

2011

Environmental and Health Regulation: Assessing Liability under Investment Treaties

Rahim Molloo

Justin Jacinto

Recommended Citation

Rahim Molloo and Justin Jacinto, *Environmental and Health Regulation: Assessing Liability under Investment Treaties*, 29 BERKELEY J. INT'L LAW. 1 (2011).

Available at: <http://scholarship.law.berkeley.edu/bjil/vol29/iss1/1>

This Article is brought to you for free and open access by the Law Journals and Related Materials at Berkeley Law Scholarship Repository. It has been accepted for inclusion in Berkeley Journal of International Law by an authorized administrator of Berkeley Law Scholarship Repository. For more information, please contact jcera@law.berkeley.edu.

Environmental and Health Regulation: Assessing Liability Under Investment Treaties

By
Rahim Moloo and Justin Jacinto*

INTRODUCTION

In 2009, an American investor initiated a North American Free Trade Agreement (“NAFTA”) arbitration, *Dow AgroSciences LLC v. Government of Canada*, based on the theory that Québec’s banning of pesticides containing an ingredient produced by the investor, 2,4-dichlorophenoxyacetic acid (2,4-D), violated the investor’s right to fair and equitable treatment and was tantamount to an expropriation.¹ Though the measure was purportedly adopted for health reasons, the claimant alleged that “there was no evidence that 2,4-D posed a health or safety risk to humans”² and that “Québec recognized the absence of a scientific basis for its Ban of 2,4-D.”³ The claimant further argued that Québec’s “stated reliance on an interpretation of the precautionary approach was motivated by political considerations, rather than any legitimate scientific concerns.”⁴

When the first claims began to be filed under NAFTA’s dispute resolution mechanism over ten years ago, the number of claims relating to environmental

* Rahim Moloo is General Counsel at the University of Central Asia and a Senior Research Fellow at Columbia University’s Vale Center for Sustainable International Investment. Justin Jacinto is an international disputes resolution practitioner and an Adjunct Professor at Georgetown University Law Center. The authors thank the participants of the Second American Society of International Law (ASIL) International Economic Law Interest Group Research Forum on Science, Risk and Law in International Governance for their helpful comments on this paper. The views expressed in this paper are the authors’ own and not necessarily those of the authors’ affiliated institutions or clients.

1. *Dow AgroSciences LLC v. Government of Canada*, NAFTA/UNCITRAL, Notice of Arbitration ¶¶ 47-53 (Mar. 31, 2009).

2. *Id.* ¶ 20.

3. *Id.* ¶ 25.

4. *Id.*

and health regulations, like *Dow AgroSciences*, surprised observers. Commentators from the International Institute for Sustainable Development writing in 1999 noted that “the unexpectedly broad and aggressive use of this process to challenge public policy and public welfare measures, including environmental measures in about half the known cases today . . . has caught governments and observers off guard” and that “the provisions designed to ensure security and predictability for the investors have now created uncertainty and unpredictability for environmental (and other) regulators.”⁵

At that time, concerns about the potential chilling effect of investment arbitration on public regulation were understandable. One of the first NAFTA cases filed, *Ethyl v. Canada*, involved banning imports of a gasoline additive suspected to be a dangerous toxin. The claimant, a U.S. chemical producer, sought \$251 million on the ground that the ban violated NAFTA’s investor protections.⁶ Observers announced that the claim was “sure to set off alarm bells throughout the public interest world,” and that it “demonstrate[d] how present and future international economic pacts could pose a danger to environmental regulations and other safeguards.”⁷ The outcome appeared to confirm their fears: in July 1998 Canada settled with the claimant and reversed the ban after losing a jurisdictional ruling.⁸

Although recent investment treaty claims concerning environmental and health regulation have proved less successful, the door remains open; indeed, *Dow AgroSciences* is by no means unique as a recent example of such a case. *Marion Unglaube v. Costa Rica*,⁹ which was registered with the International Center for Settlement of Investment Disputes (“ICSID”) in January 2008, involves an investor who was denied permits needed to develop a beachfront tourist project because of a legislative decree declaring an area of the beach a preserve for endangered leatherback turtles.¹⁰ Another ICSID case, *Vattenfall AB, et al. v. Germany*, which was registered in April 2009 and then suspended in August 2010 pursuant to a settlement agreement,¹¹ involved claims brought

5. Howard Mann & Konrad von Moltke, *NAFTA’s Chapter 11 and the Environment: Addressing the Impacts of the Investor-State Process on the Environment* (International Institute for Sustainable Development Working Paper 1999) at 5.

6. *Ethyl Corp. & Canada Ethyl Corp. v. Government of Canada*, NAFTA/UNCITRAL, Statement of Claim ¶¶ 19-50 (Oct. 2, 1997), available at <http://www.naftaclaims.com>.

7. Michelle Sforza & Mark Vallianatos, *Chemical Firm Uses Trade Pact to Contest Environmental Law*, Global Policy Forum, Apr. 1997, available at www.globalpolicy.org/component/content/article/212/45381.html.

8. Shawn McCarthy, *Failed Ban Becomes Selling Point for MMT*, THE GLOBE AND MAIL, July 21, 1998, at A3.

9. *Marion Unglaube v. Republic of Costa Rica*, ICSID Case No. ARB/08/1 (procedural details at <http://icsid.worldbank.org/ICSID/FrontServlet>).

10. Damon Vis-Dunbar & Luke Eric Peterson, *Blocked Eco-tourism Project in Costa Rica Parkland Leads to BIT Arbitration*, INVESTMENT TREATY NEWS, Feb. 21, 2008.

11. *Parties Announce Settlement of Dispute Over German Power Plant*, INVESTMENT ARB. REP., Aug. 28, 2010.

under the Energy Charter Treaty (“ECT”) relating to purportedly onerous environmental restrictions imposed on a coal-fired power plant.¹² *Philip Morris v. Uruguay*,¹³ an ICSID case registered in March 2001, involves claims relating to legislation which, amongst other things, precludes multiple product lines (e.g., “regular,” “light,” “menthol”) and requires cigarette packages to be covered by graphic images of the detrimental health effects of smoking.¹⁴

Cases relating to environmental and health measures raise difficult questions about the relationship between international investment law and government regulation of health and the environment. Can states incur liability under their investment treaty obligations for legitimate regulatory actions? How do arbitral tribunals assess legitimacy? How much deference should tribunals accord to states’ policy choices? Does international investment law have a chilling effect on regulation? Is precautionary regulation permissible? Tribunals and commentators that have grappled with such questions over the last decade have clarified certain issues in this regard. However, key aspects of the applicable legal framework remain uncertain. Indeed, even at the time a dispute arises, and the operative facts and applicable treaty language are known, the parties may not be able to predict how the tribunal will rule on fundamental legal issues.

This paper seeks to clarify the relationship between international investment law and environmental and health regulation. To contextualize the analysis, Part I reviews the legal framework within which international investment disputes are resolved. It looks specifically at how the decisions of other international tribunals, such as World Trade Organization (“WTO”) panels and the European Court of Human Rights (“ECHR”), which have grappled with similar issues, may be of assistance to tribunals interpreting investment treaties. It also examines how recent investment treaties have included provisions which expressly promote environmental and health protection.

Parts II – IV review how claims relating to environmental and health regulations are adjudicated under three key investment treaty standards—the duty to provide: (1) compensation for expropriation, including indirect expropriation and measures tantamount to expropriation; (2) fair and equitable treatment; and (3) non-discriminatory treatment, including in comparison to domestic investors (national treatment) and investors of third-party states (most-

12. Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG & Co. KG v. Federal Republic of Germany, ICSID Case No. ARB/09/6 (Mar. 30, 2009); see also Damon Vis-Dunbar, *Vattenfall Request for Arbitration Sheds New Light on Dispute with Germany*, INVESTMENT TREATY NEWS, July 11, 2009.

13. FTR Holding S.A. (Switzerland), Philip Morris Products S.A. (Switzerland) and Abal Hermanos S.A. (Uruguay) v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7 (Mar. 26, 2010).

14. Luke Eric Peterson, *Uruguay: Philip Morris Files First-Known Investment Treaty Claim Against Tobacco Regulations*, INVESTMENT ARB. REP. (Mar. 3, 2010), available at <http://www.iareporter.com/articles/20100303>.

avored nation treatment). Particular attention is given to whether and how tribunals assess the legitimacy of a governmental measure, including how the tribunals assess the state's "intent" and the measure's proportionality, effectiveness, and scientific soundness.

Part V summarizes the key elements of the three standards, identifying common themes where applicable as they apply to the assessment of whether health and environmental regulations will attract liability under international investment law. It also assesses the overall influence of international investment law on state regulation, including with regard to the specific question of whether regulation in accordance with the precautionary principle is permissible.

The authors have also added a postscript discussing the recent decision of a NAFTA tribunal in the *Chemtura Corp. v. Canada* case, which makes notable findings relating to several of the issues discussed in this paper.

I.

THE APPLICABLE LEGAL FRAMEWORK

A. *The International Legal Context*

At the outset, it is important to understand the context in which investment treaties are framed with respect to a state's other international legal obligations. This is especially true when discussing environmental and public health regulation given the recent proliferation of international law in these areas.

Investment treaties are primarily concerned with attracting foreign investment by offering substantive protections to foreign investors, including recourse to international arbitration to resolve any disputes with the host state regarding violations of the treaty.¹⁵ Investment treaties, however, do not operate in a vacuum, and as such require an analysis of other international law to interpret the commitments contained within them. The applicability of international law to investment disputes is often expressly contained in investment treaties,¹⁶ and where the dispute is submitted to ICSID's jurisdiction, Article 42(1) of the ICSID Convention requires tribunals, as a default position, to decide disputes in accordance with applicable "rules of international law."¹⁷

15. See Kenneth J. Vandavelde, *The Political Economy of a Bilateral Investment Treaty*, 92 AM. J. INT'L L. 621, 631 (1998).

16. See, e.g., Energy Charter Treaty, Dec. 17, 1994, 2080 U.N.T.S. 95, art. 26(6), available at http://www.encharter.org/fileadmin/user_upload/document/EN.pdf (requiring tribunals to apply "applicable rules and principles of international law.") [hereinafter Energy Charter Treaty]; 2004 U.S. Model Bilateral Investment Treaty, art. 30 available at <http://www.state.gov/documnts/organization/117601.pdf> (providing that tribunals shall decide investment disputes "in accordance with this Treaty and applicable rules of international law").

17. Convention on the Settlement of Investment Disputes between States and Nationals of

In any event, Article 31(3)(c) of the Vienna Convention on the Law of Treaties (the “Vienna Convention”) requires that treaties be interpreted in light of the “relevant rules of international law applicable in the relations between the parties.”¹⁸ As such, interpreting the obligations of a host state under an investment treaty may require a consideration of other treaties, customary rules, or general principles of law.¹⁹ In this regard, Philippe Sands has stated: “those charged with interpreting and applying treaties on the protection of foreign investment need to take into account the values that are reflected in norms that have arisen outside the context of the investment treaty which they are applying.”²⁰ In assessing a state’s investment treaty liability with respect to state health and environmental regulation, it may be important to seek interpretive guidance from the parties’ other international public health and environmental commitments.²¹

However, one must be careful when relying on international common law from other tribunals, such as the ECHR, as relevant sources for assessing liability under investment treaties. Steven Ratner recently suggested that care must be taken in this regard, due primarily to the varying institutional contexts in which such cases are decided.²² Contrary to Ratner’s theory, the proper starting point for assessing whether another institution’s analysis is relevant begins, not with a consideration of the institution making the decision, but with the text of the treaty being interpreted. If treaty text being considered by another

Other States, art. 42, Oct. 14, 1966, 575 U.N.T.S. 159.; *see also* MTD Equity Sdn. Bhd & MTD Chile S.A. v. Republic of Chile, ICSID Case No. ARB/01/7, ¶ 86 (May 25, 2004), *available at* <http://ita.law.uvic.ca>; Camuzzi Int’l S.A. v. The Argentine Republic, ICSID Case No. ARB/03/2, Objections to Jurisdiction, ¶¶ 132-133 (May 11, 2005), *available at* <http://ita.law.uvic.ca>; Aguaytia Energy LLC v. Republic of Peru, ICSID Case No. ARB/06/13, ¶72 (Dec. 11, 2008), *available at* <http://www.investmentclaims.com>.

18. Vienna Convention on the Law of Treaties, art. 31, May 23, 1969, 115 U.N.T.S. 331.

19. *See generally*, Conclusions of the work of the Study Group on the Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law, Report of the International Law Commission, GAOR 61st Session Supplement No. 10, Ch. XII ¶ 251, U.N. Doc. A/61/10 (2006), Conc. 18, *available at* <http://daccessdds.un.org/doc/UNDOC/GEN/G06/636/20/PDF/G0663620.pdf?OpenElement>; Campbell McLachlan, *The Principle of Systemic Integration and Article 31(3)(c) of the Vienna Convention*, 54 INT’L & COMP. L.Q. 279, 290 (2005).

20. Philippe Sands, *Searching for Balance: Concluding Remarks*, 11 N.Y.U. ENVTL. L.J. 198, 202 (2002).

21. In the international trade law context, the Appellate body in the *Shrimp-Turtle case* considered various international environmental treaties, including the United Nations Convention on the Law of the Sea, Agenda 21, the Convention on the Conservation of Migratory Species of Wild Animals and the Convention on International Trade in Endangered Species of Wild Fauna and Flora, in determining the meaning of the terms “natural resources” and “exhaustible” as they appear in article XX(g) of the General Agreement on Tariffs and Trade (“GATT”). Appellate Body Report, *United States-Import Prohibition of Certain Shrimp and Shrimp Products*, ¶ 158, WT/DS58/AB/R (Oct. 12, 1998).

22. Steven R. Ratner, *Regulatory Takings in Institutional Context: Beyond the Fear of Fragmented International Law*, 102 AM. J. INT’L L. 475, 527-28 (2008).

international tribunal closely resembles that before an investment treaty tribunal—when both are interpreted in accordance with the ordinary meaning of the terms in their context and in light of the object and purpose of the treaty²³—then the decision of that other institution should be considered carefully.²⁴ Because all international tribunals are required to interpret treaties in accordance with the same rules, *i.e.* Articles 31 and 32 of the Vienna Convention,²⁵ interpretation of similar language by another tribunal can be persuasive. Of course, as Ratner suggests, the purpose and normative legitimacy of the institution will be relevant to consider,²⁶ but that is of secondary importance to an assessment of the similarity of the texts being compared. Indeed, no matter the institutional context, another international tribunal's decision should not be given significant weight if the governing texts are materially different.²⁷

Though parallels are often drawn between the applicable standard in investment treaty claims for regulatory takings and the standard applied in other fora for similar acts, particular attention should be paid to the textual difference between the applicable treaties. For example, when the ECHR decides a regulatory takings case, the text it considers is different from the standard expropriation language in investment treaties. The Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms provides, in relevant part, that “[n]o one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.”²⁸ The Protocol also provides that this right “shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest.”²⁹ This text appears to adopt a balancing test that is not

23. See Vienna Convention, *supra* note 18, art. 31(1).

24. See, e.g., *Methanex v. United States of America*, NAFTA/UNCITRAL, Award ¶ 6 (Aug. 9, 2005), available at <http://ita.law.uvic.ca/> (“When it comes to interpreting the provisions of Section A of Chapter 11 [of NAFTA], in particular in the instant case Article 1102, the Tribunal may derive guidance from the way in which a similar phrase in the GATT has been interpreted in the past. . . . [T]he Tribunal may remain open to persuasion based on legal reasoning developed in GATT and WTO jurisprudence, if relevant.”).

25. See Vienna Convention, *supra* note 18, arts. 31, 32.

26. Ratner, *supra* note 22, at 488. In the international context, the legitimacy of the institution is particularly important given that the constituency of all international decision-making bodies, including investment treaty tribunals, includes the same group of sovereign states.

27. In discussing a recent investment tribunal's dismissal of the same expropriation claim before the Overseas Private Insurance Company (“OPIC”), Ratner seems to acknowledge that the text of the provisions before the two entities was of decisive importance. Ratner, *supra* note 22, at 525 (“[T]he ICSID panel . . . gave the OPIC determination exactly the treatment it deserved. The OPIC claim involved a completely distinct definition of expropriation OPIC's interpretation is clearly outside the consensus view, as it begins with a *sui generis* textual definition and a completely different purpose.”).

28. Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms, art. 1, Mar. 20, 1952, 213 U.N.T.S. 262.

29. *Id.*

expressly found in many investment treaties.³⁰

Similarly, when considering whether environmental and health regulations are exempt from attracting liability under investment treaties, one must be careful when making comparisons to other international texts and tribunals. One obvious comparison is with the general exception, contained in international trade agreements, for measures adopted to protect health and the environment.³¹ Thomas Waelde and Abba Kolo have suggested that the WTO's "least trade restrictive" approach to determining whether a measure is a legitimate means of protecting health or the environment on the one hand or protectionism on the other "provide[s] us with some useful analogies" in the investment treaty context.³² This analogy is questionable, however, as the decisions of WTO panels turn on the specific wording of the exceptions for health and environmental measures. GATT Article XX(b) provides an exception for trade-restrictive measures "necessary to protect human, animal or plant life or health" while GATT Article XX(g) provides an exception for measures "relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption."³³ Investment treaties rarely provide such explicit and detailed exceptions,³⁴ rather, as discussed below, the exemptions have become clearer through a series of cases interpreting and applying investment treaties.

This is not to say that parallels can not (or should not) be drawn between investment treaty arbitration and other international fora where similar disputes arise, but that care must be taken when doing so.³⁵ Indeed, as will be discussed

30. Vicki Been & Joel C. Beauvais, *The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine*, 78 N.Y.U. L. REV. 30, 57 (2003) ("The ECHR and ECJ accordingly have adopted a balancing approach to public regulatory interest and burdens on private property that is premised on the specific language of that provision.").

31. See, e.g., General Agreement on Tariffs and Trade arts. XX(b), XX(g), Apr. 15, 1994, 33 ILM 1153 (1994); Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 33 ILM 1153 (1994).

32. Thomas Waelde & Abba Kolo, *Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law*, 50 INT'L & COMP. L.Q. 811, 833 (2001).

33. General Agreement on Tariffs and Trade arts. XX(b),(g), Oct. 30, 1947, 55 U.N.T.S. 187.

34. Some investment treaties, however, include what are known as non-precluded measure clauses, which are usually limited to exempting measures that are necessary to protect national essential interests, international peace and security, and public order. See William W. Burke White & Andreas von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of non-Precluded Measures Provisions in Bilateral Investment Treaties*, 48 VA. J. INT'L L. 307, 336 (2008) (summarizing the key components of NPM clauses found in investment treaties entered into by the United States, Germany, Belgium, Luxembourg, the European Union and India). Health and Environmental exceptions are rarely ever found in non-precluded measures clauses. On the narrow scope of NPM clauses, see Rahim Moloo & Justin Jacinto, *Reviewing Standards and Standards of Review: Domestic Public Interest Regulation in International Investment Law*, in INTERNATIONAL LAW IN THE NEW ERA OF GLOBALIZATION (forthcoming, 2011).

35. See, e.g., *Fireman's Fund Insurance Co. v. United Mexican States*, Award ¶ 173, ICSID Case No. ARB(AF)/02/02, (July 17, 2006) available at <http://ita.law.uvic.ca/> (noting that "[t]he

below, investment treaty tribunals have borrowed helpful elements of the applicable substantive standards from the jurisprudence of many international tribunals, including the ECHR and WTO.

B. The Treatment of Environmental and Health Issues in Investment Treaties

Before engaging in a substantive discussion of the legality of environmental and health regulation under international investment law, it is important to understand the unique place that public health and the environment occupy in the investment treaty context.

Many recent investment treaties contain specific provisions pertaining to health and the environment. For instance, the parties to NAFTA resolved in the preamble to the treaty to: “UNDERTAKE each of the preceding [investment and trade objectives] in a manner consistent with environmental protection and conservation; PRESERVE their flexibility to safeguard the public welfare; PROMOTE sustainable development; STRENGTHEN the development and enforcement of environmental laws and regulations.”³⁶ The DR-CAFTA provides that the parties resolve to “implement th[e] Agreement in a manner consistent with environmental protection and conservation, promote sustainable development . . . and strengthen their cooperation on environmental matters.”³⁷ The ECT’s preamble makes note of international environmental agreements with energy-related aspects and “recognize[es] the increasingly urgent need for measures to protect the environment.”³⁸ Recent U.S. Bilateral Investment Treaties (“BITs”) establish that the parties desire to achieve the objectives contained in the treaty “in a manner consistent with the protection of health, safety, and the environment.”³⁹

Moving beyond the preamble, some recent investment treaties contain substantive provisions relating to health and the environment. For instance, many recent U.S. BITs provide that “[n]othing 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

parties have . . . debated the relevance of the case law of the Iran-US Claims Tribunal” and that “the Algiers Accords give a notion of expropriation different from Article 1110 of the NAFTA and also partially depart from customary international law (in particular: ‘other measures affecting property rights’). However, the tribunal, “keeping these caveats in mind,” decided that “it is justified to rely on certain awards, or at least portions thereof, in determining the customary international law meaning of expropriation in the present case.”)

36. North American Free Trade Agreement, Can.-Mex.-U.S. pmb., Dec. 17, 1992, 32 I.L.M. 605, 702.

37. Dominican Republic-Central America-United States Free Trade Agreement pmb., Aug. 5, 2004, Hein Online No. KAV 7157 [hereinafter DR-CAFTA].

38. Energy Charter Treaty, *supra* note 16, pmb.

39. 2004 U.S. Model Bilateral Investment Treaty, *supra* note 16, pmb.

environmental concerns.”⁴⁰ NAFTA⁴¹ and the DR-CAFTA⁴² contain similar provisions.⁴³ Such clauses are a form of what has come to be known as non-precluded measures clauses (“NPM clauses”), which carve out certain types of state conduct from liability under the substantive standards of protection.⁴⁴

The types of public interest regulation discussed in this article, and often at issue in investment disputes, are rarely expressly the subject of NPM clauses. Of note however, some German and recent Canadian investment treaties do provide exceptions expressly covering, among other things, health and environmental regulation. For instance, the Canada 2003 Model FIPA contains the following NPM clause:

Subject to the requirement that such measures are not applied in a manner that would constitute arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures necessary: (a) to protect human, animal or plant life or health; (b) to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement; or (c) for the conservation of living or non-living exhaustible natural resources.⁴⁵

The future inclusion of such clauses into investment treaties will clarify the treaty parties’ intention to exclude such measures from liability under the treaty. Until such time as these clauses become common place in investment treaties, however, most tribunals will be faced with investment treaties that lack such

40. 2004 U.S. Model BIT, *supra* note 16, art. 12(2). The breadth of such clauses might be limited by the requirement that measure must be “otherwise consistent with this Treaty.”

41. NAFTA, art. 1114(1). Host states have at times relied on this provision to argue that “health and environmental measure[s] are] permitted by . . . NAFTA.” Ethyl Corp. v. Canada, Statement of Defence, ¶ 97 Nov. 27, 1997, *available at* <http://naftaclaims.com/Disputes/Canada/EthylCorp/EthylCorpStatementOfDefense.pdf>.

42. DR-CAFTA, *supra* note 37, art. 10.11.

43. *See also* 2007 Norway Draft Model BIT, art. 12, which proposes slightly broader language (“Right to Regulate: Nothing in this Agreement shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Agreement that it considers appropriate to ensure that investment activity is undertaken in a manner sensitive to health, safety or environmental concerns.”).

44. *Sempra Energy Int’l v. Argentine Republic*, ICSID Case No. ARB/02/16, Decision on the Argentine Republic’s Application for Annulment of the Award ¶ 115 (June 29, 2010) (“[The NPM Clause] is a primary rule, since it delimits the scope of the substantive obligations of the BIT itself. If the requirements under Article XI are met, there is no breach of the BIT.”); *CMS Gas Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, Decision of the *Ad Hoc* Committee on the Application for Annulment of the Argentine Republic ¶ 129 (Sept. 25, 2007) (finding that “if [the NPM clause] applies, the substantive obligations under the BIT do not apply.”); *Continental Casualty Company v. Argentine Republic*, ICSID Case No. ARB/03/9, Award ¶164 (Sept. 5, 2008) (“The consequence would be that, under [the NPM clause], such measures would lie outside the scope of the Treaty so that the party taking it would not be in breach of the relevant BIT provision.”). *See generally* Burke-White & von Staden, *The Interpretation and Application of Non-Precluded Measures Provisions*, *supra* note 34.

45. Canadian Model BIT, art. 11 (2004), *available at* <http://ita.law.uvic.ca/documents/Canadian2004-FIPA-model-en.pdf>.

clarity. As such, they will ultimately be required to apply the individual treaty standards, as discussed in this paper, to the measure in question.

NAFTA and recent U.S. and Canadian investment treaties also attempt to address the race to the bottom by “recogniz[ing] that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures.”⁴⁶ To this end, the treaties allow one party to request consultations with another that is seen to have “waive[d] or otherwise derogate[d] from, or offer[ed] 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.”⁴⁷

The ECT expressly reserves the right of the host state to “regulate the environmental and safety aspects of [the] exploration, development and reclamation [of its energy resources] within its Area.”⁴⁸ The same treaty also provides that:

In pursuit of sustainable development and taking into account its obligations under those international agreements concerning the environment to which it is party, each Contracting Party shall strive to minimize in an economically efficient manner harmful Environmental Impacts occurring either within or outside its Area from all operations within the Energy Cycle in its Area, taking proper account of safety.⁴⁹

Although this trend of addressing public health and the environment in investment treaties is relatively new, it is a notable development. Indeed, in interpreting the substantive protections contained in an investment treaty, one must consider the object and purpose of the treaty, as well as the context.⁵⁰ As such, where the treaty in question expressly addresses matters relating to health and the environment, it will be important to interpret the substantive protections contained therein within the context of the relevant health and environmental provisions.

II.

REGULATORY TAKINGS RESULTING IN INDIRECT EXPROPRIATION

This section begins with a discussion of the protection against indirect expropriation without compensation, with a particular focus on the concept of non-compensable government regulation. The second part of this section will

46. 2004 U.S. Model BIT, *supra* note 16, art. 12(1); NAFTA, art. 1114(2); DR-CAFTA, *supra* note 37, art. 10.11; 2004 Canada Model FIPA, art. 11, available at <http://ita.law.uvic.ca/documents/Canadian2004-FIPA-model-en.pdf>.

47. *Id.*

48. Energy Charter Treaty, *supra* note 16, art. 18(3).

49. Energy Charter Treaty, *supra* note 16, art. 19(1).

50. Vienna Convention, *supra* note 18, art. 31(1).

discuss relevant cases that have considered whether particular governmental health and environmental regulation amounts to a compensable expropriation. The third part of this section discusses how a tribunal is to assess the legitimacy of a health or environmental measure resulting in a taking, and whether such a measure should attract the requirement to compensate the foreign investor.

A. Content of the Standard

Generally, a host state has the right to expropriate a foreign investor's property for a public purpose on a non-discriminatory basis, and in accordance with due process of law, if compensation is paid to the investor.⁵¹ Expropriation of property can be direct or indirect.⁵² An indirect expropriation, which can occur through government regulation, occurs when "a State . . . interfere[s] with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the State does not purport to have expropriated them and the legal title to the property remains with the original owner."⁵³

Though it is well accepted that both direct and indirect expropriations require the payment of compensation, it is not entirely clear when a regulatory

51. See NAFTA, art. 1110 ¶ 1; Energy Charter Treaty, *supra* note 16, art. 13 ¶ 1; 2004 U.S. Model BIT, *supra* note 16, art. 6 ¶ 1; 2008 German Model BIT, art. 4 ¶ 2, available at <http://ita.law.uvic.ca/documents/2008-GermanModelBIT.doc>; 2003 India Model BIT, art. 5 ¶ 1, available at <http://ita.law.uvic.ca/Indiamodelbit.htm>. Some investment treaties, including most U.S. BITs, follow the "hull formula" and require "prompt, adequate, and effective" compensation.

52. See *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/99/6, Award ¶ 107 (Apr. 12, 2002), available at <http://ita.law.uvic.ca/> ("When measures are taken by a State the effect of which is to deprive the investor of the use and benefit of his investment even though he may retain nominal ownership of the respective rights being the investment, the measures are often referred to as a 'creeping' or 'indirect' expropriation or, as in the BIT, as measures 'the effect of which is tantamount to expropriation.'"); see also RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 92-96 (2008); Yves Fortier & Stephen L. Drymer, *Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor*, 19 ICSID REV., FILJ 293, 297 (2004).

53. *Starrett Housing Corp. v. Islamic Republic of Iran*, Award No. ITL-32-24-1 (Dec. 19, 1983), reprinted in 4 IRAN-US CLAIMS TRIBUNAL REP. 122, 154; see also Tippetts, Abbott, McCarthy, Stratton v. TAMS-AFFA Consulting Engineers of Iran, Award No. 141-7-2 (June 22, 1984), reprinted in 6 IRAN-US CLAIMS TRIBUNAL REP. 219, 225 ("[T]aking of property may occur under international law through interference by a state in the use of that property or with the enjoyment of its benefits, even where legal title to the property is not affected."); *Occidental Petroleum and Production Co. v. Republic of Ecuador*, LCIA Case No. UN 3467, Award ¶ 85 (July 1, 2004), available at <http://ita.law.uvic.ca/> ("Expropriation need not involve the transfer of title to a given property, which was the distinctive feature of traditional expropriation under international law. It may of course affect the economic value of an investment."); Jan Paulsson & Zachary Douglas, *Indirect Expropriations in Investment Treaty Arbitrations*, in *ARBITRATING FOREIGN INVESTMENT DISPUTES: PROCEDURAL AND SUBSTANTIVE LEGAL ASPECTS* 152 (N. Horn & S. Kröll, eds. 2004) ("Indirect expropriations affect property interests in more subtle ways. Legal title to the property is not disturbed. Rather, its income producing potential is somehow diminished by acts attributable to the Host State.").

measure of general application is such that it does not require compensation, even if it results in an indirect taking from a foreign investor protected by an investment treaty.⁵⁴ This section discusses the emerging standard for assessing whether an indirect expropriation has occurred, with a specific emphasis on the point at which a regulatory measure becomes expropriatory.

1. *The Effect of the Measure*

The effect of a regulatory measure is undoubtedly important in assessing whether an indirect expropriation has taken place. Though cases are somewhat inconsistent in the language they use to describe the level of interference required in order to establish an indirect expropriation, some common themes can be identified.⁵⁵

For instance, the United Nations Conference on Trade and Development (“UNCTAD”) has suggested that “measures short of physical takings may amount to takings in that they result in the effective loss of management, use or control, or a significant depreciation of the value, of the assets of a foreign investor.”⁵⁶

One ICSID tribunal found that in order to qualify as an expropriation, the measure in question should “have the substantial effects of a certain intensity that reduce and/or eliminate the benefits legitimately expected from the exploitation of rights subject to the said measure to such an extent that they render the holding of these rights useless.”⁵⁷ Several more recent investment treaty cases have stated that in order to be expropriatory the taking “must be a substantially complete deprivation of the economic use and enjoyment of the rights to the property, or of identifiable distinct parts thereof.”⁵⁸

54. See generally Fortier & Drymer, *supra* note 52; Rudolf Dolzer, *Indirect Expropriations: New Developments?* 11 N.Y.U. ENVTL. L.J. 64 (2002); Andrew Newcombe, *The Boundaries of Regulatory Expropriation in International Law*, 20 ICSID REV., FILJ 1 (2005); Waelde & Kolo, *supra* note 32; Catherine Yannaca-Small, “*Indirect Expropriation*” and the “*Right to Regulate*” in *International Investment Law*, OECD Working Papers on International Investment (Sept. 2004), available at <http://www.oecd.org/dataoecd/22/54/33776546.pdf>.

55. See Fortier & Drymer, *supra* note 52, at 305 (noting the more widely accepted themes that have emerged to describe the tipping point at which a regulatory measure becomes an indirect expropriation).

56. UNCTAD, *Series on Issues in International Investment Agreements: Taking of Property 4* (2000).

57. *Consortium RFCC v. Royaume du Maroc*, ICSID Case No. ARB/00/6, Award (Dec. 22, 2003), available at <http://www.investmentclaims.com> (translation from French original on file with authors).

58. *Corn Products International, Inc. v. the United Mexican States*, ICSID Case No. ARB(AF)/04/01, Decision on Responsibility ¶ 87(c) (Jan. 15, 2008) available at <http://ita.law.uvic.ca/> (citing to *Fireman’s Fund Insurance Co. v. United Mexican States*, Award ¶ 176(c), ICSID Case No. ARB(AF)/02/02, (July 17, 2006) available at <http://ita.law.uvic.ca/>). See also *Telenor Mobile Communications A.S. v. The Republic of Hungary*, ICSID Case No. ARB/04/15, Award ¶ 65 (Sept. 13, 2006), available at <http://ita.law.uvic.ca/> (noting that tribunals

Though the effect of a measure is certainly relevant to assessing whether a measure is expropriatory one school of thought suggests that it is the only relevant criterion to consider and that the character and purpose of the measure in question are not relevant to the assessment (the “sole effect doctrine.”)⁵⁹ One case often cited as supporting the sole effects doctrine is the NAFTA decision in *Metalclad v. Mexico*.⁶⁰ In that case, the tribunal considered, among other things, whether an ecological decree covering lands used by the investor as a landfill site in Mexico amounted to an expropriation. The tribunal found that Mexico had “indirectly expropriated Metalclad’s investment without providing compensation,”⁶¹ because, among other things, “[the] Decree had the effect of barring forever the operation of the landfill.”⁶² The tribunal’s definition of expropriation employed in this case focused solely on the effect of a given regulatory measure, noting that expropriation under NAFTA not only covers “open, deliberate and acknowledged takings of property” but also “covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.”⁶³ Furthermore, the tribunal explained that it “need not decide or consider the motivation or intent of the adoption of the Ecological Decree” in finding that “the Ecological Decree would, in and of itself, constitute an act tantamount to expropriation.”⁶⁴

The tribunal that decided *Santa Elena v. Costa Rica* similarly suggested that only the effect of the measure in question is relevant to assessing whether an expropriation, requiring the payment of compensation, has taken place. In the *Santa Elena* case the parties agreed that a lawful direct expropriation of the claimant’s property had occurred, allegedly to preserve the ecology on the

agree that in order to constitute an expropriation “the interference with the investor’s rights must be such as substantially to deprive the investor of the economic value, use or enjoyment of its investment.”).

59. On occasion, this view was adopted by the Iran-U.S. Claims tribunal. See *Phelps Dodge Corp. v. Iran*, Award No. 217-99-2 (Mar. 19, 1986) reprinted in 10 IRAN-US CLAIMS TRIBUNAL REP. 121, 130 (“[T]he Tribunal understands the financial, economic and social concerns that inspired the law pursuant to which [the Respondent] acted, but those reasons and concerns cannot relieve the Respondent of the obligation to compensate Phelps Dodge for its loss.”); but see *Tippetts supra* note 53, at 225-26 (noting that the purpose of the measure adopted is relevant, but that “[t]he intent of the government is less important than the effects of the measures on the owner . . .”).

60. *Metalclad Corp. v. the United Mexican States, NAFTA, ICSID Case No. ARB(AF)/97/1*, Award (Aug. 30, 2000), available at <http://www.naftaclaims.com/Disputes/Mexico/Metalclad/MetalcladFinalAward.pdf>. The phrase “sole effect doctrine” is borrowed from Dolzer, *supra* note 54; see also Fortier & Drymer, *supra* note 52 referring to the “sole effect test.”

61. *Metalclad v. Mexico*, ¶ 112. The British Columbia Supreme Court set aside part of the tribunal’s award, though not on this point. *United Mexican States v. Metalclad Corp.*, 2001 BCSC 664 ¶ 2, available at <http://www.courts.gov.bc.ca/jdb-txt/SC/01/06/2001BCSC0664.htm>.

62. *Metalclad v. Mexico*, ¶ 109.

63. *Id.* ¶ 103.

64. *Id.* ¶ 111.

property being expropriated.⁶⁵ The only question for the tribunal regarded the amount of compensation the claimant was due.⁶⁶ In this context, the tribunal found that “[w]hile an expropriation or taking for environmental reasons may be classified as a taking for a public purpose, and thus may be legitimate, the fact that the Property was taken for this reason does not affect either the nature or the measure of the compensation to be paid for the taking.”⁶⁷ The tribunal explained that “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” and that “[t]he international source of the [Respondent’s] obligation to protect the environment makes no difference.”⁶⁸ The tribunal reasoned that “the state’s obligation to pay compensation remains” “no matter how laudable and beneficial to society as a whole” are the expropriatory environmental measures.⁶⁹

Similarly Professor Higgins, in her seminal lectures on the taking of property, stated that “interferences which significantly deprive the owner of the use of his property amount to a taking of that property. This will be so even if he remains in physical possession of that property.”⁷⁰ In relation to the measure’s character, Professor Higgins considered whether it makes a difference that a taking is direct or the result of a regulation. Professor Higgins asked: “Is this distinction intellectually viable? Is not the State in both cases (that is, either by a taking for a public purpose, or by regulating) purporting to act in the common good? And in each case has the owner of the property not suffered loss?”⁷¹ In answering her own question, Professor Higgins stated: “Under international law standards, a regulation that amounted (by virtue of its scope and effect) to a taking, would need to be ‘for a public purpose’ (in the sense of in the general, rather than for a private, interest). And just compensation would be due.”⁷² Professor Higgins did, however, acknowledge that “interferences with property for economic and financial regulatory purposes are tolerated to a significant

65. *Compañía del Desarrollo de Santa Elena SA v Costa Rica*, ICSID Case No. ARB/96/1, Final Award ¶ 55, ¶ 18 (Feb. 17 2000), available at <http://www.investmentclaims.com>.

66. *Id.* ¶ 54 (holding that “the fundamental issue before the Tribunal is the amount of compensation to be paid by Respondent, Costa Rica, to Claimant, CDSE. While a host of sub-issues were raised by the parties in the context of the written and oral procedures, both parties agree that such matters are relevant only insofar as they tend to affect this central issue.”)

67. *Id.* ¶ 71.

68. *Id.* ¶ 71.

69. *Id.* ¶ 72. It should be noted that subsequent to that decision, the President of the *Santa Elena* tribunal wrote an article acknowledging “the advent of the so-called ‘purpose test’” and advocating a balancing approach. Fortier & Drymer, *supra* note 52, at 326. The *Santa Elena* tribunal’s dismissal of the purpose criteria can be distinguished because that case involved a direct taking, where compensation will almost always be due.

70. Rosalyn Higgins, *The Taking of Property by the State: Recent Developments in International Law*, 176 RECUEIL DES COURS 259, 324 (1982).

71. *Id.* at 331.

72. *Id.*

degree.”⁷³

2. *The Measure’s Character and Purpose*

More recently, cases and commentators have departed from the sole effects doctrine in suggesting that the character and purpose of a given taking is relevant to assessing whether compensation is due, and that *bona fide* regulations of general application will rarely, if ever, amount to an expropriation. For instance, a leading commentary on takings concludes that normally there will be no compensable expropriation where a regulation “can be justified as being reasonably necessary to the performance by a State of its recognized obligations to protect the public health, safety, morals or welfare.”⁷⁴

Similarly, Professor Brownlie has commented that jurists supporting the compensation requirement in the event of an expropriation recognize the existence of exceptions including where the expropriation was a result of “a legitimate exercise of police power” and where the loss was “caused indirectly by health and planning legislation and the concomitant restrictions on the use of property.”⁷⁵ Professor Brownlie’s exceptions to the compensation requirement suggest that certain *bona fide* regulatory acts are of such importance to the common good that payment of compensation to investors adversely affected by such regulations would be inappropriate.

In the same regard, the Third Restatement on Foreign Relations Law of the United States indicates that “bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states” does not result in a compensable taking, subject to the conditions that the state action is “not discriminatory . . . and is not designed to cause the alien to abandon the property to the state or sell it at a distress price.”⁷⁶ Similarly, the Harvard Draft Convention on the International

73. *Id.*

74. G.C. Christie, *What Constitutes a Taking of Property Under International Law?*, 38 BRIT. Y.B. INT’L L. 307, 338 (1962); *See also id.* at 331-32 (“[T]he operation of a State’s tax laws, changes in the value of a State’s currency, actions in the interest of the public health and morality, will all serve to justify actions which because of their severity would not otherwise be justifiable . . .”).

75. IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 536 (7th ed. 2008); *see also* OECD Working Papers on International Investment, *supra* note 54, at 5, n. 10 (“It is an accepted principle of customary international law that where economic injury results from a bona fide non-discriminatory regulation within the police powers of the State, compensation is not required.”); *id.* at 5 (“Non-discriminatory measures related to anti-trust, consumer protection, securities, environmental protection, and land planning are non-compensable takings since they are regarded as essential to the functioning of the state.”); August Reinisch, *Expropriation*, 2 TRANSNAT’L DISP. MGMT. 27 (Nov. 2005), available at http://www.transnational-dispute-management.com/authors/author_detail.asp?key=933 (“In principle there is a widespread consensus that regulatory measures pursued for legitimate objectives cannot be regarded as indirect expropriation.”).

76. RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 712, cmt. (g) (1987). It is instructive to consider the definition of “police powers” as adopted in BLACK’S

Responsibility of States for Injuries to Aliens recognized that “[a]n uncompensated taking of an alien property or a deprivation of the use or enjoyment of property of an alien . . . shall not be considered wrongful” where it results from “the action of the competent authorities of the State in the maintenance of public order, health or morality; or from the valid exercise of belligerent rights or otherwise incidental to the normal operation of the laws of the State.”⁷⁷

Several cases have adopted the same reasoning, that certain *bona fide* regulation that is non-discriminatory and within the state’s police powers does not require compensation, no matter what the effect. The Iran-U.S. Claims tribunal, for instance, has stated that it is “an accepted principle of international law that a State is not liable for economic injury which is a consequence of a bona fide ‘regulation’ within the accepted police power of states.”⁷⁸ In supporting this position the tribunal in *Feldman v. Mexico* stated that “governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions, and the like.”⁷⁹ The tribunal explained that “[r]easonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this.”⁸⁰ Indeed, governmental regulation in important areas such as health and environment would be undesirably hindered if governments were constantly worried about having to pay compensation to any foreign investor adversely affected.⁸¹

Though the above cases and commentators do not necessarily suggest that the measure’s purpose be the sole criteria in assessing whether a measure be considered expropriatory, they certainly indicate that when the measure in question is a *bona fide* regulation of general application, within the legitimate exercise of the state’s police powers, a tribunal will be less likely to award compensation.

LAW DICTIONARY (5th ed. 1979): “the power of the State to place restraints on the 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.” This definition is a subset of the possible “public purposes” that a State may invoke in order to legally expropriate property.

77. Reprinted in Louis B. Sohn & Richard R. Baxter, *Responsibility of States for Injuries to the Economic Interests of Aliens*, 55 AM. J. INT’L L. 545 (1961).

78. *Sedco, Inc. v. National Iranian Oil Company*, Interlocutory Award No. ITL 55-129-3 (Oct. 28, 1985), reprinted in 9 IRAN-US CLAIMS TRIBUNAL REP. 248, 273-74.

79. *Marvin Feldman v. Mexico*, NAFTA, ICSID Case No. ARB(AF)/99/1, Award ¶103 (Dec. 16, 2002), available at <http://www.naftaclaims.com>.

80. *Id.*

81. Michael Reisman & Robert D. Sloane, *Indirect Expropriation and Its Valuation in the BIT Generation*, 74 BRIT. Y.B. INT’L L. 115, 129 (2003).

3. Meeting In-Between—The Relevance of a Measure's Effect and its Character and Purpose

From the above discussion, a logical conclusion would be that both the measure's effect and character should be taken into consideration in assessing whether compensation should be due for an indirect expropriation, including a regulatory taking. In fact, many cases have followed this approach.

One such case is *Saluka v. Czech Republic*, in which the investor in a Czech bank, IPB, alleged that it had been treated unfairly and inequitably and that it had been unlawfully deprived of its investment without compensation.⁸² The investor's claims were based on the Czech National Bank's ("CNB") decision to put IPB into forced administration, and then to transfer IPB's enterprise to another Czech Bank.⁸³ The Czech Republic on the other hand, argued that it was entitled to adopt the regulatory measure it did to fulfill its duty to maintain the stability of the banking system—the instability having been caused by the IPB's shareholders' failure to rectify several deficiencies identified by the CNB.⁸⁴

In deciding whether a compensable deprivation had occurred, the tribunal made several important observations regarding a state's ability to adopt regulations. Most notably the tribunal stated that "[i]t is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner *bona fide* regulations that are aimed at the general welfare."⁸⁵ As such, in the opinion of the tribunal, "the principle that a State does not commit an expropriation and is thus not liable to pay compensation to a dispossessed alien investor when it adopts general regulations that are 'commonly accepted as within the police power of States' forms part of customary international law today."⁸⁶ The tribunal acknowledged however, that "international law has yet to identify in a comprehensive and definitive fashion precisely what regulations are considered 'permissible' and 'commonly accepted' as falling within the police or regulatory power of States and, thus, noncompensable."⁸⁷ As such, the tribunal advocated what amounts to a

82. *Saluka Investments BV (The Netherlands) v. the Czech Republic*, UNCITRAL, Partial Award ¶165 (Mar. 17, 2006), available at <http://ita.law.uvic.ca>.

83. *Id.* ¶¶ 246-49.

84. *Id.* ¶ 270 (reproducing the text of the Decision of the Czech National Bank to put IPB under forced administration).

85. *Id.* ¶ 255. Interestingly, one of the tribunal members in this case was also on the tribunal in *Santa Elena v. Costa Rica*, where, as discussed above, the tribunal appears to have taken a contrary position.

86. *Id.* ¶ 262. The tribunal rightly took into consideration customary international law in interpreting the BIT in question based on the principle articulated in art. 31(3)(c) of the Vienna Convention requiring a consideration of "any relevant rules of international law applicable in the relations between the parties." *Id.* ¶ 254.

87. *Id.* ¶ 263.

balancing approach, finding that:

Faced with the question of *when, how and at what point an otherwise valid regulation becomes, in fact and effect, an unlawful expropriation*, international tribunals must consider the circumstances in which the question arises. The context within which an impugned measure is adopted and applied is critical to the determination of its validity.⁸⁸

The tribunal in *Saluka* decided that “the CNB was justified, under Czech law, in imposing the forced administration of IPB and appointing an administrator to exercise the forced administration.”⁸⁹ In deciding that no compensation was due to the investor, the tribunal concluded that the CNB’s decision was “a lawful and permissible regulatory action . . . aimed at the general welfare of the State, and does not fall within the ambit of any of the exceptions to the permissibility of regulatory action which are recognised by customary international law.”⁹⁰ As such, the tribunal concluded that “the Czech Republic adopted a measure which was valid and permissible as within its regulatory powers, notwithstanding that the measure had the effect of eviscerating Saluka’s investment in IPB.”⁹¹

Few, if any, cases provide a blanket exception for the obligation to compensate investors for regulatory actions that a state adopts. The tribunal in *Pope & Talbot v. Canada* had the opportunity to address an argument suggesting that a blanket exception existed.⁹² In that case the investor alleged that Canada’s implementation of the US-Canada Softwood Lumber Agreement wrongfully interfered with its business of exporting softwood lumber to the U.S. Canada argued that nondiscriminatory regulations did not constitute an expropriation under NAFTA.⁹³ In response to this argument, the tribunal found that “[r]egulations can indeed be exercised in a way that would constitute creeping expropriation.”⁹⁴ The tribunal explained that “a blanket exception for regulatory measures would create a gaping loophole in international protections against expropriation” and as such the tribunal rejected the argument that Canada’s Export Control Regime, “as a regulatory measure, is beyond the

88. *Id.* ¶ 264 (emphasis in original). In support of this proposition, the tribunal refers to, among other cases, *Too v. Greater Modesto Insurance Assocs., et al.*, Award No. 460-880-2 (Dec. 29, 1989) reprinted in 23 IRAN-US CLAIMS TRIBUNAL REP. 378, 387 (1989) (the tribunal affirming that “[a] State is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation or any other action that is commonly accepted as within the police power of States, provided it is not discriminatory and is not designed to cause the alien to abandon the property to the State or to sell it at a distress price.”).

89. *Id.* ¶ 271.

90. *Id.* ¶ 275.

91. *Id.* ¶ 276.

92. *Pope & Talbot Inc. v. the Government of Canada*, NAFTA/UNCITRAL, Interim Award (June 26, 2000), available at <http://www.naftaclaims.com>.

93. *Id.* ¶ 99.

94. *Id.*

coverage of Article 1110.”⁹⁵ Indeed, the protection against expropriation without compensation would become altogether meaningless if states were able to escape the compensation obligation by disguising all expropriations as regulations. On the facts of that case, however, the tribunal ultimately found that “the degree of interference with the Investment’s operation due to the Export Control Regime [did] not rise to an expropriation.”⁹⁶

The tribunal in *Azurix v. Argentina* affirmed the principle discussed in *Pope & Talbot*.⁹⁷ In *Azurix*, the tribunal criticized the *S.D. Myers* tribunal for suggesting that “Parties to the Bilateral Treaty are not liable for economic injury that is the consequence of *bona fide* regulation within the accepted police powers of the State.”⁹⁸ Though the *Azurix* tribunal found that the purpose of the measure in question was relevant, it found that it could not provide a blanket exception. The tribunal explained:

The argument made by *S.D. Myers* tribunal is somehow contradictory. According to it, the BIT would require that investments not be expropriated except for a public purpose and that there be compensation if such expropriation takes place and, at the same time, regulatory measures that may be tantamount to expropriation would not give rise to a claim for compensation if taken for a public purpose.⁹⁹

As such, the tribunal found that “[t]he public purpose criterion as an additional criterion to the effect of the measures under consideration needs to be complemented.”¹⁰⁰

Along the lines of these cases, several recent U.S. and Canadian investment treaties have expressly called for a balancing of the effect and the character of the measure, with a specific reference to the “reasonable investment-backed expectations” of the investor.¹⁰¹ These investment treaties provide for the following:

The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:

95. *Id.*

96. *Id.* ¶ 102.

97. *Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12, Award (July 14, 2006).

98. *Id.* ¶ 310. Although the *S.D. Myers* tribunal found that “[r]egulatory conduct by public authorities is unlikely to be the subject of legitimate complaint under Article 1110 of the NAFTA,” it “[d]id not rule out that possibility.” *S.D. Myers, Inc. v. Government of Canada*, NAFTA/UNCITRAL, Partial Award ¶ 281 (Nov. 13, 2000), available at <http://www.naftaclaims.com>.

99. *Azurix v. Argentina*, ¶ 311.

100. *Id.*

101. See KENNETH J. VANDEVELDE, U.S. INTERNATIONAL INVESTMENT AGREEMENTS 482 (2009) (“A number of tribunals have sought to formulate a standard identifying the extent of interference necessary to constitute an expropriation. Paragraph 4 [of the 2004 U.S. Model BIT, Annex B] avoids all such quantitative standards that seem to set a single criterion for evaluating whether host state action constitutes an expropriation.”).

- (i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
- (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
- (iii) the character of the government action.¹⁰²

Of course, the specific text of the applicable investment treaty is important to identifying the appropriate factors to consider in assessing whether a given regulatory measure amounts to an expropriation. However, even where BITs do not expressly contain the language found in recent U.S. and Canadian investment treaties noted above, tribunals such as that in *Continental Casualty* recognize that the factors articulated in these recent BITs are a manifestation of what is an emerging consensus in international law.¹⁰³ Most recently, the tribunal in *Glamis Gold v. the United States* noted the parties' apparent agreement that "tribunals . . . often assess whether measures of a State constitute a non-compensable regulation or a compensable expropriation by examining, *inter alia*, (1) the extent to which the measures interfered with reasonable and investment-backed expectations of a stable regulatory framework, and (2) the purpose and character of the governmental actions taken."¹⁰⁴

Several notable scholars have confirmed the criteria found in these recent investment treaties as being relevant to consider in assessing whether an indirect expropriation has taken place. For example, Yves Fortier and Stephen Drymer have noted that "the determination of when State conduct crosses the line between non-compensable regulation and compensable indirect expropriation tends to involve a balancing of several considerations."¹⁰⁵ In this regard, Fortier

102. See, e.g., DR-CAFTA, *supra* note 37, Annex 10-C, 4(a), at http://www.ustr.gov/sites/default/files/uploads/agreements/cafta/asset_upload_file328_4718.pdf; U.S.-Uruguay BIT, Annex B, 4(a), available at http://www.unctad.org/sections/dite/iiia/docs/bits/US_Uruguay.pdf; U.S.-Rwanda BIT, Nov. 1, 2006, Annex B, 4(a) available at http://www.sice.oas.org/Investment/BITSbyCountry/BITS/US_Rwanda.pdf; see generally 2004 U.S. Model BIT, Annex B, 4(a); 2004 Canada Model FIPA, Annex B.13(1)(b). Of interest, though political risk insurance for foreign investors will cover expropriation including "'creeping' expropriation, due to unlawful government acts (or a series of acts) that deprive the investor of its fundamental rights in a project" such coverage will often expressly "exclude losses due to lawful regulation or taxation by host governments . . ." OPIC, *Expropriation*, at <http://www.opic.gov/insurance/coverage-types/expropriation>.

103. *Continental Casualty Company v. Argentine Republic*, ICSID Case No. ARB/03/9, Award ¶ 276 (Sept. 5, 2008), available at <http://ita.law.uvic.ca/>.

104. *Glamis Gold, Ltd. v. the United States of America*, NAFTA/UNCITRAL, Award ¶ 356 (June 8, 2009), available at <http://ita.law.uvic.ca/>.

105. Fortier and Drymer, *supra* note 52, at 326. See also Ranter, *supra* note 22 at 527 ("Tecmed probably made an important step in incorporating the European Human Rights Court's test of proportionality, making explicit what has often stood in the background of regulatory takings decisions that reject the sole effect doctrine and consider the purpose and context of the government's actions."); Newcombe, *supra* note 54 at 55 ("The express introduction of factors, presumptions and proportionality into international expropriation law is a positive development. The concepts provide benchmarks for legal analysis and may allow for more explicit policy analysis into

and Drymer concluded that “Tribunals appear increasingly disinclined to adhere to extreme versions of the ‘sole effect’ or ‘purpose’ doctrines, and are wont in any case to consider both the character and the practical impact of governmental measures.”¹⁰⁶

In a recent comparative study on regulatory takings in various fora, Ratner has confirmed that recent decisions favor a consideration of the effect and the purpose of the measure in assessing whether it is expropriatory. He notes that, in determining whether an indirect expropriation has taken place, decision makers have generally considered, among other factors, “the context of the governmental measure, including its purpose and the proportionality between the harm to the investor and the benefit to the public.”¹⁰⁷ According to Ratner, instead of relying only on the effects of the measure, “the better view from a review of decisions is that this . . . factor is relevant.”¹⁰⁸

With regards to the relevance of the reasonable expectations of the investor, Paulsson and Douglas have noted that “one possible basis for distinguishing between compensable and uncompensable takings in a regulatory context [is] the frustration of the investor’s legitimate expectations built on a reasonable reliance upon representations and undertakings by the Host State.”¹⁰⁹ The same commentators note that compensation may also be due “[w]here the value of the investment has been *totally* destroyed by *bona fide* regulation in the public interest” as “it may be the case that international law does not allow the Host State to place such a high individual burden on an investor for the pursuit of a regulatory objective for the benefit of the community at large without the payment of compensation.”¹¹⁰

From the above analysis, the trend is clear: both the purpose and the effect of a government regulation are relevant to assessing whether a compensable expropriation has occurred. This analysis places a particular emphasis on the reasonable or legitimate expectations of the investor.

regulatory expropriation decisions.”); Simon Baughen, *Expropriation and Environmental Regulation: The Lessons of NAFTA Chapter Eleven*, 18 J. ENV’T L. 207 (2006).

106. Fortier and Drymer, *supra* note 52, at 326.

107. Ratner, *supra* note 22, at 482-83.

108. *Id.*

109. Paulsson & Douglas, *supra* note 53, at 158.

110. *Id.*; see also *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award ¶ 121 (May 29, 2003), available at <http://ita.law.uvic.ca/> (“We find no principle stating that regulatory administrative actions are *per se* excluded from the scope of the Agreement, even if they are beneficial to society as a whole—such as environmental protection—particularly if the negative economic impact of such actions on the financial position of the investor is sufficient to neutralize in full the value, or economic or commercial use of its investment without receiving any compensation whatsoever.”).

4. *Weighing the Character and Purpose of the Measure Against its Effect*

The weighing of the character of a measure, including its purpose, against its effects can be a difficult task, and inevitably will require a fact-specific analysis. Many tribunals look to the decision of the tribunal in *TECMED v. Mexico* for guidance in this regard.¹¹¹ *TECMED* is particularly instructive to understanding when government regulation resulting in a taking will be excluded from the compensation requirement.

In *TECMED v. Mexico*, the tribunal acknowledged that non-discriminatory regulations enacted for a legitimate public purpose may still result in a compensable expropriation.¹¹² The tribunal explained however that “it [is] appropriate to examine . . . whether the [measure], due to its characteristics and considering not only its effects, is an expropriatory decision.”¹¹³ The tribunal went on to explain that, in light of the public interest being protected, the proportionality of the measure must be considered:¹¹⁴

[T]he 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. . . . There must be a reasonable relationship between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure.¹¹⁵

In adopting this approach, the tribunal relied on the ECHR’s jurisprudence.¹¹⁶ Specifically, it quoted from *James et al. v. United Kingdom*, in which the ECHR tribunal found as follows:

Not only must a measure depriving a person of his property pursue, on the facts as well as in principle, a legitimate aim ‘in the public interest,’ but there must also be a *reasonable relationship of proportionality between the means employed and the aim sought to be realised* The requisite balance will not be found if the person concerned has had to bear ‘an individual and excessive burden’ The Court considers that a measure must be both appropriate for achieving its aim and not disproportionate thereto.¹¹⁷

Subsequent investment treaty tribunals have adopted similar approaches.

111. See e.g. *Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12, Award ¶¶ 311-12, 316-17 (July 14, 2006).

112. *TECMED v. Mexico*, ¶ 121.

113. *Id.* ¶ 118.

114. See Fortier and Drymer, *supra* note 52, at 326-27.

115. *TECMED v. Mexico*, ¶ 122 (emphasis added).

116. *Id.* ¶ 122.

117. Case of *James and Others v. United Kingdom*, App. No. 8793/79, 8 Eur. H.R. Rep. 123, ¶ 50 (1986). For a helpful discussion on the ECHR in the regulatory expropriation context, see Helen Mountfield, *Regulatory Expropriations in Europe: The Approach of the European Court of Human Rights*, 11 N.Y.U. ENVTL. L.J. 136 (2002); Hélène Ruiz Fabri, *The Approach Taken by the European Court of Human Rights to the Assessment of Compensation for “Regulatory Expropriations” of the Property of Foreign Investors*, 11 N.Y.U. ENVTL. L.J. 148 (2002).

For example, in *Firemen's Fund v. Mexico*, the tribunal found that “[t]o distinguish between a compensable expropriation and a non-compensable regulation by a host State” the tribunal must take into account the following factors: “whether the measure is within the recognized police powers of the host State; 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.”¹¹⁸

Similarly, the tribunal in *LG&E Energy v. Argentina* stated that “[i]n order to establish whether State measures constitute expropriation . . . the Tribunal must balance two competing interests: the degree of the measure’s interference with the right of ownership and the power of the State to adopt its policies.”¹¹⁹ With respect to the measure’s degree of interference with the investor’s right of ownership, the tribunal explained that “one must analyze the measure’s economic impact—its interference with the investor’s reasonable expectations—and the measure’s duration.”¹²⁰ As in all cases, the tribunal also noted that, in order to be considered expropriatory, the economic impact of the measure must be “substantial”¹²¹ and the taking must be permanent.¹²² The tribunal then considered the power of the State to adopt its policies. In this regard, the tribunal found that “it can generally be said that the State has the right to adopt measures having a social or general welfare purpose.”¹²³ The Tribunal explained however, that such measures “must be accepted without any imposition of liability, *except in cases where the State’s action is obviously disproportionate to the need being addressed.*”¹²⁴

The emerging consensus on the balancing and proportionality test first articulated by the *TECMED* tribunal has recently been confirmed by the *Continental Casualty v. Argentina* tribunal. That tribunal explained the distinction between compensable expropriation on the one hand, and legitimate government regulation on the other, stating:

[T]here are limitations to the use of property in the public interest that fall within typical government regulations of property entailing mostly inevitable limitations

118. *Fireman’s Fund Ins. Co. v. United Mexican States*, ICSID Case No. ARB(AF)/02/02, Award ¶ 176(j) (July 17, 2006) *available at* <http://ita.law.uvic.ca/>; *see also* *Corn Products International, Inc. v. the United Mexican States*, ICSID Case No. ARB(AF)/04/01, Decision on Responsibility ¶ 87(j) (Jan. 15, 2008), *available at* <http://ita.law.uvic.ca/> (*citing to Fireman’s Fund*).

119. *LG&E Energy Corp. and Others v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability ¶ 189 (Oct. 3, 2006), *available at* <http://ita.law.uvic.ca/>.

120. *Id.* ¶ 190.

121. *Id.* ¶ 191.

122. *Id.* ¶ 193. The tribunal noted, however, that the requirement that the taking must be permanent would not apply where “the investment’s successful development depends on the realization of certain activities at specific moments that may not endure variations.”

123. *Id.* ¶ 195, (*citing to Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award ¶ 121 (May 29, 2003), *available at* <http://ita.law.uvic.ca/>) (emphasis added).

124. *Id.*

imposed in order to ensure the rights of others or of the general public (being ultimately beneficial also to the property affected). These restrictions do not impede the basic, typical use of a given asset and do not impose an unreasonable burden on the owner as compared with other similarly situated property owners. These restrictions are not therefore considered a form of expropriation and do not require indemnification, *provided however that they do not affect property in an intolerable, discriminatory or disproportionate manner.*¹²⁵

This line of cases, all following *TECMED*, make clear that even if there is a legitimate social or general welfare purpose to a government regulation of general application, its proportionality must be assessed before a decision not to award compensation for a taking is made.

5. *The Standard Summarized*

In assessing whether a regulatory taking will amount to an expropriation, the character, purpose, and effect of the measure will be relevant. In this regard, a tribunal will likely consider (1) the degree of interference with the investment; (2) the investor's legitimate expectations in relation to the use and enjoyment of its investment; and (3) the character of the state's regulatory measure, including its purpose.

In this regard, the greater the interference with the investment, the more likely the tribunal will find that a given regulatory act is expropriatory. It should be noted that most *bona fide* regulatory actions of general application will not result in the degree of interference necessary to constitute an expropriation. It is more likely that specifically targeted acts of a state, tailored to one particular investor, will constitute the degree of interference necessary for an expropriation. On the other hand, if the government is found to be legitimately adopting certain regulations within its police powers, including for health and environmental reasons, its actions will be less likely to be found expropriatory. This proportionality analysis must be done with the legitimate expectation of the investor in mind. Indeed, any investor should expect the host state to adopt legitimate and proportionate regulatory measures in the general public's interest.¹²⁶ On the other hand, if specific commitments have been made to an

125. *Continental Casualty Company v. Argentine Republic*, ICSID Case No. ARB/03/9, Award ¶ 276 (Sept. 5, 2008), available at <http://ita.law.uvic.ca/> (emphasis added). See also *Glamis Gold, Ltd. v. the United States of America*, NAFTA/UNCITRAL, Award ¶ 356 (June 8, 2009), available at <http://ita.law.uvic.ca/> (the tribunal noting the parties apparent agreement that "tribunals . . . often assess whether measures of a State constitute a non-compensable regulation or a compensable expropriation by examining, *inter alia*, (1) the extent to which the measures interfered with reasonable and investment-backed expectations of a stable regulatory framework, and (2) the purpose and character of the governmental actions taken.").

126. *Parkerings-Compagniet AS v. Republic of Lithuania*, ICSID Case No. ARB/05/8, ¶¶ 334-36 (Sept. 11, 2007), available at <http://ita.law.uvic.ca/> (noting, in the context of assessing a breach of the fair and equitable treatment standard: "The legitimate expectations of the Claimant that the legal regime would remain unchanged are not based on or reinforced by a particular behaviour of the Respondent. . . . By deciding to invest notwithstanding th[e] possible instability [of the legal

investor, tribunals will expect that those commitments will be kept.¹²⁷

B. Regulatory Takings in Environmental and Health Regulation Cases

The specific case of takings resulting from health and environmental regulation must be considered in light of the standard articulated above. What are the specific considerations that will determine whether a taking in this context does not require compensation? Though a measure adopted for health or environmental reasons can be exempt from attracting compensation even if it results in a taking, one must consider how the health or environmental purpose's legitimacy behind such a measure can be tested.

Indeed, a tribunal will want to ensure that the host state's regulatory action is not a disguise to protect its domestic investors, or economic interests. As such, simply stating that a given regulation is adopted for an environmental or a health reason is insufficient. The tribunal must be convinced that there was in fact a legitimate environmental or health basis motivating the governmental action.

To avoid the compensation requirement for a taking, the host state will normally have to present evidence that it was motivated by genuine concerns in order to favor a finding that a given regulation was legitimate. In regards to environmental and health regulations, the evidence supporting the measure's purpose will most likely be scientific—whether based on a specific study, or a general consensus that a given environmental or health issue is indeed cause for concern. In this regard, it is helpful to consider certain case studies to appreciate the importance that such evidence will play in the outcome of an investment treaty dispute.

1. *Methanex v. United States*

In *Methanex v. United States*, the claimant claimed that California's regulatory action to ban the fuel additive MTBE amounted to an expropriation of its business, which marketed and distributed methanol, an ingredient used to

environment], the Claimant took the *business risk* to be faced with changes of laws possibly or even likely to be detrimental to its investment.”); Waelde & Kolo, *supra* note 32, at 824-25 (“The question is . . . to identify the threshold of unexpected regulatory change and of its impact on the investor's legitimate expectation which require that the investor be paid compensation. It is not . . . a question of prohibiting regulatory change, often a legitimate way of evolving the regulatory regime in tune with new knowledge, new standards and the demands of public opinion.”); Baughen, *supra* note 105, at 223 (“Is the investor [] entitled to assume that regulatory regime in force at the time the investment is made will remain unaltered throughout the lifetime of the investment? The answer to this question may well require an analysis of the motivation behind a particular regulation.”).

127. *Parkerings v. Lithuania*, ¶ 336 (noting, in the context of assessing a breach of the fair and equitable treatment standard, that in order to protect its investment, “[t]he Claimant could (and with hindsight should) have sought to protect its legitimate expectations by introducing into the investment agreement a stabilisation clause or some other provision protecting it against unexpected and unwelcome changes.”); see also Paulsson & Douglas, *supra* note 53, at 158.

manufacture MTBE.¹²⁸ California's ban was said to be adopted for environmental and health reasons, specifically, because MTBE leaking from underground storage tanks for gasoline posed a threat to groundwater and drinking water.¹²⁹ In assessing whether the ban was expropriatory, the tribunal noted as follows:

[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.¹³⁰

Following this reasoning, the tribunal found that the regulatory ban was not expropriatory.¹³¹ The tribunal explained that Methanex did not have any legitimate expectation that such a regulation would not be introduced. Rather,

Methanex entered a political economy in which it was widely known . . . that governmental environmental and health protection institutions . . . continuously monitored the use and impact of chemical compounds and commonly prohibited or restricted the use of some of those compounds for environmental and/or health reasons.¹³²

Turning to the regulation's purpose, the tribunal concluded that the health and environmental reasons given as the basis for the measure were legitimate. The tribunal found that the health reasons prompting the ban were supported by a "scientific study" that was "objectively confirmed."¹³³ In fact, the tribunal devoted 52 pages of its Award to a discussion of the scientific evidence that California relied on in adopting its regulation.¹³⁴ Importantly, the tribunal found that the University of California ("UC") Report commissioned and relied on by the state "reflect[ed] a serious, objective and scientific approach to a complex problem in California."¹³⁵ The tribunal found that:

Whilst it is possible for other scientists and researchers to disagree in good faith with certain of its methodologies, analyses and conclusions, the fact of such disagreement, even if correct, does not warrant this Tribunal in treating the UC Report as part of a political sham by California. In particular, the UC Report was subjected at the time to public hearings, testimony and peer-review; and its emergence as a serious scientific work from such an open and informed debate is

128. *Methanex v. United States of America*, NAFTA/UNCITRAL (Aug. 9, 2005), available at <http://ita.law.uvic.ca/>.

129. *Id.* Pt. II, Ch. D ¶¶ 14-16, 19.

130. *Id.* Pt. IV, Ch. D ¶ 7.

131. *Id.* Pt. IV, Ch. D ¶ 15.

132. *Id.* Pt. IV, Ch. D ¶ 9; *See also id.* at Pt. IV, Ch. D ¶ 10 (noting that *Methanex* "did not enter the United States market because of special representations made to it").

133. *Id.* Pt. IV, Ch. D ¶ 14.

134. *Id.* Pt. III, Ch. A.

135. *Id.* Pt. III, Ch. A ¶ 101.

the best evidence that it was not the product of a political sham.¹³⁶

Ultimately, the tribunal was not persuaded that the UC Report was “scientifically incorrect.”¹³⁷

Thus, the tribunal’s determination that the ban was not expropriatory was based on its conclusion that the regulation was one of general application, in the public interest, scientifically justified, and accomplished with due process. As such, the tribunal concluded that “the California ban was a lawful regulation and not an expropriation.”¹³⁸

2. *TECMED v. Mexico*

In contrast, in the *TECMED* case, which involved the government closure of the claimant’s landfill operations by refusing to renew its operating permit, the tribunal held that an expropriation had taken place. In looking at the government measure’s effects, which were specifically targeted at the claimant, the tribunal determined that when the host state “put an end to such operations and activities at the Las Víboras site, the economic or commercial value directly or indirectly associated with those operations and activities and with the assets earmarked for such operations and activities was irremediably destroyed.”¹³⁹

In considering whether the purpose of the measure exempted Mexico from compensating the investor, the tribunal did not find Mexico’s assertion that health and environmental concerns motivated its actions sufficient. The tribunal decided that the evidence reflected that the claimant’s “operation of the Landfill never compromised the ecological balance, the protection of the environment or the health of the people, and all the infringements committed were either remediable or remediated or subject to minor penalties.”¹⁴⁰

The tribunal explained that “the authorization to operate as a landfill, dated May 1994, and the subsequent permits granted by [the Hazardous Materials, Waste and Activities Division of the National Ecology Institute of Mexico (“INE”)], including the Permit, were based on the Environmental Impact Declaration of 1994, which projected a useful life of ten years for the Landfill.”¹⁴¹ Given this assessment by a government agency, it found that “the

136. *Id.*; see also *id.* Pt. III, Ch. A ¶ 102 (finding that the subsequent policy response was “contingent on the scientific findings of the UC Report” and thus also not a “sham”).

137. *Id.* Pt. III, Ch. A ¶ 101.

138. *Id.* Pt. IV, Ch. D ¶ 15.

139. *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award ¶ 117 (May 29, 2003), available at <http://ita.law.uvic.ca/>. It is of note that in *Methanex*, the measure at issue was a general regulation aimed at all investors equally, whereas in *TECMED*, the measure at issue was the refusal to renew a permit—an act targeted specifically at the claimant.

140. *Id.* ¶ 148. The tribunal found that there was no evidence that the operation of the Landfill was a real or potential threat to the environment or to public health. *Id.* ¶ 144.

141. *Id.* ¶ 150.

investor expected its investments in the Landfill to last for a long term and that it took this into account to estimate the time and business required to recover such investment and obtain the expected return upon making its tender offer for the acquisition of the assets related to the Landfill.”¹⁴²

Similarly, the Federal Environmental Protections Attorney’s Office (“PROFEPA”) confirmed in correspondence to the claimant’s investment vehicle, Cytrar, that “[t]he inspections conducted by this Office to the landfill referred to several times, have not shown [sic in the Spanish original] any indication that risks for the population’s health or the environment might exist.”¹⁴³ The tribunal noted that the municipality of Hermosillo and the federal government of the United Mexican States within the Ministry of the Environment, Natural Resources, and Fisheries (“SEMARNAP”) both “insisted that Cytrar’s Landfill operation complie[d] with the Mexican legal provisions on environmental protection and public health preservation or me[t] the requirements necessary not to impair the environment or public health.”¹⁴⁴ All of the scientific assessments, including those undertaken by the appropriate government authorities, clearly suggested that the government itself did not believe that the investment in question posed any serious environment or public health risks. Instead, the tribunal found the evidence showed that “it [wa]s irrefutable that there were factors other than compliance or non-compliance by Cytrar with the Permit’s conditions or the Mexican environmental protection laws and that such factors had a decisive effect in the decision to deny the Permit’s renewal. These factors included ‘political circumstances.’”¹⁴⁵ The circumstances the tribunal referred to also “include[d] mounting community pressure to relocate the landfill,” as confirmed through letters to the investor and oral testimony at the hearing.¹⁴⁶

The tribunal finally found that with the political circumstances as the basis for the measure, the government’s action was not proportional to its actual purpose of addressing community pressure against the landfill.¹⁴⁷ Even though there were minor violations of the permit’s terms, the tribunal stated that:

[I]t would be excessively formalistic . . . to understand that the Resolution is proportional to such violations when such infringements do not pose a present or imminent risk to the ecological balance or to people’s health, and the Resolution, without providing for the payment of compensation as required by Article 5 of the Agreement, leads to the neutralization of the investment’s economic and business value and the Claimant’s return on investment and profitability expectations upon making the investment.¹⁴⁸

142. *Id.* ¶ 150.

143. *Id.* ¶ 124 (*quoting* note from PROFEPA to Cytrar (11 Feb. 1998)).

144. *Id.* ¶ 124.

145. *Id.* ¶ 127.

146. *Id.* ¶¶ 126-27.

147. *Id.* ¶ 128.

148. *Id.* ¶ 149.

Thus the actions of the Mexican government were expropriatory and required compensation.¹⁴⁹

So despite their differences, in both *TECMED* and *Methanex*, the evidence relied on by the host state in adopting its measure was pivotal in determining whether the measure constituted a legitimate exercise of the state's regulatory power for which no compensation was due.¹⁵⁰

3. *Ethyl Corp. v. Canada*

In the case of *Ethyl Corp. v. Canada*, the availability of scientific evidence to support the measure Canada had adopted was a key factor in Canada's decision to settle the case. The claimant, a manufacturer of the gasoline additive MMT, sued Canada alleging that the government indirectly expropriated its assets by adopting an import ban on MMT for health and environmental reasons.¹⁵¹ Canada ultimately settled the case, agreeing to pay Ethyl \$19.3 million and repeal the ban on MMT.¹⁵²

Upon settling the case, Canada expressly stated that there was no evidence that low amounts of MMT were harmful to human health.¹⁵³ This was consistent with the position Canada had taken in its Statement of Defense, that "[t]he public health and environmental impacts of long-term, lower dose exposure to airborne respirable manganese and unburned MMT are unknown."¹⁵⁴ Here the government also noted that "[i]n 1994 the Department of National Health and Welfare had reviewed the available literature and assessed the direct health risk associated with exposure to airborne respirable manganese" and concluded that "*current levels* of airborne respirable manganese to which the population in large urban centers are exposed are below the benchmark air level at which no adverse health risks *are expected*."¹⁵⁵

Some commentators have argued that Canada could have invoked the

149. *Id.* ¶¶ 151, 187-97.

150. See Newcombe, *supra* note 54, at 28 ("the requirement for: (i) a scientific-based risk assessment; (ii) a rational connection between an identified risk and the measure taken; and (iii) an assessment of the regulatory options available to a state to address the risk, are important factors in determining the legitimacy of the police powers measures and whether non-compensation can be justified given the risk in question.").

151. Given that there was no apparent direct toxic effect attributable to MMT, Canada felt that "the Canadian Environmental Protection Act was not an appropriate mechanism for addressing the regulation of MMT and other manganese-based fuel additives." *Ethyl Corp. v. Canada*, Statement of Defence, ¶ 97 Nov. 27, 1997, available at <http://naftaclaims.com/Disputes/Canada/EthylCorp/EthylCorpStatementOfDefense.pdf>.

152. Shawn McCarthy, *Failed Ban Becomes Selling Point for MMT*, THE GLOBE AND MAIL (July 21, 1998) at A3.

153. *Id.*

154. *Ethyl Corp. v. Canada*, ¶ 30.

155. *Id.* ¶ 60 (emphasis in original). This study was the only explicit mention of any scientific evidence available to the government in adopting the ban.

precautionary principle in justifying its ban.¹⁵⁶ This, however, would have been a difficult argument to make in light of the fact that Canada had not adopted a complete ban on MMT, but merely an importation ban.¹⁵⁷ As the same commentators note, this approach would suggest that a “hidden protectionist agenda” was behind the measure ultimately adopted.¹⁵⁸ In any event, although Canada did not explicitly reference the precautionary principle, it did base its argument on a precautionary approach.

While Canada acknowledged that the effects of low quantities of MMT were unknown, it argued that the measure was not expropriatory “because it involve[d] the exercise of regulatory powers or ‘police’ power” and that “the Act was enacted for the maintenance of health, for the conservation of clean air and for the protection of the environment.”¹⁵⁹ This argument suggests that Canada attempted to justify its regulation of MMT based on its potential harm to health and the environment. But Canada did not believe it had a good case¹⁶⁰ and so decided to settle.

Based on the applicable legal framework and specific facts of the case, Canada made a sensible decision. A precautionary measure resulting in a substantial deprivation of an investor’s investment will more likely trigger the requirement of compensation than a measure based on science evidencing a legitimate concern. A state should be entitled to adopt precautionary regulations to protect against potential health or environmental threats, but where there is no evidence supporting a health or environmental measure, the state—and not the investor—should bear the costs of adopting that measure. While investors can reasonably expect regulation based on scientific evidence showing legitimate health or environmental concerns, they cannot be said to reasonably expect regulations lacking a scientific basis and supported only by political pressures.¹⁶¹

Of course, one must still consider the specific text of the treaty giving rise to the investor’s substantive rights to ensure that the state has not reserved the right to regulate on a precautionary basis. For instance, it could be said that the ECT endorses the precautionary principle. It provides: “In its policies and actions each Contracting Party shall strive to take precautionary measures to prevent or minimize environmental degradation.”¹⁶²

156. Waelde & Kolo, *supra* note 32, at 834.

157. *Id.*

158. *Id.*

159. *Ethyl Corp. v. Canada*, ¶ 95. Notably, Canada references the vehicle industry’s focus on “the potential” harm to health. *Id.*

160. Shawn McCarthy, *Failed Ban Becomes Selling Point for MMT*, *The Globe and Mail* (Toronto), July 21, 1998, at A3.

161. As in the *Ethyl* case, the adoption of precautionary measures will most often be driven by political pressure.

162. Energy Charter Treaty, *supra* note 16, art. 19(1).

4. *S.D. Myers v. Canada*

In *S.D. Myers v. Canada*, an American investor complained of Canada's temporary ban on the export of poly-chlorinated biphenol (PCB) waste.¹⁶³ Canada cited health and environmental reasons for its adoption of this policy,¹⁶⁴ though after a consideration of the facts, the tribunal found that "there was no legitimate environmental reason for introducing the ban"¹⁶⁵ as "the documentary record as a whole clearly indicates that the Interim Order and the Final Order were intended primarily to protect the Canadian PCB disposal industry from U.S. competition."¹⁶⁶ The tribunal found that the measure in question breached the national treatment and fair and equitable treatment requirements in NAFTA,¹⁶⁷ but not the expropriation provision.¹⁶⁸ Ultimately, the tribunal decided the ban was not expropriatory because, among other things, the measure was temporary.¹⁶⁹

Nonetheless, the tribunal's analysis in relation to the expropriation provision is notable. In its discussion the tribunal observed that in order to assess whether the investors rights had been expropriated "international law makes it appropriate for tribunals to examine the purpose and effect of governmental measures."¹⁷⁰ In light of this conclusion, the tribunal noted that "[t]he general body of precedent usually does not treat regulatory action as amounting to expropriation,"¹⁷¹ explaining that "[t]he distinction between expropriation and regulation . . . reduces the risk that governments will be subject to claims as they go about their business of managing public affairs."¹⁷² The tribunal made clear, however, that although "[r]egulatory conduct by public authorities is unlikely to be the subject of legitimate complaint under Article 1110 of the NAFTA, [] the Tribunal does not rule out that possibility."¹⁷³

Also worth noting is the fact that rather than invoking an independent study to support its measure, Canada attempted to rely on an international consensus on PCBs' environmental effects. Indeed, a scientific study does not have to be specifically commissioned for the purpose of adopting a regulatory measure,

163. *S.D. Myers, Inc. v. Government of Canada*, NAFTA/UNCITRAL, Partial Award (Nov. 13, 2000), available at <http://www.naftaclaims.com>.

164. *Id.* ¶ 152 ("CANADA says that the measure was made because CANADA believed PCBs are a significant danger to health and the environment when exported without appropriate assurances of safe transportation and destruction.").

165. *Id.* ¶ 195.

166. *Id.* ¶ 194.

167. See *infra* part III.B.

168. *S.D. Myers v. Canada*, ¶¶ 279-88.

169. *Id.* ¶¶ 287-88.

170. *Id.* ¶ 281.

171. *Id.*

172. *Id.* ¶ 282.

173. *Id.* ¶ 281.

like in *Methanex*. Such an approach would put developing countries in a particularly onerous position when wanting to regulate to protect public health or the environment, and in any case would be a waste of resources where duplicate, reliable research has already been done. Like in other investment treaty cases, and particularly in WTO cases,¹⁷⁴ other international conventions may form the basis for concluding that a particular measure is warranted to protect public health or the environment.

The *S.D. Myers* case, however, shows that the host state must be careful in relying on international conventions when alleging that they require certain action when they necessarily do not. In that case, Canada relied on the Convention on the Control of Transboundary Movements of Hazardous Waste and Their Disposal (“Basel Convention”), to which it was a party, to justify its measure barring the transboundary movement of PCBs to the United States. The tribunal considered the Basel Convention relevant to its analysis, but found that Article 11 of the Basel Convention “expressly allows parties to enter into bilateral or multilateral agreements for the cross-border movement of waste, provided that these agreements do not undermine the Basel Convention’s own insistence on environmentally sound management.”¹⁷⁵

In coming to the conclusion that the Basel Convention did not require Canada to ban the transboundary movement of PCBs, it seems that the *S.D. Myers* tribunal was simply interested in determining whether there was a legitimate scientific basis in preventing the transboundary movement of PCBs on the facts of the case. Given that PCBs’ movement across the U.S. border for disposal (*i.e.* from Ontario to Ohio) would mean that the PCBs would have to travel less distance than if it were to be disposed of in Canada (*i.e.* from Ontario to Alberta), it seemed likely, as the tribunal found,¹⁷⁶ that the regulation was invoked as a means to protect the domestic PCB disposal industry. In coming to this conclusion, the tribunal noted that Canada and the United States themselves recognized that Article 11 of the Basel Convention “clearly permitted” the transboundary movement of PCBs “with its emphasis on including cross-border movements as a means to be considered in achieving the most cost-effective and environmentally sound solution to hazardous waste management.”¹⁷⁷

As such, relying on international consensus on a health or environmental matter in adopting a measure does not necessarily legitimize the basis for that measure. A tribunal will still investigate the scope of the international consensus and whether the measure itself reasonably follows from its purported purpose.

174. See, e.g., *United States-Import Prohibition of Certain Shrimp and Shrimp Products*, *supra* note 21 (the WTO Appellate Body relying on several international conventions, such as the Convention on International Trade on Endangered Species, in finding that the protection of sea turtles was a legitimate objective).

175. *S.D. Myers v. Canada*, ¶ 213.

176. *Id.* ¶¶ 194-95.

177. *Id.* ¶ 213.

C. *Applying the Indirect Expropriation Standard to Claims Relating to Environmental and Health Regulations*

1. *Lessons from the Jurisprudence*

From the above discussion, it seems that the legitimacy of any environmental or health-related measure adopted by a host state will be assessed based on the scientific evidence relied on by the host state in deciding to adopt the measure. In this regard, the tribunal will not act as a “science court” but will be tasked with assessing whether the science relied on was “objective” and not a “political sham.” If a tribunal finds that the scientific basis for the measure passes this test, then it will be less likely to award compensation for the effects that measure has on an investment.¹⁷⁸

On the other hand, if specific commitments were made to the foreign investor regarding its investment, it will be more difficult for a host state to escape the obligation to compensate the investor in the event of a regulatory taking,¹⁷⁹ even if for environmental or health reasons based on legitimate scientific evidence. In such an instance, it would be reasonable for society as a whole to bear the cost associated with the adoption of a measure for the public good where it otherwise undermines the legitimate expectations of a foreign investor. Although a foreign investor should expect a host state to adopt regulations of general application that protect public health and the environment, an investor would not expect such measures to undermine specific promises made to it by the state.

That said, a tribunal will still have to engage in a careful consideration of the particular facts of the case in coming to a decision. For example, if significant time has elapsed since the specific commitments were made to the foreign investor, and new, relevant, scientific discoveries have been made in the interim, a host state may escape the compensation obligation if that new science demonstrates harms unknown at the time the commitments were entered into.¹⁸⁰

178. This approach is consistent with the “polluter pays” principle, which appears to be expressly adopted in the Energy Charter Treaty: “The Contracting Parties agree that the polluter in the Areas of Contracting Parties, should, in principle, bear the cost of pollution, including transboundary pollution with due regard to the public interest and without distorting Investment in the Energy Cycle or international trade.” Energy Charter Treaty, *supra* note 16, art. 19(1). *See also* Waelde & Kolo, *supra* note 32, at 846 (“It is unlikely that courts or arbitrators will find a compensable expropriation in cases where governments issue environmental regulation for legitimate purposes, in accordance with the state of scientific knowledge and accepted international guidelines.”).

179. As discussed herein, the economic deprivation would have to be substantial, and for a significant duration (if not permanent), in order to be considered a taking in the first place.

180. International law recognizes that, in certain instances, an unforeseen, fundamental change in circumstances may exempt a state from fulfilling its obligations. *See Case Concerning the Gabčíkovo-Nagymaros Project (Hungary v. Slovakia)*, Judgment (Sept. 25, 1997) ICJ REP. 1997 at 7, ¶ 104.

2. *Assessing When Compensation is Due for Legitimate Environmental and Health Related Regulations*

Once it has been determined that a host state's public health or environmental regulatory measure, of general application, has a legitimate scientific basis, the next inquiry is whether the measure is proportionate to its aim. Such an investigation begs the question: to what extent should an arbitral tribunal defer to the state's decision to regulate a health or environmental risk in a particular manner? In answering this, it is important to acknowledge one important aspect of international investment law—the remedy for a breach of an obligation contained in an investment treaty is not that the state has to withdraw its regulation, but that the investor must be compensated for the breach.¹⁸¹ As such, the question is better framed in terms of when it is that a state should bear the cost associated with a regulation versus the investor.¹⁸²

It is acknowledged that awarding compensation for the effects of *bona fide* environmental and health regulations of general application may have a chilling effect on governments adopting such regulations.¹⁸³ As such, it is questionable whether society should ever have to pay for regulatory measures that come about as new information becomes known about its health and environment. Certainly, a reasonable member of that society would not expect to have to pay for such regulation and would expect the investor causing the harm to health or the environment to pay.¹⁸⁴ On the other hand, a foreign investor often makes

181. See Higgins, *supra* note 70, at 338-39 (“[G]overnments may indeed need to be able to act *qua* government and in the public interest. That fact will prevent specific performance (including restitution) from being granted against them. But that is not to liberate them from the obligation to compensate those with whom it has entered into specific arrangements. That is the reasonable place to strike the balance between the expectations of foreign investors and the *bona fide* needs of governments to act in the public interest.”).

182. See Francisco Orrego Vicuña, *Carlos Calvo, Honorary NAFTA Citizen*, 11 N.Y.U. ENVTL. L.J. 19, 23 (2002) (“[T]he issue can be further refined as the determination of who is to pay for the economic cost of attending to the public interest involved in the measure in question. Is it to be society as a whole, represented by the state, or the owner of the affected property?”).

183. *Feldman v. Mexico*, NAFTA, ICSID Case No. ARB(AF)/99/1, Award ¶103 (Dec. 16, 2002), available at <http://www.naftaclaims.com> (“[G]overnments must be free to act in the broader public interest through protection of the environment Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this.”); see also Waelde & Kolo, *supra* note 32, at 839; Kate Miles, *International Investment Law and Climate Change: Issues in the Transition to a Low Carbon World*, Society of International Economic Law Conference (Geneva, 2 July 2008) at 22-24.

184. The polluter pays principle finds some authority in international law. See, e.g., United Nations Conference on Environment and Development, Rio de Janeiro, Braz., June 3-14, 1992, *Rio Declaration on Environment and Development*, U.N. Doc. A/CONF.151/26/Rev.1 (Vol. I), Annex I (Aug. 12, 1992), Principle 16 (“The polluter should, in principle, bear the cost of pollution, with due regard to the public interest and without distorting international trade and investment.”); But see PHILIPPE SANDS, *PRINCIPLES OF INTERNATIONAL ENVIRONMENTAL LAW* 280 (2d ed. 2003) (“It is doubtful whether [the polluter pays principle] has achieved the status of a generally applicable rule of customary international law, except perhaps in relation to states in the EC, the UNECE and the

valuable contributions to society worthy of protection, including capital investments, creating employment opportunities and transferring technology,¹⁸⁵ and as such, should not have to bear all the risk associated with new knowledge coming available.

In this regard, where the investor can be said to legitimately expect no change in the regulatory framework through specific commitments made to it by the host state, then a taking amounting to a significant interference with the rights of the investor should be compensated.¹⁸⁶ On the other hand, where no specific commitment has been obtained, even if the tribunal takes the position that compensation may be required for a *bona fide* but unduly disproportionate measure, the investor will face a significant challenge in satisfying that threshold, particularly as some tribunals grant the state a “margin of appreciation” when assessing the proportionality of the measure.¹⁸⁷

That said, even if a margin of appreciation is applied, the investor should have the opportunity to demonstrate that the measure adopted amounts to a taking and is highly disproportionate to the aim that the host state seeks to achieve.¹⁸⁸ The tribunal, for its part, is expected to undertake a fact-specific proportionality analysis which carefully balances the interests involved.¹⁸⁹

OECD.”).

185. Rahim Moloo & Alex Khachaturian, *Foreign Investment in a Post-Conflict Environment*, 10 J. WORLD INV. & TRADE 340 (2009).

186. Paulsson & Douglas, *supra* note 53, at 158; Waelde & Kolo, *supra* note 32, at 844.

187. Tecnicas Medioambientales Tecmed S.A. v. United Mexican States, ICSID Case No. ARB(AF)/00/2, Award ¶ 122 (May 29, 2003), *available at* <http://ita.law.uvic.ca/> (noting that the proportionality analysis “starts at the due deference owing to the State when defining the issues that affect its public policy or the interests of society as a whole, as well as the actions that will be implemented to protect such values”); *Saluka Investments BV (The Netherlands) v. the Czech Republic*, UNCITRAL, Partial Award ¶¶ 272-75 (Mar. 17, 2006), *available at* <http://ita.law.uvic.ca> (deciding that in the host State’s exercise of its legitimate regulatory authority, “[i]t enjoyed a margin of discretion” in the exercise of its responsibility as banking regulator); *see also* Thomas Franck, *On Proportionality of Countermeasures in International Law*, 102 AM. J. INT’L L. 715, 761 (2008) (in the ECHR context, noting that “the margin of appreciation, once conceded as a matter of law, seems to shift the burden of proof away from the constraining authority to the complaining party, and does so regardless of the facts of the case.”).

188. *Saluka v. Czech Republic*, ¶ 273 (requiring the investor to demonstrate through “clear and compelling evidence” that the host State, exercising its legitimate regulatory authority, “erred or acted otherwise improperly in reaching its decision.”).

189. Franck, *supra* note 187, at 761 (In the ECHR context, noting that “[t]he principle of proportionality . . . is case and fact specific. In many instances, it requires the tribunal to weigh the actual evidence of situational necessity.”); RESTATEMENT (THIRD), *supra* note 76, Reporter’s Note 5 (“Whether an action by the state constitutes a taking and requires compensation under international law, or is a police power regulation or tax that does not give rise to an obligation to compensate even though a foreign national suffers loss as a consequence [must be determined in light of all the circumstances].”); Marvin Feldman v. Mexico, NAFTA, ICSID Case No. ARB(AF)/99/1, Award ¶102 (Dec. 16, 2002), *available at* <http://www.naftaclaims.com> (“Ultimately, decisions as to when regulatory action becomes compensable under article 1110 and similar provisions in other agreements appear to be made based on the facts of specific cases.”); Fortier and Drymer, *supra* note 52, at 327.

In the ECHR context, from which these balancing and proportionality principles have been borrowed, Thomas Franck has commented that:

The jurisprudence leaves unclear . . . whether the [margin of appreciation] doctrine is invoked to allow the Court to relinquish its role in the rendering of second opinions . . . or whether the Court, in determining the proportionality of a state's regulatory response to special circumstances, is putting its finger on the scale to give governments some evidentiary advantage.¹⁹⁰

Franck concludes that “the true intent seems to be to deploy proportionality as a check on the margin's impact.”¹⁹¹ Accordingly, extension of a margin of appreciation can be seen as shifting the burden onto the investor to demonstrate how a measure adopted for a legitimate health or environmental aim is disproportionate.¹⁹²

In this regard, the authors disagree with the view the *S.D. Myers* tribunal endorsed with respect to the degree of discretion to be accorded to the host state in adopting its regulations. The *S.D. Myers* tribunal thought it logical that “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.”¹⁹³ In adopting this “least restrictive measure” approach the tribunal felt it appropriate to make the analogy to WTO jurisprudence noting that its conclusion was “consistent with the language and the case law arising out of the WTO family of agreements.”¹⁹⁴

Although the tribunal's observation regarding the test adopted by the WTO is correct, it does not follow that such a test should be adopted in the investment treaty context. Indeed, as noted above, it is the specific language contained in provisions such as Article XX(b) of the GATT—providing an exception for measures “*necessary* to protect human, animal or plant life or health”—that has brought about a “least restrictive measure” analysis.¹⁹⁵ In interpreting investment treaties, including NAFTA, which was the applicable treaty in *S.D. Myers*, such a strict requirement cannot be read into the text.

190. Franck, *supra* note 187, at 761.

191. *Id.* at 761.

192. While that approach is consistent with Franck's assessment of the operation of the margin in the ECHR context, it does raise the question of whether the concept is well-suited for investment law disputes, as tribunals will largely defer to the state's finding of facts and setting of policy priorities even in the absence of any such margin.

193. *S.D. Myers, Inc. v. Government of Canada*, NAFTA/UNCITRAL, Partial Award ¶ 221 (Nov. 13, 2000), available at <http://www.naftaclaims.com>. The claimant in *Methanex* appears to have adopted a similar argument in advancing its case, suggesting that adopting a more costly, more restrictive measure, demonstrates a discriminatory intent. See *Methanex v. United States of America*, NAFTA/UNCITRAL, Claimant's Second Amended Statement of Claim ¶¶ 109-10 (Nov. 5, 2002), available at <http://www.naftaclaims.com>; *Methanex v. United States of America*, NAFTA/UNCITRAL, Award Pt. II, Ch. D ¶ 24 (Aug. 9, 2005), available at <http://ita.law.uvic.ca/>.

194. *S.D. Myers v. Canada*, *supra* note 98, ¶ 221.

195. See generally, Donald H. Regan, *The Meaning of 'Necessary' in GATT Article XX and GATS Article XIV: The Myth of Cost-Benefit Balancing*, 6 WORLD TRADE REV. 347 (2007).

The appropriate approach in the investment treaty context will likely be to assess whether the measure adopted is proportionate to a legitimate environmental or health aim. In this regard, however, given that it will be for the host state to assess the level of risk it is willing to tolerate, it is hard to conceive of a situation in which a tribunal would award compensation for a taking resulting from a non-discriminatory, legitimate environmental or health regulation.¹⁹⁶ Several investment treaties make this point expressly, noting: “*Except in rare circumstances*, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.”¹⁹⁷

Where investment treaties expressly recognize this fact, it may be even less likely that a tribunal will find that a legitimate health or environmental regulation is expropriatory. As noted above, investment treaty protections should be interpreted with due regard to any general provisions contained in treaties pertaining to public health or the environment.¹⁹⁸ The Vienna Convention on the Law of Treaties requires primarily that “[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.”¹⁹⁹ For treaty interpretation purposes, context includes “the text [of the treaty], including its preamble and annexes.”²⁰⁰ As such, when weighing the various factors in the assessment of whether a given government regulation constitutes an expropriation, legitimate environmental and health regulations should be considered as having a particularly important purpose that will often outweigh any adverse impact on investors.

III.

FAIR AND EQUITABLE TREATMENT

The duty to offer foreign investors fair and equitable treatment (“FET”) is a

196. Waelde & Kolo, *supra* note 32, at 846 (“[I]t is unlikely that courts or arbitrators will find a compensable expropriation in cases where governments issue environmental regulation for legitimate purposes, in accordance with the state of scientific knowledge and accepted international guidelines.”).

197. See, e.g., 2004 U.S. Model Bilateral Investment Treaty, *supra* note 16, Annex B, 4(b) (emphasis added); DR-CAFTA, *supra* note 37, Annex 10-C, 4(b). See also VANDELDE, *supra* note 101, at 482-83; Daniel M. Price, *NAFTA Chapter 11-Private Party vs. Government, Investor-State Dispute Settlement: Frankenstein or Safety Valve?*, 26 CAN.-U.S. L.J. 107 (2000) (“The negotiators considered whether or not they ought to try to draw a bright line in the text that would distinguish between legitimate, *bona fide* and nondiscriminatory regulation, on the one hand, and an expropriatory act requiring compensation, on the other hand. We quickly gave up that enterprise.”).

198. See *supra* part I.A.

199. Vienna Convention, *supra* note 18, art. 31(1).

200. *Id.*, art. 31(2).

core investment treaty standard and a norm of customary international law.²⁰¹ The FET standard provides a certain minimum standard of treatment to foreign investors and their investments, and is the broadest of the three core standards. Claimants often have, and likely will continue to, rely on this in cases relating to environmental and health measures. The following discussion provides background on the FET standard's content, reviews the approach taken in leading cases involving environmental and health measures, and examines the possibility of developing an analytical framework for applying the standard in such cases.

A. Content of the Standard

The scope of the FET standard is notoriously resistant to elaboration in the abstract (*i.e.*, outside of the specific circumstances of a dispute).²⁰² That vagueness is a result of multiple factors, a review of which provides important context for understanding the standard's potential applicability to claims relating to environmental and health measures.

First, the standard's key terms are intrinsically imprecise and contextual. Although some tribunals begin their analysis with a review of the ordinary meaning of "fair" and "equitable," that exercise typically results in little more than an iteration of synonyms,²⁰³ which may clarify the terms' potential meaning but does not narrow the standard's overall breadth.

Second, there are significant differences in how FET clauses are formulated.²⁰⁴ For example, some treaties refer to treatment "in accordance with principles of international law,"²⁰⁵ which can affect whether the language is treated as autonomous treaty language or as an established customary international law concept.²⁰⁶ Additionally, the clause sometimes expressly prohibits certain types of state behavior, such as "arbitrary," "discriminatory," or "unreasonable" conduct.²⁰⁷ Such variations, which must be given meaning in

201. For general guidance on the FET standard see IOANA TUDOR, *THE FAIR AND EQUITABLE TREATMENT STANDARD IN THE INTERNATIONAL LAW OF FOREIGN INVESTMENT* (2008); ANDREW NEWCOMBE & LLUIS PARADELL, *LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT* 232-319 (2009); DOLZER & SCHREUER *supra* note 52, at 119-49; Todd Grierson-Weillier & Ian A. Laird, *Standards of Treatment*, in *THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW* 272-90 (Muchlinski, et al. eds. 2008).

202. See, e.g., *Mondev Int'l Ltd. v. United States of America*, NAFTA, ICSID Case No. ARB(AF)/99/2, Award ¶ 118 (Oct. 11, 2002), 42 ILM 85 (2003); 6 ICSID REP. 192 (2004) ("[a] judgment of what is fair and equitable cannot be reached in the abstract; it must depend on the facts of the particular case").

203. *MTD v. Chile*, *supra* note 17, ¶ 113 ("[i]n their ordinary meaning, the terms 'fair' and 'equitable' . . . mean 'just', 'even-handed', 'unbiased', 'legitimate'").

204. See DOLZER & SCHREUER *supra* note 52, at 121-22.

205. See TUDOR *supra* note 201, at 25.

206. See *id.* at 25-27.

207. See *id.* at 27-28.

interpreting the clause in accordance with the Vienna Convention, can be crucial when the standard is applied to the specific facts of a dispute.

Third, the FET standard has its origins in the international minimum standard of treatment (“MST”), a norm of customary international law concerning the treatment of aliens generally. Investment tribunals, mindful of the standard’s history, have traditionally looked to international law decisions addressing the MST for guidance. Particularly notable is the *Neer* case, which is often cited for the point that the standard requires claimants to establish a high threshold of wrongfulness.²⁰⁸ In light of the proliferation of international investment agreements and arbitral decisions interpreting those agreements over the last two decades, some tribunals and scholars now treat the FET standard as a customary norm which has evolved independently from, and is no longer constrained by, the MST.²⁰⁹ Such a shift, separate from its substantive merits, will be a source of additional inconsistency and uncertainty until a consensus emerges.

Despite those complications it is possible to identify certain aspects of the standard that have been consistently recognized by tribunals. Indeed, in applying the standard, tribunals often look directly to established “components” rather than attempting a complete interpretation.²¹⁰ Aspects that are particularly pertinent to claims relating to environmental and health measures are discussed below.

1. *Legitimate Expectations*

As the *Biwater Gauff* tribunal explained, “the purpose of the [FET] standard is to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment, as long as these expectations are reasonable and legitimate and have been relied upon by the investor to make the investment.”²¹¹ Although

208. *Neer v. Mexico*, 4 R. INT’L ARB. AWARDS (Oct. 15, 1926) at 4 (“[T]he treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.”).

209. See, e.g., TUDOR *supra* note 201, at 65-68 (arguing that the FET standard should be treated as an independent treaty standard, not part of the MST); DOLZER & SCHREUER *supra* note 52, at 124-28 (discussing the different views on this issue expressed by tribunals and commentators).

210. See, e.g., *Biwater Gauff Ltd v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award ¶ 602 (July 24, 2008), available at <http://ita.law.uvic.ca/> (explaining that the standard “comprises a number of different components, which have been elaborated and developed in previous arbitrations in response to specific fact situations”); *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v. Pakistan*, ICSID Case No. ARB/03/29, Award ¶ 178 (Aug. 27, 2009), available at <http://ita.law.uvic.ca/> (“The Tribunal agrees with Bayindir when it identifies the different factors which emerge from decisions of investment tribunals as forming part of the FET standard.”).

211. *Biwater Gauff Ltd v. Tanzania*, ¶ 602; see also *Saluka Investments BV (The Netherlands) v. the Czech Republic*, UNCITRAL, Partial Award ¶302 (Mar. 17, 2006), available at <http://ita.law.uvic.ca/>; TUDOR *supra* note 201 at 165 (“protection of the Investors’ [legitimate]

the principle of legitimate expectations can be seen as a substantive component of the standard, in practice it typically informs the analysis of the other components.²¹²

2. *Stability and Predictability of the Legal Framework*

Closely related to legitimate expectations is the issue of an investor's reliance on the stability and predictability of the host state's legal framework. According to the *Occidental* tribunal, "[t]he stability of the legal and business framework is . . . an essential element of fair and equitable treatment."²¹³ Not surprisingly, in cases in which the claimant complains of a state's enactment or implementation of environmental or health regulations, the investor's reliance on a stable and predictable legal framework is often at issue.

3. *Arbitrary or Discriminatory Conduct*

As the *Bayindir* tribunal noted, "the obligation . . . to refrain from taking arbitrary or discriminatory measures" is one of the "factors which emerge from decisions of investment tribunals as forming part of the FET standard."²¹⁴ Arbitrariness in the investment law context can be understood as conduct "not being founded on law but on other reasons which are not objective and fair,"²¹⁵ and thus is potentially of substantial significance to investors arguing that a regulation does not have a legitimate justification. The precise type of discrimination covered by the FET standard is subject to debate. Tribunals have traditionally acknowledged that nationality based discrimination can rise to the level of a breach of the standard, but some have argued that the FET standard only covers certain other types of discrimination (e.g., racial discrimination).²¹⁶

4. *Transparency and Procedural Fairness*

Several tribunals have affirmed that the FET standard includes a

expectations is an integral part, if not the most important element of the FET obligation"); *but see* MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Chile, ICSID Case No. ARB/01/7, Decision on the Application for Annulment ¶ 67 (Mar. 21, 2007), available at <http://ita.law.uvic.ca/> (arguing that a state's obligations derive from the terms of the treaty, not from an investor's expectations, and that tribunals should not "generate from such expectations a set of rights different from those contained in or enforceable under the BIT.").

212. TUDOR *supra* note 201, at 165-69.

213. Occidental Exploration and Production Company v. Ecuador, LCIA, UN3467, Final Award ¶ 183 (July 1, 2004), available at <http://ita.law.uvic.ca/>.

214. *Bayindir v. Pakistan*, ¶ 178.

215. TUDOR *supra* note 201, at 179; compare THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE (4th ed. 2000) (defining "arbitrary" more colloquially as "[d]etermined by chance, whim, or impulse, and not by necessity, reason, or principle.").

216. See *infra* part III.B. (regarding the *Methanex* tribunal's holding on the scope of NAFTA's FET provision).

transparency obligation. For example, the *Metalclad* tribunal explained that “all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party.”²¹⁷ The transparency obligation can be linked to the broader principle of procedural fairness, which differs from the related concept of denial of justice, as it is not limited to judicial procedures and covers serious procedural flaws in administrative and regulatory proceedings.²¹⁸

5. *Unreasonableness*

As noted above, some treaties specify that unreasonable conduct is prohibited. Under its ordinary meaning, unreasonableness appears to provide a basis for tribunals to evaluate the substantive merits of a state measure, including whether the measure was scientifically justified, proportional, or rational. However, defined more exactly as “manifestly without reasons,” the principle appears to require a mere *prima facie* showing that the state had a reason for its conduct.²¹⁹

6. *Other Aspects of the Standard*

The above list is not exhaustive. Other components—such as coercion and harassment, denial of justice, and failure to provide protection and security—are well established, but are less pertinent to claims relating to environmental and health measures.

Tribunals must also assess the overall threshold at which conduct becomes so wrongful as to violate the standard. Tribunals that treat the standard as equivalent to the MST as articulated in *Neer* are likely to set the threshold higher than those that interpret it as an independent norm or autonomous treaty language.²²⁰ However, as other MST cases articulate the threshold less stringently,²²¹ a range of interpretations is possible even if the FET standard is considered part of the MST.²²² As evidenced by the cases discussed below, the

217. *Metalclad Corp. v. the United Mexican States, NAFTA, ICSID Case No. ARB(AF)/97/1, Award ¶ 76 (Aug. 30, 2000), available at <http://www.naftaclaims.com/Disputes/Mexico/Metalclad/MetalcladFinalAward.pdf>.*

218. DOLZER & SCHREUER *supra* note 52, at 142-44; *see also id.* ¶¶ 85-97.

219. *See Glamis Gold, Ltd. v. the United States of America, NAFTA/UNCITRAL, Award ¶ 24 (June 8, 2009), available at <http://ita.law.uvic.ca>.*

220. *See, e.g., id.*

221. *E.g., Case Concerning Elettronica Sicula SpA (ELSI) (United States of America v. Italy), Judgment (July 20, 1989) ICJ REP. 1989 at 76 (interpreting the MST in a less exacting manner as referring to conduct which “shocks, or at least surprises, a sense of juridical propriety”) (emphasis added).*

222. *See DOLZER & SCHREUER supra* note 52, at 129 (citing cases relying on the less exacting *ELSI* case).

setting of the overall threshold can significantly impact how tribunals conceptualize the standard's substantive components.

The issue of good faith also bears noting. Good faith is recognized as "a broad principle that is one of the foundations of international law in general and foreign investment law in particular."²²³ While a finding of bad faith is generally considered inessential to showing a breach of the FET standard,²²⁴ it carries substantial weight as evidence of a breach,²²⁵ and has been treated as a sufficient independent basis for finding a breach.²²⁶ Such a finding can be particularly significant in situations where a state uses an environmental or health regulation as a pretext for an illegitimate purpose.

B. *The FET Standard in Environmental and Health Regulation Cases*

As noted above, claimants have filed several high profile cases relating to environmental and health regulations. In almost every case involving such measures, the claimant has included an FET claim.²²⁷ The following review of several of the more notable cases assesses the tribunals' approach to interpreting and applying the standard.

1. *Metalclad v. Mexico*

Metalclad v. Mexico, one of the first NAFTA cases in which a claimant prevailed on claims relating to environmental and health regulations, has been criticized for infringing states' ability to regulate environmental matters.²²⁸

223. *Id.* at 144.

224. *See, e.g.,* *Mondev Int'l Ltd. v. United States of America*, NAFTA, ICSID Case No. ARB(AF)/99/2, Award ¶ 116 (Oct. 11, 2002), 42 ILM 85 (2003); 6 ICSID REP. 192 (2004) ("A state may treat foreign investment unfairly and inequitably without necessarily acting in bad faith."); *Biwater Gauff Ltd v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award ¶ 602 (July 24, 2008), available at <http://ita.law.uvic.ca/> (explaining that "bad faith on the part of the State is not required for its violation").

225. *See, e.g.,* *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v. Pakistan*, ICSID Case No. ARB/03/29, Decision on Jurisdiction ¶¶ 242-43 (Nov. 14, 2005) available at <http://ita.law.uvic.ca/>; *Waste Mgmt., Inc. v. United Mexican States*, ICSID Case No. ARB (AF)/00/3, Award ¶ 138 (Apr. 30, 2004), available at <http://ita.law.uvic.ca/>.

226. *TUDOR supra* note 201, at 175 (2008) (citing *Alix Genin v. Republic of Estonia*, ICSID Case No. ARB/99/2, Final Award ¶ 367 (June 25, 2001), available at <http://ita.law.uvic.ca/>); *Siemens v. Argentina*, ICSID Case. No. ARB/02/8, Award ¶ 308 (Feb. 6, 2007), available at <http://ita.law.uvic.ca/>.

227. A notable exception is the *Ethyl v. Canada* case (*see supra* part II.B). That claimant's decision not to make an FET claim may have been due to its belief that such a claim was unlikely to succeed given that the disputed regulation was one of general application. However, the claimant may have simply reasoned that relying on the national treatment and expropriation protections was sufficient.

228. *See, e.g.,* *Public Citizen, NAFTA Chapter 11 Investor to State Cases: Bankrupting Democracy* (2001), available at <http://www.citizen.org/publications/release.cfm?ID=7076>, at 13-14; Center for International Environmental Law, *International Law On Investment: The Minimum*

Because the British Columbia Supreme Court set aside the FET aspect of the decision, the tribunal's holding has little authoritative significance with regards to the FET standard. It is, however, still notable for illustrating the issues that can arise in such cases.

Metalclad focused its FET claim on the lack of transparency and predictability in the respondent's conduct.²²⁹ With regard to transparency, it cited investment law authorities to argue that the FET standard encompassed such a principle,²³⁰ and also argued that NAFTA's preamble, which affirmed the principle of transparency, "informed" the content of Article 1105(1), NAFTA's FET provision.²³¹ The tribunal, in finding that the respondent failed to act with sufficient transparency,²³² articulated an exacting expectation of transparency to which host states should be held.²³³ Crucially, the tribunal highlighted the preamble's reference to transparency,²³⁴ but did not cite any authority for the point that the customary international law norm of FET encompassed such a principle. Its failure to do so provided the basis for the set-aside of that aspect of the award.²³⁵

In its holding, the tribunal also highlighted Mexico's failure to ensure a predictable legal framework.²³⁶ The tribunal explained that Metalclad was "entitled to rely on the representations of federal officials"²³⁷ because it "was led to believe, and did believe, that the federal and state permits allowed for the construction and operation of the landfill."²³⁸ This aspect of the award is notable as an example of how a claimant can prevail on a stability and predictability-based FET claim if it can show that it relied on specific assurances.

The decision is also an example of how cases that appear to raise

Standard Of Treatment, (2003), at http://ciel.org/Publications/investment_10Nov03.pdf, at 4.

229. *Metalclad Corp. v. the United Mexican States, NAFTA, ICSID Case No. ARB(AF)/97/1, Investor's Memorial ¶¶ 162-65 (Oct. 13, 1997)*, available at <http://www.naftaclaims.com>.

230. *Id.* ¶ 163.

231. *Id.* ¶ 162.

232. *Id.* ¶ 101.

233. *Id.* ¶ 76 ("The Tribunal understands this to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party. There should be no room for doubt or uncertainty on such matters.").

234. *Id.* ¶ 70.

235. *United Mexican States v. Metalclad Corp.*, 2001 BCSC 664 ¶¶ 68-70, available at <http://www.courts.gov.bc.ca/jdb-txt/SC/01/06/2001BCSC0664.htm>. (holding that the tribunal was mistaken to rely on the preamble to establish that the principle of transparency was part of the FET standard).

236. *Metalclad Corp. v. the United Mexican States, NAFTA, ICSID Case No. ARB(AF)/97/1, Investor's Memorial ¶ 85 (Oct. 13, 1997)*, available at <http://www.naftaclaims.com>.

237. *Id.* ¶ 89.

238. *Id.* ¶ 85.

potentially difficult and precedent-setting questions can be resolved without addressing those questions.²³⁹ Metalclad could have argued that the ecological decree covering the lands the investor used as a landfill site, which it cited as expropriatory,²⁴⁰ was also unduly arbitrary and thus violative of the FET standard. The decree appears to have been enacted without meaningful scientific studies and for the purpose of blocking the project.²⁴¹ Had Metalclad pleaded its claim differently, the tribunal could have been confronted with the difficult task of assessing whether a procedurally legitimate environmental protection measure, which appeared to have a questionable scientific justification, constituted a breach of Article 1105(1).

2. *S.D. Myers v. Canada*

S.D. Myers v. Canada is notable to the FET standard as an example of a tribunal finding for the claimant despite asserting the importance of deferring to the state's regulatory choices, as well as for its treatment of discriminatory intent and its focus on the precise character of the disputed regulatory measure.

The claimant, SDMI, argued that Canada's banning of PCB exports violated Article 1105 in multiple respects, including because it was: (1) arbitrary and discriminatory,²⁴² (2) procedurally unfair,²⁴³ and (3) a "deliberate and domestically unlawful attempt to cause injury [which] violated the obligation of good faith."²⁴⁴

The tribunal found, largely based on Canadian officials' statements and contemporaneous governmental documents referring to the objective of protecting domestic economic interests, that Canada had a protectionist intent in implementing the measure.²⁴⁵ The tribunal took that finding as sufficient to establish a breach of the national treatment standard (Article 1102),²⁴⁶ which, in turn, *per se* established a breach of Article 1105.²⁴⁷ Based on that finding, the tribunal deemed it unnecessary to review SDMI's other arguments relating to

239. See also *Empresas Lucchetti, S.A. and Lucchetti Peru, S.A. v. Republic of Peru*, ICSID Case No. No. ARB/03/4, Award (Feb. 7, 2005); 19 ICSID REV.—FILJ 359 (2004) (dismissing for lack of jurisdiction *ratione temporis* a dispute which involved environmental measures without the tribunal addressing any of the substantive arguments put forward by the parties).

240. See discussion *supra* part II.B.

241. Sanford Gaines, *Environmental Policy Implications of Investor-State Arbitration under NAFTA Chapter 11*, 7 J. OF INT'L ENV'T'L AGREEMENTS: POL., L., & ECON. 171, 181 (2007).

242. *S.D. Myers, Inc. v. Government of Canada*, NAFTA/UNCITRAL, Memorial on the Merits, pt. II, sec. I, ¶ 140 (July 20, 1999), available at <http://www.naftaclaims.com>.

243. *Id.* pt. II, sec. I, ¶ 141.

244. *Id.* pt. II, sec. I, ¶ 142.

245. *Id.* pt. II, sec. I, ¶ 194.

246. *S.D. Myers, Inc. v. Government of Canada*, NAFTA/UNCITRAL, ¶ 254 (Nov. 13, 2000), available at <http://www.naftaclaims.com>.

247. *Id.* ¶ 265.

Article 1105.²⁴⁸ As a result, the tribunal's specific holding on the FET standard is of limited significance to the question of how a tribunal may assess an environmental or health measure's legitimacy. Several aspects of the tribunal's broader discussion are, however, relevant and notable to interpretation of the standard.

First, despite articulating the principle of due deference to a state's policy choices in particularly robust terms,²⁴⁹ the tribunal closely examined Canada's motives to determine whether the measure had a discriminatory purpose. In doing so, the tribunal examined the ban's substantive merits as an environmental protection measure. As such, the decision is an important example of a subtle distinction in tribunals' approach under the FET standard. While they refrain from judging whether a measure was unnecessary, unreasonable, or disproportionate and thus a breach, the tribunal will examine such substantive issues as part of the process of assessing whether the state acted discriminatorily or arbitrarily.²⁵⁰

A second and related notable aspect of the decision is the discussion of government intent. The tribunal acknowledged that government intent is "complex and multifaceted" with decisions "shaped by different politicians and officials with differing philosophies and perspectives."²⁵¹ Despite that caveat, the tribunal was satisfied that the claimant had proven a sufficient degree of discriminatory intent by showing that Canada's policy was "*intended primarily* to protect the Canadian PCB disposal industry from U.S. competition."²⁵² The tribunal did not explain its basis for considering such a threshold to be sufficient. This approach has been deemed problematic,²⁵³ and raises questions about how to deal with compound government motives.

248. *Id.* ¶ 268. Notably, the Tribunal's approach led the NAFTA parties to issue a Note of Interpretation through the NAFTA Free Trade Commission specifying that a "breach of other provisions of NAFTA or of separate international agreements do not establish that there has been a breach of Article 1105(1)." NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions, (July 31, 2001), available at www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/NAFTA-Interpr.aspx?lang=en.

249. *S.D. Myers v. Canada*, ¶ 261 ("When interpreting and applying the 'minimum standard,' a Chapter 11 tribunal does not have an open-ended mandate to second-guess government decision-making. Governments have to make many potentially controversial choices. In doing so, they may appear to have made mistakes, to have misjudged the facts, proceeded on the basis of a misguided economic or sociological theory, placed too much emphasis on some social values over others and adopted solutions that are ultimately ineffective or counterproductive. The ordinary remedy, if there were one, for errors in modern governments is through internal political and legal processes, including elections.")

250. This distinction was further highlighted in the *Methanex* decision (see discussion *infra* part III.B).

251. *S.D. Myers v. Canada*, ¶ 161.

252. *Id.* ¶ 194 (emphasis added).

253. Marcos A. Orellana, *Science, Risk and Uncertainty: Public Health Measures and Investment Disciplines*, in *NEW ASPECTS OF INTERNATIONAL INVESTMENT LAW 770* (Ph. Kahn & T. W. Wälde eds. 2007).

A third notable aspect of the decision is the tribunal's focus on the specific character of the regulatory action giving rise to the claims. The tribunal did not dispute the legitimacy of regulating PCBs, and also took note of the fact that PCB transport posed environmental risks.²⁵⁴ It nevertheless concluded that "there was no legitimate environmental reason for introducing the ban."²⁵⁵ That statement illustrates the tribunal's view that while regulatory action relating to managing risks associated with PCB transport may have been justified, as discussed above,²⁵⁶ there was no scientific justification for the specific decision to ban PCB exports.²⁵⁷ This approach is significant as claimants may find it effective to direct tribunals' focus to specific aspects of the regulatory measure given how commonly the final design of environmental and health measures reflects economic and political considerations.

3. *TECMED v. Mexico*

In *TECMED v. Mexico*, the claimant argued that the FET standard was violated by the non-transparent and inconsistent manner in which Mexican authorities managed the renewal of a landfill permit. The decision is notable to the FET standard for holding states to a high threshold of conduct, particularly with regard to transparency, and as an example of how tribunals base the standard on the investor's legitimate expectations.

The tribunal began its discussion by noting that the standard requires "treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment."²⁵⁸ It proceeded to identify various legitimate expectations investors may have relating to their investments.²⁵⁹ In doing so, the tribunal cited *Neer*, but elaborated on it by referencing *ELSI*, which is less exacting in requiring that the conduct "shocks, or at least surprises, a sense of juridical propriety."²⁶⁰

The tribunal described the transparency component of the FET standard, which it subsequently found was violated by Mexico,²⁶¹ in particularly robust terms:

The foreign investor expects the host State to act in a consistent manner, free

254. See *S.D. Myers v. Canada*, ¶¶ 105-107, 152.

255. *Id.* ¶ 195.

256. See *supra* part II.B.

257. See *S.D. Myers v. Canada*. ¶ 176 (highlighting a contemporaneous government memorandum which found that an interim order to ban PCB exports "is not a viable option because it cannot be demonstrated that closing the border is required to deal with a significant danger to the environment or to human health"); see also *supra* part II.B.

258. *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award ¶ 154 (May 29, 2003), available at <http://ita.law.uvic.ca/>.

259. See, e.g., *id.*

260. *Id.*

261. *Id.* ¶ 162.

from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations.²⁶²

This aspect of the award has been rightly criticized for holding states to an unrealistically high standard,²⁶³ but has also been cited by subsequent tribunals.²⁶⁴

Notably, the tribunal linked the investor's legitimate expectations to the issue of whether the respondent used its governmental powers for a proper purpose:

[T]he fair expectations of the Claimant were that the Mexican laws applicable to such investment, as well as the supervision, control, prevention and punitive powers granted to the authorities in charge of managing such system, *would be used for the purpose* of assuring compliance with environmental protection, human health and ecological balance goals underlying such laws.²⁶⁵

This explanation is significant for providing a theoretical basis grounded in established interpretation of the FET standard for treating governmental regulations as violative of the standard if they are used as a pretext for an improper purpose. As discussed above,²⁶⁶ the tribunal concluded that the respondent acted for the purpose of resolving "social and political difficulties" raised by community opposition to the landfill,²⁶⁷ and had "resorted to the non-renewal of the Permit to overcome obstacles *not related* to the preservation of health and the environment."²⁶⁸

4. *Methanex v. United States*

The NAFTA case, *Methanex v. United States*, which was discussed with regard to indirect expropriation, has been described as "a major win for the environmental community,"²⁶⁹ and is one of the highest profile decisions to address claims relating to environmental and health measures. *Methanex* based

262. *Id.* ¶ 154.

263. See, e.g., Zachary Douglas, *Nothing if Not Critical for Investment Treaty Arbitration: Occidental, Eureko, Methanex*, 22 ARB. INT'L 27, 28 (2006) (describing the expectation as "perfect public regulation in a perfect world, to which all states should aspire but very few (if any) will ever attain.").

264. See, e.g., MTD Equity Sdn. Bhd & MTD Chile S.A. v. Republic of Chile, ICSID Case No. ARB/01/7, ¶ 114 (May 25, 2004), available at <http://ita.law.uvic.ca>.

265. *TECMED v. Mexico*, ¶ 157 (emphasis added); see also *id.* ¶ 154.

266. See *supra* part II.B.

267. *TECMED v. Mexico*, ¶163.

268. *Id.* ¶ 164 (emphasis added); see also *id.* ¶¶ 129-31 (discussing the tribunal's factual findings on this point).

269. Alberto Alvarez-Jiménez, *The Methanex Final Award: An Analysis from the Perspectives of Environmental Regulatory Authorities and Foreign Investors*, 23 J. OF INT'L ARB. 427 (2006).

its Article 1105(1) claim on the argument that the MTBE ban was intentionally discriminatory.²⁷⁰ In rejecting the claim, the tribunal first focused on whether the text of Article 1105(1) covered discriminatory conduct. It explained that Article 1105(1) does not mention discrimination, and that a separate reference to discrimination in Article 1105(2) is evidence that Article 1105(1) was not intended to include a non-discrimination norm.²⁷¹ The tribunal also cited the NAFTA Free Trade Commission (“FTC”) interpretation of Chapter 11, which it viewed as “conf[ir]ming claims based on alleged discrimination to Article 1102, which offers full play for a principle of non-discrimination.”²⁷²

The tribunal proceeded to examine “whether a rule of customary international law prohibits a State, in the absence of a treaty obligation, from differentiating in its treatment of nationals and aliens.”²⁷³ The tribunal concluded that in “the absence of a contrary rule of international law binding on the State parties, whether of conventional or customary origin, a State may differentiate in its treatment of nationals and aliens.”²⁷⁴ That framing of the issue follows the approach taken by the United States in its pleadings.²⁷⁵

The claimant seemingly would have benefitted by arguing that it only needed to prove that customary international law recognizes that discriminatory conduct can be unfair and inequitable such that it breaches the FET standard, not that discrimination in general is prohibited.²⁷⁶ Methanex could have cited substantial authority for the specific point that the FET standard, even if understood as part of the customary international law MST, provides for nationality-based discrimination to be treated as unfair and inequitable in

270. *Methanex v. United States of America*, NAFTA/UNCITRAL, Claimant’s Second Amended Statement of Claim ¶ 313 (Nov. 5, 2002), available at <http://www.naftaclaims.com> (“the California measures were intended to discriminate against foreign investors and their investments, and intentional discrimination is, by definition, unfair and inequitable”).

270. *S.D. Myers v. Canada*, *supra* note 98, ¶ 221.

271. *Methanex v. United States of America*, NAFTA/UNCITRAL, Award Pt. IV, Ch. C ¶¶ 14-16 (Aug. 9, 2005), available at <http://ita.law.uvic.ca/>.

272. *Id.* Pt. IV, Ch. C ¶ 24.

273. *Id.* Pt. IV, Ch. C ¶ 25.

274. *Id.* Pt. IV, Ch. C ¶ 25.

275. See *Methanex v. United States of America*, NAFTA/UNCITRAL, Amended, Statement of Defense ¶ 366 (Dec. 5, 2003), available at <http://www.naftaclaims.com> (“Methanex supplies no legal support for its suggestion that discrimination is *per se* violative of customary international law’s minimum standard.”); *Id.* ¶ 367 (arguing that “customary international law contains no general prohibition on economic discrimination against aliens.”); *Id.* ¶ 357 (examining whether Methanex had proven the existence of a “general obligation of non-discrimination”).

276. The tribunal’s acceptance of the United States’ framing of the discrimination question may be due to the claimant’s singular reliance on *Waste Management*, which the tribunal treated as authority only for the point that sectional or racial discrimination is restricted. *Methanex v. United States*, Pt. IV, Ch. C ¶ 26. Notably, although the *Waste Management* tribunal’s articulation of the standard referred to sectional or racial discrimination, that tribunal examined whether the respondent engaged in nationality-based discrimination. *Waste Management Inc. v. Mexico*, ¶¶ 123, 130.

violation of the standard.²⁷⁷ Further, discrimination may take the form of anti-foreign investor conduct in the absence of domestic or third-party comparators. Such a situation is seen in *Eureko v. Poland*, in which the tribunal concluded that the respondent's obstruction of the claimant's investment in a state-owned financial institution because of political hostility to foreign control of a strategically important company breached the FET standard.²⁷⁸ Given the absence of similarly situated domestic investors, a national treatment claim would not have been viable in that case. This point is significant because of the possibility of an investor seeking to argue that a regulatory measure was motivated by anti-foreign investor considerations.

Methanex is also notable to the FET standard for the manner in which the tribunal examined the regulatory process in its discussion of the facts. The parties submitted 14 expert reports, which disputed the methodological soundness of the study on which the MTBE ban was based, the accuracy of its substantive findings, and whether the regulatory response was rational and appropriate.²⁷⁹ The tribunal reviewed all aspects of the reports, but placed the analysis in the context of determining whether the measures "constitute a 'sham environmental protection in order to cater to local political interests or in order to protect a domestic industry.'"²⁸⁰

Although the tribunal did not precisely articulate its analytical framework for determining that the measures were not a sham, its conclusion, as also discussed above with regard to the expropriation standard, reveals its reasoning. The tribunal accepted that the UC Report "reflected a serious, objective and scientific approach to a complex problem in California."²⁸¹ It further found that while "it is possible for other scientists and researchers to disagree in good faith with certain of its methodologies, analyses and conclusions, the fact of such disagreement, even if correct, does not warrant this Tribunal in treating the UC

277. See, e.g., *Lauder v. Czech Republic*, UNCITRAL, Final Award ¶ 292 (Sept. 3, 2002); *MTD Equity Sdn. Bhd & MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, ¶ 109 (May 25, 2004), available at <http://ita.law.uvic.ca>; *Saluka Investments BV (The Netherlands) v. the Czech Republic*, UNCITRAL, Partial Award ¶ 309 (Mar. 17, 2006), available at <http://ita.law.uvic.ca>; *Eureko B.V. v. Republic of Poland*, ad hoc, Netherlands/Poland BIT, Partial Award ¶ 233 (Aug. 19, 2005); *Glamis Gold, Ltd. v. the United States of America*, NAFTA/UNCITRAL, Award ¶ 616 (June 8, 2009), available at <http://ita.law.uvic.ca>; United Nations Centre on Transnational Corporations, *Bilateral Investment Treaties* (1988) at 42; TUDOR *supra* note 201, at 178; CAMPBELL MCLACHLAN ET AL., INTERNATIONAL INVESTMENT ARBITRATION 260 (2007); PETER MUCHLINSKI, MULTINATIONAL ENTERPRISES AND THE LAW 625 (1999).

278. *Eureko v. Poland*, ¶ 213; see also *Eureko* ¶ 233 (finding that the respondent's action was motivated by "the interplay of Polish politics and nationalistic reasons of a discriminatory character").

279. *Methanex v. United States of America*, NAFTA/UNCITRAL, Award Pt. III, Ch. A ¶¶ 43, 71 (Aug. 9, 2005), available at <http://ita.law.uvic.ca/>.

280. *Id.* Pt. III, Ch. A ¶ 41.

281. *Id.* Pt. III, Ch. A ¶ 101.

Report as part of a political sham by California.”²⁸² In short, the tribunal was willing to fully examine both the procedural and substantive merits of the risk assessment and the regulatory response, but, like the *S.D. Myers* tribunal, did so only to determine whether the regulatory process was used as a pretext for improper conduct.

The tribunal’s approach is also notable for diverging from *TECMED* in not treating evidence of social or political pressure as particularly significant in determining whether the regulatory measure was arbitrary or discriminatory. In *TECMED*, the tribunal emphasized that the regulatory authority acted in response to community pressure, and not for the purpose of environmental or health protection.²⁸³ In *Methanex*, the tribunal noted the high level of public concern and political activity around MTBE, but treated it as a normal part of the regulatory process.²⁸⁴

A final notable aspect of the case is its significance to the precautionary principle, which appeared to be implicated by the dispute.²⁸⁵ Although the UC Report recognized gaps in the data on MTBE toxicity and the uncertainty regarding health risks,²⁸⁶ it found that the data showed significant risks and costs associated with water contamination.²⁸⁷ Accordingly the ban, while reflecting a strong preventative approach to regulation, did not constitute precautionary regulation, which is more properly understood as regulation made in the absence of conclusive evidence.²⁸⁸

5. *Glamis Gold, Ltd. v. United States of America*

Glamis Gold v. United States involved a Canadian mining company which had invested in a gold mine project in the United States.²⁸⁹ With regard to the FET standard, the case is most notable for affirming, at least in the NAFTA context, that claimants must establish a high level of wrongfulness for state conduct to constitute a breach.

282. *Id.*; see also *id.* at Pt. III, Ch. A ¶ 102 (finding that the subsequent policy response was “contingent on the scientific findings of the UC Report” and thus also not a “sham”).

283. *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award ¶ 132 (May 29, 2003), available at <http://ita.law.uvic.ca/>.

284. *Methanex v. United States of America*, NAFTA/UNCITRAL, Award Pt. IV, Ch. D ¶ 9 (Aug. 9, 2005), available at <http://ita.law.uvic.ca/>.

285. See *Methanex v. United States of America*, NAFTA/UNCITRAL, Submission of Non-Disputing Parties Bluewater Network, Communities for a Better Environment and Center for International Environmental Law ¶¶ 10-15 (Mar. 9, 2004), available at <http://www.naftaclaims.com> (highlighting the importance of the precautionary principle in the dispute).

286. *Methanex v. United States*, Award Pt. III, Ch. A ¶¶ 9-12.

287. *Id.* Pt. III, Ch. A ¶ 9.

288. *Methanex v. United States of America*, Submission of Bluewater Network, ¶ 10.

289. *Glamis Gold, Ltd. v. the United States of America*, NAFTA/UNCITRAL, Award ¶¶ 633-50 (June 8, 2009), available at <http://ita.law.uvic.ca/>.

Glamis began efforts to develop an open pit gold mining project in California in 1994.²⁹⁰ In 2001, the Federal Interior Department accepted the findings of a legal opinion changing the interpretation of an established rule,²⁹¹ and denied the project on the basis of its impact on a Native American spiritual pathway.²⁹² Following a change in presidential administrations, the Interior Department reversed the denial.²⁹³ The State of California subsequently adopted legislation and administrative regulations that mandated backfilling of all open pit mines to near the original surface elevation of the site.²⁹⁴

With regard to Article 1105(1), Glamis argued that the initial denial of the project violated its reasonable expectation that the state would maintain a fair and transparent business environment,²⁹⁵ and that the overall delay in the review of the project was unreasonable and intentional.²⁹⁶ Glamis further argued that the State's backfilling requirement rendered the project economically unviable.²⁹⁷

Glamis filed its claim after the FTC interpretation of Article 1105(1), and accepted that that the FET standard was to be understood as the customary international law MST.²⁹⁸ The tribunal extensively assessed the parties' arguments regarding the content of that standard, including the specific question of whether the standard had evolved since its elucidation in *Neer*.²⁹⁹ It concluded that Glamis, which had cited the relatively less exacting articulation of the standard in *ELSI*,³⁰⁰ had not proven that the standard had evolved. It thus articulated a demanding threshold:

[T]o violate the customary international law minimum standard of treatment codified in Article 1105 of the NAFTA, an act must be sufficiently egregious and shocking—a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons—so as to fall below accepted international standards.³⁰¹

The tribunal did, however, acknowledge that while the MST “remains as

290. *Id.* ¶ 10.

291. *Id.* ¶¶ 136-47.

292. *Id.* ¶¶ 153-55.

293. *Id.* ¶ 157.

294. *Id.* ¶¶ 166-84.

295. *Id.* ¶ 270.

296. *Id.* ¶ 64.

297. *Id.* ¶ 321; *see also id.* ¶ 370 (discussing the cost of backfilling and how materials “swell” to have a larger volume upon removal, which can necessitate off-site removal).

298. *Id.* ¶ 549.

299. *Id.* ¶ 601.

300. Glamis Gold, Ltd. v. the United States of America, NAFTA/UNCITRAL, Claimant's Memorial ¶ 525 (May 5, 2006), available at <http://www.naftaclaims.com> (quoting *ELSI supra* note 221, ¶ 128 (internal citation omitted)).

301. Glamis Gold, Ltd. v. the United States of America, NAFTA/UNCITRAL, Award ¶ 22 (June 8, 2009), available at <http://ita.law.uvic.ca>.

stringent as it was under *Neer*; it is entirely possible that, as an international community, we may be shocked by State actions now that did not offend us previously.”³⁰²

With regard to the 2001 denial of the project, the tribunal noted that “it is not for an international tribunal to delve into the details of and justifications for domestic law,”³⁰³ and that its task was only to determine whether the measure met the high standard of wrongfulness it had articulated.³⁰⁴ In rejecting each of the claimant’s arguments relating to the denial, the tribunal focused on whether the respondent had submitted sufficient evidence to preclude a finding of manifest wrongfulness. For example, in determining that the legal opinion on which the denial was based did not constitute a breach, the tribunal observed that the opinion was not “manifestly without reason”³⁰⁵ without examining the actual merits of the analysis.³⁰⁶

In similarly rejecting Glamis’ arguments regarding the delayed and purportedly arbitrary and discriminatory review process,³⁰⁷ the tribunal repeatedly referred to whether the respondent had made a “*prima facie*” case that its conduct was legitimate.³⁰⁸ That term provides a helpful shorthand description of the tribunal’s overall approach to the FET standard. It first looked at whether the respondent had submitted some reasonable evidence that its conduct had a legitimate basis. If so, the tribunal would be satisfied that the conduct was not manifestly wrongful, and would refrain from undertaking an in depth examination of the conduct unless the claimant produced compelling evidence of wrongfulness.

The award also includes a noteworthy discussion of the issue of whether a measure is one of general application. In dealing with the legislation requiring backfilling, the tribunal assessed, as a threshold matter, whether the law targeted the project with the specific goal of making it infeasible.³⁰⁹ The tribunal noted the difficulty of defining government intent, and the reality that policies of

302. *Id.*

303. *Id.* ¶ 762.

304. *Id.*

305. *Id.* ¶ 805.

306. *Id.* ¶ 764.

307. *Id.* ¶¶ 776, 779.

308. *See e.g., id.* ¶ 786 (“[I]t is not for this Tribunal to assess the veracity of evidentiary support for domestic governmental decisions; the Tribunal may assess only whether there was reasonable evidence, and thus the government’s reliance on such was not obviously and actionably misplaced.”); *Id.* ¶ 783 (assessing whether there was a legitimate basis for the cultural review, and concluding that the respondent “was justified in relying upon the opinion of the professionals it engaged in the way that it did, as these professionals appear quite qualified for the task and they provided substantial evidentiary support for their conclusions”).

309. The tribunal also dismissed Claimant’s argument that the legislative process denied its expectation of a “transparent and predictable” legal framework. In doing so, it mirrored the *Methanex* tribunal in highlighting the fact that California is a highly regulated state. *Id.* ¶ 800.

general applicability could be linked to “symbolic” projects that serve as a “rallying call” for legislative action.³¹⁰ It then focused on the language and drafting history of the bill to conclude that, on its face, it could apply to other mines,³¹¹ and thus could not be taken as specifically targeting the project.³¹²

In summary, the tribunal essentially crafted the *Neer* requirement that the conduct be “egregious and shocking” upon the substantive components of the FET standard. The resulting requirement that the claimant establish that the state’s conduct was manifestly wrongful would, if followed, appear to limit a claimant’s ability to successfully advance an FET claim under NAFTA relating to an environmental or health regulation. Notably, however, the *Glamis* tribunal’s interpretation of the FET standard under NAFTA was not followed by a subsequent NAFTA tribunal.³¹³

C. Applying the FET Standard to Claims Relating to Environmental and Health Regulations

As the decisions make clear, application of the FET standard varies substantially, particularly as the standard can be highly dependent on the operative facts and treaty language. Most notably, the threshold at which conduct breaches the FET standard has been set at significantly different levels. For example, while the *TECMED* tribunal held the state to an unrealistically high standard of good performance, at least with regards to transparency, the *Glamis* tribunal was much more exacting on the investor in requiring it to establish that the state’s conduct was manifestly wrongful. That said, in most cases, the FET standard’s application to environmental and health related claims comes down to a few key questions. While these questions may involve substantial nuance, they provide a road map for tribunals to follow.

First, did the state violate the investor’s legitimate expectations regarding the legal framework’s stability and predictability? The legitimate expectations’ significance under the FET standard is well-established, and an investor may be able to prevail on a claim based on a change in the legal framework.³¹⁴ However, as *Methanex* and *Glamis* made clear, because environmental or health regulation is common, claims based on such regulations are unlikely to succeed on stability and predictability grounds if the investor cannot show, as it did in *Metalclad*, that it received specific assurances of stability.

310. *Id.* ¶ 792.

311. *Id.* ¶ 794.

312. *Id.* ¶ 797.

313. *Merrill & Ring Forestry L.P. v. Canada*, NAFTA/UNCITRAL, Award ¶¶ 200-213 (Mar. 31, 2010), available at <http://ita.law.uvic.ca> (concluding that the international minimum standard is broader than that defined in the *Neer* case).

314. See TUDOR *supra* note 201, at 169-72 (discussing cases finding a breach on the basis of a failure to provide a stable and predictable legal framework).

Second, were there serious procedural deficiencies which harmed the investor? Although the threshold at which a procedural deficiency constitutes a breach has been set at widely different levels, it appears well-established that a substantial lack of transparency, consistency, or procedural fairness in the administration of government regulations may violate the FET standard.³¹⁵ Substantial deviations from established procedures are particularly significant because of the legitimate expectations principle. Emphasizing deviations also accounts for the fact that investors cannot have the same expectations from states with high and low administrative capacities.

Especially significant in the environmental and health regulation context is a failure to comply with a requirement to conduct a study (*e.g.*, a risk assessment or cost-benefit evaluation). Notably, the FET standard does not include a requirement comparable to Article 5 of the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (“SPS Agreement”), which requires that environmental and health measures be based on a risk assessment.³¹⁶ Accordingly, under the FET standard, if a study is not required by law and would not be legitimately expected given established practice, then the state may fairly act without undertaking one as long as it can show that in doing so it is not acting in an unduly arbitrary or unreasonable manner. While it may be appropriate to additionally assess whether the study was conducted in a procedurally legitimate manner, failure to comply with all applicable standards is unlikely to constitute a breach unless the study becomes so flawed as to be illegitimate.³¹⁷

Third, does the measure follow from the findings that are cited as its basis?³¹⁸ While tribunals are understandably hesitant to second-guess policy choices, it is appropriate to examine whether the measure actually followed from whatever analysis is cited as its basis. If a state undertook a study which found that no regulation was necessary, and still acted, that action is more likely to be found arbitrary. In this regard, interpretation of the terms “based on” in Article 5.1 of the SPS Agreement may be instructive.³¹⁹ The WTO Appellate Body has emphasized that “based on” is more than a “minimal procedural requirement,” and is “appropriately taken to refer to a certain *objective relationship* between two elements, that is to say, to an *objective situation* that persists and is

315. See *supra* part II.B (discussing *TECMED*).

316. Agreement on the Application of Sanitary and Phytosanitary Measures, 1867 U.N.T.S. 493, Annex 1A to the Marrakesh Agreement Establishing the World Trade Organization, art. 5, 1867 U.N.T.S. 3 (entered into force Jan. 1, 1995).

317. See, *e.g.*, *supra* part III.B (discussing the *Methanex* tribunal’s approach to this issue).

318. This question potentially overlaps with the second and fourth questions, but it also targets a particularly notable aspect of environmental and health regulated claims.

319. SPS Agreement, *supra* note 316, art. 5.1 (“Members shall ensure that their sanitary or phytosanitary measures are based on an assessment, as appropriate to the circumstances, of the risks to human, animal or plant life or health, taking into account risk assessment techniques developed by the relevant international organizations.”).

observable between an SPS measure and a risk assessment.”³²⁰ Such a degree of substantive analysis—which does not extend to whether the measure is necessary or the most rational, proportional, or efficient response—would provide investors a baseline protection from unjustified regulatory actions.

Interestingly, the precautionary principle can be pertinent to this question. The available science may not conclusively affirm or deny the presence of a risk which merits regulation. If the potential risk is serious or if there is evidence that concerns about potential risks have proven valid in factually similar situations, the precautionary principle suggests that regulation may still be appropriate. While such precautionary regulation would need to be proven necessary in the WTO context, the regulation only need not be arbitrary under the FET standard. For example, if a state restricted use of a new chemical compound where no studies proved that regulation was necessary (and also did not conclusively prove that it was safe), the state’s low risk tolerance could still be legitimate because of the recognized possibility of serious but difficult to identify risks associated with the use of such chemical compounds.

Fourth, even if the measure appears procedurally proper, does the evidence show that the measure, or some aspect of it, was taken for an improper purpose? It is not difficult to imagine a state enacting an environmental or health regulation in accordance with established procedures, and perhaps even undertaking a risk assessment providing justification for the regulation, as a pretext to achieve an improper purpose. Such conduct has been recognized as disguised protectionism in the WTO context, and motivated the enactment of the SPS Agreement.³²¹ In the investment law context, the conduct could be violative of the FET standard on the grounds of being discriminatory, arbitrary, grossly unfair, or for representing an improper use of state power contrary to the investor’s legitimate expectations. While the tribunal’s role in such a situation may be difficult, claimants subjected to such treatment should be given the opportunity to show that the respondent acted in a wrongful manner.

The claimant will certainly bear a significant burden to produce evidence of the state’s wrongful purpose, which tribunals will not lightly infer. Tribunals will, of course, consider any direct evidence of improper purpose, such as internal communications of government officials indicating protectionism.³²² However, such evidence will often be unavailable and tribunals should be willing to consider whether other forms of evidence are sufficient. Examining

320. Appellate Body Report, *European Communities – Measures Concerning Meat and Meat Products (Hormones)*, WTO Docs WT/DS26/AB/R and WT/DS48/AB/R at 189 (Jan. 16, 1998).

321. See John O. McGinnis & Mark L. Movsesian, *The World Trade Constitution*, 114 HARV. L. REV. 511, 597 (2000) (explaining that the SPS Agreement and TBT Agreement “improve on GATT . . . in that they more clearly direct WTO tribunals to apply procedure-oriented tests to root out covert discrimination”).

322. See *S.D. Myers, Inc. v. Government of Canada, NAFTA/UNCITRAL, Partial Award*, ¶¶ 161-195 (Nov. 13, 2000), available at <http://www.naftaclaims.com> (reviewing the evidence in the documentary record showing that Canada was primarily motivated by protectionist considerations).

the measure's effects can be particularly helpful in this regard as a wrongful purpose should have certain symptomatic effects (e.g., benefits to domestic investors at the expense of foreign investors). Whether the enactment of the measure is consistent with the state's typical practice is also significant as an anomalous measure may indicate that the state was motivated by other purposes. As the jurisprudence indicates, tribunals may also examine the substantive merits of a measure as evidence that the measure was highly disproportional, irrational, or not scientifically justified may suggest that it was used as a pretext for an improper objective.³²³

Situations where the evidence suggests that the state had multiple motives, or that intent varied amongst state officials, will be particularly challenging. There is a crucial, but not yet fully explored, distinction between an *S.D. Myers* type situation where the tribunal is able to conclude that the state's primary motive was wrongful, and a *Methanex* type situation where multiple motives are accepted as a normal part of the regulatory process. One approach would be to determine whether a legitimate motive existed that *could* have reasonably led to the enactment of the measure in the absence of the other motives. That approach would cover a situation where a state took action for a wrongful purpose and justified its action on some minor or tangentially related environmental or health risk. However, a situation where a *bona fide* regulation was enacted in circumstances where other incentives, such as the opportunity of domestic producers to profit, were present would not be treated as wrongful. In summary, the primary focus of a tribunal in assessing the measure's legitimacy under the FET standard is on the measure's procedural soundness and whether the measure was used as a pretext for a wrongful purpose. A measure that is substantively flawed (e.g., disproportionate or based on unsound science) is unlikely to be considered a breach of the FET standard if it is otherwise legitimate. In a situation where the applicable treaty expressly prohibits "unreasonable" conduct, a *bona fide* and procedurally legitimate measure, could, in theory, be so disproportional and unjustified as to constitute a breach. No such examples are seen in the jurisprudence, however.

One other notable issue that remains unsettled is the distinction between measures of general application and those specifically applied to a claimant's investment. While intuitively of substantial significance, this issue has not been clearly defined in the FET context. It would presumably be more difficult for a claimant to establish that a regulation of general application was discriminatory. However, the decisions, including *Glamis* in particular, illustrate the difficulty of even determining whether a measure is one of general application.³²⁴

323. The decisions of the *S.D. Myers* and *Methanex* tribunals are particularly clear examples of this practice. See *supra* parts II, III.

324. See *supra* part III.B.

IV.

NATIONAL TREATMENT AND MOST FAVORED NATION TREATMENT

Non-discrimination on the basis of nationality is a core protection of most investment treaties. It is typically addressed through a national treatment (“NT”) clause and a most-favored nation (“MFN”) clause. Under the NT standard, the state is expected to accord treatment to foreign investors and their investments “no less favorable” than that provided to comparable domestic investors and their investments.³²⁵ The MFN standard provides the same protection relative to third-party nationals and their investments.³²⁶

The basic process for assessing claims under either standard is to: (1) identify the relevant subjects for comparison (*i.e.*, the comparators considered to be “in like circumstances” with the claimant); and (2) examine whether the claimant received less favorable treatment than the comparators.³²⁷ While the practical impact of the governmental measure is the primary factor in examining whether the claimant received less favorable treatment, evidence of protectionist intent, while not requisite to a finding of discrimination, can be a significant factor.³²⁸

For claims relating to environmental or health measures, the key question is whether the state’s action was based on a legitimate policy objective.³²⁹ If the state had a legitimate basis for distinguishing the claimant and the purported comparators, then they are not “in like circumstances” for purposes of the NT and MFN assessment.³³⁰ For example, the regulation may have affected the claimant but not the comparators because the claimant’s investment was located in an environmentally sensitive area or utilized an environmentally harmful production process.³³¹

325. See NEWCOMBE & PARADELL *supra* note 201, ch. 4; DOLZER & SCHREUER *supra* note 52, at 178-86.

326. See NEWCOMBE & PARADELL *supra* note 201, ch. 5; DOLZER & SCHREUER *supra* note 52, at 186-91.

327. See *Pope & Talbot v. Canada*, NAFTA/UNCITRAL, Award on the Merits of Phase 2 ¶¶ 73-104 (Apr. 10, 2001), available at <http://www.naftaclaims.com>.

328. See, e.g., *S.D. Myers, Inc. v. Government of Canada*, NAFTA/UNCITRAL, Partial Award ¶¶ 252-54 (Nov. 13, 2000), available at <http://www.naftaclaims.com>; NEWCOMBE & PARADELL *supra* note 201, § 4.1.

329. This question can extend beyond environmental and health measures. For example, in *GAMI Investments Inc. v. United Mexican States*, the legitimate policy objective concerned the solvency of the local sugar industry. *GAMI v. Mexico*, NAFTA/UNCITRAL, Award ¶¶ 114-15 (Nov. 15, 2004), 44 ILM 545 (2005).

330. See, e.g., *Pope & Talbot v. Canada*, ¶ 79; see also DOLZER & SCHREUER *supra* note 52, at 181-83 (discussing cases supporting the accepted view that “like circumstances” can take legitimate differentiations into account).

331. See, e.g., *Methanex v. United States of America*, NAFTA/UNCITRAL, U.S. Rejoinder on the Merits ¶ 159 (23 Apr. 2004), available at <http://ita.law.uvic.ca/> (“[R]egulations limiting business activities in certain environmentally sensitive areas or imposing additional limitations on emissions where air pollution is more severe will not *ipso facto* violate national treatment even though some of

Some commentators suggest that the approach could more appropriately be described as the tribunal examining whether the respondent state had shown that it had a legitimate justification for the differential treatment.³³² While that description may be more intuitive and semantically clear than placing the examination in the context of a “like circumstances” analysis, it may not be compatible with the applicable treaty language. NT and MFN clauses typically do not provide for such a justification of discriminatory treatment.³³³

Examining regulatory distinctions as part of the “like circumstances” analysis does, however, constitute a deviation from the WTO/GATT “like products” approach.³³⁴ Indeed, in *Pope & Talbot*, the claimant argued that the tribunal should adhere to the WTO/GATT approach and consider the “in like circumstances” test satisfied if the investors or investment produced like products or services.³³⁵ Canada argued that there was no basis for such an interpretation, emphasizing the broader meaning that must be accorded to the term “circumstances.”³³⁶ The tribunal accepted Canada’s reasoning, and other investment treaty tribunals have similarly declined to import the WTO/GATT approach.³³⁷

In addition to being correct as a matter of treaty interpretation, this approach is correct as a matter of policy. While Article XX of the GATT provides an express exception for measures adopted for environmental and health protection purposes,³³⁸ no similar exception is included under most investment treaties. Accordingly, if regulatory distinctions could not be considered in the “like circumstances” analysis, states would be strictly liable if

these regulations may be applied to some operations and not to other, competing operations. In those cases, direct competitors may be deemed not to be in like circumstances for the purpose of the measure at issue because of their operations’ differing locations.”)

332. See, e.g., MEG N. KINNEAR ET AL., INVESTMENT DISPUTES UNDER NAFTA; AN ANNOTATED GUIDE TO NAFTA CHAPTER 11, 1102-26 (2009); NEWCOMBE & PARADELL *supra* note 201, at 161.

333. See, e.g., 2004 U.S. Model Bilateral Investment Treaty, *supra* note 16, arts. 3, 4; 2008 German Model BIT, art. 3; 2003 India Model BIT, art. 4; NAFTA, Ch. 11, arts. 1102, 1103; see also *Methanex v. United States of America*, NAFTA/UNCITRAL, Award ¶ 37 (Aug. 9, 2005), available at <http://ita.law.uvic.ca/> (addressing this point, and concluding that “the [NAFTA] text and the drafters’ intentions, which it manifests, show that trade provisions were not to be transported to investment provisions.”).

334. See GATT, *supra* note 33, art. III(2) (“The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products.”).

335. *Pope & Talbot v. Canada*, NAFTA/UNCITRAL, Memorial of the Investor Initial Phase ¶¶ 63-72 (Jan. 28, 2000), available at <http://www.naftaclaims.com>.

336. *Pope & Talbot v. Canada*, NAFTA/UNCITRAL, Government of Canada Counter-Memorial ¶¶ 185-97 (Mar. 29, 2000), available at <http://www.naftaclaims.com>.

337. See, e.g., *Occidental Exploration and Prod. Co. v. Ecuador*, UNICTRAL, Final Award ¶ 176 (July 1, 2004).

338. GATT, *supra* note 33, art. XX(b), (g).

an action resulted in foreign investors receiving less favorable treatment.³³⁹ Further, the deviation from WTO/GATT jurisprudence is not as definite as some claimants have argued. For a period of time, GATT jurisprudence applied an “aims and effects” test that included an examination of legitimate regulatory distinctions in the “like products” analysis,³⁴⁰ and there are indications that aspects of that test are reappearing in recent WTO decisions.³⁴¹

However the test is articulated, the essential analysis is whether the state had a legitimate policy basis for the differential treatment. Whether the claimant bears the burden of proving that fact, or whether the burden shifts to the respondent, is a disputed question.³⁴² It is the opinion of the authors that the question itself is misguided. The claimant certainly bears the burden of establishing that it is in “like circumstances” with a comparator that received differential treatment. Whether a legitimate regulatory distinction precludes a finding of “like circumstances” is a factor to be taken into account by the tribunal in determining whether the claimant has met its burden. The claimant could take the initiative in arguing that no such distinction is present or could wait to rebut an argument to that effect from the respondent. If the respondent did not argue that such a distinction existed, it would be incongruous to conclude that the claimant had failed to meet its burden.

Additionally, even if the state may need to show that it had a legitimate basis for its action, tribunals tend to defer to states’ policy choices. For example, the *Pope & Talbot* tribunal only examined “whether there is a reasonable nexus between the measure and a rational, non-discriminatory government policy,”³⁴³ not whether the action was necessary. In *Feldman v. Mexico*, the tribunal looked at whether there was “any rational justification in the record” for the less

339. The *S.D. Myers* tribunal appeared to adopt this reasoning: “The Tribunal considers that the interpretation of the phrase ‘like circumstances’ in Article 1102 must take into account the general principles that emerge from the legal context of the NAFTA, including both its concern with the environment and the need to avoid trade distortions that are not justified by environmental concerns. The assessment of ‘like circumstances’ must also take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest.” *S.D. Myers, Inc. v. Government of Canada*, NAFTA/UNCITRAL, ¶ 250 (Nov. 13, 2000), available at <http://www.naftaclaims.com>.

340. See Nicholas DiMascio & Joost Pauwelyn, *Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?* 102 AM. J. INT’L L. 48, 63 (2008).

341. *Id.* at 65.

342. See, e.g., *Pope & Talbot Inc. v. the Government of Canada*, NAFTA/UNCITRAL, Interim Award ¶¶ 78-82 (June 26, 2000), available at <http://www.naftaclaims.com> (placing the burden of showing a legitimate distinction on the respondent); *United Parcel Service of America, Inc. v. Canada*, NAFTA/UNCITRAL, Award on the Merits ¶¶ 83-87 (June 11, 2007), available at <http://www.naftaclaims.com> (placing the burden on the claimant); see also *id.*, Separate Statement of Dean Ronald A. Cass ¶ 17 (June 11, 2007) (arguing that the decision erred in not shifting the burden to the respondent); *KINNEAR ET AL.*, *supra* note 332, at 1102-26 (arguing that shifting the burden sets the threshold too low for the investor); DiMascio & Pauwelyn, *supra* note 340, at 86 (arguing that the claimant should retain the full burden of proving nationality-based discrimination).

343. *Pope & Talbot v. Canada*, ¶ 81.

favorable treatment.³⁴⁴ That approach resembles the *Glamis* tribunal's examination of whether the state made a *prima facie* showing of legitimacy under the FET standard.³⁴⁵ If anything, such a degree of deference may be too substantial in the context of applying the NT and MFN standards. While the FET standard is intended to provide only a baseline level of protection to investors against wrongful treatment, the NT and MFN standards typically provide full protection against nationality-based discrimination. Thus, while the state's legitimate regulatory responsibilities justify a broad "like circumstances" analysis so that the state is not strictly liable for actions which have a discriminatory *effect*, they do not justify extending substantial deference to the state in assessing whether a health or environmental regulation had a discriminatory *intent*.

In that regard, the *S.D. Myers* tribunal's willingness to fully examine the state's motives with the goal of identifying the primary motive, *i.e.*, to favor domestic PCB treatment enterprises, appears generally appropriate. For all the reasons cited above under the FET standard, such an approach may represent a more difficult task for the tribunal, but it addresses the fact that states can produce "some rational justification" for their conduct with relative ease.³⁴⁶

V. CONCLUSION

Each of the three core standards involves significant nuance and raises unique legal issues. With respect to health and environmental regulation, however, there appears to be convergence on the significance of the issue of legitimacy. Under all three standards, the question of whether the state measure was motivated by legitimate regulatory objectives is likely to be at issue at some point in the analysis. Under the FET and nondiscrimination standards, the resolution of that question is likely to be dispositive. If the measure is illegitimate, then it constitutes a breach. If it is legitimate, then, with the exception of situations where the measure violates specific assurances given to the investor, it likely will not constitute a breach.

Under the expropriation standard, there has traditionally been somewhat more space for a legitimate health or environmental regulation to require compensation. However, the emerging trend in this regard, as expressly articulated in recent investment treaties, is that such a regulation would rarely attract compensation, except in certain specific circumstances: where the taking undermined the specific commitments granted to the investor; or, according to some tribunals and commentators, where the measure had a highly

344. Marvin Feldman v. Mexico, NAFTA, ICSID Case No. ARB(AF)/99/1, Award ¶182 (Dec. 16, 2002), available at <http://www.naftaclaims.com>.

345. See *supra* part II.B.

346. See *Pope & Talbot v. Canada*, ¶¶ 80-81 (raising this concern).

disproportionate impact on the investment relative to its purpose.

Notably, certain states have adopted a policy to expressly exclude *bona fide* government regulation from the scope of the expropriation provision in investment treaties. For instance, the 2007 Norwegian Draft Model BIT provides that its expropriation provision “shall not . . . in any way impair the right of a Party to enforce such laws as it deems necessary to control the use of property in accordance with the general interest.”³⁴⁷ This provision appears to exclude the host state from liability under the expropriation provision for *bona fide*, generally applicable government regulation in the interest of the public.³⁴⁸ Host states concerned about their ability to regulate in the public interest may wish to include similar language in future investment treaties. In any event, whether or not the investment treaty expressly provides such an exception, the legitimacy of the measure’s purpose will remain of critical importance in assessing whether the exception would apply.

What, then, does it mean for a tribunal to determine whether a measure is legitimate? Although such a question could be construed as a tautology, it appears that tribunals have been able to give it meaning. Indeed, much of the analysis in this paper is essentially an unbundling of the term “legitimate.” While all the nuances cannot be captured in a concise summary, it is possible to identify one crucial distinction: legitimacy in the international investment law context largely concerns the objectives and procedural soundness of a measure, not its substantive merits (although substantive deficiencies may evidence a wrongful motive). A regulatory action may be illegitimate if, for example, discrimination or unjust enrichment motivated it, or if it seriously departed from established procedures. It would not be illegitimate just because, for example, the underlying scientific justification was flawed or later proved mistaken, or if the cost-benefit analysis greatly emphasized risk avoidance over investment protection or economic value.

In that respect, international investment law is distinct from international trade law in not requiring an assessment of whether a regulation was “necessary” for protecting health or the environment. Such a distinction is sensible given the different legal frameworks and objectives of investment and trade law. Regulations in the investment law context are applied directly to the

347. 2007 Norway Draft Model BIT, art. 6(2), at <http://ita.law.uvic.ca/>; see also *id.* art. 12 (“Nothing in this Agreement shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Agreement that it considers appropriate to ensure that investment activity is undertaken in a manner sensitive to health, safety or environmental concerns.”).

348. This conclusion is confirmed by the cover letter to the Model BIT. See Cover Letter to 2007 Norway Draft Model BIT (7 Jan. 2008) at 2, at <http://ita.law.uvic.ca/> (“The right of states to exercise legitimate authority has . . . been a central factor in the work on a new Norwegian model agreement. In order to meet the authorities’ need to regulate, the draft model agreement contains provisions that emphasize the legitimacy of states’ general legislative authority, exercise of authority and political freedom of action in their own territory.”).

state's own territory, while in trade law, they address conduct that occurs extra-territorially. Additionally, states typically are more incentivized to violate their international trade obligations (given the differing political views on the merits of imports and foreign investment).³⁴⁹

That said, the risk with the investment law approach—particularly the placing of the burden on the investor to establish that the state's purpose was wrongful—is that states will be too readily able to do what they have done in the trade context, which is to use environmental or health regulation as a cover for wrongful conduct. While investors succeeded in early cases which fit this dynamic, such as *S.D. Myers* and *Metalclad*, they might find it more difficult to prevail if host states become more adept at disguising their actions.

The final question, then, is, if the state of international investment law is as suggested above, what does that mean for government regulation? Put simply, a state's ability to engage in good faith environmental and health regulation does not appear to be significantly impeded by international investment law. In the FET and nondiscrimination context, that appears to include regulation in accordance with the precautionary principle, as investment law, unlike WTO/GATT jurisprudence, does not include a "necessity" test which could be problematic for precautionary regulation. Even if the indirect expropriation standard is interpreted as potentially requiring compensation for "takings" caused by legitimate regulations, the space for investors to prevail on such a claim appears very narrow—albeit more open in cases of precautionary regulation.

Somewhat ironically, one way in which international investment law appears capable of influencing environmental and health regulation is by incentivizing improved administration of environmental and health affairs by penalizing states for procedural shortcomings. Although it may be optimistic to expect such a positive impact, the possibility that a state's international investment obligations could improve governance in this area should not be that surprising. As the above analysis makes clear, investment protections are in large part concerned with whether a state acts in good faith. States that conduct their regulatory affairs in a transparent, fact-driven manner with the aim of fulfilling legitimate environmental and health objectives should have little cause to worry about liability under investment treaties.

* * *

POSTSCRIPT

The recently issued decision in a NAFTA case, *Chemtura Corp. v. Canada*, is a significant marker of international investment law's development regarding

349. See DiMascio & Pauwelyn, *supra* note 340, at 53-58.

claims relating to environmental and health measures. The claimant, a major U.S. based chemical manufacturer, argued that measures taken by Canada relating to the review and eventual banning of an agro-chemical, lindane, constituted a breach of Canada's investment treaty obligations.³⁵⁰ As such, the case bears significant resemblances to the *Ethyl* and *Dow AgroSciences* cases, which likewise involved bans of chemicals (albeit a manifestly more suspect importation ban in *Ethyl*).

The award, which is the unanimous decision of a prominent tribunal,³⁵¹ decisively rejects the claimant's arguments that Canada breached its NAFTA obligations, specifically Article 1110 (expropriation) and Article 1105 (FET/MST).³⁵² As a general matter, the award thus stands as a strong confirmation that legitimate regulatory conduct does not significantly conflict with a state's investment treaty obligations.

In addressing the claim of indirect expropriation, the tribunal found that the cancellation of the claimant's lindane registrations did not substantially deprive the claimant of its investment, and no such expropriation had taken place.³⁵³ The tribunal found that "the sales from lindane products were a relatively small part of the overall sales of Chemtura Canada at all relevant times" and as such "the interference of the Respondent with the Claimant's investment can not be deemed 'substantial'."³⁵⁴

Nonetheless, the tribunal found that the measures in question constitute "a valid exercise of the Respondent's police powers." The tribunal explained:

[T]he Tribunal considers in any event that the measures challenged by the Claimant constituted a valid exercise of the Respondent's police powers. As discussed in detail in connection with Article 1105 of NAFTA, the [Pest Management Regulatory Agency of Canada] 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.³⁵⁵

The authors agree that, under the circumstances presented in this case, especially given the legitimate health and environmental concerns, Canada's measures were a legitimate exercise of its police powers. However, the authors caution against a broad reading of this passage as a general police power exception for acts that would otherwise constitute expropriatory acts. As

350. *Chemtura Corp. v. Canada*, NAFTA/UNCITRAL, Award ¶¶ 92-96 (Aug. 2, 2010).

351. The tribunal was comprised of Gabrielle Kaufman-Kohler (President), Charles N. Brower, and James R. Crawford.

352. *Chemtura Corp. v. Canada*. The claimant also unsuccessfully argued that it was entitled to the protection provided by more favorable FET standards found in other BITs by virtue of NAFTA's MFN clause. *Id.* ¶¶ 231-37.

353. *Id.* ¶¶ 259-65.

354. *Id.* ¶ 263.

355. *Id.* ¶ 266.

discussed in this article a regulatory measure within the state's police powers may be expropriatory and attract the compensation requirement if it violates specific commitments made to an investor. Some tribunals will also treat the measure as expropriatory if it is highly disproportionate relative to the measure's purpose.

With regard to the FET standard, the claimant argued that several specific measures constituted a breach, either because: (i) the state lacked a sufficient scientific basis for taking the measure; (ii) the measure was taken in bad faith because it was motivated by a wrongful purpose; or (iii) the regulatory process associated with the measure was flawed and unfair.

The tribunal expressly rejected determining whether the measure constituted a breach because its scientific basis was flawed.³⁵⁶ The tribunal was willing, however, to examine the overall factual context in assessing arguments that the measures were taken in bad faith.³⁵⁷ In making that assessment, the tribunal noted that the burden of proof rested on the claimant, and that the standard of proof was demanding.³⁵⁸ On the facts, the tribunal found that the claimant failed to satisfy that burden with respect to any of the measures.³⁵⁹ The claimant appears to have lacked direct evidence of disingenuous purpose of the sort seen in *S.D. Myers* and the overall factual context did not provide a basis for inferring bad faith.

The tribunal made it clear that while shortcomings in the regulatory process could rise to a level of unfairness constituting a breach the state would not be held to an unreasonably high standard. It explained, for example, that it "must take into account the obvious fact that the operation of complex administration is not always optimal in practice and that the mere existences of delays is not sufficient for a breach of the international minimum standard of treatment."³⁶⁰ The tribunal then noted, however, "This is not to say that a violation must be outrageous in order to breach such standard."³⁶¹ While the tribunal identified additional general principles that would guide its assessment on this point,³⁶² it ultimately found that there were no significant procedural shortcomings, which made it unnecessary for the tribunal to more precisely determine what type of

356. *Id.* ¶ 134.

357. *See, e.g. id.* ¶ 137.

358. *Id.* at 137 (citing *Bayindir v. Pakistan, supra* note 210, ¶ 143)

359. *Id.* part II.B.

360. *Id.* ¶ 215.

361. *Id.*

362. *Id.* ("(1) The failure to fulfill the objectives of administrative regulations without more does not necessarily rise to a breach of international law. (2) A failure to satisfy requirements of national law does not necessarily violate international law. (3) Proof of a good faith effort by the Government to achieve the objectives of its laws and regulations may counter-balance instances of disregard of legal or regulatory requirements. (4) The record as a whole – not isolated events – determines whether there has been a breach of international law.") (quoting *GAMI Investments, Inc. v. Mexico, NAFTA/UNCITRAL, Award* ¶ 97 (Nov. 15, 2004)).

procedural infirmities constitute a breach.

In summary, the tribunal's unambiguous rejection of the claims confirms that investment treaty obligations do not significantly impede a state's ability to engage in legitimate regulatory activities. Consistent with the authors' analysis in this article, it will be unlikely that a *bona fide* regulatory measure of general application will result in the level of interference necessary to be considered expropriatory. In any event, where the purpose of the measure is compelling, such as for the protection of human health and the environment, it will be difficult to show that the measure is disproportionate to the purpose in question, and will rarely be found to be expropriatory. With regard to the FET standard, even if NAFTA jurisprudence may be seen as fragmented because of the Note of Interpretation equating the FET standard with the international MST, the tribunal's rejection of the FET claims in this case had more to do with the fundamental character and purpose of the FET standard than whether or not it equates to the MST. As such, that aspect of the decision may be influential in affirming that the space under the FET standard for claimants to seek recovery for harm caused by legitimate regulatory conduct is limited.