we believe, *it must add colour, texture and shading to our interpretation* of the agreements, annexed to the WTO, in this case, the GATT 1994.<sup>236</sup>

This significant decision by the AB continued to state that while the preamble of the GATT 1947 was used as the basis for the preamble of the new WTO Agreement, negotiators rejected that “*full use of the resources of the world*” enshrined in the preamble of the GATT 1947 was appropriate for the world trading system of the 1990’s.<sup>237</sup> As a result, the AB interpreted the preambular language of the WTO Agreement so as to reflect a contemporary vision of the world trade system, which favors sustainable development.

As it follows from the above examples, the AB not only took into account the *telos* of the agreement, but also illustrated how it may function for the purposes of interpretation. To repeat, since the preamble is a part of the treaty, this may affect how its substantive obligations will be interpreted and applied. Virtually, the preamble may not merely reflect a set of principal policy objectives and fundamental values agreed by the parties, but inform the interpretation of the substantial standards of the treaty.

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<sup>235</sup> *Ibid*, para.131

<sup>236</sup> *Ibid*.

<sup>237</sup> Rajendra Ramlogan, *Sustainable Development: Towards a Judicial Interpretation* (Leiden; Boston: Martinus Nijhoff Publishers, 2011) at 56.

Another important aspect here is that the AB's interpretative approach took into consideration non – trade interests though the reference to the preamble of the WTO Agreement. Thus, even if the fundamental objective of the regime is specific, as for example, trade or investment liberalization, the preamble of the treaty may help to align these economic rules with sustainable development, if the object and purpose of the treaty includes, *inter alia*, relevant non-economic considerations.

### ***2.1.2. Other Principles and Means of Treaty Interpretation under the VCLT***

#### **(a) Subsequent Agreements and Practice**

The VCLT requires in its Article 31(3) that the treaty parties' subsequent agreements and practice shall be taken into account regarding treaty interpretation. Indeed, as Anthony Aust has emphasized, “[h]owever precise a text appears to be, the way in which it is actually applied by the parties is usually a good indication of what they understand it to mean, provided practice is consistent, and is common to, or accepted by all the parties.”<sup>238</sup> As a result, subsequent agreement and practice between the parties as enshrined in Article 31(3)(a) and (b) of the VCLT constitute another important means of interpretation, providing a gateway for the treaty parties to play a role in the process of their treaty interpretation.

While the VCLT does not define the terms “subsequent agreement” and “subsequent practice,” it is generally understood that the agreement must be one between the parties, that is between all the parties to the treaty and it “must have been arrived at after the respective treaty was concluded.”<sup>239</sup> The International Law Commission (ILC) commentary in this regard states that:

[a]n agreement as to the interpretation of a provision reached after the conclusion of the treaty represents an authentic interpretation by the parties which must be read into the treaty for purpose of its interpretation.<sup>240</sup>

In turn, subsequent practice covers any application of the treaty through either active or passive conduct. The WTO Appellate Body provided the following definition of subsequent practice: “... a ‘concordant, common and consistent’ sequence of acts or pronouncements which is sufficient to establish a discernible pattern implying the agreement of the parties [to a treaty] regarding its interpretation ...”<sup>241</sup> Further, in *US – Gambling* the AB reaffirmed the general rule regarding subsequent practice, stating that:

[...] (i) there must be a common, consistent, discernible pattern of acts or pronouncements; and (ii) those acts or pronouncements must imply *agreement* on the interpretation of the relevant provisions.<sup>242</sup> (original emphasis)

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<sup>238</sup> A. Aust, *supra* note 194 at 194.

<sup>239</sup> Georg Nolte, *Treaties and Subsequent Practice* (Oxford: Oxford University Press, 2013), 309

<sup>240</sup> International Law Commission, *Commentary on the Draft Vienna Convention (1966)* Vol.2 YBILC, 221. It is also important to distinguish that an agreement regarding the interpretation of a treaty and agreement dealing with the same subject matter, but not for the purpose of interpretation, agreed by the parties of the treaty.

<sup>241</sup> The AB further noted that “an isolated act is generally not sufficient to establish subsequent practice.” See *Japan – Alcoholic Beverages*, Appellate Body Report, *supra* note 206, Sec. E, at 13.

<sup>242</sup> *US - Gambling*, Appellate Body Report, *supra* note 214 at 192.

It is important to note that the practice of only one party of the treaty is not sufficient to be taken into account for interpretation purposes. Article 31(3)(b) of the VCLT demands the agreement of *all* the parties in order to make practice relevant for treaty interpretation.<sup>243</sup> This was also reaffirmed by the AB, which stated that the practice must be adopted by all instead of one or few parties to a multilateral agreement,<sup>244</sup> as it is difficult to identify “an agreement between the parties” in the unilateral actions of one or a very few parties.

The AB has relied from time to time on Article 31(3)(a) and (b) of the VCLT in dispute settlement cases and it is considered as an accepted part of WTO jurisprudence which makes an influential contribution to the methods of interpretation of international norms. In this regard, Professor Nolte observes that along with the WTO adjudicatory bodies, the ICJ often considers whether a treaty provision must be interpreted in the light of a subsequent agreement or of a subsequent practice of the parties to the treaties, applying a liberal and flexible approach to their use.<sup>245</sup> For instance, in the *Kasikili/Sedudu Island* dispute<sup>246</sup> and the *Wall Opinion of 2004*,<sup>247</sup> the ICJ arguably expanded the use of subsequent practice which, in the Court’s eyes, may not only imply the treaty interpretation, but perhaps even a modification of treaty obligations over time.

In particular, when concluding in its Advisory Opinion on the Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory, the ICJ emphasized that:

The Court takes note of an interpretation of [...] an increasing tendency over time for the General Assembly and the Security Council to deal in parallel with the same matter concerning the maintenance of international peace and security. The Court considers that *the accepted practice of the Assembly, as it has evolved, is consistent with Article 12, paragraph 1 [of the UN Charter]*.<sup>248</sup> (emphasis added)

Importantly, Article 12 of the UN Charter,<sup>249</sup> in fact, prohibits the General Assembly making any recommendation with regard to any dispute or situation, *while* the Security Council is exercising its functions in respect of that dispute or situation. Nevertheless, the Court considered it appropriate to

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<sup>243</sup> Alexander Orakhelashvili, *The Interpretation of Acts and Rules in Public International Law* (Oxford: Oxford University Press, 2008) at 356-357.

<sup>244</sup> *European Community – Customs Classification of Frozen Boneless Chicken Cuts (Complaint by Brazil)* (2005) WT/DS269/AB/R, WT/DS286/AB/R (Appellate Body Report), online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds269\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds269_e.htm)> [*EC – Chicken Cuts*] at 259. Also A. Roberts identifies ways in which treaty parties generate state practice for the interpretative purposes, namely, by modifying its model BIT, formulating pleadings as a respondent, intervening in arbitrations as a non-disputing party, issuing public statements about its understanding of particular provisions, and reaching joint interpretations with the other treaty parties, including through bodies like the NAFTA Free Trade Commission. See Anthea Roberts, “Power and Persuasion in Investment Treaty Interpretation: the Dual Role of States” (2010) 104:2 AJIL 179 at 194.

<sup>245</sup> Georg Nolte, “Subsequent Practice as a Means of Interpretation in the Jurisprudence of the WTO Appellate Body” in Enzo Cannizaro, ed., *The Law of Treaties Beyond the Vienna Convention* (New York: Oxford University Press, 2011), 141-142.

<sup>246</sup> *Kasikili/Sedudu Island (Botswana v Namibia)*, Merits, [1999] ICJ Reports 1045, para. 50 at 1045 – 76 [*Kasikili/Sedudu Island*].

<sup>247</sup> *Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory*, Advisory Opinion [2004] ICJ Reports 136, para. 24 at 136, 148 [*Wall Opinion of 2004*]. See also A. Mark Weisburd, “The International Court of Justice and the Concept of State Practice” (2009) 31 UPA J Int’l L 295.

<sup>248</sup> See *Wall Opinion of 2004*, *ibid.*, para. 27 at 149.

<sup>249</sup> Article 12 of the UN Charter states that “while the Security Council is exercising in respect of any dispute or situation the functions assigned to it in the present Charter, the General Assembly shall not make any recommendation with regard to that dispute or situation.” See *Charter of the United Nations*, 26 June 1945, Can TS 1945 No 7 [UN Charter].

examine the significance of Article 12 in the given context and came to this conclusion, stating that this “increasing tendency over time” for the General Assembly and the Security Council to act in parallel was compatible with Article 12, paragraph 1 of the UN Charter because it had been an “accepted practice of the General Assembly, as it has evolved”. The Court observed that initially both the General Assembly and the Security Council interpreted and applied Article 12 to the extent that “the Assembly could not make a recommendation on a question concerning the maintenance of international peace and security, while the matter remained on the Council’s agenda... However, this interpretation has evolved subsequently.”<sup>250</sup> By justifying its position the Court pointed out that “the General Assembly deemed itself entitled in 1961 to adopt recommendations in the matter of the Congo (resolutions 1955 (XV) and 1600 (XVI)) and in 1963 in respect of the Portuguese colonies (Resolution 1913 (XVIII)),” while those cases appeared on the Security Council’s agenda.<sup>251</sup> Thus, the Court dismissed the attempts to limit the scope of Article 12 particularly relying on the subsequent practice of the General Assembly in its application.

Consequently, in some cases subsequent practice (as well as subsequent agreements) may also be helpful in determining whether the meaning of a term used in the treaty is static, or whether it may evolve over time. More specifically, it may assist in identifying whether the presumed intention of the parties at the time of conclusion of the treaty was to give a particular term a meaning that is capable of evolving over time. In this context, the Working Group of the ILC suggested that there are conceptual linkages between subsequent practice and the method of evolutionary interpretation. This is, however, despite the key distinction that subsequent practice entails the interpretation of a treaty “on the basis of something about the later behavior of the parties”, while evolutionary interpretation involves “developmental interpretation ... based on some evidence of the original intention of the parties that the treaty be capable of evolution.”<sup>252</sup>

Moreover, there is an important distinction between subsequent practice which shows what the parties meant at the time the treaty was concluded and subsequent practice which shows that the parties agree that the meaning has changed. This, in turn, differs from the evolutionary method of interpretation, at least conceptually, since it means that the parties intended at the time they concluded the treaty that the meaning of a word or expression was not to remain fixed but would evolve over time. One should also bear in mind that an evolutionary meaning can be determined in such a case without reference to any subsequent practice of the parties to a treaty, though there may be cases in which subsequent practice confirms that the parties considered the term or expression to have an evolutionary meaning.

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<sup>250</sup> See *Wall Opinion of 2004*, *supra* note 247, para. 27 at p. 149

<sup>251</sup> *Ibid.*

<sup>252</sup> Julian Arato, “Subsequent Practice and Evolutive Interpretation: Techniques of Treaty Interpretation over Time and Their Diverse Consequences” (2010) 9:3 *Law & Prac Int'l Courts & Trib* 443 at 443, 445.

In contrast to the ICJ, the ECJ does not often refer to the subsequent practice between the parties, but in some cases, the Court relies on its “all-encompassing purposive interpretation to take account of changing contexts and subsequent developments.”<sup>253</sup> Indeed, Articles 31(3)(a) and (b) of the VCLT allow for an “evolutionary” approach to interpretation - one to establish a contemporary meaning of a provision that has developed since the inception of the treaty. In its jurisprudence, the ECHR expressly refers to changing circumstances in different European states,<sup>254</sup> contributing to the common assertion that the meaning of certain terms may change with times. Analogously, the Appellate Body in *US - Shrimp*,<sup>255</sup> the ICJ in *Costa Rica v. Nicaragua*<sup>256</sup> and the PCA in *Iron Rhine Railway*<sup>257</sup> have recognized that certain terms have an evolutionary meaning.<sup>258</sup>

While in certain cases subsequent agreement and practice might be helpful for evolutionary interpretation, they may assist in clarifying the ordinary meaning of a treaty provision at the time it was adopted (“contemporaneous interpretation”), which in view of S.D. Murphy, is “the most important way in which subsequent conduct features in treaty interpretation when it is used”.<sup>259</sup>

The better view is, however, that either contemporaneous or evolutionary interpretation is significant for the treaty interpretation as they both aim at clarification of the meaning of its provisions. Their application should rather be distinguished depending on the circumstances of the case. Referring to judicial practice, the ILC noted in its Fragmentation Report, that it might be relevant to use evolutionary interpretation “where the parties by their choice of language intend to key into that evolving meaning without adopting their own idiosyncratic definition (for example, use of terms such as ‘expropriation’ [...] in the relevant treaty)”<sup>260</sup> or “where, by reading that language against its [treaty’s] object and purpose, it appears that the parties have committed themselves to a project of progressive development”<sup>261</sup> and when the obligation concerned is stated in very general terms.<sup>262</sup>

It seems obvious that the meaning of some words can change over time depending on states’ subsequent conduct. The word “development” used in the preambles of some treaties may, in some

<sup>253</sup> Enzo Cannizzaro, *The Law of Treaties Beyond the Vienna Convention* (New York: Oxford University Press, 2011), 142. See *Francovich and Others v Italy*, C-6/90 and C-9/90, [1991] ECR I-5357, at para. 32; *Regina v Secretary of State for Transport, Ex parte Factortame Ltd.*, C-213/89, [1990] ECR I-2433, at para. 20.

<sup>254</sup> *Tyrer v United Kingdom (Ireland v United Kingdom)*, No 5856/72 (1978), 2 EHRR 25, at para. 31 [*Tyrer v United Kingdom*]. See E. Cannizzaro, *supra* note 253 at 142; Malgosia Fitzmaurice, “Dynamic Evolutive Interpretation of Treaties” (2008) 21 Hague YB Int’l L 101.

<sup>255</sup> In *US - Shrimp*, the Appellate Body has recognized that the expression “natural resources” in Article XX(g) GATT is “by definition, evolutionary” so as to also cover living resources. See *US - Shrimp*, Appellate Body Report, *supra* note 207, at para 130.

<sup>256</sup> The ICJ, in a case concerning a dispute between Costa Rica and Nicaragua, has also recognized that the words “articles of trade” (*objetos de comercio*) to cover not only goods but also services. The Court concluded that “comercio,” being a “generic” term, “was likely to evolve over time.” *Case Concerning the Dispute Regarding Navigational and Related Rights (Costa Rica v Nicaragua)*, Judgment (2009), ICJ Report 2009, paras. 79-81 at 213.

<sup>257</sup> See *Iron Rhine* *supra* note 9, at para 79.

<sup>258</sup> It must be noted that evolutionary interpretation can be categorized in two forms – evolutionary interpretation based on terminology and in light of object and purpose. See J. Arato, *supra* note 252 at 467.

<sup>259</sup> Sean D. Murphy, *infra* note 335 at 86.

<sup>260</sup> *Fragmentation of International Law: Difficulties arising from the Diversification and Expansion of International Law*, Report of the Study Group of the International Law Commission finalized by Martti Koskenniemi (13 April 2006), UN Doc. A/CN.4/L.682 (2006) 1, para. 478 at 242 [*Fragmentation Report*].

<sup>261</sup> *Ibid.*

<sup>262</sup> *Ibid.*

cases, go beyond the concept of pure “economic” development. The notion of “expropriation” itself can be a clear example of an evolving concept that today embraces more than just a direct taking. Furthermore, a broad formulation of exceptions based on Article XX GATT, such terms as “public health” or “environmental protection” is justified in light of contemporary concerns of international law and sustainable development. Based on the above, the evolutionary interpretation of treaty provisions in light of subsequent conduct of the states may be viewed as a relevant approach to integrate sustainable development consideration into investor-state arbitration, though when used among other means of interpretation in compliance with the requirements of Article 31 of the VCLT.

#### (b) The Principle of Systemic Integration

The legal rules of interpretation cannot be adequately addressed without examination of an important and “one of the most neglected corners of the interpretation section.”<sup>263</sup> Article 31(3)(c) of the VCLT, which facilitates the so-called *principle of systemic integration*.<sup>264</sup> It requires a treaty interpreter to take into account *any relevant rules* applicable in the relations *between the parties* along with the context.<sup>265</sup> Such formulation, however, leaves some questions open. For instance, some interpretative issues arising out of its application relate to the phrase “any relevant rules” One approach to this norm is to include only well-established rules of law, while another - to include public international law in general as mentioned in Articles 38 and 59 of the ICJ Statutes.<sup>266</sup> Other interpretative questions relate to the wording “between the parties.” The commonly accepted understanding of the word “parties” in Article 31(3)(c) of the VCLT is that it refers to all parties to the principal treaty all of whom also have to be parties to the secondary treaty. At the same time, the ILC Study Group argues that Article 31(3)(c) VCLT should only require applicability between the parties to a particular dispute rather than all parties to the treaty.<sup>267</sup>

It worth noting that most of these controversial issues are not relevant for interpretation and application of investment treaties<sup>268</sup> due to bilateral nature of a large number of such treaties (with the

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<sup>263</sup> Campbell McLachlan, “The Principle of Systemic Integration and Article 31(3)(c) of the Vienna Convention” (2005) 54 ICLQ 279.

<sup>264</sup> *Ibid*; See also Chester Brown, “Bringing Sustainable Development Issues before Investment Treaty Tribunals” in Marie-Claire Cordonier Segger, Markus W. Gehring, & Andrew Newcombe, eds., *Sustainable Development in World Investment Law* (The Hague: Kluwer Law International, 2011) 171 at 187; In some studies the principle of systemic integration is also regarded as the principle of harmonious interpretation. This is because the Article 31(3)(c) VCLT is viewed by some authors as a tool for achieving harmonious interpretation by taking into account the broader context of international law. See I. Van Damme, *Treaty Interpretation by the WTO Appellate Body*, *supra* note 190 at 357- 365; See Fragmentation Report, *supra* 260 at paras. 37-43, see also conclusion 19.

<sup>265</sup> Article 31(3)(c) of VCLT. As explained by the ILC, the article gives expression to the objective of “systemic integration” according to which, whatever their subject matter, treaties are a creation of the international legal system and their operation is predicated upon that fact. See ILC Fragmentation Report, *supra* 260 at para.14 (17).

<sup>266</sup> See C. McLachlan *supra* note 263 at 290.

<sup>267</sup> See Freya Baetens, “Muddling the Waters of Treaty Interpretation? Relevant Rules of International Law in the *MOX Plant OSPAR Arbitration* and *EC Biotech Case*” (2008) 77:3 Nordic J Int'l L 197–216; Joost Pauwelyn, *Conflict of Norms in Public International Law* (Cambridge: Cambridge University Press, 2003); Duncan French, “Treaty Interpretation and the Incorporation of Extraneous Legal Rules” 55 ICLQ 281. The ILC Study Group argues that Art. 31(3)(c) VCLT should only require applicability between the parties to a particular dispute rather than all parties to the treaty.

<sup>268</sup> This applies in particular to the question whether the relevant rules referred to in Article 31(3)(c) of the VCLT must be applicable to the parties to the dispute or to the parties to the relevant treaty and was relevant in the plurilateral WTO context.

exception of the Energy Charter Treaty, the NAFTA and plurilateral free-trade agreements having an investment chapter).

In addition, it remains unclear what an expression “taken into account” really means in the context of Article 31(3)(c). In fact, it could signify almost anything and may “undermine the important distinction between applicable law and systemic integration.”<sup>269</sup> As explained by Tarcisio Gazzini and Yannick Radi, this distinction lies in the following: while the principle of systemic integration requires the interpreter to take into account all relevant rules of *international law regardless of the consent* of the parties, the applicable law refers to the relevant legal rules governing the substantive issues in dispute which are normally *agreed upon by the parties* and in many cases belonged to the *national legal systems*.<sup>270</sup>

Another important aspect which is the subject of ongoing academic debate is a concept of the “relevant rules of international law” applicable between the parties. In view of some commentators, the relevant rules of international law invoked under the Article 31(3)(c) of the VCLT should be restrictively used in the interpretation: only customary international law can be applied and the general principles of public international law regarding evidence, procedure and jurisdiction are usually referred to.<sup>271</sup> Similarly, Campbell McLachlan argues that customary international law and general principles of international law should be considered under the Article 31(3)(c) of the VCLT.<sup>272</sup> This view is supported by the study by the International Law Commission. In particular, the ILC Study Group noted that “Article 31(3)(c) deals with the case where material sources external to the treaty are relevant for its interpretation. These may include other treaties, customary rules, or general principles of law.”<sup>273</sup>

International courts and arbitral tribunals have also taken into account external legal rules and principles in applying the Article 31(3)(c) of the VCLT. So far, the latter has been referred to and applied by the ICJ,<sup>274</sup> the ECHR,<sup>275</sup> the WTO AB,<sup>276</sup> the PCA Tribunal<sup>277</sup> and the investor-state tribunals,<sup>278</sup> though the judicial practice in this regard is hardly consistent. The first case which shed

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<sup>269</sup> Tarcisio Gazzini & Yannick Radi, “Foreign Investment with a Human Face, with Special Reference to Indigenous Peoples’ Rights” in R. Hofmann, C. Tams, eds., *International Investment Law and Its Others* (Baden-Baden: Nomos, 2012) 87 at 95.

<sup>270</sup> *Ibid.*

<sup>271</sup> M. Lennard, *supra* note 206 at 42-44.

<sup>272</sup> C. McLachlan, *supra* note 263 at 314.

<sup>273</sup> Fragmentation Report, *supra* note 260 at para.251, conclusion 18. For the critical view on this regard, see Christina Voigt, *Sustainable Development as a Principle of International Law: Resolving Conflicts between Climate Measures and WTO Law* (Leiden: Martinus Nijhoff Publishers, 2009) at 28. Under general principles of law it is understood the general principles of law recognized by civilized nations as incorporated in the Statute of the ICJ. See Article 38(1)(c) of the *Statute of the International Court of Justice* (1945) 3 Bevans 1179; 59 Stat. 1031; TS. 993 at 25.

<sup>274</sup> *Case concerning Oil Platforms (Islamic Republic of Iran v United States of America)* [2003] ICJ Report 161, 42 ILM 1334, 1352, para.41 [*Oil Platforms*].

<sup>275</sup> *Loizidou v. Turkey* [GC], (1996) ECHR Series A, No. 310, 23 EHRR 513; *Fogarty v. United Kingdom* [GC], (2001) ECHR 762, 123 ILR 54, 65; *Al-Adsani v United Kingdom* [GC], (2001) ECHR 2001-XI, ECHR 761, 34; *McElhinney v Ireland* [GC], (2001), 34 EHRR 323, (2001) IHRL 2990.

<sup>276</sup> *US – Shrimp*, Appellate Body Report, *supra* note 207 at para.158.

<sup>277</sup> *Iron Rhine*, *supra* note 9, at para 79.

<sup>278</sup> *Pope & Talbot*, *supra* note 63, at para. 46.

light on the Article 31(3)(c) of the VCLT as a means of interpretation was the *Oil Platforms* case.<sup>279</sup> When interpreting the provisions of the *1955 Treaty of Amity, Economic Relations and Consular Rights between the United States and Iran* (1955 Treaty), the ICJ addressed the relations between the 1955 Treaty and general international law by reference to Article 31(3)(c) of the VCLT:

[I]nterpretation must take into account ‘any relevant rules of international law applicable in the relations between the parties’ (Art. 31, para. 3 (c)). The Court cannot accept that Article XX, paragraph 1 (d), of the 1955 Treaty was intended to operate wholly independently of the relevant rules of international law on the use of force. [...] The application of the relevant rules of international law relating to this question thus forms an integral part of the task of interpretation.<sup>280</sup>

Thus, to determine the interpretation of Article XX of the 1955 Treaty, the ICJ found that reference to the provisions of the UN Charter as well as to the customary international law was justified.<sup>281</sup>

The usage of Article 31(3)(c) has been developing throughout the jurisprudence of other reputable adjudicatory bodies. The tribunal in the *Iron Rhine*<sup>282</sup> case relied on the principle of systemic integration by recalling paragraph 140 of the *Gabčíkovo–Nagymaros Project*,<sup>283</sup> where applying Art. 31(3)(c) of the VCLT, the tribunal found that “international environmental law has relevance to the relations between the Parties.”<sup>284</sup> Then, the *Iron Rhine* Tribunal clarified that international law today “require[s] the integration of appropriate environmental measures in the design and implementation of economic development activities.”<sup>285</sup> In that context the tribunal further stated that:

[e]nvironmental law and the law on development stand not as alternatives but as mutually reinforcing, integral concepts, which require that where development may cause significant harm to the environment there is a duty to prevent, or at least mitigate, such harm.<sup>286</sup>

This decision is important as it points out that the duty to prevent or mitigate the environmental harm, as consequence of development, has “become a principle of general international law.”<sup>287</sup> Although the *Iron Rhine* tribunal did not engage in a thorough analysis of the content of the principle of systemic integration codified in Article 31(3)(c), it relied on the principle as embedded in the reasoning of the tribunal in the *Gabčíkovo–Nagymaros Project* to justify its own conclusions concerning integration of environmental protection in the developmental process.

Other international courts and tribunals have also resorted to systemic integration in their reasoning. In *Golder v. United Kingdom*,<sup>288</sup> the ECHR explicitly referred to the Article 31(3)(c) and

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<sup>279</sup> *Oil Platforms*, *supra* note 274 at para. 32.

<sup>280</sup> *Ibid.*, at para. 41.

<sup>281</sup> *Ibid.*, at para. 42.

<sup>282</sup> See *Iron Rhine supra* note 9, at para. 80.

<sup>283</sup> See *Gabčíkovo supra* note 9, para.140, at 78.

<sup>284</sup> See *Iron Rhine supra* note 9, at para. 58.

<sup>285</sup> *Ibid.* at para. 59.

<sup>286</sup> *Ibid.*

<sup>287</sup> *Ibid.*

<sup>288</sup> *Golder v United Kingdom, supra* note 220, at para. 35

found that the general principles of law were covered by its rule. In the arbitration concerning the *OSPAR Convention* case<sup>289</sup> the tribunal constituted under the Permanent Court of Arbitration applied a restrictive approach, stating that Article 31(3)(c) allows application of only presently existing legal rules, regardless whether they are written or customary.

In some cases, through the process incorporated in Article 31(3)(c) of the VCLT, international courts and arbitral tribunals, including the ECHR and investor-state tribunals, have even referred to resolutions of international organizations, soft law instruments and the teachings of the most highly qualified publicists,<sup>290</sup> which are arguably excluded from the scope of Article 31(3)(c) of the VCLT.<sup>291</sup>

Leaving aside the controversies, which exist around the scope and formulation of Article 31(3)(c) of the VCLT, it is important to focus on the potential which the principle of systemic integration possesses as a tool enhancing the formal and substantive unity of international law.<sup>292</sup> The ILC regards systemic integration and Article 31(3)(c) of VCLT as a possible response to the issue of fragmentation. It considers it quite useful when normative conflicts occur between different sub-fields of international law, such as, for instance, investment and environmental protection. This is because systemic integration presupposes the formal unity of international legal system<sup>293</sup> where no rule can be interpreted on its own, disconnected from international law.

Indeed, the principle of systemic integration as enshrined in Article 31(3)(c) of the VCLT offers interpreters a useful procedural framework, which at the practical level allows them to strike a balance between conflicting norms with the aim to ensure the greatest possible effect for such provisions. In this context, the principle has been addressed in a number of studies as the key to incorporating sustainable development through treaty interpretation.<sup>294</sup> It is viewed as tool for integration of “external” rules relating to various manifestations of sustainable development.

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<sup>289</sup> *Dispute concerning Access to Information under Article 9 of the OSPAR Convention (Ireland v United Kingdom and Northern Ireland)*, [2003] 42 ILM 1118, paras. 90-101, at 90-91 [*OSPAR Convention Case*].

<sup>290</sup> For instance, in *Loizidou v Turkey* the ECHR referred to the UN Security Council Resolution 541 (1983). See *Loizidou v Turkey supra* note 275. Under international law “the teachings of the most highly qualified publicists” are considered as a supplementary source of international law under the article 38.1 of the Statute of the International Court of Justice. According to K. Fauchald, legal doctrine was used as a source of information about interpretive arguments in a number of decisions, for instance in *Tokio Tokelès v Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction (29 April 2004) at paras 91 and 92, online: ITA Law <[http://italaw.com/documents/Tokios-Jurisdiction\\_000.pdf](http://italaw.com/documents/Tokios-Jurisdiction_000.pdf)> [*Tokio Tokelès v Ukraine*], and *SGS Société Générale de Surveillance v Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision on the Objection of Jurisdiction (January 29, 2004) at para. 146, online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0782.pdf>> [*SGS v. Philippines*]. See Ole Kristian Fauchald, “The Legal Reasoning of ICSID Tribunals – an Empirical Analysis” (2008) 19:2 EJIL 301 at 351. However, the predominant opinion among scholars is that the academic writings do not create norms, but evidence them. R. Gardiner, *supra* note 228 at 268.

<sup>291</sup> It is argued that Article 31(3)(c) of the VCLT refers only to binding norms deriving from formal sources of international law. See Sir Humphrey Waldock, “Sixth Report on the Law of Treaties”, II YBILC, UN doc. A/CN.4/SER.A/1966/add. 1 (1967), para. 10 at p. 97.

<sup>292</sup> Jean d’Aspremont, “The Systemic Integration of International Law by Domestic Courts: Domestic Judges as Architects of the Consistency of the International Legal Order” in Ole K. Fauchald & André Nollkaemper, eds, *The Practice of International and National Courts and the (De-)Fragmentation of International Law* (Oxford: Hart Publishing, 2012) 141 at 158.

<sup>293</sup> Philippe Sands, “Treaty, Custom and the Cross-Fertilization of International Law”, (1998) 1 Yale Hum Rts & Dev L J 85 at 95.

<sup>294</sup> See, for instance, P. Sands, *ibid* at 85; C. McLachlan *supra* note 263 at 279; I. Van Damme, “Other Issues in WTO Treaty Interpretation” in I. Van Damme, ed., *Treaty Interpretation by the WTO Appellate Body* (Oxford: Oxford University Press, 2009) 305; C. Brown, *supra* note 264 at 186; Brief references to the principle can be found in the following judgements: *Case concerning the Right of Passage over Indian Territory (Portugal v India)*, [1957] ICJ Reports 125 at 142; *Nasser Esphahanian v Bank Tejarat*, (1983) 2 Iran-US CTR 157, 23 ILM 489; *Golder v UK*, *supra* note 220 at paras. 27–31; *Loizidou v Turkey supra* note 275 at para. 44; *Al-Adsani v United Kingdom*, *supra* note 275 at paras. 55–56.

This method may especially be useful in the context of investment disputes as not many investment treaties affirm parties' obligations under non-investment instruments directly in their texts.<sup>295</sup> As a result, reference to evolving international law can establish the meaning and content of certain concepts applied in international investment law. For instance, in cases of indirect expropriation involving state regulation in sensitive areas, tribunals may consider norms of international environmental agreements or other non-investment instruments (for instance, instruments dealing with cultural heritage) when interpreting the concept of "indirect expropriation" or in order to support its reasoning when dealing with non-investment considerations.<sup>296</sup> As will be explored in the following section, in some cases investment tribunals have applied the principle of systemic integration, however, in relation to investment protection standards other than indirect expropriation.

Stressing the general importance of the principle for developmental concerns, the ILC on the International Law on Sustainable Development noted that "sustainable development will only be realized when the principle of integration is properly – and fully – implemented."<sup>297</sup> Moreover, Article 31(3)(c) of the VCLT appears to be the only codified principle of interpretation that expressly refers to other rules of international law.<sup>298</sup> This makes it a unique interpretative instrument that may be viewed as one of the legal avenues by which investor-state tribunals could begin to develop a case law that balances investment protection and state's right to regulate in pursuit of sustainable development.

### (c) *Supplementary Rules of Interpretation*

The secondary sources of interpretation contained in Article 32 of the VCLT<sup>299</sup> are, *inter alia*, the intention of the parties at the time of drafting, as reflected by the *travaux préparatoires*.<sup>300</sup> They may only be resorted to when it is needed to confirm meaning established under the principle of *good faith* interpretation or in case the meaning of the treaty remains ambiguous or leads to an absurd result.<sup>301</sup> It is worth noting that the list of supplementary interpretative elements of Article 32 of the VCLT is not exhaustive: an interpreter is not bound to use only those elements which are explicitly mentioned in the Vienna Convention - preparatory work or circumstances of conclusion of the treaty.

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<sup>295</sup> However, some treaties, as for example NAFTA, affirm parties' obligations under non-investment instruments directly in their texts and/or in their side agreements.

<sup>296</sup> A reference to international non-investment treaty may help to balance different norms and competing interests when deciding a case involving indirect expropriation. A good example can be drawn from *Parkerings v Lithuania*, where the tribunal relied on the World Heritage Convention to support its reasoning. See *Parkerings-Compagniet AS v Republic of Lithuania*, ICSID Case No. ARB/05/8, Award (11 September 2007) at para. 392, online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0619.pdf>> [*Parkerings v. Lithuania*].

<sup>297</sup> Report of the Commission on the International Law on Sustainable Development (Toronto: International Law Commission Conference, 2006), online: ILC <<http://www.ila-hq.com>>.

<sup>298</sup> Marina Foltea, *International Organizations in WTO Dispute Settlement: How Much Institutional Sensitivity* (Cambridge: Cambridge University Press, 2012) at 36.

<sup>299</sup> Article 32 of the VCLT, *supra* note 16.

<sup>300</sup> *Travaux préparatoires* also referred to as "negotiating history" and "drafting history", are the preparatory works, including documents, reports, minutes, drafts, and other materials, from the drafting and the negotiation of the treaty. See the reports of the negotiation of the International Convention for the Suppression of the Financing of Terrorism 1997 (UN docs A/54/37, A/C.6/54/L.2 and A/54/615). For the discussion on this issue see Julian Davis Mortenson, "The *Travaux* of *Travaux*: Is the Vienna Convention Hostile to Drafting History?" (2013) 107 AJIL 780; Yves le Bouthillier, "Article 32: Supplementary Means of Interpretation" in Olivier Corten & Pierre Klein, eds., *The Vienna Conventions on The Law of Treaties: A Commentary* (Oxford: Oxford University Press, 2011) 841 at 842.

<sup>301</sup> Article 32 of the VCLT, *supra* note 16, cited as in J. Pauwelyn & M. Elsig, *supra* note 191 at 448.

In the view of some scholars, however, the means of interpretation provided by Article 32 of the VCLT are of limited legal value: recourse to them is optional, while referring to those listed in Article 31 of the VCLT is mandatory.<sup>302</sup> The mere fact that these rules are labeled as supplementary already implies a legal qualification thereof.<sup>303</sup> Nevertheless, the examination of the current judicial practice shows that the supplementary character of Article 32 of the VCLT does not deprive it from being a rule of customary international law<sup>304</sup> as well as from being used in the interpretative process by international courts and arbitral tribunals.<sup>305</sup>

Moreover, some commentators argue that, even when the ordinary meaning appears to be clear, if it is evident from the *travaux préparatoires* that such meaning does not represent the intention of the parties, the obligation in Article 31(1) of the VCLT to interpret a treaty in good faith requires a court to “correct” the ordinary meaning.<sup>306</sup> Although it seems to require *travaux préparatoires* to bear more than merely complementary function, this suggestion demonstrates that supplementary means of interpretation may play a role in shaping the meaning of treaty provisions. In sum, supplementary means of interpretation may confirm a particular interpretation reached on the basis of primary interpretive tools under Article 31 of the VCLT or to clarify an ambiguous term, guiding the interpreter to the authentic reading of the parties’ intention. In that sense, the release of *travaux préparatoires* “may be a means for countries to ensure that their original intent is preserved.”<sup>307</sup>

The supplementary means of interpretation may be resorted to when interpreting concepts like “environment protection,” “public health implications” and similar notions, since they may be helpful in determining whether the intention of the parties was to leave room for such non-economic objectives within the treaty in question. However, as noted by Anthony Aust, the investigation of a treaty’s

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<sup>302</sup> Mitsuo Matsushita, Thomas Schoenbaum, & Petros Mavroidis, *The World Trade Organization: Law, Practice and Policy*, (Oxford: Oxford University Press, 2006), 34.

<sup>303</sup> *Ibid* at 32.

<sup>304</sup> The AB in *Japan – Alcoholic Beverages* emphasized the status of Article 31 of the VCLT as being the rule of customary international law and noted that Article 32 has attained the same status. See Appellate Body Report, *Japan – Alcoholic Beverages*, Appellate Body Report, *supra* note 206 at 11.

<sup>305</sup> In *Border and Transborder Armed Actions* the ICJ resorted to preparatory works to confirm its interpretation of the Pact of Bogota. *Border and Transborder Armed Actions (Nicaragua v Honduras)*, [1988], ICJ Reports 69, Jurisdiction of the Court and Admissibility of the Application, (1989) 28 ILM 338. See also *Rights of Nationals of the United States of America in Morocco (Rights of Nationals) (France v United States)*, [1952] ICJ Reports 176. The Appellate Body looked at the drafting history of the Havana Charter in *Canada – Certain Measures Concerning Periodicals* or to the circumstances of conclusion of the agreement to recognise the Oilseed Agreement as a supplementary means of interpretation of Schedule LXXX in the *European Communities – Measures Affecting Importation of Certain Poultry Products*. See *Canada – Certain Measures Concerning Periodicals (Complaint by United States)*, (1997) WT/DS31/AB/R (Appellate Body Report) at 34, online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds31\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds31_e.htm)>; *European Communities – Measures Affecting Importation of Certain Poultry Products (Complaint by Brazil)*, (1998) WT/DS69/AB/R (Appellate Body Report), Section IV at 83, online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds69\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds69_e.htm)>. See also *US – Shrimp*, *supra* note 210 at para. 157; *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef (Complaints by the United States and Australia)*, (2001) WT/DS161/R & WT/DS169/R (WTO Panel Report) at para. 539, online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds161\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds161_e.htm)>; *United States – Subsidies on Upland Cotton (Complaint by Brazil)*, (2005) WT/DS267/AB/R (Appellate Body Report) at para. 623, online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds267\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds267_e.htm)>. However, the rule codified in Article 32 VCLT was only rarely employed by the ECJ, mostly because of the complex and incompletely published legislative history. On this issue, see Hannes Rösler, “Interpretation of EU Law” in J. Basedow, K. J. Hopt & R. Zimmermann, eds., *The Max Planck Encyclopedia of European Private Law*, Vol. II (Oxford: Oxford University Press, 2012) 979 at 979.

<sup>306</sup> Stephen M. Schwebel, “May Preparatory Work be Used to Correct Rather than Confirm the ‘Clean’ Meaning of a Treaty Provision?” in J. Makarczyk, ed., *Theory of International Law at the Threshold of 21st Century: Essays in Honour of Krzysztof Skubiszewski* (The Hague: Kluwer Law International, 1996) 541 at 547.

<sup>307</sup> UNCTAD, “*Interpretation of IIAs: What States Can Do*”, *supra* note 181 at 12.

drafting history is a time-consuming exercise, while the findings might appear marginal and not always decisive.<sup>308</sup> Therefore, the preparatory works and other supplementary sources of interpretation should always be approached with care.

## **2.2. Interpreting Indirect Expropriation and Other Provisions in BITs: A Look at The Vienna Convention And Beyond**

### *2.2.1. The Specific Character of Investment Treaty Law*

The interpretation of treaty provisions may vary according to the use of particular means of interpretation and the category of rules to be interpreted. This is because the interpretation of international investment agreements, WTO agreements or human rights treaties requires an interpreter to take into account the specific characteristics of the particular regime. The unique character of international investment law is highlighted by numerous scholarly studies: what distinguishes it from other legal regimes is its specific purpose, nature, structure and the dispute settlement mechanism.

A centerpiece of the system of international investment law is investment treaties in the form of BITs or plurilateral instruments. They constitute agreements between states providing individuals, who are not themselves, parties to the instruments, with specific rights of action. They allow foreign investors to sue states directly under international law using the investor-state dispute settlement mechanism provided by such agreements. This transforms international investment law into a system that functions through combining public international law rules with private enforcement in investor-state arbitrations.<sup>309</sup>

The mechanism of investor-state arbitration, which is at the heart of the regime, offers a unique system of dispute settlement. Although its procedural framework is borrowed from the model of international commercial arbitration, it has distinct features. One of the principal specificities is the involvement of a public interest element. Indeed, as noted by Anthea Roberts, instead of being contractual disputes between private parties as in the case of international commercial arbitration, investor-state disputes concern public actions and involve public interests.<sup>310</sup> By their nature, many investor-state disputes automatically involve general public interest: because a state is a party to such dispute, the public has an interest in the conduct or misconduct of its government.<sup>311</sup> In some cases, investor-state tribunals may also play a role in producing important public policy implications and developing investment treaty law through treaty interpretation.

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<sup>308</sup> A. Aust, *Modern Treaty Law and Practice*, *supra* note 194 at 247.

<sup>309</sup> Stephan W. Schill, “W(h)ither Fragmentation? On the Literature and Sociology of International Investment Law” (2011) 22:3 Eur J Int Law 875 at 876.

<sup>310</sup> Anthea Roberts, “Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System” (2013) 107 AJIL 45 at 45.

<sup>311</sup> In the context of investor-state arbitration, the “public” character of the state action significantly varies. However, in some cases, the state action may result in breach of a contract for services and thus, it may be more in the nature of a commercial act, than a public.

In addressing these issues, it is important to situate the discussion in the broader context of the evolution that international investment law has undergone in the past decades.<sup>312</sup> Historically, one of the most important characteristics of international investment law has been its almost exclusive orientation with respect to the protection of foreign investors. In this regard, BITs are considered to be particular instruments which provide special guarantees for foreign investors. In *Spyridon Roussalis v. Romania*<sup>313</sup> the Tribunal underlines the special role of the investment treaty stressing “the higher and more specific level of protection offered by the BIT to the investors compared to the more general protections offered to them by the human rights instruments.”<sup>314</sup> This explains the specific object and purpose of investment treaties as well as the “increasing specialization and autonomization of the discipline.”<sup>315</sup> Consequently, the core investment treaty standards, such as protection against uncompensated expropriation, retained and developed their status as international rules while being considered by the actors of the regime from the standpoint of its core objective – investment protection. As a result, in a number of disputes all doubts and ambiguities were resolved in the investors’ favor along with the partial or full ignorance of social or environmental concerns as related to the public interest.

In the past decade, however, the character of international investment law has been considerably changed. A new generation of investment policies is emerging, pursuing a broader objective aiming at investment protection with due consideration of the public interest. The 2012 US Model BIT,<sup>316</sup> the 2004 Canada Model BIT,<sup>317</sup> as well as a number of more recent BITs signed by Canada,<sup>318</sup> India<sup>319</sup> or Colombia<sup>320</sup> have been developing as the instruments, which can promote and protect foreign investment in a way that contributes to sustainable development goals. The objects of such BITs have been changing accordingly: environmental and social concerns are increasingly being expressed in the preamble and in other provisions. These developments, as reflected in modern investment treaties, set up a new framework for their interpretation, however, not without new challenges.

It is important to note that sustainable development should not be seen in the present context as a concept which creates new obligations<sup>321</sup> or ignores the purposes of the investment protection regime.

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<sup>312</sup> M. Sattorova, *supra* note 108 at 321.

<sup>313</sup> *Spyridon Roussalis v Romania*, ICSID Case No. ARB/06/1), Award (2011), online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0723.pdf>> [*Spyridon Roussalis v Romania*].

<sup>314</sup> *Ibid*, para .312 at 53.

<sup>315</sup> S. W. Schill, *supra* note 309 at 876.

<sup>316</sup> See the 2012 US Model BIT, *supra* note 23.

<sup>317</sup> See the 2004 Canada’s Model BIT, *supra* note 33.

<sup>318</sup> See, for instance, the 2013 Canada – Benin BIT, 2012 Canada – China BIT, 2011 Canada – Kuwait BIT, 2010 Canada –Slovakia BIT, and 2013 Canada – Tanzania BIT.

<sup>319</sup> See the 2010 India – Congo BIT, 2010 India – Latvia BIT, 2011 India – Lithuania BIT, 2011 India - Nepal BIT, and 2011 India – Slovenia BIT (an exception is the 2013 India – the United Arab Emirates BIT which does not contain factors for determination of indirect expropriation).

<sup>320</sup> See, for instance, the 2011 Colombia – Japan BIT and the 2010 Colombia – UK BIT.

<sup>321</sup> Rahim Moloo & Jenny J. Chao, “International Investment Law and Sustainable Development: Bridging the Unsustainable Divide” in Andrea K. Bjorklund, ed, *Yearbook on International Investment Law and Policy 2012-2013* (Oxford: Oxford University Press, 2014) 273 at 278. The authors emphasize that sustainable development should rather be viewed as an umbrella concept for many already existing and recognized norms alongside other norms that remain in the nascent stages of development.

The protection of human, animal and plant health under the “umbrella” of sustainable development is not a primary objective of the regime. However, when interpreting BITs, particularly those that more explicitly address non-investment considerations and safeguard state’s regulatory space, the adjudicators should consider the specific character of international investment law and of the respective BITs so as to align their interpretation to sustainable development. In particular, the means of interpretation incorporated in Articles 31- 32 of the VCLT can assist in implementing such approach.

### 2.2.2. *Defining Interpretative Approaches of Investor-State Tribunals*

The general rule of interpretation embedded in Articles 31 and 32 of the VCLT apply to investment treaties as much as they apply to other international law treaties. The applicability of the Vienna Convention was clearly underlined in NAFTA arbitration - *Waste Management v. Mexico*.<sup>322</sup> In this case, the tribunal examined, *inter alia*, Article 1131 of the NAFTA which determines the applicable law for investment arbitration disputes. The Article provides that “Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law” as well as that “an interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section.”<sup>323</sup> Considering this, the tribunal stated:

The thrust of this Article permits this Arbitral Tribunal to be guided, in matters of interpretation, by the rules laid down by the Vienna Convention on the Law of Treaties signed on 23 May 1969, which establishes the general rule of interpretation of treaties at Article 31...<sup>324</sup>

In referring to the general rule of interpretation under Vienna Convention, investor-state tribunals sometimes point out the customary character of the rule. For instance, in *Tokios Tokelés v. Ukraine* the tribunal stated:

As have other tribunals, we interpret the ICSID Convention and the Treaty between the Contracting Parties according to the rules set forth in the Vienna Convention on the Law of Treaties much of which reflects customary international law.<sup>325</sup>

References to the ways in which the treaty shall be interpreted can be found in different parts of the treaty. For instance, along with Article 1131, Article 102(2) of the NAFTA stipulates: “The Parties shall interpret and apply the provisions of this Agreement in the light of its objectives set out in

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<sup>322</sup> *Waste Management, Inc. v United Mexican States*, ICSID Case No. ARB(AF)/98/2, Award (June 2, 2000) online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0892.pdf>> [*Waste Management v Mexico*].

<sup>323</sup> Article 1131 of the NAFTA, *supra* note 49.

<sup>324</sup> *Waste Management*, *supra* note 322 at para 9.

<sup>325</sup> *Tokio Tokelés v Ukraine*, *supra* note 290 at para.27 See also *Noble Ventures, Inc. v Romania*, ICSID Case No. ARB/01/11, Award (12 October, 2005) at para. 50, online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0565.pdf>> [*Noble Ventures v Romania*].

paragraph 1 and in accordance with applicable rules of international law.”<sup>326</sup> Empirical studies show that investor-state tribunals from time to time relied on the rules of interpretation of the Vienna Convention in their reasoning; however, it is argued that in practice tribunals demonstrate a certain degree of inconsistency with respect to how exactly the interpretive issues should be approached and the interpretative material - used.<sup>327</sup> Arguably, this is because most investment treaties rarely set out a specific guidance for tribunals in this regard.

#### (a) Contextual Interpretation

The important questions of how tribunals interpret investment treaties and which interpretive arguments they use have been discussed in a number of studies so far.<sup>328</sup> In the comprehensive study, exploring 98 decisions in 72 ICSID cases in the period from 1998 until 2006, K. Fauchald describes a clear preference of ICSID tribunals for the objective (textual) approach to treaty interpretation.<sup>329</sup> By contrast, in other studies, such as the one by C. Schreuer<sup>330</sup> as well as recent work of J. Pauwelyn and M. Elsig,<sup>331</sup> the investor-state arbitration is characterized as one favouring the intent-based (contextual) method of interpretation rather than literal reading of treaty provisions.

However, for the purposes of this paper it is more important to focus on the role of context as an interpretative element under Article 31 of the VCLT in the reasoning of the investment tribunals. This is because contextual arguments may play a role for the proportionality analysis as they may serve as a legal avenue to address both investment and non-investment factors in order to balance the competing interests in the process of treaty interpretation.

The broad concept of indirect expropriation as appeared in many investment treaties could be difficult to reconcile if relying on a literal meaning of the term alone. The use of interpretative elements such as the context as well as the object and purpose of the contemporary BITs may be helpful in this regard. Stressing the relevance of “context” for the interpretation of BITs, the tribunal in *Impregilo v. Argentina*<sup>332</sup> particularly stated:

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<sup>326</sup> See Article 102 (2) of the NAFTA, *supra* note 49. Similar provisions can be found in Article 4 and Annex D of the ECT, *supra* note 81.

<sup>327</sup> K. Fauchald, *supra* note 290 at 305. The author particularly notes that BITs rarely include the references to the rules of treaty interpretation.

<sup>328</sup> See K. Fauchald *supra* note 290, J. Pauwelyn & M. Elsig, *supra* note 191, C. Schreuer, “Diversity and Harmonization of Treaty Interpretation in Investment Arbitration,” in Malgosia Fitzmaurice, Olufemi Elias & Panos Merkouris, eds., *Treaty Interpretation and the Vienna Convention on the Law of on the Law of Treaties: 30 Years On* (Leiden: Martinus Nijhoff, 2010), 129-151; Trinh Hai Yen, *The Interpretation of Investment Treaties* (Leiden: Brill Nijhoff, 2014) at 20. Wolfgang Alschner, “Interpreting Investment Treaties as Incomplete Contracts: Lessons from Contract Theory” (2013), online: <<http://ssrn.com/abstract=2241652>>.

<sup>329</sup> K. Fauchald *supra* note 290 at 317. The author noted that some tribunals along with the textual interpretation, made use of a teleological approach. However, it was quite difficult to distinguish clearly between instances where tribunals preferred literal approach and where they opted for teleological one.

<sup>330</sup> C. Schreuer, *supra* note 329 at 138.

<sup>331</sup> J. Pauwelyn & M. Elsig, *supra* note 191.

<sup>332</sup> *Impregilo S.p.A. v Argentine Republic*, ICSID Case No. ARB/07/17, Award (June 21, 2011), IIC 498, online: World Bank <[https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC2171\\_En&caseId=C109](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC2171_En&caseId=C109)> [*Impregilo v. Argentina*].

The ambiguity to which they [terminological differences] may give rise must be resolved by reading the provisions not only according to their wording but also in their context (cf. Article 31 of the Vienna Convention on the Law of Treaties). The immediate context of Article 8(2) is Article 8(3), and these two provisions, when read together, have to be given a reasonable meaning.<sup>333</sup>

As discussed in the previous section, the “context” of a treaty includes not only the text, but also a variety of components regarding the interpretation of provisions of the treaties.<sup>334</sup> Past jurisprudence shows that investor-state tribunals rather frequently resorted to contextual arguments by referencing the preamble (addressing the object and purpose of the treaty), annexes to the treaties, or directly related rules and regulations.<sup>335</sup>

For instance, in *CMS v. Argentina*,<sup>336</sup> to support its interpretation, the ICSID tribunal referred to the provisions of the Protocol attached to the 1991 U.S. - Argentina BIT, when establishing how severe an economic emergency may be to qualify as an “essential security interest” under the mentioned BIT.<sup>337</sup> For the purposes of interpretation, it also took into consideration “external” documents which did not constitute a part of the 1991 U.S. - Argentina BIT at all, such as the letter of submission of the BIT to Congress in Argentina and the Report of the pertinent Congressional Committee.<sup>338</sup> Although the tribunal finally ruled against Argentina, it went on to make a long inventory of contextual arguments in conjunction with textual and teleological analysis in the process of interpretation of the state’s “necessity defense” concept.<sup>339</sup> This approach seems to be consistent with Article 31 of the VCLT and clearly reflects the principle that in the process of interpretation a text should not be taken in isolation from the context and from the object and purpose of the treaty.

In another ICSID case - *Tokios Tokelès v. Ukraine* - the tribunal similarly resorted to contextual analysis along with consideration of other interpretative elements, when determining whether the

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<sup>333</sup> *Ibid*, para.86 at 23.

<sup>334</sup> As already discussed, the context includes not only text, but also the preamble, annexes, footnotes, protocols, any agreement or instrument in connection with the conclusion of the treaty and any subsequent agreement and practice regarding its interpretation.

<sup>335</sup> K. Fauchald *supra* note 290 at 320. The contextual arguments were identified by K. Fauchald in 49 of the 98 decisions. This particularly means that the references to context appeared in nearly half of the analyzed ICSID decisions. In the author’s view, the contextual arguments functioned as “essential arguments”, i.e. constituted an important factor in the subsequent analysis of the tribunal. While references to such elements as preamble, annexes and other treaty provisions appear quite often in the tribunals’ reasoning, other elements are rarely used by them. See Sean D. Murphy, “The Relevance of Subsequent Agreement and Subsequent Practice for the Interpretation of Treaties” in Georg Nolte, ed., *Treaties and Subsequent Practice* (Oxford: Oxford University Press, 2013) 82 at 82.

<sup>336</sup> *CMS Gas Transmission Company v Argentine Republic*, ICSID Case No. ARB/01/8, Award (May 12, 2005), online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0184.pdf>> [*CMS v Argentina*]. This arbitration represents one of the ICSID cases collectively known as the Argentine Gas Cases. In this case, Argentina has argued for a necessity defense - the defense that it should be excused from liability for damages to foreign investments because of the “state of necessity” during its economic crisis. Among other issues, the tribunal examined whether the emergency measures enacted by Argentina to combat its economic crisis can be qualified as necessary to protect its essential security interest according to the non-precluded measures clause of 1991 U.S. - Argentina BIT, which, in certain circumstances, limits investor protection. See also *CMS v Argentina*, ICSID, Case No. ARB/01/08, Decision of the Ad Hoc Committee on the Application for Annulment of the Argentine Republic (September 25, 2007) (2009) 14 ICSID Rep. 251. For further analysis of the Argentine Gas Cases, see José E. Alvarez & Kathryn Khamsi, “The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime,” 2008/2009 YB Int’l Inv L & Pol’y 379 at 379; Elizabeth A. Martinez, “Understanding the Debate Over Necessity: Unanswered Questions and Future Implications of Annulments in the Argentine Gas Cases” (2012) 23 Duke J. Comp. & Int’l L, 149.

<sup>337</sup> *CMS v Argentina*, *supra* note 336, para. 362 at 104.

<sup>338</sup> *Ibid*.

<sup>339</sup> *Ibid*, paras. 337, 345, 353, 359.

definition of “investment” under the 1994 Ukraine-Lithuania BIT<sup>340</sup> required Tokios Tokelès to demonstrate that the capital used to make an investment in Ukraine originated from non-Ukrainian sources.<sup>341</sup> Ultimately, the tribunal found no basis on which to impose this restriction on the scope of covered investments, concluding that:

... neither the text of the definition of “investment,” nor the context in which the term is defined, nor the object and purpose of the Treaty allow such an origin-of-capital requirement to be implied. [...] In addition, the context in which the term “investment” is defined, namely, ‘every kind of asset invested by an investor,’ does not support the restriction advocated by the Respondent.<sup>342</sup>

An interesting example of contextual arguments is illustrated by the ICSID case *Plama v. Bulgaria*,<sup>343</sup> where the Tribunal interpreted the provisions of the 1987 Bulgaria - Cyprus BIT in light of its object and purpose. In so doing, the Tribunal observed that the investment protection objectives of the particular BIT were “undeniable in their generality,” however, in the Tribunal’s view, these objectives are “legally insufficient to conclude that the Contracting Parties to the Bulgaria-Cyprus BIT intended to cover agreement to arbitrate in other treaties by the MFN [Most-Favoured Nation] clause to which Bulgaria (and Cyprus for that matter) is a Contracting Party.”<sup>344</sup> Other examples of contextual interpretation in the reasoning of investor-state tribunals can also be found in *CSOB v. Slovakia*,<sup>345</sup> *Siemens v. Argentina*,<sup>346</sup> *Mihaly v. Sri Lanka* and others.<sup>347</sup>

#### (b) Teleological Interpretation

In some cases, it is quite difficult to distinguish clearly between the different ways in which tribunals made use of the object and purpose – as a contextual or teleological argument. In his study,

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<sup>340</sup> The definition “investment” in Article 1(1) of the 1994 Ukraine – Lithuania BIT is the following: “The term ‘investment’ shall mean every kind of asset invested by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with law and regulations of the latter and in particular, though not exclusively, shall include:

a) movable and immovable property as well as any other rights in rem such as mortgages, liens or pledges and another similar rights;  
b) shares, stocks and any other form of participation in companies;  
c) claims to money or to any performance having an economic value;  
d) intellectual property rights such as copyrights, patents, industrial designs, technical processes, know-how, trade secrets, trademarks and goodwill;  
e) any right conferred by law or under contract and any license and permit in accordance with law, including concessions to search for, cultivate, extract and exploit natural resources.” (Author’s translation).

See Article 1(1) of the Agreement Between the Government of Ukraine and the Government of the Republic of Lithuania for the Promotion and Reciprocal Protection of Investments (signed February 8, 1994, brought in force February 27, 1995), online (in Ukrainian): Verkhovna Rada of Ukraine <[http://zakon4.rada.gov.ua/laws/show/440\\_417](http://zakon4.rada.gov.ua/laws/show/440_417)>.

<sup>341</sup> *Tokios Tokelès v Ukraine*, *supra* note 290, para.77 at 33.

<sup>342</sup> *Ibid.*

<sup>343</sup> *Plama Consortium Limited v Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction (February 8, 2005), online: ECT <[http://www.encharter.org/fileadmin/user\\_upload/document/Plama\\_Bulgaria\\_Award.pdf](http://www.encharter.org/fileadmin/user_upload/document/Plama_Bulgaria_Award.pdf)> [*Plama v Bulgaria*].

<sup>344</sup> *Ibid.*, para.193 at 62.

<sup>345</sup> *Ceskoslovenska Obchodni Banka, A.S. v The Slovak Republic*, ICISD Case ARB/97/4, Award (December 29, 2004) at para. 84, online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0671.pdf>> [*CSOB v Slovakia*].

<sup>346</sup> *Siemens A.G. v The Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction (3 August 2004), online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0788.pdf>> [*Siemens v. Argentina*], at paras. 105 – 106.

<sup>347</sup> *Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/00/2, Award (March 15, 2002), para. 33, at 15, online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0532.pdf>>. [*Mihaly v Sri Lanka*]

Fauchald particularly observed that for ICSID tribunals it was more common to use it to identify the states' intentions.<sup>348</sup>

Where it has been invoked, teleological interpretation has served as an avenue to underline the specific purpose of the investment protection regime. For example, the Tribunal in *Siemens v. Argentina* stated that:

The Tribunal will be guided by the purpose of the Treaty as expressed in its title and preamble. It is a treaty 'to protect' and 'to promote' investments. The preamble provides that the parties have agreed to the provisions of the Treaty for the purpose of creating favourable conditions for the investments of nationals or companies of one of the two States in the territory of the other State. [...] The intention of the parties is clear. It is to create favourable conditions for investments and to stimulate private initiative.<sup>349</sup>

In *Tokios Tokelès v. Ukraine* the tribunal also referred to the object and purpose of the BIT to justify its findings:

Finally, the origin-of-capital requirement is inconsistent with the object and purpose of the Treaty, which, as discussed above, is to provide broad protection to investors and their investments in the territory of either party.<sup>350</sup>

Indeed, some tribunals consider it fair to rely on the "exclusive" objective of the regime, if that purpose is agreed by the parties to a BIT, as, for instance, in *Ron Fuchs v. Georgia*.<sup>351</sup> After literal examination of the ordinary meaning of the standard of fair and equitable treatment (FET), the Tribunal cited the objects and purposes of the Georgia - Greece BIT,<sup>352</sup> stressing that "the standard of FET in Article 2(2) must therefore be understood in the context of this aim of encouraging the inflow and retention of foreign investment."<sup>353</sup> In the context of indirect expropriation, however, the references to the BIT's preamble which do not address public concerns would justify pro-investor protectionism rather than contributing to due consideration of public interest. From a sustainable development perspective, this approach is clearly unsatisfactory as it makes impossible to embrace its three pillars - economic, social, and environment in a balanced manner.

In this context, it is also useful to recall a particular NAFTA case - *Metalclad v. Mexico*,<sup>354</sup> where expropriation was allegedly motivated by environmental reasons. A notable aspect of this decision is that the tribunal omitted references to the environmental concerns in the preambular language of the NAFTA addressed by the Parties in their pleading,<sup>355</sup> while it stressed the other purposes of the treaty

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<sup>348</sup> K. Fauchald *supra* note 290 at 350.

<sup>349</sup> *Siemens v. Argentina*, *supra* note 346 at para. 81. In *SGS v. Philippines*, the tribunal also subscribed to purposive-oriented interpretation stating at para. 116 that "The BIT is a treaty for the promotion and reciprocal protection of investments. According to the preamble, it is intended 'to create and maintained favourable conditions for investments of investors of one Contracting Party in the territory of the other.'" See *SGS v. Philippines*, *supra* note 290 at para. 116.

<sup>350</sup> *Tokio Tokelès v. Ukraine*, *supra* note 290, para.77 at 33.

<sup>351</sup> *Iaonnis Kardassopoulos and Ron Fuchs v Republic of Georgia*, ICSID Case Nos. ARB/05/18 and ARB/07/15, Award (March 3, 2010), online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0347.pdf>> [*Ron Fuchs v Georgia*].

<sup>352</sup> Agreement between the Government of the Hellenic Republic and the Republic of Georgia on the Promotion and Reciprocal Protection of Investments signed on 9 November 1994 and entered into force on 3 August 1996 [the 1994 Georgia-Greece BIT].

<sup>353</sup> *Ron Fuchs v Georgia*, *supra* note 351, para. 433 at 140.

<sup>354</sup> See *Metalclad v Mexico*, *supra* note 46.

<sup>355</sup> See, e.g. Mexico's Counter Memorial, (February 17, 1998) at para.838.

(both in the preamble and Article 102). In particular, the Tribunal highlighted the importance to ensure transparency, a predictable commercial framework and the need to increase cross-border investment opportunities.<sup>356</sup> In the view of some authors, such a failure of the tribunal to refer to particular preamble language is indicative of the tribunal's view of the importance to be attached to environment concerns in the context of investment disputes.<sup>357</sup>

This, however, does not mean that object and purpose of investment treaty could not contribute to the respect of sustainable development concerns. Instead, the situation may be different in case of some more recent BITs. Their preambles incorporate specifically designed language favoring non-investment considerations. Hence, the teleological interpretation may theoretically appear more useful in providing tribunals with avenues to balance economic and environmental issues through interpretation of indirect expropriation and other standards in a manner more sensible to host state's concerns, in light of the "updated" objectives of the BITs. For instance, the 2008 Rwanda – US BIT provides a good example in this respect. While the treaty aims, *inter alia*, to "promote greater economic cooperation between them with respect to investment," its preamble also stresses the parties' desire "to achieve these objectives in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labor rights."<sup>358</sup> Environmental and social concerns are also incorporated in other parts of the treaty, e.g. Article 12 entitled "Investment and Environment."<sup>359</sup>

Considering this, the object and purpose of such treaties may prevent strong one-sided interpretation of treaty obligations<sup>360</sup> by providing textual grounds for tribunals to address non-investment concerns of a dispute. Moreover, if taken along with the updated context in other different parts of the BIT, the object and purpose may help to justify state regulatory measures adopted in the public interest or inform the tribunals that it might be useful to consult other rules and principles of international law (for instance, international environmental or human rights treaties,<sup>361</sup> emerging law on sustainable development and other sub-fields of international law).

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<sup>356</sup> See *Metalclad v Mexico*, *supra* note 46 at paras. 70, 71, 75.

<sup>357</sup> Michele Potestà, "Mapping Environmental Concerns in International Investment Agreements: How Far have We gone?" in Tullio Treves, Francesco Seatzu & Seline Trevisanut, eds., *Foreign Investment, International Law and Common Concerns* (London: Routledge, 2014) 193 at 198.

<sup>358</sup> See Preamble of the 2008 Rwanda – US BIT.

<sup>359</sup> Article 12 of the 2008 Rwanda – US BIT "Investment and Environment" reads as follows:

1. The Parties recognize that it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic environmental laws. Accordingly, each Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such laws in a manner that weakens or reduces the protections afforded in those laws as an encouragement for the establishment, acquisition, expansion, or retention of an investment in its territory. If a Party considers that the other Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.

2. Nothing in this Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns. (footnotes omitted).

<sup>360</sup> M. Potestà, *supra* note 357 at 199.

<sup>361</sup> For instance, the tribunals may consider the *Convention on Long-range Transboundary Air Pollution* (adopted 13 November 1979, entered into force 16 March 1983) 1302 UNTS 217 [1979 UNECE Convention]; the *Vienna Convention for the Protection of the Ozone Layer* (adopted 22 March 1985, entered into force 22 September 1988) 1513 UNTS 293; or the *Convention on Biological Diversity* (adopted 5 June 1992, entered into force 29 December 1993) 1760 UNTS 79 [Convention on Biological Diversity]. Tribunals may also

### (c) Evolutionary Interpretation

There are other legal principles such as, *inter alia*, evolutionary interpretation and systemic integration that should also be considered when interpreting contemporary BITs in the context of indirect expropriation.<sup>362</sup> The principle of evolutionary interpretation is of particular importance for a pro-sustainable development interpretation – it may help to safeguard the state’s right to regulate in the interest of society and thereby to strengthen the sustainable development dimension of the investment protection regime.

While BITs, as any other international treaties, can change over time adapting to new factual and legal circumstances, both the wording and the meaning of the terms they use change accordingly. Such developments are particularly traceable in regard to such concepts as “*expropriation*” (which today covers more than just direct expropriation, but also measures equivalent to expropriation or nationalization);<sup>363</sup> “*investments*” (which now may include more kinds of investment than in earlier treaties, e.g. goodwill, market share).<sup>364</sup> Furthermore, using evolutionary interpretation, future tribunals may attempt to establish a contemporary meaning of such concepts as, for instance, “environmental protection” or “public interest,”<sup>365</sup> so as to consider modern technical, scientific and legal developments.

In this regard, the important issues are when and to what extent evolutionary interpretation should be permitted. While there is no single rule of application of evolutionary approach, a crucial task of a tribunal relying on this tool remains to be the same as for the other methods – to interpret a treaty so as to make it effective in terms of intention of the parties and practical in terms of its application.

In discussing the context of application of evolutionary interpretation, Eirik Bjorge argues that evolutionary interpretation is, in principle, more suited to some types of treaties than it is for others, taking specialized human rights jurisprudence as an example.<sup>366</sup> However, it seems appropriate to stress

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take account of agreements on cultural matters such as the *Convention concerning the Protection of the World Cultural and Natural Heritage* (adopted 16 November 1972, entered into force 17 December 1975) 1037 UNTS 151, 27 UST 37, 11 ILM 1358 [*UNESCO World Heritage Convention*] as well as to take account of human rights treaties, treaties on educational matters, treaties setting labour standards and other instruments. At the same time, the environmental treaties cannot automatically become relevant if the preamble mentions “sustainable development” or “climate change.” See I. Van Damme, *Treaty Interpretation by the WTO Appellate Body*, *supra* note 190 at 365.

<sup>362</sup> Importantly, past investor-state tribunals have already favored some of these principles. For instance, in *SGS v Philippines* and *Eureko v Poland* the tribunals invoked the principle of effective interpretation, stressing that “treaties, and hence their clauses, are to be interpreted so as to render them effective rather than ineffective.” See *SGS v Philippines*, *supra* note 289 at para.116; *Eureko BV v Republic of Poland*, Ad Hoc Tribunal, UNCITRAL, Partial Award (19 August 2005) at para. 248, online: ITA Law <[http://www.italaw.com/sites/default/files/case-documents/ita0308\\_0.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0308_0.pdf)> [*Eureko v Poland*].

<sup>363</sup> See, e.g. Art.11 of the 2011 Colombia – Japan BIT.

<sup>364</sup> See, e.g. Art. 1 of the 1990 Canada – Poland BIT (which includes more limited list of kinds of investments) and Art. 1 of the 2009 Canada - Romania BIT (where the list is more extensive and includes goodwill). Moreover, some countries become to include much greater detail in their definition of investment to provide guidance to tribunals with respect to its interpretation, as e.g. the 2008 US – Rwanda BIT based on the 2004 US Model BIT. Such developments, however, differ depending on the particular state’s practice in this respect. For instance, the fact that the definition of investment in the 2008 German Model BIT is virtually identical to the one in the 1960 German-Malaysia BIT demonstrates how little the formulation has changed in the Germany’s approach over nearly half a century. For further discussion on this subject, see generally Emmanuel Gaillard, “Identify or Define? Reflections on the Evolution of the Concept of Investment in ICSID Practice” in C. Binder et al., eds., *International Investment Law for the 21<sup>st</sup> Century* (New York: Oxford University Press, 2009) 403.

<sup>365</sup> Assuming that these terms are present in a particular treaty.

<sup>366</sup> Eirik Bjorge, *Evolutionary Interpretation of Treaties* (New York: Oxford University Press, 2014) at 10.

that it is likely that some terms in the treaties may suit more than others to evolutionary interpretation. As Judge *ad hoc* Guillaume has pointed out in already cited *Dispute regarding Navigational and Related Rights*,<sup>367</sup> the cases which support evolutionary interpretation seem to relate to more general terms (as opposed to contemporaneous approach, which mostly concerns specific treaty terms – “water-parting”;<sup>368</sup> “main channel/Thalweg”<sup>369</sup>). It is also noted in the 2013 Report of the International Law Commission that this is particularly true “for terms which are ‘by definition evolutionary’, such as ‘the strenuous conditions of the modern world’ or ‘the well-being and development of such people.’”<sup>370</sup> Moreover, it is further suggested that the “‘generic’ nature of a particular term in a treaty<sup>371</sup> and the fact that a treaty is designed to be of ‘continuing duration’<sup>372</sup> may also give rise to an evolving meaning.”<sup>373</sup>

Given the multiplicity of treaties and factual circumstances that may arise in the investment disputes, it is difficult to formulate precise criteria for application of evolutionary interpretation with respect to BITs as well as to outline a certain category of terms which suited this approach more than others. However, by summarizing the above discussion, the following aspects can be stressed: first, BITs may give rise to an evolving meaning to the terms in their provisions as such treaties are usually concluded for a long period of time in order to provide a stable investment regime (10-15 years, and often include a mechanism of automatic prolongation and survival clauses). While the duration of a typical BIT may be characterized as “continuing”, the meaning of the terms incorporated in its provisions may evolve over time. Second, according to a “general rule” formulated by the ICJ in *Dispute regarding Navigational and Related Rights*, those terms of investment treaty which have a general character are likely the candidates for evolutionary interpretation.<sup>374</sup>

In the WTO law, the AB’s interpretation of the term “exhaustible natural resources” contained in Article XX (g) may serve as a good practical example in this regard. As already mentioned, in *US – Shrimp* the AB recognized that the generic term “natural resources” is not static.<sup>375</sup> As a result, applying evolutionary interpretation, the AB expanded the meaning of the term to cover both “living” and “non-living” natural resources, which is much broader than the original understanding of the negotiators of

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<sup>367</sup> *Case Concerning the Dispute Regarding Navigational and Related Rights*, *supra* note 256, Declaration of Judge *ad hoc* Guillaume, para. 9 at p. 290.

<sup>368</sup> *Case concerning a boundary dispute between Argentina and Chile concerning delimitation of the frontier line between boundary post 62 and Mount Fitzroy* (1994) 22 RIAA 3, para. 130 at 43.

<sup>369</sup> See *Kasikili/Sedudu Island*, *supra* note 246.

<sup>370</sup> Report of the International Law Commission, (6 May – 7 July and 8 July – 9 August 2013), UNGAOR, 65<sup>th</sup> Sess., UN Doc. A/68/10 (2013), at 25 [2013 Report of ILC].

<sup>371</sup> *Aegean Sea Continental Shelf case (Greece v Turkey)* (1978) ICJ Reports 3, para. 77 at 32.

<sup>372</sup> *US – Shrimp*, Appellate Body Report, *supra* note 207 at para. 130.

<sup>373</sup> The 2013 Report of the ILC, *supra* note 370 at 26.

<sup>374</sup> This rule, however, does not provide a universal solution to all questions regarding evolutionary interpretation. As stated by the ICJ in other cases, a term may have a “generic” nature (*Aegean Sea case supra* note 369) or may be “by definition evolutionary” (*Namibia Case, infra* note 375). In general, the determination of whether the term in question is suited to evolutionary interpretation depends on many factors. In this regard, an indicator of evolving meaning of the term may be a text of the treaty itself or the actual practice in the sphere where such notion is usually applied. For instance, one may observe that in the past, the dominant form of expropriation was direct expropriation or nationalization, while in the course of time it evolved and was substituted by its indirect forms involving a new component - regulatory measures. Beyond that, as already suggested, a recourse to subsequent agreements and subsequent practice under Articles 31 and 32 of the VCLT may be helpful in determining whether the parties intended to give a term such meaning which is capable of evolving over time.

<sup>375</sup> *US – Shrimp*, Appellate Body Report, *supra* note 207 at para. 130.

the 1947 GATT, as reflected in the negotiating history. The AB particularly stressed that the treaty provisions in question “were actually crafted more than 50 years ago,” and therefore, the term should be interpreted “in the light of contemporary concerns of the community of nations.”<sup>376</sup> It must be noted that in justifying evolutionary interpretation in *US-Shrimp* the AB did not, however, explicitly rely on the Vienna Convention, noting that the content of provision is “by definition, evolutionary.”<sup>377</sup> In the view of some authors, the AB followed this approach particularly because the preamble of the WTO Agreement envisaged future action “in accordance with the objective of sustainable development.”<sup>378</sup>

Another example of evolutionary interpretation can be found in *Kuwait v. Aminoil*,<sup>379</sup> which is mostly known for its developments in assessing the compensation due in respect of a lawful expropriation. At the same time, the reasoning of the award is also notable for its “dynamic” approach to interpretation of a so-called “stabilization clause.”<sup>380</sup> The tribunal upheld the binding nature of that clause in the oil concession contract, while recognizing that the contract at stake “ha[d] undergone great changes since 1948” when it was first signed. The point of departure for tribunal therefore became “a change in the nature of the contract itself, brought about by time, and the acquiescence or conduct of the Parties.”<sup>381</sup> As a result, the stabilization clause was considered by the majority not in isolation of the “changed” contract, but as a part of it. Hence, they found that the clause also changed in nature and no longer possessed its “former absolute character.”<sup>382</sup> Finally, the tribunal concluded that “the take-over of AMINOIL’s enterprise was not, in 1977, inconsistent with the contract of concession, provided always that the nationalization did not possess any confiscatory character.”<sup>383</sup> Thus, since the contract has been signed long time ago, the tribunal recognized great changes in its nature as a whole. In particular, it considered that Kuwait had introduced new elements in the contractual relationship, including successive levy increases and greater host government control in the management structure, and the investor had acquiesced to these changes.<sup>384</sup> Taking this into account, the tribunal interpreted the provision in question in an evolutionary manner.

In ICSID case law, some tribunals also relied on the evolutionary interpretation of the treaty provisions. In *LG&E v. Argentina*<sup>385</sup> the tribunal adopted this approach when examining the meaning of the concept of fair and equitable treatment (FET). After reinforcing that its interpretation had to

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<sup>376</sup> *Ibid*, para. 129.

<sup>377</sup> *Ibid*, para. 130. The AB cited an Advisory Opinion of the ICJ on *Namibia Case*, stating that where concepts embodied in a treaty are “by definition, evolutionary,” their interpretation cannot remain unaffected by the subsequent development of law”. See *Legal Consequences for States of the Continued Presence of South Africa in Namibia (South West Africa) notwithstanding Security Council Resolution 276 (1970)*, Advisory Opinion, [1971] ICJ Reports 16 at 31 [*Namibia Case*].

<sup>378</sup> Robert Howse, *The WTO System: Law, Politics & Legitimacy* (London: Cameron May, 2007), 233.

<sup>379</sup> *The Government of the State of Kuwait v American Independent Oil Company*, [1982] 66 ILR 518; 21 ILM 976 [*Kuwait v Aminoil*].

<sup>380</sup> Stabilization clauses are often intended to mitigate the State’s ability to change the content of the governing law as therefore typically used as protection against expropriation. In order to shield stabilization clauses against their unilateral abrogation through host State legislation, they are governed by international law, even if otherwise the chosen law is domestic law.

<sup>381</sup> *Kuwait v Aminoil*, *supra* note 379 at para. 101.

<sup>382</sup> *Ibid*, at para. 100.

<sup>383</sup> *Ibid*.

<sup>384</sup> Lorenzo Cotula, “Reconciling Regulatory Stability and Evolution of Environmental Standards in Investment contracts: Towards a Rethink of Stabilization Clauses” (2008) 1:2 J World Energy Law Bus 158 at 176.

<sup>385</sup> *LG&E v Argentina*, *supra* note 80.

follow the Vienna Convention, the tribunal noted that FET should be interpreted in an evolutionary manner and with respect to the specific circumstances of the case.<sup>386</sup>

According to this view, evolutionary interpretation would give rise to the possibility of further extension of the meaning of particular terms or expressions incorporated in the investment treaty, which may be considered as inherently evolutionary. Theoretically, the concept of indirect expropriation can be interpreted to adjust the application of the BIT according to the changing circumstances between the parties and particular developments over time, as in *Kuwait v. Aminoil*. In other words, the concept may be interpreted so as to exclude from its scope the effects of host states' *bona fide* regulation inspired by development of international standards, such as in the areas of environmental law.

There is the growing concern to adopt policies and practices that contribute to the quality of environment on a long-term basis. Today, the international community strongly advocates environmental sustainability concerns through a number of organizations (including the UN, the OECD, the World Bank Group) putting these concerns at the core of the post - 2015 global agenda.<sup>387</sup> In line with a worldwide movement toward sustainable development, countries strive to respond to global and regional environmental issues at both international and domestic levels by implementing the major UN environmental conventions on climate, biodiversity and desertification, adopting national strategies for sustainable development and environmental policies to help reduce environmental degradation.<sup>388</sup> Importantly, one can also observe a widespread support for environmental sustainability within the business community.<sup>389</sup> These initiatives show that both the public and private sectors recognize and respect the need to improve environmental protection in the face of economic development.

To achieve desirable outcomes, however, these efforts should also be supported by investment protection regime. In particular, where environmental policies implemented by states with a purpose to

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<sup>386</sup> *Ibid*, at para. 123. The Tribunal emphasized that “Due to the fact that such international standards have a generic nature and that their interpretation varies with the course of time and with the circumstances of each case, it becomes difficult to establish an unequivocal and static concept of these notions”. On the evolutionary interpretation of FET, see Barnali Choudhury, “Evolution or Devolution? Defining Fair and Equitable Treatment in International Investment Law” (2005) 6 J World Inv & Trade 297. Also see generally Eirik Bjorge, *supra* note 366.

<sup>387</sup> See, for instance, World Bank, *Toward a Green, Clean and Resilient World for All: A World Bank Group Environment Strategy 2012-2022* (Washington D.C: World Bank Group, 2012), online: World Bank <[http://siteresources.worldbank.org/ENVIRONMENT/Resources/Env\\_Stratgy\\_2012.pdf](http://siteresources.worldbank.org/ENVIRONMENT/Resources/Env_Stratgy_2012.pdf)>; *OECD Environmental Outlook to 2050: The Consequences of Inaction*, (Paris: OECD, 2012), online: OECD <<http://www.oecd.org/environment/outlookto2050>>; United Nations Environment Programme [UNEP], *UNEP Year Book 2014: Emerging Issues in Our Global Environment* (UNEP, 2013), online: UNEP <[www.unep.org/yearbook/2014/](http://www.unep.org/yearbook/2014/)>.

<sup>388</sup> As early as in 1992 the UN Conference on Environment and Development (UNCED) asked countries to adopt national strategies for sustainable development. Since that moment, some countries have taken a strategic approach in developing, planning, implementing, and monitoring a mix of specific policy initiatives. For instance, Canada has developed a Federal Sustainable Development Strategy. See “A Federal Sustainable Development Strategy for Canada 2013-2016”, Sustainable Development Office (November, 2013), online: Environment Canada <<http://www.ec.gc.ca/dd-sd/default.asp?lang=En&n=A22718BA-1>>. Also, according to OECD, a number of countries have prepared formal sustainable development strategies or plans. Of these, Australia, Finland, France, Japan, Luxembourg, the Netherlands, Austria, the Czech Republic, Denmark, Germany, Greece, Iceland, Ireland, Italy, Korea, New Zealand, Norway, Poland, Portugal, the Slovak Republic Sweden, Switzerland and the United Kingdom formulated strategies relatively early and some (e.g., the United Kingdom) have since revised their strategies. See OECD, “Good Practices in the National Sustainable Development Strategies of OECD Countries” (OECD, 2006), online: OECD <<http://www.oecd.org/greengrowth/36655769.pdf>>.

<sup>389</sup> Recently, a group of 29 companies from all over the globe drew up a project called Vision 2050. The participating companies include Volkswagen, Accenture, Alcoa, The Boeing Company, The Procter & Gamble Company and Toyota Motor Corporation just to mention a few.

achieve sustainable development are in place, investment rules should be interpreted to reinforce the agreed-upon regulation. The interpretation of indirect expropriation may have a significant impact on this process as some of the state's policies and regulatory measures may face a risk to be challenged as being detrimental to foreign investment. In this context, there is a need for an evolutionary interpretation of the concept that provides more regulatory freedom for the host states to enhance environmental sustainability through appropriate measures, for instance, by adopting higher environmental standards, limiting air pollution, shifting to low-carbon energy systems. This will help states to move towards sustainable development, strengthening their capacity to adopt required policy, standards and negotiate emerging environment agreements.

In this regard, the language of preambles and other treaty provisions favoring non-investment concerns and referring to a dynamic concept of sustainable development or environment protection may provide a textual basis for the evolutionary interpretation of indirect expropriation provisions, especially in old generation BITs.<sup>390</sup> In particular, the concept of “indirect expropriation” may be interpreted in an evolutionary manner so as to exclude legitimate environmental regulation from the scope of expropriation considering modern scientific and legal developments. Also, the wording “measures designed to address environmental concerns” or “environmental concerns” could be a subject of evolutionary interpretation which may include a wider category of legitimate regulatory measures aimed at the environmental protection. At this point, it is important to take account of growing international environmental standards, development of modern environmental practices and recognition of the need for sustainable development by international community, of which host and home states may well be the members. Such an approach to interpretation may accordingly reflect changes in prevailing ideas, values and standards of the investment protection regime making it more sensible to host states' regulatory autonomy.

#### (d) Systemic Integration and Article 31(3)(c) of the Vienna Convention

Another promising tool that can assist to promote sustainable development-oriented interpretation in the indirect expropriation context is Article 31(3)(c) of the VCLT (and its customary equivalent - the principle of “systemic integration”). Some investment tribunals have already applied this technique, although explicit references to Article 31(3)(c) appear rather infrequently in their reasoning.

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<sup>390</sup> See 2013 Report of the ILC *supra* note 370 at 27-28. In some cases, the text of the treaty itself may assist to determine if the term should evolve. This position has been expressed by Pierre-Marie Dupuy, who argued that “[t]he terms in which the treaty provisions to be interpreted are drafted provide a solid indication of whether the text is open to an evolutionary interpretation.” See Pierre-Marie Dupuy, “Evolutionary Interpretation of Treaties: Between Memory and Prophecy” in E. Cannizzaro, ed., *The Law of Treaties Beyond the Vienna Convention* (New York: Oxford University Press, 2011) 123 at 137.

One such example is the case of *Parkerings v. Lithuania*<sup>391</sup> concerning the creation of a modern parking system for the historic center of Vilnius, which is a UNESCO protected site. In this case a Norwegian investor was awarded the contract to build two multi-story car parks (MSCP), but shortly thereafter the municipality of the City of Vilnius allowed another foreign investor to build the park. Among other considerations, the ICSID tribunal addressed the investor's MFN claim under the 1992 Lithuania - Norway BIT alleging that a competing Dutch company had received more favourable treatment with regard to a similar parking construction project. In determining whether *Parkerings* was in "like circumstances" with the Dutch investor, the Tribunal noted:

[T]he fact that the [*Parkerings*] MSCP project in Gedimino extended significantly more into the Old Town as defined by UNESCO, is decisive. [...] The historical and archaeological preservation and environmental protection could be and in this case were a justification for the refusal of the project. The potential negative impact of the project in the Old Town was increased by its considerable size and its proximity with the culturally sensitive area of the Cathedral. Consequently, MSCP in Gedimino was not similar with the MSCP constructed by [the other investor].<sup>392</sup>

As one can see, the tribunal distinguished the two parking projects based on their different archaeological and environmental impacts for the UNESCO protected site. In its reasoning, the tribunal expressly recognized the relevance of application of non-investment rules identified in international environmental instruments, such as the *World Heritage Convention*<sup>393</sup> for justification of the differentiated treatment, even though it did not explicitly refer to systemic integration as codified in Article 31(3)(c) of VCLT.

Another example can be drawn from *Chemtura v. Canada*,<sup>394</sup> the NAFTA arbitration concerning indirect expropriation, where the tribunal used provisions of international environmental treaties for interpretative purposes. In this case, a lawsuit was brought against Canada by the manufacturer of an agricultural pesticide, lindane, banned or restricted in numerous countries from the 1970s. While it was used in North American canola production until the late 1990s, the Canadian regulatory authority, following an elaborate scientific review, banned lindane in the early 2000s on health and environmental grounds. In this connection, *Chemtura* claimed that Canada breached its NAFTA Chapter 11 obligations through its regulatory actions.<sup>395</sup>

Ultimately, the tribunal found that Canada did not breach Article 1110 of the NAFTA. In this context, it held that "irrespective of the existence of a contractual deprivation," the adopted measure is a valid exercise of Canada's police powers and, as a result, does not constitute indirect expropriation.<sup>396</sup> In its analysis, the tribunal took into account and explicitly referred to international environmental

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<sup>391</sup> See *Parkerings v. Lithuania*, *supra* note 296.

<sup>392</sup> *Ibid.*, at para. 392.

<sup>393</sup> *UNESCO World Heritage Convention*, *supra* note 361.

<sup>394</sup> See *Chemtura v. Canada*, *supra* note 73.

<sup>395</sup> In particular, Article 1110 (Expropriation) and Article 1105 (Minimum Standard of Treatment/FET) of the NAFTA, *supra* note 49.

<sup>396</sup> *Chemtura v. Canada*, *supra* note 73 at para. 266.

instruments, invoked by Canada to justify its regulatory measure affecting foreign investment.<sup>397</sup> Although the tribunal did not employ the language of Article 31(3)(c) of the VCLT, it seems to integrate “external” non-investment rules and practice under the international environmental agreements as an element of its reasoning in the indirect expropriation context.

While Article 31(3)(c) has been the subject of much discussion in the investment law literature, as noted by some commentators, tribunals have tended not to acknowledge this provision of the VCLT, even in cases, such as *Chemtura* or *Parkerings*, where they revert to external legal norms for interpretive guidance.<sup>398</sup>

Against this backdrop, there are a number of cases, including *Santa Elena v. Costa Rica*<sup>399</sup> where investor-state tribunals did not even mention the international environmental instruments which were invoked by respondents, despite the existence of environmental concerns that affected the public interest. These arbitrations are prime illustrations of the situations when tribunals did not use, but could have used other rules of international law relying on systemic integration under Art. 31(3)(c).

In *Santa Elena v. Costa Rica*, the foreign investor (CDSE) purchased for tourism development the property known as “Santa Elena” in 1970, consisting over 30 kilometres of Pacific coastline. On May 5, 1978, Costa Rica issued an expropriation decree for Santa Elena to convert the Property into a national park and proposed to pay CDSE US\$ 1,900,000 in compensation. CDSE disagreed with the offered amount and initiated arbitration against Costa Rica, claiming US\$ 6,400,000.<sup>400</sup> Finally, the tribunal determined the amount of compensation to be paid to the affected investor (at the figure of US\$ 4,150,000). In its analysis, the tribunal declined the potential relevance of international environmental treaties,<sup>401</sup> although Costa Rica referred to them to justify its obligation and concern to protect the environment - “the dazzling variety of flora and fauna.”<sup>402</sup> As a result, tribunal stated:

International law permits the Government of Costa Rica to expropriate foreign-owned property within its territory for a public purpose and against the prompt payment of adequate and effective compensation. [...] 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.* (emphasis added)<sup>403</sup>

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<sup>397</sup> *Aarhus Protocol to the 1979 Convention on Long-Range Transboundary Air Pollution on Persistent Organic Pollutants (POPs)* (Aarhus, June 24, 1998) 37 ILM 505 and *Convention for the Protection of the Marine Environment of the North – East Atlantic* (usually known as the OSPAR Convention) (adopted 22 September 1992, entered into force 25 March 1998), 2354 UNTS 67; 32 ILM 1069; see *Chemtura*, *supra* note 73 at para. 135.

<sup>398</sup> Luke Eric Peterson, “Analysis: Tribunal in *Grand River v. USA*. Arbitration Declines to Import Non-Investment Law Obligations into NAFTA: Role of Other ‘Relevant’ Legal Obligations in Treaty Interpretation Under Vienna Convention Is Not Discussed”, online: Investment Arbitration Reporter <[http://www.iareporter.com/articles/20110306\\_3](http://www.iareporter.com/articles/20110306_3)>.

<sup>399</sup> *Santa Elena v Costa Rica*, *supra* note 47.

<sup>400</sup> In this case, the fact of expropriation as such was not in dispute, while the tribunal was asked to determine the amount of compensation to be paid to CDSE by Costa Rica.

<sup>401</sup> *Convention on Biological Diversity*, *supra* note 361. It must be mentioned that when the dispute initially arose, the Convention was not yet concluded.

<sup>402</sup> *Santa Elena v Costa Rica*, *supra* note 47 at para.15.

<sup>403</sup> *Ibid*, at para.71, internal footnote omitted. Then, in paragraph 72 the tribunal also highlighted: “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”.

Despite the involved public interest concerns, the tribunal refused to consider either the purpose of the measure itself, or the rules derived from instruments of international law, underlining it. Moreover, the ignorance of the environmental “component” of the measure served as a reason for tribunal’s reluctance to consider Costa Rica’s obligations under the international environmental agreements.<sup>404</sup> In addition, the tribunal did not take account norms of the World Heritage Convention which, in the words of C.N. Brower and E.R. Hellbeck, would have had a strong effect on the amount of compensation.<sup>405</sup>

The approach, adopted in *Santa Elena* seems clearly inappropriate. By adopting a strong one-dimensional approach, it failed to take into account other considerations, including the arguments concerning environmental instruments referred by the parties. While tribunals have wide discretion in determining whether and to what extent a particular rule is relevant to the dispute, in conducting such an analysis they are guided by several considerations, including norms provided by the pleadings of the parties.<sup>406</sup> Thus, where an investment dispute involves environmental or social dimensions and especially where the parties stress relevant considerations in their pleadings, a tribunal should not ignore these concerns.

In this regard, an approach that embraces different interpretative elements, particularly including the context, might be preferable for several reasons. First, it allows reading the text of BIT in its individual context by taking into account particular circumstances surrounding it,<sup>407</sup> which is important for determining indirect expropriation that requires an individual case-by-case inquiry.

Second, the most compatible with sustainable development approach – the proportionality test gives a possibility for a tribunal to address different factors (both investment and non-investment) in order to balance the competing interests. Thus, the contextual arguments based on relevant preambular language or other treaty provisions addressing environmental issues may help to minimize a one-sided approach to indirect expropriation within the framework of proportionality approach. In this case, a tribunal may also rely on the principle of systemic integration under Article 31(3)(c) of the VCLT in order to invoke international treaties related to environmental protection. These international norms may help to justify imposing environmental restrictions.

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<sup>404</sup> Footnote 32 to this paragraph added: “For this reason, the Tribunal does not analyse the detailed evidence submitted regarding what Respondent refers to as its international legal obligation to preserve the unique ecological site that is the Santa Elena Property”, *Santa Elena v Costa Rica*, *supra* note 47 at para 71.

<sup>405</sup> Charles N. Brower & Eckhard R. Hellbeck, “The Implications of National and International Environmental Obligations for Foreign Investment Protection Standards, Including Valuations: A Report from the Front Lines, in *International Investments and Protection of the Environment: The Role of Dispute Resolution Mechanism*” International Bureau of the Permanent Court of Arbitration (The Hague, The Netherlands: Kluwer Law International, 2001), para. 25 at 19.

<sup>406</sup> See J. Viñuales, *supra* note 124.

<sup>407</sup> Georges Abi-Saab, “Cours Général de Droit International Public” (1987) 207 RdC 9 at 215, cited as in I. Van Damme, *supra* note 190.

In the more recent case of *Grand River v. United States*<sup>408</sup> the individual Claimants who were Native Americans invoked the customary international rule that requires state authorities to consult indigenous peoples on decisions significantly affecting them, saying it was relevant to determining the content of the NAFTA Article 1105 (which provides for “treatment in accordance with international law”). In the view of the Claimants, the minimum standard of protection under Article 1105 could have been interpreted in light of other international law instruments such as those on human rights and indigenous people’s rights protection with the help of systemic integration under the VCLT.<sup>409</sup> After examination of the facts, the tribunal found that the US indeed failed to consult indigenous people.<sup>410</sup> It highlighted their special circumstances, stating that:

[i]t has taken into account ... the Claimants’ atypical situation as First Nations enterprises and entrepreneurs carrying on cross-border trade in the tradition of their ancestors. It is mindful of the economic difficulties faced by the First Nations communities of which they form part ... as the result of historical factors, and of the role of Claimants’ business ventures, particularly on the reservation at Ohsweken, as an important source of employment and income. The Tribunal believes that it would have been appropriate for governmental authorities in the United States to give greater recognition to, through appropriate consultations, the interests and concerns of Native American communities and entrepreneurs potentially affected by the MSA and related measures.<sup>411</sup>

Furthermore, the tribunal expressly referred to the Article 31(3)(c) of VCLT in its analysis, however, at the end, it stated that it does not have a mandate to import “any relevant rules of international law” into the NAFTA context or to allow alteration of an interpretation established through the normal interpretative process.<sup>412</sup> The only point where the tribunal took the “specific circumstances” of the Claimants into account was when it decided on the costs.<sup>413</sup> In view of this discussion, the *Grand River* case reinforces the need for further elaboration on the role and application of systemic integration as codified in Article 31(3)(c) of VCLT in investor-state arbitration.

By its legal nature, the principle of systemic integration offers the tribunals the option of applying a systemic interpretation which can be instrumental in achieving “a certain degree of synchronization between sub-systems of international law.”<sup>414</sup> While scholarly views that express a self-contained vision of international investment law and arbitration are no longer the doctrinal mainstream,<sup>415</sup> some

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<sup>408</sup> *Grand River v United States*, *supra* note 90.

<sup>409</sup> The Claimants referred to several instruments, including the American Convention on Human Rights (Art. 21), the International Labor Organization’s Convention No. 169 (Art.6(1)(a)) and the UN Declaration on the Rights of Indigenous People (Art. 17), *Grand River v United States*, *supra* note 90 at para. 182(3).

<sup>410</sup> *Ibid* at para. 212.

<sup>411</sup> *Ibid* at para. 247 [footnotes omitted].

<sup>412</sup> *Ibid* at para. 71.

<sup>413</sup> While Article 40 of the 1976 UNCITRAL Arbitration Rules stipulates that the claimants have to bear all costs, the tribunal took into account the special status of the Claimants as indigenous people and decided that each party shall bear its own costs of representation and that both parties shall share the cost of the proceedings. *Grand River v United States*, *supra* note 90 at para. 247. See also UNGA Res 31/98, “Arbitration Rules of the United Nations Commission on International Trade Law” (15 December 1976) UN Doc A/RES/31/98.

<sup>414</sup> I. Van Damme, *supra* note 186 at 9.

<sup>415</sup> See S. Di Benedetto, *supra* note 25 at 28. See also Bruno Simma & Dirk Pulkowski, “Of Planets and the Universe: Self-Contained regimes in International Law”, (2006) 17:3 EJIL 483, 529; D. French, “Treaty Interpretation and the Incorporation of Extraneous Legal Rules”, (2006) 55 ICLQ, 281, 314. Edward Guntrip, “Systemic Integration and International Investment Law” in James Crawford & Sarah Nouwen, eds., *Select Proceedings of the European Society of International Law* (Oxford: Hart Publishing, 2012), 257.

commentators have developed arguments in support of a strict autonomy of the discipline. For instance, when referring to the question of indirect expropriation, S.R. Ratner not only considers “fragmentation” of public international law<sup>416</sup> as being a positive phenomenon, but also claims that it is “impossible, unnecessary and counter-productive” to build up a “coherent doctrine to cover all cases of regulatory takings beyond a rather general level.”<sup>417</sup>

Ratner’s position, however, does not take account of interpretative methods in cases where the problem is to reconcile regimes with different purposes<sup>418</sup> (e.g. a regulatory expropriation of land to observe obligations under international environmental treaties). Moreover, a closer scrutiny of Ratner’s arguments shows that his theory of the regime’s strong autonomy and speciality actually makes some exceptions in favour of important public policies. In his article, Ratner particularly stresses that:

[L]imits to cross-regime fertilization should not prevent decision-makers from incorporating *basic community policies* when needed... These include structural questions like the law of treaties as well substantive matters like human rights or *environmental protection*.<sup>419</sup> (emphasis added)

A less polar opinion in respect of autonomy of *leges speciales* has been expressed by WTO Appellate Body, which clearly stated that WTO rules were not intended to exist “in clinical isolation from the rest of international law.”<sup>420</sup> Inspired by the AB’s logic, the ICSID tribunal in *Phoenix v. Czech Republic*<sup>421</sup> said in this context:

It is evident to the Tribunal that the same holds true in international investment law and that the ICSID Convention’s jurisdictional requirements – as well as those of the BIT – cannot be read and interpreted in isolation from public international law, and its general principles.<sup>422</sup>

Finally, the tribunal decided that the dispute fell outside the jurisdiction of the ICSID and its competence. However, one can see that when analyzing the jurisdiction issues, the tribunal clearly underlined the necessity of systemic integration in BIT interpretation within the broader context of international law as well as its general principles. Arguably, the same logic may be applied to interpretation of treaty’s specific provisions, such as expropriation, which in the same manner as WTO rules were not intended to exist “in clinical isolation from the rest of international law.” By referring to the public international law and its general principles, the approach of *Phoenix* tribunal leaves some space for further integration of sustainable development as a principle itself. In this regard Professor

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<sup>416</sup> “Fragmentation” is based on the premise that individual areas of public international law are becoming increasingly specialised and divided, that legal principles are becoming incoherent and, as a result, public international law is losing general applicability. See Bruno Simma, “Universality of International Law from the Perspective of a Practitioner” (2009) 20 EJIL 266, 270; See generally Fragmentation Report, *supra* 260.

<sup>417</sup> Steven R. Ratner, “Regulatory Takings in Institutional Context: Beyond the Fear of Fragmented International Law” (2008) 102 AJIL 475-528 cited as in See S. Di Benedetto, *supra* note 25, at 28.

<sup>418</sup> See S. Di Benedetto, *supra* note 25, at 30.

<sup>419</sup> See S. R. Ratner, *supra* note 417.

<sup>420</sup> *US – Reformulated Gasoline*, Appellate Body Report, *supra* note 205 at 70.

<sup>421</sup> *Phoenix Action, Ltd. v The Czech Republic*, ICSID Case No. ARB/06/5, Award (15 April 2009), online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0668.pdf>> [*Phoenix v. Czech Republic*].

<sup>422</sup> *Ibid*, para.78 at 32.

Van Aaken suggests, if one accepts that sustainable development is evolving into customary law principle,<sup>423</sup> then it should be employed as such not only by the WTO, where it is expressly written in the preamble, but also in investment arbitration.<sup>424</sup>

Obviously, this suggestion would be of relevance for future investor-state arbitration covering indirect expropriation and other investment protection standards. At the present moment, however, sustainable development has not obtained the status of customary law principle,<sup>425</sup> and the investor-state tribunals do not apply the principle of systemic integration so as to effectively address non-economic interests.

#### (e) Sustainable Development in the Reasoning of Investment Tribunals

*S.D. Myers v. Canada*<sup>426</sup> is one of the cases where the tribunal implicitly referred to sustainable development in the investment protection context. In general, the tribunal's interpretative approach appears quite distinct with respect to importance of the intent of the state's measure, consideration of contextual arguments, the degree of openness towards environmental concerns and their mutual supportiveness with economic development. In its decision, the tribunal made extensive reference to international environmental law texts such as 1986 *US – Canada Agreement Concerning the Transboundary Movement of Hazardous Wastes (Transboundary Agreement)*,<sup>427</sup> the 1989 *Basel Convention*,<sup>428</sup> the 1994 *North American Agreement on Environmental Cooperation (NAAEC)*<sup>429</sup> and the environmental agreements mentioned in the NAAEC.

In setting the framework for its interpretative approach, the tribunal stated that:

In the context of a Chapter 11 dispute, *it is appropriate to begin with the Preamble to the treaty*, which asserts that the Parties are resolved, *inter alia*, to... Create an expanded and secure market for the goods and services produced in their countries... to ensure a predictable commercial framework for business planning and investment... and to do so *in a manner consistent with environmental protection and conservation [...]* (emphasis added).<sup>430</sup>

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<sup>423</sup> *Gabčíkovo-Nagymaros Project* *supra* note 9, paras. 140–141 and *Case concerning Pulp Mills on the River Uruguay (Argentina v. Uruguay)*, [2006] Provisional Measures Order, ICJ Reports 113, at para. 80, as well as *Case concerning Pulp Mills on the River Uruguay (Argentina v. Uruguay)*, [2010] Judgment, ICJ Reports 54, at para. 177; See Anne Van Aaken, “Opportunities for and Limits to an Economic Analysis of International Economic Law” (July 6, 2010) Society of International Economic Law, Second Biennial Global Conference, University of Barcelona, July 8-10, 2010, U. of St. Gallen Law & Economics Working Paper No. 2010-09, at 25, online: <<http://ssrn.com/abstract=1635390>>.

<sup>424</sup> *Ibid.*

<sup>425</sup> See Alan Boyle & David Freestone, “Introduction” in A. Boyle & D. Freestone, eds., *International Law and Sustainable Development: Past Achievements and Future Challenges* (Oxford: Oxford University Press, 1999) 1 at 1; V. Lowe, “Sustainable Development and Unsustainable Arguments” in A. Boyle & D. Freestone, *ibid.*, 19 at 24.

<sup>426</sup> *S.D. Myers v. Canada*, *supra* note 21. In this case the US investor challenged a Canadian legislative order banning exports of PCBs and PCB wastes, claiming, *inter alia*, violation of Article 1102 (National Treatment), Article 1105 (Minimum Standard of Treatment), 1106 (Performance Requirements) and 1110 (Expropriation and Compensation) of the NAFTA, *supra* note 49.

<sup>427</sup> The Agreement of the Government of Canada and the Government of the United States of America Concerning the Transboundary Movement of Hazardous Wastes, 26 October 1986, CTS. (1986) No.39 [*Transboundary Agreement*].

<sup>428</sup> *Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal*, (signed at Basel, March 22, 1989), 1673 UNTS 126; 28 ILM 657 (1989) [*Basel Convention*].

<sup>429</sup> The North American Agreement on Environmental Cooperation [NAAEC], September 14, 1993, Can.T.S.1994 No. 3, a “side” agreement created to respond to environmental concerns related to the NAFTA, *supra* note 49.

<sup>430</sup> *S.D. Myers v. Canada*, *supra* note 21 at para.196. In addition, the importance of environmental provisions in the NAFTA, including its preambular language, is emphasized in the Opinion of Arbitrator Schwartz.

Thus, the tribunal generally set the tone for interpretation that linked the economic objectives of the NAFTA with the need for environmental protection and conservation. The tribunal found it useful to rely, *inter alia*, on teleological interpretation and, further, referred to Article 102(2) of the NAFTA (“Objectives”).<sup>431</sup>

Although it did not expressly mention Article 31(3)(c) of VCLT, it must be noted that a similar rule is already embedded in the Article 102(2) of the NAFTA, which allows interpretation and application of the treaty provisions “in accordance with applicable rules of international law.”<sup>432</sup> In light of this, the next step of the tribunal was to review the other international agreements to which the Parties adhere.<sup>433</sup> The tribunal started its analysis from the *Transboundary Agreement*, particularly stressing its sustainable development dimension.<sup>434</sup> It then proceeded to find that the Agreement does not grant its parties absolute freedom to limit the import or export of hazardous waste by enacting any measures under their national law.

Chronologically, the next instrument was the *Basel Convention*. Importantly, the tribunal again underlined the mutual supportiveness between economic objectives and environmental protection. In its reasoning, it also turned to evaluate the extent to which the Convention supports the sustainable development concept in comparison to the *Transboundary Agreement*.<sup>435</sup>

In its analysis, the tribunal stressed that the “the drafters of the NAFTA evidently considered which earlier environmental treaties would prevail over the specific rules of the NAFTA in case of conflict. Article 104 provided that the *Basel Convention* would have priority if and when it was ratified by the NAFTA Parties.”<sup>436</sup> Thus, the contextual element, the annex to Article 104, particularly guided the reasoning of the tribunal with respect to the relations between the *Basel Convention* and the NAFTA. In this connection, it further clarified that:

[...] it should not be presumed that CANADA would have been able to use it to justify the breach of a specific NAFTA provision because... where a party has a choice among equally effective and reasonably available alternatives for complying... with a Basel Convention

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<sup>431</sup> *Ibid* at para 200. The tribunal pointed out that Article 102(2) obliges the Parties to “...interpret and apply the provisions of [the] Agreement objectives set out in paragraph 1 and in accordance with the applicable rules of international law.” The objectives specified in Article 102 (1) of the NAFTA are to:

a) eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties;

b) promote conditions of fair competition in the free trade area;

c) increase substantially investment opportunities in the territories of the Parties;

d) provide adequate and effective protection and enforcement of intellectual property rights in each Party's territory;

e) create effective procedures for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and

f) establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement.

<sup>432</sup> Article 102(2) of the NAFTA, *supra* note 49.

<sup>433</sup> *S.D. Myers v. Canada*, *supra* note 21 at para. 204.

<sup>434</sup> *Ibid*. The tribunal stated that “[...] This agreement recognizes the possibility of achieving both economic efficiencies and the effective management of hazardous waste by cross-border shipments.”<sup>434</sup>

<sup>435</sup> *Ibid*, at para. 212. The tribunal pointed out that “the Basel Convention is not as explicit as the Transboundary Agreement in emphasizing the potential benefits of cross-border movement of toxic wastes in achieving economies and better protecting the environment”.

<sup>436</sup> *Ibid*, at para. 214.

obligation, it is obliged to choose the alternative that is ...least inconsistent... with the NAFTA. If one such alternative were to involve no inconsistency with the Basel Convention, clearly this should be followed.<sup>437</sup>

The NAAEC was the final environmental instrument addressed by the tribunal in the course of its reasoning. Here it once again referred to the treaty objectives, reaffirming the compatibility and mutual supportiveness of the environment and cross-border trade.<sup>438</sup> In relying on the Preamble to the NAFTA, the NAAEC itself and the international agreements affirmed in the NAAEC, the tribunal stated that specific provisions of the NAFTA (*viz.* “like circumstances” in Article 1102(1) “National Treatment”)<sup>439</sup> should be interpreted in light of three interpretative points (which it termed “principles”), namely:

- Parties have the right to establish high levels of environmental protection. They are not obliged to compromise their standards merely to satisfy the political or economic interests of other states
- Parties should avoid creating distortions to trade
- Environmental protection and economic development can and should be mutually supportive.<sup>440</sup>

In light of these principles, the tribunal further concluded: “Where a state can achieve its chosen level of environmental protection through a variety of equally effective and reasonable means, it is obliged to adopt the alternative that is most consistent with open trade.”<sup>441</sup> While the tribunal’s reasoning seems to follow the concept of sustainable development by balancing the objects of trade and environmental protection, some authors argue that this approach is “clearly not guided by mutual supportiveness perspective since it considered that a priority should be given to trade concerns.”<sup>442</sup> This argument, however, seems not entirely convincing. Since no hierarchy is provided for between three different pillars of sustainable development concept, they are seen as interdependent and mutually reinforcing elements.<sup>443</sup> For this reason, the main attraction of the concept is that “both sides in any legal argument may be able to rely on it.”<sup>444</sup> In this regard, as explained by Advocate General Léger of the European Court of Justice in its Opinion in *First Corporate Shipping*, the concept of sustainable development “does not mean that that the interests of the environment must necessarily and systematically prevail over the interests defended in the context of the other policies pursued by the [European] Community... On the contrary, it emphasized the “necessary balance between various

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<sup>437</sup> *Ibid*, at paras. 214-215 (italics original).

<sup>438</sup> The tribunal stated that “[t]he NAAEC’s Statement of Objectives include both Article l(d) - support for the environmental goals and objectives of the NAFTA, and Article l(e) - avoidance of new barriers of distortions in cross-border trade.” *Ibid*, at para.217.

<sup>439</sup> Article 1102(1) “National Treatment” reads as follows:

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in *like circumstances*, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments. (emphasis added)

<sup>440</sup> *S.D. Myers v. Canada*, *supra* note 21 at para. 220.

<sup>441</sup> *Ibid*, at para. 221.

<sup>442</sup> Laurence Boisson de Chazourmes & Makane Moïse Mbengue, “A ‘Footnote as a Principle.’ Mutual Supportiveness and its Relevance in an Era of Fragmentation” in H. Hestermeyer, et al, eds., *Coexistence, Cooperation and Solidarity: Liber Amicorum for Rüdiger Wolfrum*, Vol. I, (Leiden: Martinus Nijhoff Publishers, 2012) 1615 at 1621.

<sup>443</sup> Nicolas de Sadeleer, *EU Environmental Law and the Internal Market* (Oxford: Oxford University Press, 2014) at 17.

<sup>444</sup> Patricia Birmie, Alan Boyle & Catharine Redgwell, *International Law and Environment*, 3<sup>rd</sup> ed (Oxford: Oxford University Press, 2009) at 116.

interests which sometimes clash, but which must be reconciled.”<sup>445</sup> It must be noted that in the regimes where the primary objective is specific, such as trade or investment liberalization, it is natural for tribunals to focus on the inherent tasks of the regime. What is particularly important here is whether the tribunal intends to align these specific goals and tasks with the other two “pillars” of sustainable development.

Against this background, the tribunal’s approach in *S.D. Myers* can be viewed as merely “focusing” on the specific objectives of the regime, rather than prioritizing them. In an attempt to promote mutual supportiveness of the economic and environmental pillars, the tribunal seems to “set the boundaries” for environmental measures which, if crossed, may affect trade and economic development. At a closer look, this does not envisage prioritization. Had the economic objectives prevailed, the tribunal would demand application of the measure that may be *less effective* for environmental purposes, but the most consistent with open trade.

In this case, however, the tribunal asked the state to seek an “alternative” that is most consistent with open trade among the *equally effective* and reasonable means to achieve the necessary level of environmental protection. In other words, it required the state to choose between two or more equal measures, one of each may appear less restrictive in relation to the economic interests pursued by the regime. Theoretically, the chosen “alternative” would contribute to the environment and would not contradict with open trade, which is nothing but the technique of balancing. Considering this, the tribunal’s approach in *S.D. Myers*, which adopted contextual and teleological interpretation, seems to be consistent with sustainable development concept and the principle of mutual supportiveness.

Although Canada was subsequently found to have breached its obligations under the national treatment standard provided by Article 1102 of the NAFTA,<sup>446</sup> this decision is significant for the several reasons. When interpreting NAFTA provisions, the tribunal applied a distinct approach which involved combination of contextual and teleological interpretation. Through the teleological approach, the tribunal attempted to address environmental and economic values in equal manner, stressing their mutual supportiveness. On the other hand, by applying contextual interpretation, the tribunal paid attention the treaty’s preamble, annexes and other provisions, which informed its interpretation of the substantive standards of the NAFTA. In particular, when interpreting the phrase “like circumstances”, the tribunal considered the general principles “that emerge from the legal context of the NAFTA.”<sup>447</sup> Although the tribunal did not resort to Article 31(3)(c) of VCLT, it embedded systemic integration in its reasoning on the basis of similar rule contained in the NAFTA. This gave the tribunal a path to review the parties’ investment obligations in the context of rules of international environmental

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<sup>445</sup> Opinion AG Léger in *The Queen v Secretary of State for the Environment, Transport and the Regions, ex parte First Corporate Shipping Ltd*, [2000], C-371/98, ECR I-9235 at para. 54 [*First Corporate Shipping*].

<sup>446</sup> The Tribunal ruled against Canada particularly because it found that the ban was motivated by protectionism of the domestic PCB industry, rather than concerns about environmental protection.

<sup>447</sup> *S.D. Myers v. Canada*, *supra* note 21 at para. 247. That is the preamble of the NAFTA, NAAEC and the environmental agreements mentioned in the NAAEC.

agreements, applicable between them. Finally, the tribunal referred, although implicitly, to the conception of sustainable development<sup>448</sup> and the mutual supportiveness of the economic development and environment protection<sup>449</sup>. As a result, the established interpretative framework made it appropriate for the tribunal to engage in a balancing of interests in a proportional manner.<sup>450</sup> While Article 31(3)(c) of VCLT was not expressly invoked by the tribunal, its reasoning appears to be consistent with the systemic integration under the Vienna Convention. Thus, the *S.D. Myers* decision is a prime illustration how interpretation may assist to balance investment protection and environmental concerns in investor-state arbitration.

## CONCLUSIONS

This Chapter has provided an overview of various interpretative methods by which environmental and sustainable development issues can be considered in the process of interpretation of BITs when dealing with indirect expropriation. Because it has not sought to set out an exhaustive exploration of the instruments that might be available to the tribunals, this Chapter has focused only on the selected methods of interpretation available under Articles 31 and 32 of the VCLT along with the principles of effective and evolutionary interpretation. This analysis has shown that the rules of interpretation incorporated in Articles 31 and 32 of the VCLT constitute a valuable and underexploited instrument for treaty interpretation that has the potential to reconcile investment protection and sustainable development concerns. Thus, the goal for the tribunals is to make the best possible use of these rules.

The practice of the WTO AB, the ICJ, the PCA, the ECHR and other adjudicatory bodies demonstrate that the literal interpretation alone is not always sufficient – the treaties may incorporate the same words, but the parties’ intent behind them might differ. Thus, the systematic view of the whole treaty must be taken into account by looking at the context of such treaty. The approach of the WTO Appellate Body combining textual and contextual interpretation seems to be the most balanced in this regard.

While indirect expropriation and other substantive standards of BITs are largely standardized, the particular terms used in the treaties may considerably vary, which jeopardize the consistency of interpretation. Recognizing the “holistic” nature of the interpretative task, the elements of context such as preamble, annexes, subsequent agreements and practice between the parties should be considered by the investment tribunals in the process of treaty interpretation. For instance, the preambles, and the supplementary means of interpretation, *inter alia*, may be resorted to when interpreting the concepts like “indirect expropriation” or determining the scope of state’s “environmental measures” or measures “designed to address environmental concerns” to assist in establishing whether the parties’ intention

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<sup>448</sup> *Ibid*, at para. 247. The tribunal referred to the concept of sustainable development in the context of the principles of Rio declaration.

<sup>449</sup> *Ibid*, at paras. 220, 247.

<sup>450</sup> A state is obliged to adopt the alternative for environmental protection that is available and most consistent with open trade.

was to leave room for such non-economic objectives within the treaty in question. In view of the above, the context as introduced in the preambles, annexes, operational provisions that refer to environmental protection and in some cases - subsequent agreement or subsequent practice between the parties - may suggest whether the definition of “indirect expropriation” excludes certain state measures, even if such measures had some impact on the investments.

Notwithstanding their practical importance, past investment tribunals dealing with indirect expropriation did not use the potential of Articles 31 and 32 of the VCLT in full, if it applied them at all. In particular, the majority of cases have been decided based on inadequate consideration of contextual arguments. In some cases, despite the existing environmental concerns, the tribunals did not even mention the international environmental agreements referred to by the parties. It must be noted, however, that the extent to which the context can support interpretation compatible with sustainable development largely depends on the language of the treaty.

Against this background, it must be noted that context as an interpretative element is highly important for a balanced interpretation of an investment treaty. While the proportionality test offers a framework that is arguably most compatible with sustainable development, this framework still requires proper consideration of non-investment arguments in order to adequately balance investment and non-investment concerns. Thus, consideration of the context may support the interpretation of investment protection provisions, like the prohibition of indirect expropriation without compensation, in a manner that balances investment protection with other concerns, while the most effective and rigorous way to achieve such a balance is through a proportionality analysis. At the same time, the interpretative means such as systemic integration under Article 31(3)(c) of the VCLT, subsequent agreements and subsequent practice under Article 31(a) and (b) of the VCLT and in some cases, evolutionary interpretation may help to support a balanced and progressive reasoning employing a proportionality test, ensure its proper application, and thereby, reinforce a pro-sustainable development approach to indirect expropriation.

In particular, Article 31(3)(c) of the VCLT may be applied as a tool for integration of “external” rules relating to various manifestations of sustainable development. A tribunal may rely on the international environmental agreements and other instruments that impose obligations regarding conservation of biological diversity, control of hazardous substances, air pollution, use of freshwater resources and others. References to relevant environmental norms may enhance host state’s position concerning the regulatory measures adopted to protect the environment in the context of indirect expropriation.

Other means of contextual interpretation may also be relevant for the proportionality test. Subsequent agreement and subsequent practice may not only assist in clarifying the ordinary meaning of a treaty provision at the time it was adopted, but in some cases, they might also be supportive for evolutionary interpretation. This type of interpretation - whether invoked independently or with the

help of subsequent agreement and subsequent practice - would give rise to the possibility of further extension of the meaning of particular terms such as “environmental protection” or “environmental measures” so as to consider modern technical, scientific and legal developments that reflect a pro-sustainable development approach. While evolutionary interpretation itself does not require tribunals to apply a proportionality analysis, it may be employed using a proportionality approach to ensure the proper balancing of competing interests as well as it could help to adjust the application of the BIT according to the changing circumstances between the parties and particular developments over time.

Considering this, the general rules of interpretation contained in Articles 31 and 32 of the VCLT along with the particular non-codified principles are not only important for investment tribunals because they make their reasoning more precise, transparent and impartial. They are also important because the rules and principles addressed in this Chapter affirm the potential to guide tribunals in reconciling investment protection and sustainable development objectives. Despite this fact, investment tribunals have not fully explored their value in integrating environmental sustainability concerns in the field of indirect expropriation.

As it will be discussed in the next Chapter, in contrast to a broad and unspecified language of earlier BITs, a new generation of investment treaties includes provisions that reinforce the adoption of pro-sustainable development interpretation by providing a clear textual basis for contextual arguments that would address environmental protection and other non-investment concerns. An innovative language of these provisions could assist to achieve a balanced interpretation of indirect expropriation standard based on the proportionality approach.

## CHAPTER III. INDIRECT EXPROPRIATION, POLICY SPACE, AND SUSTAINABLE DEVELOPMENT IN THE NEW GENERATION OF BITS: A WAY FORWARD?

### *Introduction*

Going beyond from their traditional role of investment protection, the new generation of BITS has begun to address public health, the protection of the environment and other public interest concerns with a view to ensuring that states can put in place a regulatory framework that would be conducive to sustainable development. Recent treaties attempt to preserve sufficient policy space and regulatory flexibility for host states to pursue public welfare by setting a specific framework for tribunals' approach to interpretation and application of indirect expropriation provisions. An empirical analysis of newly concluded bilateral instruments will provide a picture of the changes in modern treaty practice.

This Chapter analyses 61 bilateral investment treaties signed among 63 countries in the period from 2010 to 2013. Some BITS were left out because they have not been made public. The analysis covers selected provisions, which directly or indirectly relate to the state's right to regulate: namely, preamble, expropriation, commitments not to lower environmental standards and other environment-related clauses. They are explored with a view to identifying archetypes of provisions which would have particular interpretative value for safeguarding host states' ability and flexibility to regulate in indirect expropriation context. In particular, the following types of provisions were analyzed through the lens of the following questions:

*Preamble (Section 3.1.1):* Does the preamble strike a balance between the investment and non-investment interests? Does it specifically address sustainable development, environmental and/or other non-economic concerns among the treaty objectives?

*Expropriation (Section 3.1.2):* Do treaty provisions on expropriation cover both direct and indirect forms of expropriation, contain definition of both forms and clearly distinguish between them? Does the expropriation clause include guidance for identifying indirect expropriation by incorporating a provision preserving policy space for legitimate regulation for the public welfare objectives?<sup>451</sup>

*Not – Lowering Standards (Section 3.1.3):* Does the treaty contain provisions discouraging parties from lowering their domestic health, environmental or other standards in an effort to improve their positions in attracting, promoting or protecting foreign investments?

*Other Environment-Related Provisions (Section 3.1.4):* Does the treaty contain any other environment – related provisions, which preserve the host state's policy space to regulate in the public interest? Do these provisions contain references to international environmental agreements and the

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<sup>451</sup> The analysis is limited to the discussion of the identified questions. It does not address other issues which are out of the scope of the study, as e.g. compensation for expropriation or an investor's right for judicial review of arbitral decisions and of the valuation of the investment by the host state's competent authorities.

commitments parties make under such instruments? Do BITs recognize the right of each party to establish its own level of domestic environmental protection and policy?

Based on this analysis, the Chapter will identify and synthesize the common patterns of treaty provisions and language that would result in an interpretation of indirect expropriation most compatible with states being free to act to achieve sustainable development.

### **3.1. Common Patterns of Provisions Preserving Policy Space in the Context of Indirect Expropriation**

#### *3.1.1. Preamble*

The first type of provision contained in most BITs is a preamble which usually defines the intentions and objectives of the contracting parties when concluding a treaty. While preambles are not considered as being operative provisions in the sense of establishing legally binding rights or obligations, this does not mean that the wording of preambles is unimportant. As suggested by Article 31 of the VCLT and discussed extensively above, no reading of the BIT can be complete without reading its preamble.<sup>452</sup> The interpretation and application of treaty obligations may be informed by the compatibility of the interpretation with the objectives highlighted in the preamble.<sup>453</sup> The significance of the preamble is also confirmed in the practice of international courts and tribunals, which have relied on the objectives of the treaties when interpreting the practical significance of states' specific obligations.<sup>454</sup>

BITs are important instruments in foreign economic policy and cooperation. States communicate their policy messages through the preambles of these agreements. Early BITs often defined intentions and objectives of the contracting parties quite briefly by using vague formulations. Their preambles typically highlight “development of economic cooperation” between the countries and “stimulation of individual business initiative” in order “to promote investments for their mutual prosperity.”<sup>455</sup> This narrow investment-oriented focus did not address policy objectives other than those having a traditional economic orientation. It is critical to underscore that a number of new-generation BITs still follow the early treaty practice. A prime example of such “old-style” approach adopted by a new investment treaty is preamble of the 2011 Bahrain – Turkmenistan BIT. It reads:

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<sup>452</sup> As indicated earlier, Article 31 of the VCLT provides that the preamble forms part of the treaty text and, as such, part of the terms and “context” of the treaty and thus should be taken into account for purposes of treaty interpretation.

<sup>453</sup> See J. A. VanDuzer, et al., *supra* note 3 at 42.

<sup>454</sup> See, for instance, already discussed *S.D. Myers v Canada*, *supra* note 21 at para.196; *Siemens v Argentina*, *supra* note 346 at para. 81; *Tokio Tokelés v Ukraine*, *supra* note 290, para.77 at 33.

<sup>455</sup> See, for instance, the 1995 Italy-Belarus BIT, 1998 Japan – Bangladesh BIT, 2000 Jordan – Bahrain BIT, 2001 India – Kuwait BIT, 2009 Russia – Angola BIT, available online: UNCTAD <<http://investmentpolicyhub.unctad.org/IIA/IiasByCountry#iiaInnerMenu>>.

Table 1. Example of traditional form of preamble used in newly concluded BIT

<b>2011 Bahrain – Turkmenistan BIT</b>
<p>The Government of the Kingdom of Bahrain and the Government of Turkmenistan hereinafter called the “Contracting Parties”;</p> <p>Desiring to create and maintain favourable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party;</p> <p>Recognizing that the encouragement and reciprocal protection of such investments by an international agreement will be conducive to the stimulation of individual business initiatives and will increase prosperity in both Contracting Parties;</p> <p>Have agreed as follows: [...] <sup>456</sup></p>

The situation, however, has begun to change. An increasing number of states have been opting to include in their recent BITs preambles that address non-economic concerns. They sometimes also employ specific language, aimed at making it clear that the objectives of investment promotion and protection are in line with the objectives of sustainable development. For example, the BIT signed by Austria and Nigeria in 2013 states in the preamble that the parties recognise investment “as an engine of economic growth” that “can play a key role in ensuring that economic growth is sustainable.”<sup>457</sup>

The objective of investment as a long-term commitment to sustainable development is documented in the preamble of the 2012 Russia – Zimbabwe BIT, which states:

Recognising that the encouragement and reciprocal protection of investments under this Agreement will stimulate the flow of capital and *contribute to the increase of a long term sustainable economic growth and development* in the States of both Contracting Parties.<sup>458</sup> (emphasis added)

Another example of a link between economic goals and sustainable development can be found in the preamble of the 2011 Japan – Papua New Guinea BIT, where it states:

Recognising that economic development, social development and environmental protection are *interdependent and mutually reinforcing pillars of sustainable development* and that cooperative efforts of the Contracting Parties to promote investment *can play an important role in enhancing sustainable development*.<sup>459</sup> (emphasis added)

The preamble of 2012 Albania – Azerbaijan BIT illustrates another common type of introductory language calling for the balance between the promotion of sustainable development and the promotion and protection of investments. It, particularly, states:

Desiring to achieve these [economic] objectives *in a manner consistent with the protection of the health, safety, and the environment and the promotion of sustainable development*.<sup>460</sup>

<sup>456</sup> See Preamble of Bahrain – Turkmenistan BIT (signed February 2, 2011, not in force).

<sup>457</sup> Austria – Nigeria BIT (signed April 8, 2013, not in force).

<sup>458</sup> The Russian Federation – Zimbabwe BIT (signed October 7, 2012, brought into force September 10, 2014).

<sup>459</sup> Japan – Papua New Guinea BIT (signed April 26, 2011, not in force).

<sup>460</sup> Azerbaijan – Estonia BIT (signed April 7, 2010, not in force).

The language used stating that parties strive to achieve the objectives indicated in the preamble in a manner consistent with sustainable development can, arguably, lead to coherence between different policy objectives and, importantly, more balanced interpretations of treaty provisions which takes into account both investment and non-investment concerns of host state and foreign investor.

There is also a textual reference to the principles of sustainable development in the preamble of 2012 Canada – China BIT:

Recognizing the need to promote investment *based on the principles of sustainable development*.<sup>461</sup> (emphasis added)

Obviously, the interpretative significance depends on the specific language embedded in the preambles. By referring to the “principles” of sustainable development, this provision would seem to justify reference to the external non-economic instruments, such as the Rio Declaration, which contain such principles as part of the interpretative context.

Based on the above discussion, two broad categories of preambles can be distinguished:<sup>462</sup> the first group includes those that continue to follow the “old-style” approach by addressing merely economic objectives of investment treaties. This type of preamble is found in 49 out of 61 BITs in the sample.<sup>463</sup>

The second group of preambles goes a step further and attempts to harmonize the specific goals of the investment treaties with non-economic considerations. It must be noted that some treaties of this group address non-economic issues in their preambles by merely referring to parties’ commitments not to lower the level of environmental protection in their countries,<sup>464</sup> while others make it clear that the investment promotion and protection should be approached in a way compatible with the promotion of sustainable development.<sup>465</sup> The latter type of preambular language that refers to sustainable development as an objective of the treaty has the most significant interpretative value. Given that preambles should inform the interpretation of other treaty provisions, the investor-state tribunals would consider the preambular language as part of the context which means that they should interpret the treaty in a manner consistent with the non-economic concerns expressed in the preamble. This may help to achieve the more balanced interpretation of the indirect expropriation rules as well as provide a

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<sup>461</sup> Canada – China BIT (September 9, 2012, brought into force October 1, 2014).

<sup>462</sup> *An example of a preamble falling under the first category* (the 2011 Bahrain – Turkmenistan BIT): “Desiring to create and maintain favourable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party; Recognizing that the encouragement and reciprocal protection of such investments by an international agreement will be conducive to the stimulation of individual business initiatives and will increase prosperity in both Contracting Parties; Have agreed as follows: [...]”.

*An example of a preamble falling under the second category* (the 2010 Azerbaijan – Estonia BIT): “DESIRING to achieve these objectives in a manner consistent with the protection of health, safety, and the environment and the promotion of sustainable development [...]”.

<sup>463</sup> Similar preambles can also be found in the 2011 Bangladesh – United Arab Emirates BIT, 2010 Bosnia and Herzegovina – Romania BIT, 2010 Colombia – UK BIT, 2011 Croatia – Israel BIT, 2010 India – Latvia BIT, 2013 India - United Arab Emirates BIT, 2010 Macedonia – Morocco BIT, 2010 Russia – Singapore BIT, 2013 Russia – Uzbekistan BIT and a number of other treaties.

<sup>464</sup> 9 BITs contain the not-lowering standard in the preambles only and 8 more – in both preamble and operative provisions. The not-lowering standard will be discussed in more detail later.

<sup>465</sup> See e.g. the 2010 Azerbaijan – Estonia BIT, 2012 Kazakhstan – Austria BIT, 2010 Egypt – Switzerland BIT, 2012 Canada – China BIT, the 2012 Albania - Azerbaijan BIT, 2013 Russia – Zimbabwe BIT.

“gateway” for consideration of non-investment norms (for instance, those derived from international environmental agreements).

The preambular language that contains references to sustainable development with minor variations is found in 12 out of 61 surveyed BITs.<sup>466</sup> Of these 12 treaties, 9 BITs expressly refer to “sustainable development,” 2 more use similar wording: “...economic growth is sustainable” (2013 Austria – Nigeria BIT), “sustainable economic growth and development” (2012 Russia – Zimbabwe BIT) and 1 refers to the “principles of sustainable development” (2012 Canada - China BIT).

Despite slightly different wording, these BITs intend to achieve the same goal - to reconceptualise the traditional investment promotion and protection goals of investment treaties by linking them with sustainable development as an objective of the treaty. The significance of this development is that the mentioned treaties consider the promotion and protection of investment as the “means” to an “end” (that is sustainable economic growth), rather than the end itself. Being included in a preamble, such wording will neither establish any binding obligations on the parties, nor carve-out any policy measure from the scope of expropriation clause. Nonetheless, it could provide useful guidance to those involved in interpretation or application of the treaties and point to according importance to be attributed to different objectives of the parties.<sup>467</sup>

To summarize, an explicit reference to the promotion of sustainable development is still relatively infrequent in investment treaty practice.<sup>468</sup> To date, only a minority of sample of BITs signed between 2010 and 2013 contain a preambular language addressing the nexus between investment and sustainable development. That relatively few treaties adopt this approach, however, is unsurprising given that sustainable development itself is an emerging concept that received much attention only in the past decades.<sup>469</sup> Against this background, the mentioning of non-economic goals in BIT preambles can be seen as an important innovation evidencing the shift towards non-economic values<sup>470</sup> in

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<sup>466</sup> These treaties include: the 2013 Austria - Nigeria BIT, 2012 Canada – China BIT, 2013 Canada – Tanzania BIT, 2013 Canada – Benin BIT, 2012 Russia – Zimbabwe BIT, 2012 Albania – Azerbaijan BIT, 2011 Japan – Papua New Guinea BIT, 2012 Kazakhstan-Austria BIT, 2011 Canada – Kuwait BIT, 2011 Colombia – Japan BIT, 2011 Azerbaijan – Estonia BIT and 2010 Egypt – Switzerland BIT. With exception to 2011 Colombia-Japan BIT, this statistic does not include the references to environmental and sustainable development issues as a part of Not-lowering standard contained in the preambles of some BITs, as it will be addressed in the next section.

<sup>467</sup> See J. A. VanDuzer et al., *supra* note 3 at 48.

<sup>468</sup> Céline Lévesque & Andrew Newcombe, “Commentary of the Canadian Model FIPA” in C. Brown, ed., *Commentaries on Selected Model Investment Treaties* (Oxford: Oxford University Press, 2013) 62.

<sup>469</sup> Over the past 20 years governments, businesses, and civil society have accepted sustainable development as a guiding principle, made progress on sustainable development metrics, and improved business and NGO participation in the sustainable development process. For more systematized discussion on this issue see John Drexhage & Deborah Murphy, “Sustainable Development: From Brundland to Rio 2012”, Background Paper prepared for consideration by the High Level Panel on Global Sustainability at its first meeting, 19 September 2010 (New York: UN Headquarters, 2010), online: United Nations <[http://www.un.org/wcm/webdav/site/climatechange/shared/gsp/docs/GSP1-6\\_Background%20on%20Sustainable%20Devt.pdf](http://www.un.org/wcm/webdav/site/climatechange/shared/gsp/docs/GSP1-6_Background%20on%20Sustainable%20Devt.pdf)>.

<sup>470</sup> See, for instance, Kathryn Gordon & Joachim Pohl “Environmental Concerns in International Investment Agreements: A Survey”, OECD Working Papers on International Investment (OECD, 2011), online: OECD <[http://www.oecd.org/daf/inv/investment-policy/WP-2011\\_1.pdf](http://www.oecd.org/daf/inv/investment-policy/WP-2011_1.pdf)> at 21.

investment treaty law. Such innovation is clearly in line with the UNCTAD Investment Policy Framework for Sustainable Development and other authoritative instruments in the field.<sup>471</sup>

To conclude, the way sustainable development is referred to in the preambles of BITs (*viz.* that investment promotion and protection should be achieved in a manner consistent with sustainable development) may play a significant role in an interpretation of indirect expropriation. In particular, it supports interpretation that requires proportionality between the impact on the investor and the importance of the environmental interest to be protected. As already mentioned in previous Chapter, preambular language provides a textual basis for context in light of which the other treaty provisions should be interpreted in accordance with the rule of Article 31 of the VCLT. Thereby, it may assist in establishing the meaning of the concepts “indirect expropriation” or determining the scope of state’s regulatory measures adopted “in the public interest” at a particular stage of the proportionality assessment. Moreover, as a part of context, the preambular language referring to sustainable development illustrates the parties’ express intention to leave space for non-investment objectives, such as environmental protection within the BIT in question. This may reinforce the balanced interpretation that reconciles investment protection with states’ freedom to regulate in pursuit of sustainable development. Taking this into account, future tribunals should be influenced in accordance with the approach to interpretation which takes the systematic view of the whole treaty while combining textual along with contextual interpretation.

### *3.1.2. Indirect Expropriation and Regulatory Space: What New BITs Offer for a Balanced Interpretation?*

The second type of new provision in BITs is revised expropriation obligations. Notably, all 61 surveyed BITs incorporate articles covering both its direct and indirect forms. Continuing with the traditional approach, almost all BITs under review contain specific criteria for a lawful expropriation (60 out of 61 BITs).<sup>472</sup>

With respect to indirect expropriation, 14 out of 61 BITs provide a definition of the concept itself and establish specific factors for its determination.<sup>473</sup> In some cases these determinants are listed either in the text of the articles or in interpretative annexes to the agreements (7 out of 61 BITs). Furthermore,

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<sup>471</sup> According to the 2012 UNCTAD Investment Policy Framework for Sustainable Development, linking investment and non-economic goals as an objective is one of the options to promote sustainable development within the investment treaty regime. See Table 5. “Policy options to operationalize sustainable development objectives in IIAs” in 2012 UNCTAD Investment Policy Framework for Sustainable Development, *supra* note 168 at 45. See also, SADC Model Bilateral Investment Treaty Template with Commentary, Southern African Development Community (July, 2012) (Gaborone: Southern African Development Community, 2012) at 5, 7, online: IISD <<http://www.iisd.org/itn/wp-content/uploads/2012/10/sadc-model-bit-template-final.pdf>> [SADC Model BIT]; See J. A. VanDuzer, et al., *supra* note 3, 45-47;

<sup>472</sup> The 2011 Croatia - Israel BIT covers only 3 elements of lawful expropriation: public purpose, non-discrimination and compensation. All the rest BITs contain all 4 elements.

<sup>473</sup> As we will see later, this set of factors includes: the economic impact of the measure; the degree of interference with investor-backed expectations, the character of the measure. These elements are typically included in the expropriation provisions which are categorized by this study as falling into Group III. See, e.g. 2012 Canada – China BIT; 2011 India – Lithuania BIT, 2010 Colombia – UK BIT and others.

there is an increasing number of treaties, which include provisions preserving policy space for legitimate regulation in the public interest: 21 out of 61 BITs incorporate police powers exceptions that exclude the legitimate non-discriminatory regulation from the scope of indirect expropriation.<sup>474</sup> As a start, there is a description of the main varieties in formulations of the provision on expropriation.

All BITs under review recognize the right of host states to expropriate foreign private property under certain conditions: (1) for a public purpose, (2) in a non-discriminatory manner, (3) in accordance with law, and (4) against compensation. While these criteria are almost universal, other provisions may essentially vary. For instance, nearly all BITs mention “expropriation,” “nationalization,” and “similar measures” aiming to cover indirect forms of expropriation. The spectrum of the language describing this category of state’s actions varies from “measures having the same effect to expropriation,”<sup>475</sup> “measure tantamount to expropriation or nationalization,” “other measures of dispossession” to “measures having an effect of dispossession.”<sup>476</sup> Some BITs are even more specific: “Neither Contracting Party shall take any measure depriving directly or indirectly, nationals or persons of the other Contracting Party of their investments or measures having an equivalent effect [...]”<sup>477</sup> aiming to capture all possible kinds of measures that may have similar effect to expropriation.

a) Expropriation clauses: Group I

In general, the provisions of expropriation can be categorized into three groups. The first group (“Group I”) includes the clauses which mention the two forms of expropriation, but neither define the term of an indirect taking, nor provide the provisions preserving policy space for the state’s right to regulate. In this category fall those new BITs that continue to follow the approach of “old-generation” investment treaties.<sup>478</sup> Of the surveyed treaties, 39 BITs contain expropriation provisions which can be classified as Group I.<sup>479</sup>

Table 2. Example of clauses falling into Group I

<b>2012 Morocco-Viet Nam BIT</b>
Article 4 Expropriation and Compensation
1. Investments of investors of either Contracting Party in the territory of the other Contracting Party <b><i>shall not be expropriated, nationalized or subject to measures having an equivalent effect</i></b> (hereinafter referred to “expropriation”) except for a public purpose, in accordance with due process of law, on a non-discriminatory basis and against prompt, adequate and effective compensation.

<sup>474</sup> These provisions include, inter alia, the express “police powers” exceptions that carve-out legitimate regulation in the public interest from the scope of expropriation. See, e.g. Article 10(5) of the 2013 Canada – Tanzania BIT.

<sup>475</sup> Article 5 (1) of Moldova – Qatar BIT (signed December 10, 2012, not in force).

<sup>476</sup> Article 4 (1) of Morocco – Serbia BIT (signed June 6, 2013, not in force).

<sup>477</sup> Article 4 of Netherlands – Oman BIT (signed January 17, 2009, not in force).

<sup>478</sup> See e.g. Romesh Weeramantry, “The Law of Indirect Expropriation and the Iran – United States Claims Tribunal’s Role in Its Development” in Leon Trakman & Nicola Ranieri, eds., *Regionalism in International Investment Law* (Oxford: Oxford University Press, 2013), 331 at 331.

<sup>479</sup> BITs that contain expropriation provisions falling into Group I are signed by Albania, Bosnia and Herzegovina, Macedonia, Morocco, Japan, Russia, Kazakhstan, Serbia and a number of other countries. For detailed information, please, see Annex A “Recent Developments in BITs (2010 - 2013)”.

2. Such compensation shall amount to the market value of the expropriated investment immediately before expropriation has taken place or become public knowledge whichever is the earlier. [...] <sup>480</sup>

Article 4 of the 2012 Morocco – Viet Nam BIT can be taken as a good example of these first generation of expropriation provisions. The first section establishes a general obligation not to expropriate foreign investor’s property except under certain conditions including paying compensation. It extends its scope so as to capture both direct and indirect forms of expropriation.<sup>481</sup> However, the provision neither clearly defines the concepts, nor suggests any specific criteria for the identification of “measures having an equivalent effect” to expropriation. Also, it is silent with respect to “police powers” exceptions preserving policy space of host states. Finally, the second section stipulates how the compensation for expropriation should be paid to investor.

From a standpoint of interpretation, it is one of those vague provisions that typically generate controversy around the concept of indirect expropriation and create tensions with the state’s right to regulate in the public interest. Like most “old-style” investment treaties, it does not provide details or guidance in this respect, which would inevitably leave investment tribunals with significant room for interpretation.

Some recent BITs go further and include more detailed provisions on expropriation. For instance, the language adopted in the 2013 India – United Arab Emirates BIT (“*de facto* confiscatory or expropriatory effect,” “results in totally or near totally depriving the Investor from the ownership,” “total or near total loss or damage to the economic value of his Investments”) provides more precise description of those measures which can be deemed expropriatory.

Table 3. Example of clauses falling into Group I

<b>2013 India – United Arab Emirates BIT</b>
Article 7 Expropriation
1. a) Investments made by Investors of one Contracting Party in the territory of the other Contracting Party <b><i>shall not be nationalized, expropriated, dispossessed or subjected to direct or indirect Measures having effect equivalent to nationalization, expropriation or dispossession</i></b> (hereinafter collectively referred to as “expropriation”) by the other Contracting Party except for a public purpose related to the internal needs of that Contracting Party and against expeditious, adequate and effective compensation and on condition that such Measures are taken on a non-discriminatory basis and in accordance with the procedures established under law. [...]

<sup>480</sup> Article 4 of Morocco – Viet Nam BIT (signed June 15, 2012, not in force). This type of clauses can be found in the treaties adopted the “old-style” approach to expropriation, incl. those signed by Albania (2011 Albania – Malta BIT, 2011 Albania – Qatar BIT, 2012 Albania – Azerbaijan BIT), Estonia (2010 Azerbaijan – Estonia BIT, 2010 Estonia – Moldova BIT), Macedonia (2011 Macedonia – Qatar BIT, 2011 Macedonia – Lithuania BIT), Japan (2012 Japan – Iraq BIT, 2012 Japan – Kuwait BIT, 2013 Japan – Myanmar BIT, 2013 Japan – Mozambique BIT), the Russian Federation (2010 Russia – Singapore BIT, 2010 Russia – United Arab Emirates BIT, 2011 Russia – Equatorial Guinea BIT, 2012 Russia – Nicaragua BIT, 2013 Russia – Uzbekistan BIT), a number of Near East countries (2011 Bahrain – Turkmenistan BIT, 2011 Bangladesh – United Arab Emirates BIT, 2011 Israel – Croatia BIT, 2012 Moldova – Qatar BIT, 2012 Cameroon – Turkey BIT, 2012 Turkey – Pakistan BIT, 2013 Netherlands – United Arab Emirates BIT.)

<sup>481</sup> Accordingly, any measures taken by a host country having an effect equivalent to expropriation might need to be accompanied by prompt, adequate and effective compensation.

5. The *term "expropriation" shall also apply to interventions or regulatory Measures* by a Contracting Party such as the freezing or blocking of the Investment, compulsory sale of all or part of the Investment, or *other comparable Measures, that have a de facto confiscatory or expropriatory effect in that their effect results in totally or near totally depriving the Investor from the ownership, control or substantial benefits over his Investment or which may result in total or near total loss or damage to the economic value of his Investment.*

Being essentially focused on the degree of state's interference with the investor's property, this provision may provide better guidance for the tribunal's assessment of indirect expropriation. However, this type of provisions suggests an inequality between treaty obligations: on the one hand, it provides for the protection of investor's interests, while on the other hand it does not offer any balancing or safeguards for the host state's right to regulate in the public interest that is a basic attribute of sovereignty under international law.<sup>482</sup> Such balance may be achieved by inclusion of a special carve-out for legitimate non-discriminatory measures, which would not constitute expropriation.

Overall, the expropriation provisions related to Group I, like those present in the 2012 Morocco – Viet Nam BIT and the 2013 India – United Arab Emirates BIT, create a kind of asymmetry between economic and non-economic considerations in the indirect expropriation context: on the one hand, they include definition of indirect expropriation and description of the degree of interference required for an expropriation. On the other hand, they do not address environmental protection and other sustainable development concerns to ensure a necessary balance between the competing interests. This leaves scope for application of one-sided sole effects test, discussed in Chapter I, assuming that a BIT does not contain a preamble that refers to sustainable development and that an interpreter does not apply the principle of systemic integration under Article 31(3)(c) of the VCLT or evolutionary interpretation which support consideration of non-investment interests.

#### b) Expropriation clauses: Group II

The second group includes expropriation clauses which (i) cover both forms of expropriation and (ii) either address the state's right to regulate or provide a definition of indirect expropriation. The review has shown that 9 out of 61 surveyed BITs incorporate expropriation provisions which can be classified as Group II.<sup>483</sup> The provisions categorized into the second group ("Group II") are more explicit in covering measures having the effect of expropriation than the first group. A good example is Article 6 of the 2012 Gabon – Turkey BIT that constitutes the most common type of language used by BITs falling under this category.

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<sup>482</sup> Howard Mann, "The Right of States to Regulate and International Investment Law", Expert Meeting on the Development Dimension of FDI: Policies to Enhance the Role of FDI in Support of the Competitiveness of the Enterprise Sector and the Economic Performance of Host Economies, Taking into Account the Trade/Investment Interface, in the National and International Context (Geneva, 6–8 November 2002), 5, online: IISD <[http://www.iisd.org/pdf/2003/investment\\_right\\_to\\_regulate.pdf](http://www.iisd.org/pdf/2003/investment_right_to_regulate.pdf)>.

<sup>483</sup> Most BITs classified as falling into Group II are signed by Turkey (7 out of 9 BITs). The other agreements from this category are signed by Austria (the 2013 Austria – Nigeria BIT and the 2010 Austria - Kosovo BIT).

Table 4. Example of clauses falling into Group II

<b>2012 Gabon-Turkey BIT</b>
<p>Article 6 Expropriation</p>
<p>1. Investments <i>shall not be expropriated, nationalized or subject, directly or indirectly, to measures of similar effects</i> (hereinafter referred as expropriation) except for a public purpose, in a non-discriminatory manner, upon payment of prompt, adequate and effective compensation, and in accordance with due process of law and the general principles of treatment provided for in Article 4 of this Agreement.</p> <p>2. <i>Non-discriminatory legal measures designed and applied to protect legitimate public welfare objectives, such as health, safety and environment, do not constitute indirect expropriation.</i> [...] <sup>484</sup> (emphasis added)</p>

As one can see, Article 6 of the 2012 Gabon – Turkey BIT stipulates that the expropriation clause does not contain a definition of indirect expropriation, but merely clarify that investor’s property shall not be expropriated “directly or indirectly,” or subjected to “measures of similar effects.”<sup>485</sup> At the same time, paragraph 2 of the Article incorporates specific provisions addressing the states’ right to regulate in the public interest. In particular, it aims to exclude the non-discriminatory measures adopted in the public interest from the scope of expropriation. This is the traditional customary international law approach, drawn from the notion that “police powers” measures are not, by definition, acts of expropriation.<sup>486</sup> The inclusion of such clause in the treaty main text can help to preserve the host states’ policy space for regulation designed to protect legitimate public welfare objectives, where the term “*legitimate public welfare objective*” can cover a wide range of state’s goals as those relating to public health, security and the environmental protection.<sup>487</sup>

Yet, it is important to bear in mind that the “police powers” exceptions do not encourage a balanced proportionality assessment, while they provide a textual basis for application of another analytical framework - the police powers test. Accordingly, these types of provisions can be less functional for the purposes of the interpretative approach that requires an assessment of proportionality. Provisions that operate as police powers exception will be discussed further in more detail below.

### c) Expropriation clauses: Group III

The third group of expropriation clauses (“Group III”) includes provisions that impose a proportionality framework which, arguably, ensures better symmetry between the investment protection and the preservation of host states’ regulatory space. The clauses falling under this category typically include: (i) formulations covering both forms of expropriation; (ii) definition of indirect expropriation; (iii) guidance for conducting a multi-factor assessment of indirect expropriation, and (iv)

<sup>484</sup> Article 6 “Expropriation” of Gabon – Turkey BIT (signed July 18, 2012, not in force).

<sup>485</sup> *Ibid*, Article 6 (1).

<sup>486</sup> SADC Model BIT, *supra* note 471 at 26.

<sup>487</sup> This type of clause will also be addressed in further sections, when examining its variations within the Third category of provisions.

provisions intended to reinforce the host state’s right to regulate. This category of clauses is usually found in the treaties where one of the parties is Canada,<sup>488</sup> India<sup>489</sup> or Colombia<sup>490</sup> as well as in the 2013 Belarus – Lao’s People Democratic Republic BIT.<sup>491</sup> In total, 14 out of 61 surveyed BITs incorporate expropriation provisions in Group III, which establish a set of specific criteria for assessment of states’ measures based on a proportionality framework.

Table 5. Example of clauses falling into Group III

<b>2013 Canada – Tanzania BIT</b>
Article 10 - Expropriation
<p>1. A Party shall not nationalize or expropriate covered investments either directly or indirectly through measures having an effect equivalent to nationalization or expropriation (hereinafter referred to as “expropriation”) except for a purpose which is in the public interest, in accordance with due process of law, in a non-discriminatory manner and on payment of prompt, adequate and effective compensation. [...]</p> <p>5. For the purposes of this Article, direct expropriation occurs where an investment is nationalised or otherwise directly expropriated through formal transfer of title or outright seizure and indirect expropriation results from a measure or series of measures of a Party that have an effect equivalent to direct expropriation without formal transfer of title or outright seizure.</p> <p>In the context of a any dispute arising under Section C, the determination of whether a measure or series of measures of a Party constitute an indirect expropriation shall be determined through a case-by-case, fact-based inquiry that shall consider, among other factors:</p> <ul style="list-style-type: none"> <li>(a) the economic impact of the measure or series of measures, although the sole fact that a measure or series of measures of a Party has an adverse effect on the economic value of an investment shall not establish that an indirect expropriation has occurred;</li> <li>(b) the extent to which the measure or series of measures interfere with distinct, reasonable investment-backed expectations; and</li> <li>(c) the character of the measure or series of measures.</li> </ul> <p>Except in rare circumstances, such as when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith, non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation.<sup>492</sup></p>

All surveyed BITs signed by Canada, including the Canada-Tanzania BIT, closely follow the 2004 Canada Model BIT<sup>493</sup> and incorporate almost identical structure and content, though with some minor variations. The treaties cover direct and indirect expropriation (and measures equivalent to it), while the real innovation that distinguishes these “new-generation” BITs from their “predecessors” is

<sup>488</sup> In line with previous practice, the third category of expropriation clauses is present in the 2013 Canada – Benin BIT, 2012 Canada – China BIT, 2011 Canada – Kuwait BIT, 2010 Canada – Slovakia BIT, and 2013 Canada – Tanzania BIT.

<sup>489</sup> This category of provisions also appears in 2010 India – Congo BIT, 2010 India – Latvia BIT, 2011 India – Lithuania BIT, 2011 India – Nepal BIT, and 2011 India – Slovenia BIT (an exception is the 2013 India – the United Arab Emirates BIT, which does not contain factors for determination of indirect expropriation and safeguards for measures falling within the state’s police powers).

<sup>490</sup> This type of clauses appears in the 2011 Colombia – Japan BIT and 2010 Colombia – UK BIT.

<sup>491</sup> Although the 2013 Belarus – Lao’s People Democratic Republic BIT does not contain a definition of indirect expropriation, as other BITs from the third category of agreements, it nevertheless adopts the approach of 2012 US Model BIT and 2004 Canada Model BIT by establishing a set of specific factors for its determination. See 2004 Canada’s Model BIT, *supra* note 33; 2012 US Model BIT, *supra* note 23.

<sup>492</sup> Article 10 of the 2013 Canada – Tanzania BIT (signed May 17, 2013, brought in force December 9, 2013).

<sup>493</sup> See 2004 Canada’s Model BIT, *supra* note 33. Although there is no treaty signed by the US among the surveyed BITs, it must be generally noted that the BITs following the 2012 US Model also contain the guidance for determining indirect expropriation with some variations.

a detailed definition of “indirect expropriation”<sup>494</sup>. These treaties also contain formulations providing better accommodation for legitimate non-discriminatory public interest regulation within the expropriation provisions.<sup>495</sup> The surveyed BITs signed by India and Colombia are substantially similar to the treaties concluded by Canada, although with slight variations in wording.

One of the most distinct characteristic of the expropriation provisions in Group III is an intention to clearly distinguish indirect expropriation from a non-compensable regulation, while balancing of the state’s right to regulate in pursuit of public welfare and foreign investors’ rights and protections. This type of provision provides specific *guidance* for conducting this balancing. In particular, it guides tribunals regarding what characteristics should be taken into account when determining what measures constitutes indirect expropriation. Among the factors that ought to be considered for assessment of state measure, the clause include (i) the economic impact of the measure coupled with important clarification that it cannot be a sole factor of the evaluation; (ii) the extent to which such measure interfere with investor’s expectations; and (iii) the character of the measure.

In addition to these factors, there may also be included other determinants, such as non-discriminatory character of the measure,<sup>496</sup> duration of the measure<sup>497</sup> and clarification that its “character” involves consideration of object, context and intent.<sup>498</sup> In addition, treaties sometimes include in their interpretative guidance provisions requiring a kind of proportionality element. For instance, the Annex to the 2011 India – Lithuania BIT requires tribunals to consider whether there is a reasonable nexus between the state measure and the intention to expropriate.<sup>499</sup>

It is worth noting that the indicated list of criteria is non – exhaustive, hence it does not preclude a tribunal from taking into account any other elements in addition to those highlighted in the clause. Importantly, this guidance as included in the annexes or operative provisions on expropriation, invite tribunals to rely on the particular technique – the proportionality test - to determine the occurrence of indirect expropriation.

An illustration of how these criteria may relate to the application of proportionality test in practice can be drawn from past case law of investment tribunals (sometimes importing from the ECHR’s

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<sup>494</sup> C. Lévesque & A. Newcombe, *supra* note 468 at 94.

<sup>495</sup> Luke Eric Peterson, “Evaluating Canada’s 2004 Model Foreign Investment Protection Agreement In Light of Civil Society Concerns” (Briefing Note, the Canadian Council for International Co-operation, 2006) at 3, online: Canadian Council for International Co-operation <[http://www.ccic.ca/\\_files/en/what\\_we\\_do/trade\\_2006-06\\_foreign\\_investment\\_memo\\_e.pdf](http://www.ccic.ca/_files/en/what_we_do/trade_2006-06_foreign_investment_memo_e.pdf)>.

<sup>496</sup> See Annex to the 2011 India – Lithuania BIT.

<sup>497</sup> Actually, this criterion has not been universally applied by the tribunals for the establishment of indirect expropriation (e.g. the NAFTA tribunal in *S.D. Myers* concluded that in some circumstances, deprivation is amounted to expropriation even if it were temporary). In some cases, it may nevertheless serve as an important component of the proportionality test to measure whether the regulation has had a severe enough impact on investment to be qualified as expropriatory. For instance, in *LG&E v. Argentina* the Tribunal also held that the duration of the measure is an element to be taken into consideration. See *LG&E v. Argentina*, *supra* note 80 at para.151.

<sup>498</sup> These criteria can be found in recent FTAs concluded by Canada. See, for instance, Annex X.11: Expropriation of Canada – EU FTA.

<sup>499</sup> Annex to the 2011 India – Lithuania BIT.

jurisprudence).<sup>500</sup> Such examples are the decisions in *Tecmed v. Mexico*,<sup>501</sup> or *Fireman's Fund v. Mexico*.<sup>502</sup> In *Fireman's Fund* the tribunal declared that to distinguish between an expropriatory measure and a non-compensable regulation, “the following factors (usually in combination) may be taken into account: [...] the (public) purpose and effect of the measure; whether the measure is discriminatory; the proportionality, between the means employed and the aim sought to be realized; and the bona fide nature of the measure.”<sup>503</sup> Also, the tribunal stated that “the investor’s reasonable ‘investment-backed expectations’ may be a relevant factor whether (indirect) expropriation has occurred.”<sup>504</sup> Indeed, as already mentioned in Chapter 1, reasonable and legitimate expectations of an investor influence initial decisions to invest in the host state’s economy and constitute the important factors in determining of indirect expropriation. Thus, for the purposes of assessing proportionality, the tribunals must take into account the investor’s expectations in terms of the impact on the investor. If such expectations are denied, public concerns such as, for instance, environmental protection would strongly override the investor’s interest, which is not in line with sustainable development concept that recognizes the importance of both competing interests.

In *Tecmed*, however, the tribunal adopted a slightly different approach when determining whether an indirect expropriation has occurred.<sup>505</sup> In applying the proportionality test to the facts at hand, the tribunal followed a two-step analysis. Firstly, it addressed the impact of the measure to determine whether it was sufficiently intense to amount to substantive deprivation.<sup>506</sup> Secondly, to establish whether such measure is expropriatory, it considered two factors: the public purpose of regulation, and the proportionality of the applied regulatory measure to its effects on the foreign investor’s property.<sup>507</sup> The tribunal consequently found that the measure’s impact on the investor’s property was “extreme” and amounted to indirect expropriation, particularly because the means used by the host State’s authorities did not demonstrate a reasonable proportionality between the interest protected (the environment) and the protection of the investor’s rights.<sup>508</sup>

Despite borrowing from the ECHR jurisprudence, the proportionality test has been differently applied in the *Tecmed* case: while in the human rights system the proportionality test includes three-

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<sup>500</sup> Although the examples of case law that will be discussed below do not refer to the interpretative guidance of the 2011 India – Lithuania BIT and specifically, factors included in it, nevertheless, in one of the cases tribunal relied on similar factors for the purposes of application of the proportionality assessment. Thus, it may serve as an illustration of how such factors, if included in the interpretative guidance, may relate to the proportionality analysis in practice.

<sup>501</sup> *Tecmed v Mexico*, *supra* note 86, at para.122

<sup>502</sup> *Fireman's Fund Insurance Company v The United Mexican States*, ICSID Case No. ARB(AF)/02/1, Award, (17 July 2006) at para. 176, online: ITA Law <<http://www.italaw.com/sites/default/files/case-documents/ita0331.pdf>> [*Fireman's Fund v Mexico*].

<sup>503</sup> *Ibid.*

<sup>504</sup> *Ibid.*

<sup>505</sup> The *Fireman's* and the *Tecmed* both focus on the economic impact (the effect) of the measure and agree that it should be assessed in light of the investor’s expectations, however, the *Tecmed's* approach considers only the purpose of the measure, which is balanced against its effect, but it does not assess whether such measure is discriminatory.

<sup>506</sup> At this stage, the Tribunal considered that the severity of interference with investments depends on two factors: a temporal and a substantive one.

<sup>507</sup> In view of the Tribunal, such an analysis involves an examination of “whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the Proportionality.” *Tecmed v Mexico*, *supra* note 86, at para. 122.

<sup>508</sup> *Tecmed v Mexico*, *supra* note 86, at para. 148.

step analysis - “suitability”,<sup>509</sup> “necessity”<sup>510</sup> and “proportionality *stricto sensu*”,<sup>511</sup> the *Tecmed* tribunal seems to have skipped the “suitability” and “necessity” stages of the test, proceeding directly to the proportionality *stricto sensu*.<sup>512</sup>

The *Tecmed*'s approach has been criticized by some authors as being problematic for several reasons.<sup>513</sup> By omitting two important steps of the analysis, the tribunal weighed and balanced benefits from the state measure against the restriction of the foreign investor's right without deciding whether the applied measure is suitable. Furthermore, it has not considered whether there is an alternative measure which was less restrictive, but equally effective in achieving the pursued objective. This approach seems dubious as it could result in a finding that a measure is lawful even if there are other available means that would cause less interference with investment while being equally effective for achieving the aim of the measure.<sup>514</sup> In other words, “skipping” the second step of the proportionality test may reduce the possibility of finding among the equally effective and reasonable measures an “alternative” one, which may help to achieve the necessary level of environmental protection most consistent with protection of investor's interests. In turn, this may lead to asymmetrical restriction of the foreign investor's rights and therefore decrease the effectiveness of the proportionality approach and its compatibility with sustainable development.

The *Tecmed* tribunal did not act consistently with the elements of the proportionality test as introduced by the ECHR. As well it did not clarify how exactly the balancing process should be applied. Nevertheless, it unveiled the potential of the test for its development and application in future investor-state disputes involving indirect expropriation claims.

Other investment tribunals also found the proportionality approach helpful in order to make the distinction between indirect expropriation and non-compensable regulation. At the same time, they similarly vary in their approaches to application of the proportionality framework, deviating from the test established by the ECHR. For example, it is argued that in *S.D. Myers v. Canada*, by referring to Article 104 of the NAFTA, the tribunal reduced its analysis to the “necessity” step or least restrictive measures test.<sup>515</sup> It is also important to note that the BITs themselves do not reflect the three-step approach as used in the human rights system.<sup>516</sup> For instance, among the surveyed BITs, none of the treaties explicitly refers to the requirement of “necessity” in the expropriation provisions, including the

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<sup>509</sup> As already mentioned in Chapter I, the “suitability” step requires that the measures must be appropriate to protect the interest in question and presuppose a degree of causal relationship between the measure and the objective pursued. Jan H. Jans, *supra* note 142, 239 at 243.

<sup>510</sup> In ECHR jurisprudence, “Strasbourg organs require Member States to adopt the measure which is the least burdensome on an individual person's rights but is equally capable of achieving the same legitimate objective.” Yutaka Arai Takahashi, *The Margin of Appreciation Doctrine and The Principle of Proportionality*, (Oxford: Hart Publishing, 2001), at 16.

<sup>511</sup> The third step – “proportionality *stricto sensu*” requires court to weigh the competing interests and decide whether the measure is excessive or disproportionate with regard to the pursued objective. C. Henckels, *supra* note 141 at 228.

<sup>512</sup> *Ibid.*, at 233.

<sup>513</sup> *Ibid.*

<sup>514</sup> *Ibid.*

<sup>515</sup> See A. Kulick, *Global Public Interest in International Investment Law*, *supra* note 170 at 266.

<sup>516</sup> See the discussion about the proportionality approach in Chapter I.

interpretative guidance.<sup>517</sup> Similarly, the treaties do not include indicators for how the last stage of the proportionality analysis – proportionality *stricto sensu*<sup>518</sup> – is to be conducted.

Table 6. Examples of guidance for multi-factor assessment of indirect expropriation

Country	Guidance for Multi-Factor Assessment
<b>Colombia</b> (Art. VI “Expropriation” of the 2010 Colombia-UK BIT)	<ul style="list-style-type: none"> <li>• “The determination of whether a measure or series of measures constitute ... indirect expropriation requires... inquiry into various factors including, but not limited to the scope of the measure or series of measures and their interference with the reasonable and distinguishable expectations concerning the investment.”</li> </ul>
<b>Canada</b> <sup>519</sup> (Annex B.10 to the 2012 Canada-China BIT) <b>India</b> (Protocol to the 2010 India – Latvia BIT)	<ul style="list-style-type: none"> <li>• “... the economic impact of the measure or series of measures ...”</li> <li>• “...the extent to which the measures or series of measures interfere with distinct, reasonable, investment-backed expectations;</li> <li>• “...the character of the measures or series of measures...”</li> </ul>
<b>India</b> <sup>520</sup> (Annex to the 2011 India – Lithuania BIT)	<ul style="list-style-type: none"> <li>• “...the economic impact of the measure or a series of measures”</li> <li>• “...the extent to which the measure is discriminatory”</li> <li>• “...the extent to which the measure or series of measures interfere with distinct, reasonable, investment-backed expectations;</li> <li>• “...the character and intent of the measure or series of measures, whether they are for bona fide public interest purposes or not...”</li> <li>• “...whether there is a reasonable nexus between them and the intention to expropriate.”</li> </ul>

As one can see, some surveyed treaties incorporate specific provisions that to some extent follow the proportionality framework as defined in the *Fireman’s Fund*. For example, the interpretative annex of the 2011 India – Lithuania BIT requires the assessment of, *inter alia*, (i) the effect of the measure - based on the criterion “*economic impact of the measure*”;<sup>521</sup> (ii) whether the measure is *discriminatory*<sup>522</sup> and (iii) the *degree of interference with investor’s expectations*.<sup>523</sup> Then, it requires taking account of (iv) *the character and intent* of the measures, whether they are for *bona fide public interest purposes* to assess, accordingly, the public purpose, the aim and the *bona fide* nature of the measure.<sup>524</sup> Finally, the annex introduces a requirement to assess (v) a *reasonable nexus* between the employed measures and the *intention to expropriate*, which, at first glance, seems to be a kind of element of the proportionality.<sup>525</sup> However, at a closer look, this provision only remotely resembles the final stage of the test - proportionality in its narrow sense (proportionality *stricto sensu*). Rather, it is appeared to be closer to the first step of the proportionality test - a suitability assessment. Thus, the provision fails to include an important criterion representing the third stage of proportionality analysis and requiring that the measures must not be excessive or disproportionate with regard to the pursued objective. Instead, it requires a “nexus” between the applied measures and the “intention to expropriate”

<sup>517</sup> In the context of expropriation, none of the surveyed BITs expressly includes a requirement to assess if there is an alternative equally effective measure that would cause less severe interference with the investment.

<sup>518</sup> See the discussion of the stages of proportionality test in Chapter I.

<sup>519</sup> Similar provisions can be found in Article 10 of the 2013 Canada – Tanzania BIT.

<sup>520</sup> Also see e.g. Article 5(2) of the 2011 India – Nepal BIT; Protocol to the 2011 India – Slovenia BIT.

<sup>521</sup> See Para. 2(i) of Annex to the 2011 India – Lithuania BIT.

<sup>522</sup> *Ibid*, Para. 2(ii).

<sup>523</sup> *Ibid*, Para. 2(iii).

<sup>524</sup> *Ibid*, Para. 2(iv).

<sup>525</sup> *Ibid*, Para. 2(v).

that would engage tribunal to deviate from the classical form of proportionality as applied, for instance, in the human rights system. This approach seems to be dubious because of the following reasons.

A classic proportionality test involves a “means-ends relationship.”<sup>526</sup> The means employed by host state to attain a legitimate objective should be the least restrictive measure, and the impact on the individual rights has to be proportional to the pursued objectives. Thus, the traditional model of test requires a review of the objectives submitted by a state to justify its regulatory measures. This stage involves weighing the *public interest* in attaining the objectives against the effect of state actions on foreign investor, which is a clear balancing of the competing interests. More severe the measure is, more significant should be the public interest in achieving the objective.

In contrast, as already mentioned, the interpretative guidance requires a reasonable nexus between the applied measure and the intention to expropriate. Although the India-Lithuania BIT is one of few appeared in the surveyed BITs which attempts to include elements of a comprehensive three-step analysis for identification of indirect expropriation, it is still lacking a proper basis for true balancing of competing objectives, as offered by the proportionality test.

According to general understanding, the term “nexus” implies some definite link, some minimum connection between the pursued objective and host state’s intention to interfere with foreign property. This seems to be less strict and less clear criterion than proportionality, according to which the measure must be proportional to the effect caused in light of its purpose, but not merely related to the pursued objective. As a result, the “nexus” requirement as appeared in the interpretative guidance establishes a lesser threshold for state regulation to be justified as non-expropriatory. Also, it does not determine how close a connection there must be between the applied regulation and state’s intention to expropriate foreign investments.

Interestingly, the “nexus” requirement introduced by the interpretative guidance to some extent resembles the “essential nexus” standard evolved in U.S. legal system from cases dealing with regulatory takings, namely, exactions of real property. The standard was established in *Nollan v. California*,<sup>527</sup> where the Supreme Court of the United States held that there had to be an essential nexus between state’s interest in dedication of property as a condition of granting a development permit for a project, and the impacts of the project for which the permit was sought. In other words, in order to meet the requirements of “nexus” test there must be a close fit between the means chosen by the state, such as the type of regulation to be used, and the state’s objective in passing the regulation (public purpose). It is worth noting, however, that the test applied by U.S. courts requires a correspondence between the

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<sup>526</sup> Nicholas Emiliou, *The Principle of Proportionality in European Law: A Comparative Study* (London: Kluwer Law International, 1996) at 23-24.

<sup>527</sup> *Nollan v California Coastal Commission*, 483 U.S. 825, 107 S. Ct. 3141 [1987]. In this case, the California Coastal Commission granted a permit to the Nollans (Appellants) to replace a small bungalow on their beachfront lot with a larger house upon the condition that they allow the public an easement to pass across their beach, which was located between two public beaches. The Appellants brought this suit in order to invalidate a condition on their land permit. The court of appeals held that the condition was valid and reversed the writ of mandamus that was issued by the superior court.

government's measure and its purpose, but not the intention to expropriate. Indeed, a question whether the government had an intention to appropriate the foreign investments is not relevant to balancing of the competing interests and determination whether the indirect expropriation has occurred. An existence of such intention does not exclude a legitimate public purpose pursued by host state. Hence, this element would be unable to assist in distinction between normal regulatory action and indirect expropriation.

It is important to note that in its later ruling adopted in *Dolan v. City of Tigard*<sup>528</sup> the Supreme Court added the "proportionality" requirement to the "essential nexus" test. The Court clarified that when governments impose permit conditions, there must be "rough proportionality" between the condition's requirements and the impacts of the development.<sup>529</sup> Thus, the Supreme Court reaffirmed the importance of proportionality and stressed that the "essential nexus" criterion alone is not sufficient for identifying when government regulation becomes a taking that requires compensation under the Fifth Amendment.<sup>530</sup>

Based on the above discussion, proportionality is highly important criterion in the context of indirect expropriation. It serves the purpose to determine whether an interference with foreign investments can be objectively and reasonably justified, therefore it is at this stage a true balancing of competing interests takes place. Accordingly, an absence of this element would make a test, aiming to identify an occurrence of indirect expropriation, less effective.

Although the discussed model of guidance represents one of the most developed forms existing in the investment treaties,<sup>531</sup> it clearly needs to be enhanced by a more robust proportionality test. Arguably, the identification of indirect expropriation may be more fruitful when the language and structure of an interpretative guidance provides for more elaborated criteria to assess the measure in question, which requires tribunal to evaluate, *inter alia*, the economic impact of the measure, the extent

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<sup>528</sup> *Florence Dolan, Petitioner v City of Tigard*, 512 U.S. 374, 129 L.Ed 2d 304 [1994]. In this case, Florence Dolan (Petitioner) owned a property (a store) located adjacent to and partially on a creek's 100-year floodplain and wished to redevelop the store, doubling its size and paving her gravel parking lot. The City of Tigard granted her a permit to complete the redevelopment, subject to conditions that required Dolan to (i) dedicate the portion of the property within the floodplain to a recreational public greenway designed to minimize flood damage and (ii) dedicate a segment adjacent to the floodplain to the development of a pedestrian/bicycle pathway in order to reduce traffic congestion in town that may have been caused by her larger store. Dolan appealed the city's decision to the Land Use Board of Appeals, which affirmed the decision. Both the Oregon Court of Appeals and the Oregon Supreme Court affirmed the decision. The United States Supreme Court granted certiorari.

<sup>529</sup> *Ibid* at para. 398. In particular, the U.S. Supreme Court ruled that, a court must first determine whether an essential nexus exists between legitimate state interests and the permit conditions; if the court finds that a nexus exists, then the court must determine whether the city has shown a rough proportionality between the exactions and the projected impact of the proposed development, that is, while no precise mathematical calculation is required, the city must make some sort of individualized determination that the permit conditions are related both in nature and extent to the impact of the proposed development; in such circumstances, the burden properly rests on the city to justify the required dedication, because the city has made an adjudicative decision to condition the owner's application for a building permit on an individual parcel.

<sup>530</sup> A. James Casner, W. Barton Leach & Susan F. French, *Cases and Text and Property*, 5th ed (New York: Aspen Publishers, 2004) at 1221. It must be also noted that in its later decision in *Lingle v Chevron*, the U.S. Supreme Court recognizes that the "substantially advances" formula is not a valid method for identification of regulatory takings for which the Fifth Amendment requires compensation. See *Lingle v Chevron, U.S.A, Inc.*, 544 U.S. 528 [2005].

<sup>531</sup> A number of surveyed BITs signed by Canada (as well as some India's and Colombia's BITs) contain a guidance similar to those embedded in the most recent models of Canada and US BITs which provide less detailed set of criteria without express reference to the proportionality assessment. The approach adopted in these BITs seems to leave more space for tribunal's discretion when determining the occurrence of indirect expropriation that may result in interpretation that restrict state's regulatory freedom in pursuit of sustainable development.

to which the measure is discriminatory, the extent to which the measure interferes with distinct, reasonable, investment-backed expectations, the character and intent of the measure, whether it is for *bona fide* public interest purposes or not and whether the measure is disproportional to the pursued public purpose. Moreover, while the guidance usually provides a *non-exhaustive* list of factors relevant for the assessment, it does not preclude the tribunals to recourse to the “necessity” and “proportionality” steps in order to act consistently with all the elements of the proportionality borrowed from the robust ECHR-approach.

In general, the introduced provisions set a framework for a comprehensive analysis, which excludes the situations where a challenged regulation could be analyzed through the lens of the “*sole effects*” test - solely from the standpoint of its negative impact on investments, putting aside other relevant factors such as the purpose of a legitimate non-discriminatory measure. In particular, the purpose element is critical for the distinction between indirect expropriation and mere regulatory measures. Even if the state’s action has an effect of substantial deprivation, the proportionality test, which measures the purpose of such action, may result in a situation where no liability will be attached to the state, if the regulatory measure appears proportional to the pursued objective.

Presumably, such guidance sets the framework for a more balanced interpretation than one contained in earlier BITs, although it may also be further improved. The proposed framework by definition requires embracing a broader spectrum of contextual elements when assessing such factors as the character of state’s measure and the reasons behind its application, the boundaries of state’s regulatory space, its developing nature and investor’s expectations.

It is worth noting that when the interpretative guidance is less specific in respect of the proportionality steps, the role of interpretative tools becomes more significant. In this regard, the means of interpretation under Articles 31 - 32 of the VCLT may help to arrive at the “right” meaning of the terms based on reasoning that is more balanced, taking into consideration the factors which are important for both competing interests. For instance, if the dispute involves an environmental component, it may be necessary to rely on non-investment instruments to justify the purpose of the applied regulatory measures of the host state. From this standpoint, the existence of commitments under international environmental agreements may reinforce the host state’s argument that the line between non-expropriatory regulatory measure applied to protect public interest and indirect expropriation has not been crossed.<sup>532</sup>

In practice, this may be done with the help of systemic integration under Article 31(3)(c) of the VCLT. This interpretive instrument may help a tribunal to invoke non-investment treaties related to environmental protection, which would have an effect on the required balancing of the competing

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<sup>532</sup> See T. Gazzini & Y. Radi *supra* note 269 at 94.

interests. Such invocation of international environmental treaties may help to justify host state's environmental regulation.

In addition to interpretative guidance, some treaties contain a particular type of clause specifically designed to preserve policy space for state's regulatory measures. Among the surveyed BITs, 22 out of 61 treaties adopt "police powers" exceptions<sup>533</sup> that reinforce the ability of states to regulate in the public interest and intend to prevent expansive interpretations of indirect expropriation by investment tribunals. A good example is Article 10(5) of the 2013 Canada – Tanzania BIT that stipulates:

*Except in rare circumstances, such as when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith, non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation.*<sup>534</sup> (emphasis added)

This provision clearly reinforces the "police powers" rule according to which certain state measures designed and applied in the public interest can be excluded from the scope of expropriation and therefore, do not require compensation. Some commentators have criticized the wording of this clause, namely, the phrase "except in rare circumstances," as one potentially undermining the character of the carve-out and leaving to the tribunal to decide the issue, instead of formulating a clear definition.<sup>535</sup> However, this phrase limits the scope of the carve-out and thus restricts chances to adopt an expansive approach to the concept of indirect expropriation. Furthermore, the clause may be argued to favour proportionality if the phrase "so severe in the light of their purpose" is substituted by "manifestly disproportionate in light of their purpose."<sup>536</sup>

A number of BITs go further and include some textual variations in this type of provision. To illustrate, Article VIII of the 2010 Colombia – UK BIT entitled "Investment and Environment", states:

Non-discriminatory measures that the Contracting Parties take for reasons of public purpose or social interest (which shall have a meaning compatible with that of 'public purpose') including for reasons of public health, safety and environmental protection, which are taken in good faith, which are not arbitrary, and which are not disproportionate in light of their purpose, shall not constitute indirect expropriation.<sup>537</sup> (emphasis added)

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<sup>533</sup> The indicated number of BITs containing the police powers exception includes treaties falling in both categories (Group III and Group II).

<sup>534</sup> Article 10(5) of the 2013 Canada – Tanzania BIT. It must be noted, there are other models of exceptions which do not include the wording "except in rare circumstances." For example, one could be found in the ASEAN–Australia–New Zealand FTA: "Non-discriminatory regulatory actions by a Party that are designed and applied to achieve legitimate public welfare objectives, such as the protection of public health, safety, and the environment do not constitute expropriation of the type referred to in Paragraph 2(b) [indirect expropriation]". See Annex on Expropriation and Compensation to the Agreement establishing the ASEAN – Australia - New Zealand Free Trade Area, online: Department of Foreign Affairs and Trade of Australian Government <[http://www.dfat.gov.au/about-us/publications/trade-investment/agreement-establishing-asean-aanzfta/Documents/aanzfta\\_chapter11\\_ann.PDF](http://www.dfat.gov.au/about-us/publications/trade-investment/agreement-establishing-asean-aanzfta/Documents/aanzfta_chapter11_ann.PDF)>.

<sup>535</sup> Nathalie Bernasconi - Osterwalder & Howard Mann, "A Response to the European Commission's December 2013 Document 'Investment Provisions in the EU-Canada Free Trade Agreement (CETA)'", International Institute for Sustainable Development Report (February, 2014) at 9, online: IISD <[www.iisd.org/pdf/2014/reponse\\_eu\\_ceta.pdf](http://www.iisd.org/pdf/2014/reponse_eu_ceta.pdf)>.

<sup>536</sup> This may encourage tribunals to apply the proportionality test in determining whether or not a measure amounted to indirect expropriation. Such version of the police powers exceptions would help to avoid a one-sided police powers approach, when an effect on foreign investments is irrelevant for establishment of indirect expropriation.

<sup>537</sup> Article VIII 2(c) of Colombia – UK BIT (signed March 17, 2010, not in force). Similar formulations can be found in Article 5(2)(b) (i) of the 2011 India – Nepal BIT; Annex B.10 Expropriation of the 2012 Canada-China BIT.

This provision clearly suggests that a certain category of measures motivated by legitimate policy concerns are falling within police powers, and hence, were not compensable. Thus, the clause seems to give a sort of priority to legitimate environmental regulation over investor protection. At the same time, the clause includes additional requirements (the measure must not be “arbitrary” or “disproportionate in light of its purpose”), which are not typical for the “classic” police powers exception. This type of provisions seems to be construed so as to limit the scope of the police powers carve-out by inserting the additional factors (similarly to Canada’s language “in rare circumstances”). However, in contrast to the carve-out included in Canada’s BIT, this clause requires tribunals to apply slightly different methodology in order to establish whether the measure in question constitutes legitimate non-compensable regulation. In particular, the provision requires taking into account whether the measure in question is arbitrary and disproportional in light of its purpose. Although it does not clarify what kind of proportionality analysis should be adopted in this regard, the clause, arguably, provides a textual basis for a more balanced interpretation and leaves less space for tribunal’s discretion in relation of the concept of indirect expropriation.

The investment treaties in Group III provide a clear affirmation of the right to regulate alongside the elaborated rights for foreign investors to ensure a proper balance between investment protection and the sufficient regulatory space for state to act pursuing the sustainable development objectives. If expressly embedded in the treaty text, the clause would serve to support the required balance. Conversely, the absence of such a provision may result in a situation where arbitrators may marginalize the right to regulate in their application of the treaty aiming to shield foreign investors’ rights and protections and the approach to interpretation advocated in Chapter 2 is not applied. Where BIT’s provisions do not clearly provide for this there will be uncertainty as to whether legitimate public concerns addressed by government regulation, will be considered by tribunals. At the same time, one should bear in mind that the traditional police powers exceptions do not include qualifiers such as “proportionality of a measure in light of its purpose” and thus do not encourage a proportionality assessment. As a result, the expropriation provisions related to Group II which contain classic police powers exception, but without multi-factor interpretative guidance, seems to be less functional for the purposes of the interpretative approach that supports the proportionality test. On the one hand, these BITs address host state’s policy space and include more developed provisions than the treaties related to Group I (for instance, by virtue of the police powers exceptions and environment-related clauses). While on the other hand, BITs of Group II are unable to provide a framework for a balanced analysis that allows taking account of both important components – economic impact on foreign investments and state’s right to regulate pursuing public interest policies, interfering with such investment.

In view of the above discussion, the expropriation provisions falling into Category III seem to be a preferable model that possesses a number of distinguishable features. As already stressed, it offers a comprehensive framework for a structured proportionality analysis that allows consideration the factors

important for both competing parties. However, this model may be more fruitful if among other criteria it includes an explicit proportionality requirement instead of the “nexus” test. In this case, such framework would arguably favour a more balanced weighing of interests. The model also favours more nuanced interpretation that embraces a broader spectrum of contextual elements when assessing for instance, the character of the applied measure, the boundaries of state’s regulatory space, its developing nature and investor’s expectations. By offering this combination, the expropriation provisions falling into Category III would encourage tribunals to apply the approach most compatible with sustainable development.

### 3.1.3. Not-Lowering Environmental Standards Provisions as Contextual Elements

A commitment not to lowering standards is the third type of provision seeking to enhance the commitments of the parties to safeguard important policy areas like public health, the protection of environment and others. These provisions, in fact, address concerns about “pollution havens,”<sup>538</sup> the well-known public concerns associated with environmental impacts of investment treaties. Commitments not to lower environmental standards discourage contracting parties from the “race to the bottom” in which developing countries that become more focused on the economy and less on the environment, lower their environmental standards in order to attract foreign investments.

Typically, BITs incorporate not-lowering standards provisions either in their preambles or as a separate provision within the main text of a treaty. The inclusion of this standard is not innovative in itself – such clauses have appeared in BITs since 1990 as well as in NAFTA in 1992.<sup>539</sup> Newly concluded agreements increasingly follow this practice: 25 out of 61 BITs have provisions specifically addressing not-lowering standards. Out of these 25 treaties, 9 BITs contain the standard in the preambles, 8 BITs in their operative provisions, and 8 more BITs in both preamble and operative provisions.<sup>540</sup> Language used in the surveyed BITs varies quite widely. For instance, Article 4 “Investment and Environment” of the 2013 Austria – Nigeria BIT is an example of traditional not-lowering standard provisions. It states:

The Contracting Parties recognise that *it is inappropriate* to encourage an investment by weakening domestic environmental laws.<sup>541</sup> (emphasis added)

Such provisions have been criticized by some legal observers. Being skeptical about their legal significance, they argue that this kind of formulations is merely symbolic: treaties express parties’

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<sup>538</sup> “Pollution Haven” hypothesis is based on the concept that countries set inefficiently low environmental standards or set efficient standards but fail to enforce them to attract foreign capital. Eric Neumayer, “Pollution Havens: An Analysis of Policy Options for Dealing with an Elusive Phenomenon” (2001) 10:2 JED 147. See also Ryan Kellogg, “The Pollution Haven Hypothesis: Significance and Insignificance” (Selected paper prepared for presentation at the American Agricultural Economics Association Annual Meeting, Long Beach, California, July 23-26, 2006), online: <<http://ageconsearch.umn.edu/bitstream/21191/1/sp06ke01.pdf>>.

<sup>539</sup> K. Gordon & J. Pohl, *supra* note 470 at 21.

<sup>540</sup> Such treaties are: the 2013 Austria – Nigeria BIT, 2012 Bangladesh - Turkey BIT, 2011 Colombia – Japan BIT, 2012 Japan – Iraq BIT, 2012 Japan – Kuwait BIT, 2012 Japan – Mozambique BIT, 2013 Japan - Myanmar BIT, 2011 Japan – Papua – New Guinea BIT.

<sup>541</sup> Article 4 of Austria – Nigeria BIT (signed April 8, 2013, not in force). Similar clause can be found in Article 18 (3) of the 2012 Canada – China BIT; Article 4 of the 2012 Kazakhstan – Austria BIT.

commitment in non-binding language by only “acknowledging” inappropriateness of certain conduct (lowering environmental standards), rather than prohibiting them from doing so.<sup>542</sup> In contrast, some more recent treaties make a more remarkable step. A number of surveyed BITs have started to include stronger formulations in their provisions on the inappropriateness of reducing the protection afforded in domestic environmental law and policy. For instance, the 2012 Bangladesh – Turkey BIT is one of the treaties that includes the not-lowering standards language in both the preamble and operative provisions. Its Article 4(1) provides an example of language, which is stronger than traditional not-lowering standard provisions:

Table 7. Example of a stronger language in not-lowering standard clauses

<b>2012 Bangladesh – Turkey BIT</b>
<p>Article 4 – Protection of Public Health and Environment</p> <p>1. A Contracting Party <i>shall not waive or otherwise derogate</i> from its national public health and environmental policies as an encouragement or otherwise, to the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment and sale or other disposal of an investment of an investor of the other Contracting Party.<sup>543</sup></p>

As one can see, the clause includes a “non-derogation” provision.<sup>544</sup> The contracting states’ commitment is formulated as an obligation of conduct (“shall not”) requiring that no waiver or derogation take place from its national regulation. At the same time, the scope of the clause is narrowed down by the list of cases (establishment, acquisition, expansion, and so on) when the party should avoid derogation from its domestic health and environmental policies. In addition, the treaty does not define what is covered by “public health and environmental policies” placing the task of interpreting a scope of this phrase in the tribunal’s sphere.

This kind of clause may contribute to the interpretation of the substantive standards of the treaty, as a part of its context, according to Article 31 of the VCLT. It expressly refers to the role of host state to pursue other policy goals such as public health and environment, *while* encouraging the investments. This allows tribunal to interpret treaty provisions in a broader context linking the goal of investment promotion with the goal of environment protection, rather than prioritizing the former over the latter. While the not-lowering standards clause may play only a complementary role in the interpretative process, it may clarify the parties’ intent regarding the importance of environmental concerns in the context of investment treaty and its pure economic objectives.

<sup>542</sup> “Environment”, UNCTAD Series on Issues on International Investment Agreements (New York and Geneva: UNCTAD, 2001), UNCTAD/ITE/IIT/23, 38, online: UNCTAD <<http://unctad.org/en/Docs/psiteiitd23.en.pdf>>.

<sup>543</sup> Article 4 of the 2012 Bangladesh – Turkey BIT (signed April 12, 2012, brought in force). It must be noted that this type of clauses is specifically chosen with a view to demonstrate an example of stronger legally binding language of the non-lowering standard, since a majority of analogous provisions, where included, adopt less strict approach and as a result, sometimes considered as having minimal legal significance.

<sup>544</sup> This category includes different type of “not-lowering” provisions where parties recognize that it is inappropriate to attract investment by weakening or reducing the level of environmental protection afforded by domestic laws. Thus, such provisions require parties to refrain from derogating from their laws and regulations in a way that weaken environmental protection.

Moreover, in the view of some authors, such provisions may serve to prevent the development by foreign investors of expectations that less stringent regulation will be adopted.<sup>545</sup> In this case, the provisions arguably may be taken into account by tribunals when assessing regulatory measures by means of the proportionality test. Particularly, when looking at the criterion of legitimate investment-backed expectation of regulatory stability and assessing the deprivation of investor's property. The inclusion of such clause may reduce investor's expectations about relaxation of the host state's regulatory framework in the specified areas (public health and environment), provided that the host state does not give specific assurances to attract the foreign investor on which the latter can reasonably rely in making its decision to invest.

Another point that should be addressed here is that in parallel with Article 4(1), the not-lowering standard is also included in the preambular language of the Bangladesh – Turkey BIT. It reads:

Being convinced that these [economic] objectives can be achieved without relaxing health, safety and environmental measures of general application as well as internationally recognized labor rights.<sup>546</sup>

The reason why two similar clauses appear in the same BIT is that arguably these provisions have different interpretative value and legal effect. As already mentioned, a preamble does not create binding obligations for the contracting parties, however it sets out the context of the instrument and it is to be considered in the process of treaty interpretation as required by Article 31 of the VCLT. In light of this, the not-lowering standards reference incorporated in the preamble of the Bangladesh – Turkey BIT can rather be viewed as an attempt to guide the interpretation of the interpretation of the BIT's operative provisions. In contrast, Article 4 incorporated in the operative part of the treaty, produces binding legal effects on the parties, and hence, its primary task is different from “adding colours, texture and shading” to interpretation. However, being also a part of the context, it may accordingly inform the interpretation of substantive treaty provision, through the technique of contextual interpretation, as was done, for instance, in *S.D. Myers v. Canada*.<sup>547</sup>

### 3.1.4. Other Environment-related Provisions: Reinforcing State's Regulatory Freedom

A number of BITs include different types of provisions which may protect host state's right to regulate. In addition to traditional not-lowering standards and “non-derogation” provisions, some agreements include clauses that seek to preserve states' regulatory freedom in environmental matters, by establishing that the standards of protection imposed by BITs “ought not to result in them being prevented from establishing their own levels”<sup>548</sup> of environmental legislation. A prime illustration of

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<sup>545</sup> See T. Gazzini, *supra* note 13 at 946.

<sup>546</sup> See Preamble of the 2012 Bangladesh – Turkey BIT.

<sup>547</sup> *S.D. Myers v Canada*, *supra* note 21.

<sup>548</sup> Vid Prislán & Ruben Zandvliet, “Labor Provisions in International Investment Agreements: Prospects for Sustainable Development” in Andrea Bjorklund, ed., *Yearbook on International Investment Law and Policy 2012-2013* (Oxford: Oxford University Press, 2014) 357 at 383.

such innovative provisions is Article 2(2) “Promotion of Investments” of the 2013 Netherlands – United Arab Emirates BIT, that stipulates:

Both Contracting Parties recognize the right of each Contracting Party *to establish its own level of domestic environmental protection and its own sustainable development policy and priorities*, and to adopt or modify its environmental laws and regulations and shall strive as far as possible to continue to improve their laws and regulations.<sup>549</sup>

As one can see, the Article records a shared understanding of the contracting parties that their regulatory discretion with respect to important public interest concerns, including sustainable development policy, priorities and its own level of environmental protection is recognized under this agreement. In practice, this provision may be used additionally, among other means, to help to justify application of host state’s regulatory measures aiming to protect the environment in the context of indirect expropriation.

In general, this approach seems quite progressive in terms of the language adopted - it explicitly refers to sustainable development in the operative provision of the treaty. From the viewpoint of interpretation, it may provide a basis for contextual arguments that support non-investment considerations when assessing the host state’s regulatory actions within the framework of a proportionality test. In particular, this provision may assist to justify the legitimacy and necessity of the applied regulation in light of established sustainable development priorities, policies and the level of environmental protection of the host state.

In addition, the illustrated clause expressly stipulates additional commitments to “strive as far as possible” to keep improving laws and regulations of the parties. This is an important inclusion encouraging the parties to raise the level of domestic standards.<sup>550</sup> On the other hand, the clause merely requires parties to strive to improve their environmental laws and regulations, but not to achieve them. Furthermore, it does not make clear any priority of legitimate environmental regulation over investment protection. Therefore, this type of clauses may merely serve as a valuable part of a treaty’s context with regard to which other treaty provisions may be interpreted rather than an exception. In particular, if a BIT in question does not incorporate expropriation provisions related to Category III that suggest a comprehensive framework, there might be a risk of one-sided interpretation that addresses only investment-related consideration. In such a case, effectiveness of this clause as a source of context is increased by providing textual references to non-investment issues such as state’s regulatory discretion regarding important public interest concerns, including “sustainable development policy and priorities.”

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<sup>549</sup> Article 2(2) “Promotion of Investment” of the 2013 Netherlands – United Arab Emirates BIT (signed November 26, 2013, not in force).

<sup>550</sup> By contrast, there are “not-lowering standard” provisions that require parties “not to derogate” from their domestic public policies and standards, without actually being concerned how high the level of those standards is. See V. Prislán & R. Zandvliet, *supra* note 534 at 383. The authors address the provisions of investment and free-trade agreements particularly related to labor standards, however, the same is applicable to environmental provisions in BITs, discussed in present Chapter (see, for instance, Article 3(5) of the 2011 Bangladesh – United Arab Emirates BIT).

The 2010 Belgium – Luxembourg Economic Union - Montenegro BIT (the 2010 BLEU – Montenegro BIT) contains one of the most thorough combinations of environmental provisions, although with less strict and progressive language, than previous examples.<sup>551</sup> Its Article 5(1) similarly requires that each party shall strive to continue to improve their national legislation. At the same time, the Article goes further requiring parties to ensure that their legislation “provide for *high levels* of environmental protection”<sup>552</sup> (emphasis added). As explained by some authors, this type of provisions may be useful for states which can rely on them to argue against the investor’s expectation in respect of stability of environmental legislation in the absence of specific commitments to the contrary.<sup>553</sup>

Another important provision is section 3 of Article 5 that addresses the parties’ obligations accepted under international environmental instruments:

The Contracting Parties reaffirm their *commitments under the international environmental agreements, which they have accepted*. They shall strive to ensure that such commitments are fully recognized and implemented by their domestic legislation.<sup>554</sup> (emphasis added)

As one can see, the provision records recognition of the parties’ external non-economic obligations accepted under international environmental treaties, while it does not expressly deal with inconsistencies between an obligation in the BIT (expropriation) and an obligation of a party under those treaties. Nonetheless, such provisions may appear useful for the state’s defense against claims regarding expropriation. In particular, consideration of host state’s commitments under international environmental treaties may be relevant in assessing proportionality of the state measures. A tribunal may consider the standard of indirect expropriation in light of the clause reaffirming the parties’ obligations accepted under international environmental instruments and thus it may be able to give proper attention to ecological objective of the applied state measure and the public interest related to protection of biological diversity. This may influence the reasoning of tribunal when assessing the legitimacy of state measure as well as in balancing the objective of the measure against its effect on foreign investment.

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<sup>551</sup> For instance, when speaking about policies and priorities, Article 5 “Environment” of the 2010 BLEU – Montenegro BIT does not employ the notion of sustainable development, substituting it by the narrower concept - “environmental development”.

<sup>552</sup> Article 5(1) “Environment” of the 2010 BLEU – Montenegro BIT (signed February 16, 2010, not in force).

<sup>553</sup> Alessandra Asteriti, “Waiting for the Environmentalists: Environmental Language in Investment Treaties” in C.J. Tams & R. Hofmann, eds., *International Investment Law and Its Others* (Baden-Baden: Nomos, 2012), 24, online: <<http://ssrn.com/abstract=2028405>>. Legitimate expectations are closely connected with the requirements of stability and predictability of the host states regulatory environment and constitute a part of the fair and equitable standard. At the same time, the concept of legitimate expectations was also used from time to time in the disputes involving expropriation claims. One such example is *Methanex v. USA*, discussed in the First chapter. Furthermore, under the proportionality test, the interference with legitimate investor’s expectations appears as an individual criterion, among other factors, to determine indirect expropriation. In this regard, it is argued that this type of clauses, as presented in Art. 5 (1) of the 2010 BLEU – Montenegro BIT, may assist states in their defence with regard to particular regulatory changes for environmental purposes, e.g. in an attempt to improve domestic environmental standards.

<sup>554</sup> Article 5(3) “Environment” of the 2010 BLEU – Montenegro BIT reads: “recognizing the right of each Contracting Party to establish its own level of domestic environmental protection and environmental development policies and priorities, and to adopt or modify accordingly its environmental legislation, each Contracting Party shall strive to *ensure that its legislation provide for high levels of environmental protection* and shall strive to continue to improve this legislation.” (emphasis added), see the 2010 BLEU – Montenegro BIT.

In this point, one should note that international treaty commitments were taken into account as part of the interpretive context by the tribunals in *S.D. Myers v. Canada*,<sup>555</sup> *Parkerings v. Lithuania*,<sup>556</sup> and *Chemtura v. Canada*.<sup>557</sup> If taken into account as a part of treaty context under the rules of Article 31 of the VCLT, they would provide a gateway to consider non-investment rules in the context of indirect expropriation.<sup>558</sup>

Lastly, Article VIII of the 2010 Colombia – United Kingdom BIT provides another interesting example of provisions that seek to safeguard the host state’s policy space. It reads:

Nothing in this Agreement shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure that *it considers appropriate* to ensure that an investment activity in its territory is undertaken *in a manner sensitive to environmental concerns*, provided that such measures are *non-discriminatory* and *proportionate to the objectives sought*.<sup>559</sup> (emphasis added)

This type of clause aims at reaffirming the right of states to adopt measures necessary to protect the environment. The language and content of such provisions vary. Some of them closely follow Article XX GATT “General Exceptions”.<sup>560</sup> Other provisions are drafted in stronger and more effective

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<sup>555</sup> *S.D. Myers v. Canada*, *supra* note 21.

<sup>556</sup> *Parkerings v. Lithuania*, *supra* note 296.

<sup>557</sup> *Chemtura v. Canada*, *supra* note 73.

<sup>558</sup> While the investor-state disputes involving the environmental component vary, in some situations (as is the case of *Parkerings*, *Chemtura*, *S.D. Myers*, and other cases) a tribunal may need to rely on the international environmental or other non-investment treaties to support its reasoning. In this context, international non-investment rules should not be considered in some hierarchical order with respect to the investment obligations. Either they do not allow a state to breach an investment treaty obligation. Instead, in its reasoning, a tribunal may rely on environmental treaty in order to balance different norms and competing interests in case involving indirect expropriation (as did tribunal in *Parkerings*). See *Parkerings v. Lithuania*, *supra* note 296 at para. 392. In turn, the invocation of non-investment rules in the context of expropriation may favour a cross-fertilization and coherence between different treaty regimes. In addition, this clause may also be invoked in the investment disputes with the environmental component by *amici curiae*, as they often discuss the link between international environmental law and the regulatory measures challenged by the investor. Examples are the *amicus* briefs submitted in *Methanex v. USA*, *Suez v. Argentina*, *Biwater v. Tanzania* and others. See Jorge E. Viñuales, “The Environmental Regulation of Foreign Investment Schemes under International Law” in Pierre-Marie Dupuy & Jorge E. Viñuales, eds., *Harnessing Foreign Investment to Promote Environmental Protection. Incentives and Safeguards* (Cambridge: Cambridge University Press, 2013) 273 at 313. See also generally Eugenia Levine, “Amicus Curiae in International Investment Arbitration: The Implications of an Increase in Third-Party Participation” (2011) 29:1 Berkeley J Int’l L, 200 - 224; Christian Schliemann, “Requirements for Amicus Curiae Participation.” *supra* note 121. Decision of the Tribunal on Petition from Third Persons to Intervene as “Amici Curiae”, 15 January 2001. The *amicus curiae* submissions of the IISD as of March 9, 2004 is available online: <[http://www.iisd.org/pdf/2004/trade\\_methanex\\_submissions.pdf](http://www.iisd.org/pdf/2004/trade_methanex_submissions.pdf)>; *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v The Argentine Republic*, ICSID case No. ARB/03/19, Order in Response to Petition for Participation as Amicus Curiae (19 May 2005), Order in Response to a Petition by Five Non-Governmental Organizations for Permission to Make an Amicus Curiae Submission (12 February 2007), online: CEIL <[http://www.ciel.org/Publications/SUEZ\\_Amicus\\_English\\_4Apr07.pdf](http://www.ciel.org/Publications/SUEZ_Amicus_English_4Apr07.pdf)> [*Suez v. Argentina*]; *Biwater v Tanzania*, *supra* note 50, Procedural Order No. 5 (2 February 2007), online: ITA Law <[http://www.italaw.com/sites/default/files/case-documents/ita0091\\_0.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0091_0.pdf)>.

<sup>559</sup> Article VIII of the 2010 Colombia – United Kingdom BIT.

<sup>560</sup> See Article XX GATT, *supra* note 230. (Similar approach is to incorporate Art. XIV, GATS in relation to investments). Some authors, such as A. Newcombe, argue that the inclusion of general exceptions would have a limited role to play in international investment law. He also stresses that it is because general exceptions in treaties may be interpreted too narrowly based on GATT Article XX jurisprudence, resulting in a limitation of policy space, the IISD did not include a GATT Article XX-like general exceptions clause in its Model BIT. See A. Newcombe, “General Exceptions in International Investment Agreements” in M.-C. Cordonier Segger, M. W. Gehring & A. Newcombe (eds.), *Sustainable Development in World Investment Law* (Alphen van den Rijn: Kluwer Law International, 2011). Similarly, Céline Lévesque considers that inclusion of exceptions based on Article XX GATT may result in the narrow interpretation of such provisions and therefore reduce rather than improve the balance between investment protection and other public policy objectives. Moreover, Professor Lévesque particularly emphasizes that in the context of expropriation, general exceptions in IIAs do not function as a police power doctrine equivalent or codify this international customary law doctrine in IIAs. Instead, it provides for the cases that are not expropriations, and, as such, do not call for a duty of compensation. See Céline Lévesque, “The Inclusion of GATT Article XX Exceptions in IIAs: A Potentially Risky Policy” in Roberto Echandi & Pierre Sauvé, eds., *Prospects in International Investment Law and Policy* (Cambridge: Cambridge University Press, 2013) 363 at 370. For an opposing viewpoint, see T. Gazzini, *supra* note 13 at 929-963. It must be noted that this paper is not engaged in the discussion about the GATT Article XX-like general exceptions and their legal effect as it is beyond the scope of the study.

language, from the standpoint of preservation of host states' regulatory space. The present clause differs from Article XX GATT and arguably, provides stronger statement for the purposes of assessment by tribunals of the exercise of regulatory powers and investor's interests involved than some other clauses that purport to protect state's right to regulate. It seems to give priority for legitimate environmental regulation over the investment protection, if a measure in question meets the indicated requirements.<sup>561</sup>

Perhaps more important, language of this provision sets a framework for effective balancing. First, the clause does not incorporate specific wording such as "otherwise consistent with this Chapter" which is found, for example, in NAFTA Chapter 11, that potentially limits the effect of such a provision.<sup>562</sup> Second, through inserting the wording "it considers appropriate" the provision introduces the so-called "self-judging" language. As explained by Professor Vandevelde, the effect of this may be "to render nonjusticiable a party's invocation of the exception" on the environmental grounds which at a minimum requires a tribunal "to give great deference to a party's invocation of the exception."<sup>563</sup> Thus, the clause gives discretion to the state to define whether a measure is necessary to protect the environment. In turn, a reference to a broad concept "environmental concerns" ensures that a wide range of environmental issues may be potentially captured by the scope of this provision. Finally, it is important to note that in order to fall within such exceptions the measure should be both proportionate to the sought objectives and non-discriminatory, which are, presumably, the justiciable requirements. Importantly, the clause requires a proportionality assessment – not as part of the indirect expropriation analysis, but separately in order to see if the exception applies. This could engage a tribunal in determining if a particular government measure can be excluded from the scope of indirect expropriation not by means of application of one-sided police powers test, but with the help of proportionality assessment, which is, arguably, most compatible with sustainable development. Due to the presence of proportionality requirement, this model of exceptions provides more balanced framework for consideration of both investment and non-investment concerns that essentially differs from traditional exceptions based on police powers doctrine.

While the above examples do not represent the whole spectrum of the environment-related provisions which may appear in recent BITs, these clauses together illustrate a general trend toward including clauses intended, in different ways, to ensure that states can act to achieve sustainable development. Moreover, the inclusion of this type of provisions in the main treaty text, above all, may

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<sup>561</sup> Notably, a BIT containing such a clause does not prevent state from enacting "any measure it considers appropriate," including regulation that has an effect of expropriation, if a host state indeed considers it is necessary. However, the treaty would still require compensation to be paid if investor's property is expropriated.

<sup>562</sup> In order for a provision to be an exception, it must allow acts that without the exception would be violation of the treaty, but not "otherwise consistent" with the Chapter. As a result of this requirement, the legal effect of such exception is likely to be limited as it does nothing to save a claim against a state that a measure is a breach of the Chapter. See H. Mann, "Investment Agreements and the Regulatory State: Can Exceptions Clauses Create a Safe Haven for Governments?" Issues in International Investment Law, Background Papers for the Developing Country Investment Negotiators' Forum (Singapore, October 1-2, 2007) at 8, online: IISD <[http://www.iisd.org/pdf/2007/inv\\_agreements\\_reg\\_state.pdf](http://www.iisd.org/pdf/2007/inv_agreements_reg_state.pdf)>.

<sup>563</sup> Kenneth J. Vandevelde, "Rebalancing Through Exceptions" (2013) 17:2 Lewis & Clark Review, 449 at 451.

be viewed as a strong political statement reinforcing important public policy concerns related to environment and sustainable development.

### **3.2. Archetype of Provisions Most Compatible with State’s Ability to Regulate in Pursuit of Sustainable Development**

The above analysis makes it possible to identify an archetype of treaty provisions that may result in the interpretation of indirect expropriation based on the proportionality approach, which is most compatible with states being free to act to achieve sustainable development. The findings are based on the most recent BITs practice and cover the following provisions of the agreements: (a) Expropriation; (b) Preamble; (c) Not – lowering standards and (d) Other environment-related clauses.

Among these provisions, only the expropriation clause may, in some cases, interfere with state’s regulatory freedom and influence its ability to adopt regulation in pursuit of sustainable development.<sup>564</sup> Based on the systemic analysis of 61 newly concluded BITs, the identified expropriation provisions were categorized in three groups depending on the language and approach they use. In comparison with the first two categories, the provisions falling into Group III demonstrates the highest degree of specificity and sophistication regarding the definition of indirect expropriation and preservation the host state’s regulatory space.

Other provisions, such as the Preamble, the Not-lowering standards clause and the other environment-related clauses in some cases address the right of the states to regulate, while they do not purport to prevail over the investor protection provisions, including expropriation. Nevertheless, depending on their wording, these provisions can have an impact on the interpretation and application of the expropriation clause as a part of context. Thus, some versions can provide a gateway to consider non-economic considerations in the indirect expropriation context and suggest that a proportionality approach should be adopted to the concept of indirect expropriation.

The patterns identified in BITs from the categories of clauses addressed in the above are synthesized below to create a model (archetype) of provisions, which may lead to the interpretation of indirect expropriation that is most compatible with states being free to act to achieve sustainable development.

#### *3.2.1. Indirect Expropriation*

##### **1. Covered forms and conditions for lawful expropriation<sup>565</sup>**

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<sup>564</sup> In some cases, depending on the language adopted, certain types of other clauses such as the police powers “carve-outs,” and the exceptions may also interfere with host state’s regulatory autonomy.

<sup>565</sup> Arguably, the elements of expropriation clause introduced in this section do not have a direct impact on the promotion of sustainable development in investment treaties. However, their structure and content may influence the interpretation and application of the concept

- (a) *Explicitly covers direct and indirect forms*
- (b) *Provides clear definition of both concepts*
- (c) *Establishes mandatory conditions for lawful expropriation: Public purpose, Due process of law, Non-discrimination and Compensation*

Generally, the expropriation clause is a logical point of departure for the assessment of indirect expropriation. Although the specific wording may vary, in order to improve the chances of consistent interpretation, it is necessary to note which forms of expropriation are covered by the treaty, provide their clear definition and establish the requirements for when expropriation of foreign investment should be viewed as lawful.

The survey of recent BITs shows that not all agreements address the issue of indirect expropriation in the same manner. While all of them contain elements (a) and (c) listed above, only some treaties define what constitutes indirect expropriation. A vague definition of the concept, however, may give rise to an over-expansive and inconsistent interpretation by investment tribunals and permit them to take approaches incompatible or less compatible with sustainable development. The model clause introduced below is based on the expropriation provisions of the 2013 Canada – Tanzania BIT and contains useful wording that can help to avoid these risks.

<b>Model provisions:</b>
<p>1. A Party shall not nationalize or expropriate covered investments either directly or indirectly through measures having an effect equivalent to nationalization or expropriation (hereinafter referred to as “expropriation”) except for a purpose which is in the public interest, in accordance with due process of law, in a non-discriminatory manner and on payment of prompt, adequate and effective compensation.”<sup>566</sup></p> <p>2. Direct expropriation occurs where an investment is nationalised or otherwise directly expropriated through formal transfer of title or outright seizure and indirect expropriation results from a measure or series of measures of a Party that have an effect equivalent to direct expropriation without formal transfer of title or outright seizure.”<sup>567</sup></p>

## **2. Guidance for multi-factor assessment of indirect expropriation**

- (a) *Indicates that assessment requires a case-by-case and fact-based inquiry*
- (b) *Establishes a non-exhaustive set of factors to be considered for the assessment*
  - *Economic impact and duration of state’s measure*
  - *Degree of interference with legitimate, distinct, reasonable investor-backed expectations*<sup>568</sup>
  - *Character (object, context and intent) of state’s measure*

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so as to limit the state’s right to regulate in the public interest. While these elements form a base of the indirect expropriation standard, they are included here for the purposes of holistic understanding of the proposed archetype of investment treaty provisions.

<sup>566</sup> Article 10(5) of the 2013 Canada – Tanzania BIT.

<sup>567</sup> Annex to the 2013 Canada – Tanzania BIT.

<sup>568</sup> In the context of the indirect expropriation, the concept of legitimate expectations provides tribunals with the ability to balance investors’ interests in being provided with a stable, predictable, and consistent investment environment with the right of states’ to exercise their sovereignty through regulation. When determine whether a regulatory act is expropriatory, some tribunals have regard to whether a regulatory act has disappointed an investor’s legitimate expectations, thus applying the concept as an element of the proportionality framework.

- *Non-discriminatory, non-arbitrary nature of measure, taken in good faith*
  - *Requires assessing whether the measure is proportional in light of its purpose.*
- (c) *Provides clarification that economic impact alone is insufficient to establish indirect expropriation.*

The presence of this provision is highly important to ensure a balanced approach to indirect expropriation based on the proportionality framework. It requires tribunals to employ a comprehensive and more balanced multi-step examination taking into account a broader range of factors. The analysis presented in the Chapter I also indicates that the proportionality test offers more precise and transparent structure, and it is considered the most compatible with sustainable development than the alternative techniques. The particular interpretative significance of the provisions that offer a proportionality framework can be summarized as follows: first, they can help prevent expansive interpretations of the concept of indirect expropriation; second, such provisions require taking account of a broader spectrum of contextual elements (for instance, the character of state’s measure and the reasons behind its application, the boundaries of state’s regulatory space, its developing nature and investor’s expectations). Thus, they minimize the situations where a standard of indirect expropriation can be interpreted from the standpoint of investor’s economic interest alone, i.e. without consideration of important public policy issues of a host state. Finally, this type of provision may safeguard the ability of states to regulate in pursuit of sustainable development while ensuring a legally sound basis for a balanced reasoning. In particular, it would not favor a one-sided pro-state reasoning and thus would not discourage investment in the way a full police powers approach does.

A number of recent BITs have adopted this approach by clarifying the factors for determination of indirect expropriation, although with some variations.<sup>569</sup> The following clause illustrates a model which provides guidance for the assessment of indirect expropriation, based on a comprehensive framework that encourages tribunals to engage in the three-step proportionality assessment, closely following the version of proportionality test applied by the ECHR. The model clause below, arguably, provides a clearer textual basis for application of the proportionality test. It is based on the wording of the 2013 Canada – Tanzania BIT and 2011 India – Lithuania BIT.

<b>Model Provisions</b>
<p>The determination of whether a measure or series of measures of a Party constitute an indirect expropriation shall be determined through a case-by-case, fact-based inquiry that shall consider, among other factors:</p> <p>(a) the economic impact of the measure or series of measures,<sup>570</sup> although the sole fact that a measure or series of measures of a Party has an adverse effect on the economic value of an investment shall not establish that an indirect expropriation has occurred;</p>

<sup>569</sup> In particular, this category of clauses usually appear in the treaties where one of the parties is Canada, India or Colombia as well as in the 2013 Belarus – Lao’s People Democratic Republic BIT. Using the multi-step framework is also coherent with a trend in investor-state arbitration going in the same direction.

<sup>570</sup> The duration of the regulation could be added to the criterion in order to determine whether the regulation has had a severe enough impact on property to constitute an indirect expropriation.

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| <p>(b) the extent to which the measure or series of measures interfere with distinct, reasonable investment-backed expectations; and</p> <p>(c) the character and intent of the measure or series of measures, whether they are non-discriminatory, taken in good faith for public interest purposes including for reasons of public health, safety, and environmental protection, and whether the measures are proportionate to the objectives sought.</p> |
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### 3.2.2 Preamble

#### **Reference to non-economic concerns**<sup>571</sup>

- (a) *Strikes a balance between investor interests and sustainable development goals to prevent excessively “asymmetrical” interpretation of expropriation in favor of investors*
- (b) *Expressly refers to the concept of sustainable development and its principles, as well as other public policy concerns (health, environment protection, etc.)*

The model clause below adopts the preambular statement found in the 2010 Azerbaijan – Estonia BIT. It expressly demonstrates a recognition by the parties that the economic objectives of the agreement - “to promote and protect investments” - should be pursued without abuse of non-economic objectives and to promote sustainable development. The particular reference to sustainable development as an objective of the treaty has a significant interpretative value - it guides an interpreter about the parties’ strong intention to take a balanced view of investment and non-investment concerns. Arguably, it may offer meaningful assistance in interpreting the substantive provisions of the treaty as a part of its context under Article 31(1) of the VCLT or for the purposes of teleological interpretation. As such, where the preamble of the BIT contains reference to sustainable development, it will be important to interpret the substantive protections of the treaty within the context of the relevant environmental provisions, for instance, in the light of non-investment rules of international law. Thus, the tribunals may invoke this type of preamble to support the balancing reasoning related to the environmental component of the disputes involving indirect expropriation claims.

<b>Model Provision</b>
<p>“DESIRING to achieve these objectives in a manner consistent with the protection of the health, safety, the environment and the promotion of sustainable development.”<sup>572</sup></p>

### 3.2.3. Not – lowering Standards

#### **Discouragement Parties from lowering environmental and other standards**

- (a) *Incorporates a binding obligation (“shall”)*
- (b) *Records the Parties’ shared understanding that it is inappropriate to attract investments by relaxing domestic standards, laws and regulations pertaining to public welfare*

The not-lowering provision may play a complementary role in the interpretative process by clarifying the parties’ intent regarding the importance of environmental concerns in the context of

<sup>571</sup> A preamble may additionally include a not-lowering standards clause and references to international environmental agreements.

<sup>572</sup> See Preamble of the 2010 Azerbaijan - Estonia BIT.

investment promotion and protection. As a part of its context, according to Article 31 of the VCLT, the clause may potentially contribute to the interpretation of indirect expropriation and other substantive standards of the treaty. It expressly refers to the role of host state to pursue other policy goals such as public health and environment, when encouraging the foreign investments. As a result, this may help tribunals to interpret treaty provisions in a broader context linking the goal of investment promotion with the goal of environment protection, rather than prioritizing the former over the latter.

The advantage of this type of clause is that it formulates the contracting states’ commitment as an obligation of conduct (“shall not waive or otherwise derogate from...”), requiring that no derogation will take place from public health, safety and environmental measures as an encouragement of foreign investments. At the same time, a scope of the clause is narrowed down by the list of cases when the party should avoid derogation from health, safety and environmental policies (“encouragement or otherwise for the establishment, acquisition, expansion operation, management, maintenance, use, enjoyment and sale or other disposal an investment of an investor”). This may be helpful for avoiding too expansive interpretation of its provision in favour of the state. Another distinct feature of this clause is that it may serve to prevent the development by foreign investors of expectations that less stringent regulation will be adopted. In particular, an interpreter may rely on this provision when looking at the criterion of legitimate investment-backed expectation of regulatory stability and assessing the deprivation of investor’s property within the proportionality framework. Accordingly, the clause may contribute to justification that an investor could not have relied on expectations that less stringent environmental regulation will be adopted by host state. The model of not-lowering standard clause introduced below is based on the provision of the 2013 Canada – Tanzania BIT.

<b>Model Provisions</b>
The Parties recognize that it is inappropriate to encourage investment by relaxing public health, safety or environmental measures. Accordingly, a Party shall not waive or otherwise derogate from, or offer to waive or otherwise derogate from such measures as an encouragement or otherwise for the establishment, acquisition, expansion operation, management, maintenance, use, enjoyment and sale or other disposal an investment of an investor. <sup>573</sup>

*3.2.4. Other Environmental – related provisions*

**1. Reservation of policy space for environmental regulation**

This clause reaffirms the sovereign right of host states to take measures that they consider appropriate for the protection of the environment and promotion of sustainable development. By inclusion of a broad concept “environmental concerns”, it strives to cover a wide range of measures adopted by the states on the environmental grounds. At the same time, the inclusion of such qualifiers as “non-discriminatory character” of the measure and its “proportionality to the pursued objectives”

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<sup>573</sup> Article 15 of the 2013 Canada – Tanzania BIT.

makes the application of the clause conditional on the fulfilment of these requirements and thus limits its scope.

Importantly, this provision explicitly requires a test of whether the measure is proportionate. At the same time, it may have different interpretative value depending on the structure and content of expropriation provisions included in the BIT. For instance, if a treaty includes the expropriation provisions falling into Category III, which provide comprehensive multi-factor guidance, it may have less interpretative significance. However, if such guidance does not expressly incorporate a proportionality requirement, as it is the case of the surveyed BITs, the clause may serve as an important tool for encouraging a tribunal not to adopt a sole effects test and to engage in a proportionality analysis. Moreover, this type of provision seems to give priority to environmental regulation over investor protection, if the measure in question meets the indicated requirements. Hence, it may be interpreted as an exception. Virtually, this type of provision could operate independently as the exception from the obligation not to expropriate without compensation or as a direction to interpret indirect expropriation in a manner that was consistent with present reservation clause.<sup>574</sup> This option may be important for states having essential environmental and sustainable development concerns. The model clause below adopts language of Article VIII of the 2010 Colombia – United Kingdom BIT.

Model Provision
Nothing in this Agreement shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure that it considers appropriate to ensure that an investment activity in its territory is undertaken in a manner sensitive to environmental concerns, provided that such measures are non-discriminatory, taken in good faith and proportionate to the objectives sought. <sup>575</sup>

**2. Recognition of Parties’ non-economic commitments under IEAs**

The next provision records recognition of the parties’ external non-economic obligations accepted under international environmental agreements. Such clause may appear useful for proportionality assessment of expropriation involving an environmental component: it clearly invites interpretation of investment treaty provisions in the light of international environmental instruments. Accordingly, it provides a gateway to invoke non-investment rules when applying the proportionality test that would have an effect on the balancing of competing interests. In particular, it may help to justify host state regulation by relying on international treaties related to environmental protection. The clause has the potential to encourage the interpreter to take into account the relevant international environmental norms under Article 31(3)(c) VCLT.

<sup>574</sup> In order to avoid confusion about how the present clause and the multi-factor framework for determining whether an indirect expropriation had occurred would operate together, the model clause adopts the language of the indirect expropriation provision, in so far as relevant.

<sup>575</sup> Article VIII of the 2010 Colombia – UK BIT.

Paragraph 2 of the model below defines the relationship of the investment treaty to other international environmental agreements of which the parties to the BIT are parties. It stipulates that in case of any inconsistencies between the norms of BIT and the obligations imposed by the international environmental law, the latter norms shall prevail. In this regard, the term “shall” points to an imperative character of the norm, requiring non-investment rules to take precedence over treaty provisions. This, however, is subject to some conditions.

In particular, it establishes that a party “where has a choice among equally effective and reasonable available means” should apply that measure which is “least inconsistent with the other provisions” of this BIT. Thus, if the adverse effect on the investment can be avoided when achieving a particular environmental goal, the investment - restrictive measure must be replaced with an alternative one that achieves the goal without restricting investment. However, if restriction on investment is necessary to achieve the environmental goal, the issue then becomes whether the host state has chosen the least restrictive means of doing so. Such an approach reserves sovereign right of host state’s to regulate in pursuit of sustainable development as well as it may shield the foreign investment from negative impact when such impact can be eliminated by choosing a suitable alternative measure.

Importantly, the principle embedded in paragraph 2 does not allow any restrictive measure on investment to be justified in light of any environmental considerations. Instead, the provision may cover only those measures which are introduced in terms of specific obligations in the environmental treaties accepted by both parties. This may assist to prevent unfair manipulations with environmental purposes of applied regulatory restrictions. The model provision below adopts language of the 2010 BLEU – Montenegro BIT and Article 104 of the NAFTA.

<b>Model Provision</b>
<ol style="list-style-type: none"> <li>1. The Parties reaffirm their commitments under the international environmental agreements, which they have accepted. They shall strive to ensure that such commitments are fully recognized and implemented by their domestic legislation.</li> <li>2. In the event of any inconsistencies between this Agreement and the specific obligations set out in the international environmental agreements referred to in paragraph 1, such obligations shall prevail to the extent of the inconsistency, provided that where a Party has a choice among equally effective and reasonably available means of complying with such obligations, the Party chooses the alternative that is the least inconsistent with the other provisions of this Agreement.</li> </ol>

## CONCLUSIONS

Faced with common global economic, social and environmental challenges, today the international community stresses the need to harness economic growth for sustainable development, where investment is a primary driver of such growth.<sup>576</sup> Thus, it is important for all countries and for developing countries in particular to ensure that investment, including foreign direct investment (FDI), contributes to sustainable development objectives. In light of the ongoing debates about the role of FDI for sustainable development, the international rules on the protection of foreign investment have begun to change in fundamental ways over the last two decades, facing both old and new challenges. One of the most notorious challenges relates to the question how to decrease the tension between a state's regulatory freedom and private property rights, safeguarding interests of both public and private actors. Investment rules must achieve a crucial balance: on the one hand, they should strive to protect the interests of foreign investors, and, on the other hand, they must support the right of host states to take measures to advance legitimate public welfare objectives, such as protection of the environment.

In dealing with indirect expropriation commitments in investment treaties past tribunals relied on three different approaches - "sole effects", "police powers" or "proportionality." Some tribunals looked exclusively to the economic impact of the measure on the investor's property; some exclusively to the underlying purpose of the measure; and others to both the economic impact on the investments and the characteristics of the measure. This multiplicity in the tests for indirect expropriation demonstrates that there is no unanimity of positions in international investment law as to which test should be applied to establish indirect expropriation. From the sustainable development perspective, however, different approaches may lead to different outcomes, adversely affecting the interests of one or another party.

The analysis provided in Chapter I showed that the proportionality test offers tribunals a framework for resolution of conflicts between public and private interests that is most compatible with sustainable development. In comparison to the other two approaches, the proportionality test suggests a more balanced, transparent and developed methodology. Importantly, the test allows taking account both investment and non-investment elements, including the economic impact on investments and "environmental" purpose of the measure. In this regard, its aim is not to determine which interests – a host state's or a foreign investor's - should be granted a "higher" status. Rather, it is to ensure equal consideration of the competing interests and balancing them under an established framework of proportionality. At the conclusion of Chapter I, it is suggested that the effectiveness of differentiation between indirect expropriation and legitimate regulation in pursuit of sustainable development depends on taking into account not one, but a number of elements which includes the language of the investment treaty, the methods of its interpretation and the test for expropriation.

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<sup>576</sup> See Preface of the 2012 UNCTAD Investment Policy Framework for Sustainable Development *supra* note 168.

Considering this, Chapter II addressed the interpretative approaches of investor-state tribunals in light of the customary rules of treaty interpretation contained in Articles 31 and 32 of the Vienna Convention on the Law of Treaties. Under these rules, recourse may be had to textual, contextual or teleological interpretation, or their combination. The analysis of investor-state cases has shown that in a number of cases, despite the existing environmental concerns, the tribunals did not mention the international environmental agreements at all or relied on the contextual arguments by referring to the treaty's preamble to support the expressly stated objective of the regime – protection of investment. This is because most of earlier investment treaties do not address non-investment issues in either their preambles or the operative provisions. As a result, such treaties do not contain textual grounds allowing taking into account the environmental issues as a part of the treaty's context, which is problematic from the standpoint of sustainable development. Considering this, the tribunals could use, but did not use the potential of systemic integration under Article 31(3)(c) of the VCLT or evolutionary interpretation which may be especially relevant for old generation treaty. In turn, this contributed to adoption of a strong one-dimensional approach in favour of foreign investors without proper consideration of host state interests.

In view of these facts, it is argued that some new generation treaties may help to overcome this challenge by providing tribunals with new analytical tools for adjudicating disputes involving competing policy objectives. This may push arbitrators towards adopting a more balanced approach to investment protection and consistent interpretation of investment treaties than they have tended to adopt in the course of applying a broad and unspecified language of earlier BITs.

Against this background, through the focus on one particular aspect, indirect expropriation, this thesis raises a question: what would be archetypes of investment treaty provisions that may result in the interpretation of indirect expropriation most compatible with states being free to act to achieve sustainable development? To answer this question, the 61 most recently concluded BITs were reviewed. In broad terms, it was found that some “new generation” BITs exhibit three general characteristics relevant to indirect expropriation and state's regulatory freedom: (1) express inclusion of environmental concerns and sustainable development in preambles and operative treaty provisions; (2) new analytical tools for tribunals such as more clearly defined terms and guidance for assessment of indirect expropriation; (3) incorporation of safeguards for state regulatory autonomy in its classic form (“police powers” exceptions) as well as through “modified” environment-related clauses.

As demonstrated in Chapter III, the recent BITs, indeed, extend their traditional goals to include specifically the protection of environment and other non-investment objectives. The survey, however, showed that even among the most recently concluded BITs, not all treaties pay the same attention to these non-investments concerns in the context of state's regulatory freedom. Most BITs, particularly those signed by Albania, Bangladesh, Bosnia and Herzegovina, Kazakhstan, Macedonia, Morocco and Russia, continue to adopt an “old-generation” approach cultivating vague language in respect to indirect

expropriation, without addressing other “external” values promoted by the objectives of sustainable development.

A number of other countries have incorporated additional protections regarding environment in their agreements. Some BITs even explicitly refer to sustainable development among their objectives. At the same time, they still include broad provisions on indirect expropriation without clear indication of criteria to establish its occurrence or distinguish legitimate regulation. Among such countries, *inter alia*, are Azerbaijan, Austria, Japan, Netherlands and Turkey. In contrast, the most balanced approach, among the surveyed BITs, is presented in the treaties recently signed by Canada, India and Colombia. Such treaties define the concept of indirect expropriation, provide a comprehensive multi-factor guidance for its assessment based on a certain type of proportionality framework, incorporate carve-outs to exclude legitimate regulatory actions from the scope of indirect expropriation and explicitly address environmental and sustainable development concerns in the preambles and operative provisions. However none of these BITs closely follows the three-step version of the test as applied by the ECHR. The analysis showed that the surveyed provisions do not provide a clear basis for balancing in comparison to the classic model of proportionality that exists in the European human rights system. Thus, it is suggested that this category of provision may be improved by inclusion of proportionality requirement among other criteria serving for identification of indirect expropriation.

Based on this survey of recent treaties, the provisions of those BITs, which appear to reflect a more effective balance between the investment protection and host state’s regulatory autonomy, were synthesized into archetypal provisions which best ensure that investment treaties are interpreted in a way most compatible with sustainable development. The analysis covered selected treaty provisions, which directly or indirectly relate to the concept of indirect expropriation and the state’s right to regulate: namely, preamble, expropriation, not-lowering standard and other environment-related clauses.

The identified archetype of treaty provisions starts from the expropriation clause - a logical point of departure for the assessment of indirect expropriation. The presented model clause contains useful wording that can help to avoid the risks of an over-expansive and inconsistent interpretation of indirect expropriation by investment tribunals. For this purpose, the clause explicitly covers direct and indirect forms of expropriation, provides clear definition of both concepts and establishes mandatory conditions for lawful expropriation: public purpose, due process of law, non-discrimination and compensation.<sup>577</sup>

The next element of this provision is guidance regarding a multi-factor assessment of indirect expropriation, which is, arguably, one of the most important components of the model. Such guidance requires tribunals to employ a comprehensive multi-step examination taking into account a number of

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<sup>577</sup> In addition to the indicated elements, the introduced archetype of provisions also includes model clauses that set limitation of the scope of expropriation provision so as (i) to cover only tangible and intangible property rights of foreign investor; and (ii) to exclude the actions of the host state’s authorities taken as a part of normal business activity and/or designed or applied in the public interest of its nationals.

factors that based on a proportionality framework. The particular interpretative significance of these provisions can be summarized as follows: first, the guidance can help prevent interpretations of the concept of indirect expropriation that do not take into account the public purpose of the measure; second, it requires consideration of a broader spectrum of factors to ensure a balancing of competing interests. Due to its multi-factor structure, it may embrace a range of contextual elements and minimize the situations of one-sided interpretation of indirect expropriation. In this regard, the most essential advantage of the guidance that it is capable to provide a framework, which allows taking account of both competing interests in a balanced manner. Based on the above, this type of provisions may safeguard the ability of states to regulate in pursuit of sustainable development while ensuring a legally sound basis for a balanced reasoning.

The archetype provision specifically indicates that assessment requires a case-by-case and fact-based inquiry and establishes a non-exhaustive set of factors to be considered for the assessment, including but not limited to (i) economic impact and duration of state's measure;<sup>578</sup> (ii) degree of interference with distinct, reasonable investment-backed expectations; (iii) character (object, context and intent) of state's measure; (iv) non-discriminatory, non-arbitrary nature of measure, taken in good faith for reasons of public purpose or social interest; and, most importantly, it requires (v) assessing whether the measure is proportional the objectives sought. This model of guidance provides more explicit textual basis for application of the comprehensive proportionality test.

The other provisions included in the proposed archetype are the preambles and environment-related provisions. They do not expressly "interfere" with the expropriation provisions, but they could serve as a source of context under Article 31 of the VCLT and thereby, inform interpretation of the indirect expropriation concept as well as other relevant operative provisions of BIT. It must be noted, if a treaty contains a clear expropriation clause which is based on a multi-factor assessment framework, the interpretative significance of preambles and environment - related provisions may be limited. At the same time, these provisions may help to ensure that the other investment provision are not interpreted in a manner that only favours investment protection. On the other hand, if a BIT does not include an expropriation provision with the multi-factor assessment framework, the interpretative significance of these preambular and environment-related provisions, as a source of context for a balanced interpretation of indirect expropriation, may be essentially increased.

The model preamble strikes a balance between investor interests and sustainable development goals to prevent excessively "asymmetrical" interpretation of expropriation in favor of investors and expressly refers to the concept of sustainable development and its principles, other public policy concerns like protection of the environment.

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<sup>578</sup> Provides clarification that economic impact alone is insufficient to establish indirect expropriation.

In this regard, a particular point of interest is indicating that the investment protection and promotion goals of the treaty are to be achieved in a manner consistent with sustainable development in the preamble. It guides an interpreter to take into account the parties' strong intention to take a balanced view of investment and non-investment concerns and thus has significant interpretative value as a part of treaty context under Article 31 of the VCLT or for the purposes of teleological interpretation.

Among the different types of environment-related clauses,<sup>579</sup> probably, the most significant from the perspective of interpretation is a provision that establishes reservation of policy space for environmental regulation. One distinct characteristic of the model is a requirement for a proportionality assessment, which is highly important for a balanced interpretation of treaty in the absence of expropriation provisions that contain the interpretative guidance with embedded proportionality framework. While this type of provision seems to give priority to environmental regulation over investor protection, if the measure in question meets the indicated requirements, it may be interpreted as an exception from the obligation not to expropriate without compensation or as a direction to interpret indirect expropriation in a manner that was consistent with the introduced reservation clause.

To conclude, the proportionality framework is central to the identified archetype treaty provisions. This is because expropriation provisions which suggest specific guidance premised on a proportionality test, arguably, have the greatest potential to be interpreted to achieve three significant goals - investment promotion and protection, environmental protection, and social wellbeing - at the same time. Other model clauses included in the archetype such as preambles and environment-related provisions may also help to find an optimal balance between two equally important competing interests - safeguarding the host state's regulatory freedom and protection of foreign investment. However, if some of these provisions are not presented in the treaty, this may accordingly reduce the opportunity to apply a balanced approach to indirect expropriation and create a risk of one-sided interpretation of the concept.

Taking this into account, full and systematic incorporation of the identified archetype of provisions in further BITs would contribute to consistency, increase legal certainty and facilitate implementation of the most appropriate approach to ensuring that investment treaties are interpreted in a way that compatible with sustainable development.

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<sup>579</sup> The identified archetype provisions include a number of environment-related clauses that differ in terms of their structure, content, scope and interpretative significance. These provisions include a not-lowering standard clause, the provisions recognizing the state's level of protection, application and enforcement of environmental laws, the provisions that provide for reservation of policy space for environmental regulation, and clauses that record recognition of parties' commitments under international environmental agreements.

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## INVESTMENT TREATIES AND AGREEMENTS

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## ANNEX A. DEVELOPMENTS IN RECENT BITs (2010 - 2013)

GENERAL INFORMATION			PREAMBLE			EXPROPRIATION					ENVIRONMENT-RELATED PROVISIONS	
No.	PARTNERS OF BITs	Year <sup>1</sup>	Reference to SD	Non-Lowering Standard	IEAs <sup>2</sup>	Direct/ Indirect	Lawful Expropriation <sup>3</sup>	Indirect Expropriation		Police Powers Exceptions	Not-lowering Standard Clause	Other Environment-related Clauses
								Definition	Factors for determination			
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
1.	Albania - Azerbaijan	2012	+			+	+					
2.	Albania - Malta	2011				+	+					
3.	Albania - Qatar	2011				+	+					
4.	Albania – San Marino	2012				+	+					
5.	Austria - Nigeria	2013	+	+	+	+	+			+	+	
6.	Austria - Kosovo	2010	+		+	+	+			+	+	
7.	Azerbaijan - Estonia	2010	+			+	+					
8.	Bahrain - Turkmenistan	2011				+	+					
9.	Bangladesh - Turkey	2012		+		+	+			+		+
10.	Bangladesh – Arab Emirates	2011				+	+					+
11.	Belarus – Lao Republic	2013				+	+		+	+		
12.	BLEU - Montenegro	2010				+	+				+ <sup>4</sup>	+
13.	Bosnia and Herz. - Romania	2010				+	+					
14.	Bosnia and Herz. – San Marino	2011				+	+					
15.	Cameroon - Turkey	2012		+		+	+			+		
16.	Canada – Benin	2013	+			+	+	+	+	+	+	+
17.	Canada - China	2012	+			+	+	+	+	+	+	
18.	Canada - Kuwait	2011	+			+	+	+	+	+	+	+
19.	Canada - Slovakia	2010				+	+	+	+	+	+	+
20.	Canada - Tanzania	2013	+			+	+	+	+	+	+	+
21.	Colombia - Japan	2011	+	+		+	+	+	+	+	+	+
22.	Colombia - UK	2010				+	+	+	+	+	+	+

<sup>1</sup> Year of signature (may differ from the year of entry into force).

<sup>2</sup> BIT contains references to the international environmental agreements (IEA).

<sup>3</sup> BIT contains four elements of lawful expropriation (public purpose; non-discrimination; due process and compensation)

<sup>4</sup> BIT provides definition of the term “environmental legislation” used in the environmental – related clause.

	I	II	III	IV	V	VI	VII	VIII	IX	X	XII	XII
23.	Croatia – Israel	2011				+	+ <sup>5</sup>					
24.	Egypt - Switzerland	2010	+	+		+	+					
25.	Estonia - Moldova	2010				+	+					
26.	Gabon - Turkey	2012		+		+	+			+		
27.	India - Congo	2010				+	+	+	+	+		
28.	India - Latvia	2010				+	+	+	+	+		
29.	India - Lithuania	2011				+	+	+	+	+		
30.	India - Nepal	2011				+	+	+	+	+		
31.	India - Slovenia	2011				+	+	+	+	+		
32.	India – Arab Emirates	2013				+	+	+				
33.	Japan - Iraq	2012		+		+	+				+	+
34.	Japan - Kuwait	2012		+		+	+				+	+
35.	Japan - Mozambique	2013		+		+	+				+	+
36.	Japan - Myanmar	2013		+		+	+				+	+
37.	Japan – Papua-New Guinea	2011	+	+		+	+				+	+
38.	Japan – Saudi Arabia	2013		+		+	+					
39.	Kazakhstan - Afghanistan	2012										
40.	Kazakhstan - Austria	2012										
41.	Kazakhstan - Macedonia	2011				+	+					
42.	Kenya - Slovakia	2011		+		+	+					
43.	Macedonia - Qatar	2011				+	+					
44.	Macedonia - Lithuania	2011				+	+					
45.	Macedonia - Morocco	2010				+	+					
46.	Moldova - Qatar	2012				+	+					
47.	Morocco – Serbia	2013				+	+					
48.	Morocco – Viet Nam	2012				+	+					
49.	Netherlands – Arab Emirates	2013				+	+					+ <sup>6</sup>
50.	Nigeria - Turkey	2011		+		+	+			+		
51.	Russia – Arab Emirates	2010										
52.	Russia – Equatorial Guinea	2011										
53.	Russia - Nicaragua	2012				+	+					
54.	Russia - Singapore	2010										
55.	Russia - Uzbekistan	2013				+	+					
56.	Russia - Zimbabwe	2012	+									
57.	Serbia – Arab Emirates	2013				+	+					
58.	Switzerland-Trinidad and Tobago	2010		+		+	+					
59.	Turkey - Pakistan	2012		+		+	+			+		

<sup>5</sup> BIT covers only 3 elements of lawful expropriation: public purpose, non-discrimination and compensation.

<sup>6</sup> Art. 2 of the BIT makes express reference to sustainable development policy.

60.	Turkey - Senegal	2010		+		+	+			+		
61.	Turkey - Tanzania	2011				+	+			+		
	<i>Total:</i>		12	17	2	54	54	13	13	22	16	16