

**GALATASARAY UNIVERSITY
SOCIAL SCIENCES INSTITUTE
DEPARTMENT OF PRIVATE LAW**

**BALANCING INVESTOR RIGHTS
AND THE PROTECTION OF ENVIRONMENT
IN INVESTMENT DISPUTES**

MASTER THESIS

Ürün TEKİN

Thesis Advisor: Prof. Dr. Tolga AYOĞLU

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FOREWORD

I have always been in awe of the nature. Since I started studying law, I have been looking for a way to contribute to the protection of the nature I loved, but I had also chosen to specialise on private law.

During my master studies in Geneva, I watched a documentary, and witnessed the suffering of local communities which I have been learning to protect against state interventions. Indeed, what if these interventions aimed to protect the local population against polluting practices of the investor?

I decided to work on balancing the private interests of the investor with the great interest of the local community, and indirectly of all communities that share the one and only mother earth.

Hoping that my conclusions would be a raindrop of contribution to the protection of environment, I would like to thank a few people who have made this thesis possible.

First of all, I would like to thank Prof. Dr. Tolga Ayoğlu, my thesis advisor, for his valuable time, guidance and patience. He has always believed in me and supported my work. I am truly grateful.

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ABBREVIATIONS

art.	: Article
BIT	: Bilateral investment treaty
DCF	: Discounted Cashflow
DSU	: Dispute Settlement Understanding
ECHR	: European Convention on Human Rights
ECtHR	: European Court of Human Rights
eds.	: Editors
<i>e.g.</i>	: <i>exempli gratia</i> (for the sake of example)
EIA	: Environmental Impact Assessment (<i>Çevre Etki Değerlendirmesi</i>)
<i>et. seq.</i>	: <i>et sequens</i> (and following)
EU	: European Union
FET	: Fair and equitable treatment
GATT	: General Agreement on Tariffs and Trade
<i>Ibid.</i>	: <i>ibidem</i> (in the same place as previous)
ICJ	: International Court of Justice
ICSID	: International Centre for Settlement of Investment Disputes
<i>i.e.</i>	: <i>id est</i> (that is)
ILA	: International Law Association
ILC	: International Law Commission

MAI	: Multilateral Agreement on Investment
MTBE	: Methy tert-buthyl ether
MPEPIL	: Max Planck Encyclopaedia of Public International Law
NAFTA	: North Atlantic Free trade Agreement
No.	: number
OECD	: Organisation for Economic Co-operation and Development
<i>op.cit.</i>	: <i>opere citato</i> (in the cited work)
p.	: page
para./paras.	: paragraph/paragraphs
PBS	: Public Broadcasting Service (American TV Channel)
PCA	: Permanent Court of Arbitration
PCIJ	: Permanent Court of International Justice
pp.	: page to page
SLO	: Social Licence to Operate
UK	: United Kingdom
UN	: United Nations
UNESCO	: UN Educational, Scientific and Cultural Organization
USA	: United States of America
USD	: United States Dollars
v.	: <i>versus</i>
VCLT	: Vienna Convention on the Law of Treaties
vol.	: volume

WTO : World Trade Organization



RESUME

Pour attirer l'investissement et promouvoir le développement, les Etats offrent une protection internationale aux investisseurs étrangers par les traités d'investissement bilatéraux ou multilatéraux. Ces traités offrent une protection du droit international aux investisseurs et à l'investissement, qui sont normalement soumis au droit municipal de l'État hôte. En dehors du cadre de la protection internationale des investissements, les personnes privées ne pourraient pas bénéficier de la protection du droit international.

Lorsque les Etats prennent des mesures pour protéger l'environnement, il est très probable que ces mesures portent atteinte aux droits de l'investisseurs étrangers. En conséquence, les intérêts économiques des investisseurs se heurtent aux grands intérêts de la communauté locale. Si nous protégeons l'investisseur comme on fait pour toutes autres interventions de l'État, nous limitons considérablement la capacité et la volonté de l'État de protéger son environnement. Cependant, si nous protégeons l'environnement aux dépens des investisseurs, ceux-ci risqueraient de ne pas attirer l'investissement dans les pays où les considérations environnementales sont élevées. Pour régler ce conflit d'intérêts, il faut trouver un équilibre entre la protection internationale accordée à l'investissement et les intérêts des États en matière de protection de l'environnement.

La protection de l'environnement est réalisée en utilisant le droit de réglementation des États. Nous ne pouvons pas nier l'existence du droit inhérent des États de réglementer en vertu du droit international. Cependant, ce droit, en soi, ne justifie pas l'ingérence dans des droits de propriété qui sont également protégés par les règles du droit international. En principe, le droit de l'État aux expropriations unilatérales est reconnu, mais ces expropriations unilatérales doivent être corrigés au moyen d'une compensation proportionnelle.

Les concerns de préservation de l'environnement se reflètent déjà dans les pays développés qui ont des systèmes juridiques avancés. Cependant, en ce qui concerne

les pays en développement, il faut toujours des progrès importants. Les réformes que doivent être effectuées par les pays en développement aussi intéressent le monde entier aussi que les communautés locales de cet État. En conséquence, le fardeau de l'indemnisation causé par un acte dont le monde entier profitera ne devrait pas être porté par à l'État en développement.

Compte tenu du droit international, le principe du pollueur-payeur est déjà établi en tant que principe du droit international de l'environnement. L'investisseur peut avoir établi une pratique polluante avec l'autorisation de l'État à un moment donné, ou bien être devenu polluant au fil du temps avec l'ignorance de l'État. Cela ne signifie pas que l'État ne peut pas décider d'éviter la pratique polluante. Lorsque l'intérêt public lié à l'environnement qui se trouve à la base de l'acte de l'État (ce qui monte au niveau d'expropriation) est très important, il convient de donner à l'État la possibilité d'éviter des lourdes conséquences financières. Sinon, l'Etat ne sera peut-être pas aussi disposé à améliorer la protection de son environnement.

La question clé ici est le but de l'État hôte. Si les actes de l'État ne sont pas faits de bonne foi, l'État devrait être tenu de recouvrer les dommages de l'investisseur. C'est une conclusion tout à fait logique puisque l'État hôte ne devrait pas être autorisé à utiliser les concerns environnementales alléguées pour satisfaire ses autres buts, telles que les buts économiques.

La proportionnalité est l'un des critères à utiliser pour résoudre ce dilemme. Concept largement appliqué en droit administratif et en droit international des droits de l'homme, plusieurs tribunaux des investissements ont analysé l'action de l'État hôte afin de déterminer s'il s'agissait de l'acte approprié pour atteindre les objectifs prétendument poursuivis par l'État hôte. Les mesures environnementales sont également soumises au critère de proportionnalité : si un tribunal parvient à la conclusion que l'État hôte aurait pu obtenir les résultats souhaités avec des mesures de moins d'ingérence, il est probable que l'État hôte manquera à ses obligations en vertu du traité d'investissement.

La non-discrimination est l'autre critère important à cette fin. Il est évident qu'une action visant spécifiquement l'investisseur étranger ne sera pas conforme aux traités d'investissement, même si elle est proportionnelle à l'objectif. La seule exception à cette conclusion évidente serait une situation dans laquelle l'objectif

souhaité ne peut être atteint qu'en ciblant cet investisseur spécifique. Un scénario similaire consiste de sélectionner un secteur, sans raison valable. Si l'environnement est pollué de la même manière par différents secteurs mais l'État hôte met en œuvre une réglementation n'interférant que dans l'un de ces secteurs, l'investisseur peut alors présenter le cas pour discrimination devant un tribunal des investissements.

Si l'intervention de l'État est proportionnelle, non discriminatoire et de bonne foi, l'État devrait être exempté de l'indemnisation des pertes subies par l'investisseur.

En résumé, si l'acte de l'État n'est pas proportionné, ce qui inclut l'illégitimité du but et le caractère inadéquat de la mesure par rapport à l'objectif de l'État, l'investisseur devrait être accordé une compensation. Si la mesure prise par l'État est discriminatoire pour l'investisseur ou le secteur, l'investisseur doit, encore une fois, être accordé une compensation.

En conséquence, nous pouvons décider si une indemnisation est appropriée en examinant la proportionnalité de la mesure ainsi que le caractère non discriminatoire de la mesure, compte tenu bien entendu des principes généraux du droit. Une fois que nous avons établi qu'une indemnisation devrait être accordée à l'investisseur, il convient de poser une question de calcul. Alors, quels sont les critères à examiner lors de la détermination du montant de l'indemnisation ?

Il est bien évident que si l'État n'a pas agi de bonne foi, l'investisseur devrait bénéficier d'une indemnisation intégrale. Cette indemnisation intégrale devrait couvrir toutes les pertes de l'investisseur, ce qui comprend tous les coûts de l'investissement ainsi que les bénéfices perdus de l'investisseur.

En revanche, si l'État a agi de bonne foi, mais a enfreint d'autres critères, il ne devrait pas être tenu de payer les bénéfices perdus ; mais devrait compenser les coûts de l'investissement. À notre avis, ce sera généralement le cas lorsque le but ultime de la mesure prise par l'État est de protéger son environnement et sa population par son intermédiaire.

En parallèle de principe du pollueur-payeur du droit international de l'environnement, dans les cas où l'État interfère avec un investissement nuisible à l'environnement, sans enfreindre les principes de proportionnalité ou de non-

discrimination, le coût de l'investissement polluant devrait être à la charge de l'investisseur. En conséquence, l'État ne devrait pas être tenu d'indemniser les pertes éventuelles.

Nous pensons que dans la plupart des différends environnementales, l'État devra indemniser l'investisseur car il enfreindra très probablement les principes de proportionnalité ou de non-discrimination sans enfreindre les obligations de bonne foi. En conséquence, l'État ne sera tenu d'indemniser que les coûts de l'investissement. L'investisseur n'aura pas perdu de ressources ; mais ne sera pas en mesure de recevoir le bénéfice attendu. La charge de la protection de l'environnement sera partagée par l'investisseur polluant et l'État contrevenant au droit international.

Nous pensons que ces conclusions créent un équilibre des intérêts de l'investisseur et de l'État, dans la mesure où elles tiennent compte à la fois de la protection des investissements internationaux et du droit de réglementer ; l'intérêt économique des investisseurs et celui de la communauté locale ; et à la fois l'investisseur polluant et les violations du droit international par l'État.

Dans la Partie I, nous nous sommes concentrés sur les concepts fondamentaux du droit international et leur lien avec les différends relatifs aux investissements liés à l'environnement. Dans la Partie I Chapitre I, nous avons discuté la fragmentation du droit des investissements internationaux. Pour cela, nous avons examiné la fragmentation du droit international et tenté de déterminer le statut du droit international des investissements. En particulier, nous avons tenté de déterminer si le droit des investissements pouvait être considéré comme un régime juridique autonome.

A la Partie I Chapitre II, nous avons examiné la protection des investissements. Premièrement, nous avons examiné la protection des investissements dans le cadre traditionnel du droit international, dite la protection diplomatique des personnes privées. Ensuite, nous avons expliqué la transition vers les droits directs modernes dans le droit international des investissements et discuté des différences entre ces deux approches. Puis, nous avons essayé de déterminer quand les investissements devenaient indignes de protection. Dans ce contexte, nous avons examiné les conséquences de la violation du droit national, dite la condition de légalité, la violation du droit international, en particulier de l'ordre public international, et des concepts d'abus de droit et de la doctrine d'« unclean hands ».

Dans la partie I, section III, nous avons examiné les règles relatives à la protection de l'environnement. Dans ce contexte, nous avons abordé la question des développements en matière de rédaction de BIT à partir de l'ère de la protection réciproque des investissements vers les provisions de « carve-out ». Nous avons également examiné le modèle BIT turc dans, ainsi que l'évolution de la tendance dans les BITs turcs. Nous avons ensuite examiné si des conventions internationales sur l'environnement pouvaient jouer un rôle dans les différends relatifs aux investissements. Nous avons abordé les lois nationales et en particulier les procédures d'évaluation de l'impact sur l'environnement, en accordant une attention particulière à la réglementation turque. Ensuite, nous avons discuté des concepts de licence sociale d'exploitation et nous avons évalué si la procédure d'évaluation de l'impact sur l'environnement en Turquie était réellement une licence sociale. Enfin, nous nous sommes concentrés sur le concept de responsabilité sociale des entreprises, qui n'est pas un concept juridique mais qui trouve toujours une application importante.

Dans la Partie I Chapitre IV, nous avons examiné la loi applicable aux différends relatifs aux investissements liés à la protection de l'environnement. Tout d'abord, nous avons examiné le concept de développement durable et son insuffisance. Puis, nous avons déterminé que les règles applicables aux différends relatif à l'investissement sont en principe les règles du traité sur l'investissement. Toutefois, des principes généraux de droit international (en particulier de la CVDI) ou des traités d'investissement (BIT) peuvent imposer l'application d'autres règles pertinentes. Parmi ces règles peuvent figurer des traités internationaux sur l'environnement qui créent des obligations privées et le droit de l'État hôte, y compris ses règles environnementales. En principe, le droit international de l'environnement n'impose des obligations qu'aux États. Cependant, certains traités peuvent donner des droits directs à des personnes privées. Ces traités alors peuvent être appliqués par les tribunaux. En outre, des principes généraux du droit international de l'environnement, tels que le principe du pollueur-payeur, peuvent trouver une application dans les différends relatifs aux investissements liés à l'environnement, ainsi qu'aux politiques publiques internationales / transnationales. Dans le cadre de ce chapitre, nous avons également discuté la responsabilité sociale des sociétés, ainsi que de l'application du droit de l'État d'accueil et du droit de l'État d'origine de l'investisseur.

Ici nous avons conclu qu'en tant que principe de droit international, les investissements devaient être conformes au droit de l'État hôte et la plupart des traités d'investissement précisaient expressément cette exigence. Nous avons en outre conclu que s'il existe une violation du droit de l'État d'accueil lors de l'établissement de l'investissement, l'investisseur ne pourrait, dans la plupart des cas, pas bénéficier des droits qui lui étaient offerts en vertu du traité d'investissement. Plus important encore, nous avons vu la possible violation par l'investisseur d'une politique publique internationale ou transnationale. Nous avons examiné les résultats d'une violation de l'ordre public par l'investisseur lui-même, qui ne donnerait lieu à aucune protection en vertu d'un traité d'investissement. Nous avons également examiné les cas où le partenaire local de l'investisseur causait la violation, où l'investisseur pouvait toujours bénéficier de la protection prévue par la convention si l'investisseur était totalement innocent, ou, selon d'autres tribunaux, si la violation était mineure.

A la Partie II nous avons mis l'accent sur la violation des droits des investisseurs dans l'intérêt de la protection de l'environnement. En particulier, nous avons discuté des différences entre les normes de traitement les plus importantes, FET, Expropriation, et le niveau général d'indemnisation. Nous avons également observé que le droit de réglementer peut constituer une défense pour l'État hôte afin de réglementer les questions environnementales et nous avons analysé les limites et les conditions de ce moyen de défense.

Pour cette raison, nous avons examiné deux extrémités de la doctrine, à savoir la doctrine des seuls effets et la doctrine des pouvoirs policiers radicaux. Nous avons ensuite examiné si le but de la modification de la réglementation pouvait avoir une influence sur la non-responsabilité de l'État intervenant. Dans ce contexte, nous avons discuté du concept de proportionnalité et de non-discrimination des investisseurs.

Enfin, compte tenu de toutes ces questions, nous avons abouti aux conclusions susmentionnées.

ABSTRACT

To attract investment and promote development States offer international protection to foreign investors through bilateral or multilateral investment treaties. These treaties offer international law protection to investors and to the investment, which are normally subject to the host State's domestic law. Outside the framework of international investment protection, private persons would not be able to benefit from the protection of international law.

When States take measures that aim to protect the environment, there is a high possibility that these measures interfere with the foreign investors' rights. Accordingly, the economic interests of the investors clash with the grand interests of the local community, the host State's subjects. If we protect the investor just like against any other State intervention, we greatly limit the State's ability and willingness to protect its environment. However, if we only protect the environment at the expense of investors, then the investors would not risk investing in countries where environmental concerns are high. Settling this conflict of interests requires balancing the international protection afforded to the investment with State's interests in protecting the environment.

The protection of environment is executed using the States' right to regulate. We cannot deny the existence of the States' inherent right to regulate under international law. However, this right by itself, does not justify the interference with property rights which are also protected by international law rules. As a principle, the State's right to unilateral takings is recognised but these unilateral takings must be corrected through a proportional compensation.

Environment preservation concerns are already reflected to well established developed countries with advanced legal systems. However, when it comes to developing countries, there is still room for significant progress. The reforms that the developing countries need to undergo are in great interest of the whole world among with the local communities of the State. Accordingly, the burden of compensation

caused by an act that the whole world will eventually benefit, should not be left solely on the developing State.

Considering international law, the principle of polluter-pays is already established as a principle of international environmental law. The investor may have established a polluting practice with the authorisation of the State at a given time, or the practice may have become polluting over time with the ignorance of the State for a period of time. This does not mean that the State may not decide to avoid the polluting practice. When the environment related public interest behind the act of the state –that amounts to taking of the polluting investment– is very significant, the State should be given the opportunity to avoid heavy financial consequences. Otherwise it may not be as willing to improve its environment protection.

The key question here is the purpose of the host State. If the State's act is in not made bona fide, the State should be obliged to recover investor's rights in full. This is a quite logical conclusion since the host State should not be allowed to utilise alleged environmental concerns to satisfy its other concerns, such as economic concerns.

Proportionality is one of the criteria to be employed in settling this dilemma. As a concept that has been widely applied in administrative law and international human rights law, several investment tribunals have analysed the host State's action to understand if it was the right act to achieve the goals that are allegedly pursued by the host State. Environmental measures are similarly subject to proportionality test: if an investment tribunal reaches the conclusion that the host State could have achieved the desired results with less interfering measures, then it is likely that the host State will be in breach of its obligations under the investment treaty.

Non-discrimination is the other important criteria for this purpose. It is obvious that an action targeting the foreign investor specifically will not be in conformity with the investment treaty, even if it is proportional to the goal. The only exception to this obvious conclusion would be a situation where the goal desired can only be achieved by targeting that specific investor. A similar scenario is singling out a sector, without a valid reason. If the environment is polluted in the same manner by different sectors but the host State implements a regulation interfering only with one of these sectors, then investor may present a strong discrimination claim before an investment tribunal.

If the State's interfering act is proportional, non-discriminatory and made bona fide, the State should be exempted from compensating losses of the investor.

In summary, if the State's act is not proportionate, which includes the illegitimacy of the goal and inappropriateness of the measure to the State's goal, the investor should be awarded a compensation. If the measure taken by the State is discriminatory to the investor or to the sector, then the investor must be, once more, awarded a compensation.

Accordingly, we may decide whether a compensation is due by examining the proportionality of the measure as well as the non-discriminatory character of the measure considering of course general principles of law. After we establish that a compensation should be awarded to the investor, a question related to calculation should be raised: What are the criteria that we should examine while determining the amount of compensation?

Once more, it is quite clear that if the State has not acted in good faith, the investor should be awarded a full compensation. This full compensation should cover all the losses of the investor which includes all costs of the investment as well as future lost profits of the investor.

On the other hand, if the State has acted in good faith, but breached other criteria, it should not be required to pay for the lost profits; but compensate only the costs of the investment. In our opinion, this will usually be the case when the ultimate goal of the State's measure is the protection of its environment and its population through it.

In line with the polluter-pays principle of international environmental law, in the cases where the State interfered with the investment that is harmful to the environment, without breaching the principles of proportionality or non-discrimination, the costs of the polluting investment should be the burden of the investor. Accordingly, the State should not be obliged to compensate any losses.

We believe that in most environmental cases the State will need to pay a compensation to the investor, because it will most probably be in breach of proportionality or non-discrimination principles without breaching good faith obligations. Accordingly, the State will only be obliged to compensate the costs of the

investment. The investor will not have lost any resources; but will not be able to receive the expected profit. The burden of protection of the environment will be shared by the polluting investor and international law-breaching State.

We believe these conclusions create a balance of interests of the investor and the State as they take into consideration both the international investment protection and the right to regulate; both the investors' economic interest and the interest of the local community; and both the investor's polluting and State's breaches of international law.

In Part I, we focused on fundamental concepts of international law and how they relate to environment related investment disputes. In Part I Section I we discussed fragmentation of international investment law. For this we examined the fragmentation of international law and tried to determine the status of international investment law. Particularly we tried to answer whether investment law can be considered a self-contained legal regime.

In Part I Section II, we examined protection of investments. First, we addressed the protection of investments in the traditional international law framework, *i.e.* the diplomatic protection of private persons. Then, we explained the transition to modern direct rights under international investment law and discussed the differences under these two approaches. Later, we tried to determine when investments become unworthy of protection. In this context we examined the results of the breach of national law *i.e.* the legality requirement, the breach of international law, particularly of the international public policy, and the concepts of abuse of rights and unclean hands doctrine.

In Part I Section III, we examined rules that are relevant to the environment protection. In this context we addressed the issue of developments in BIT drafting from the era of reciprocal protection of investments to carve out provisions. We also examined the Turkish model BIT in this chapter, as well as the changed tendency in Turkish BITs. Then, we examined whether international environmental conventions that could play a role in the investment disputes. Afterwards, we discussed national laws and especially the environmental impact assessment procedures giving a particular focus to Turkish regulation. Then we discussed the concepts of social licence to operate and we assessed whether Turkish environmental impact assessment procedure is actually a social licence. Lastly, we focused on the concept of social

responsibility of corporations, which is not a legal concept but still finds important application.

In Part I Section IV, we examined the law applicable to investment disputes in relation to the protection of environment. First, we examined the concept of sustainable development and how it did not suffice. Then we determined that in principle rules applicable to the investment dispute are the rules of the investment treaty. However, general principles of international law (particularly VCLT) or investment treaties (BIT) may require the application of other relevant rules. Amongst these rules may come international environmental treaties that give rise to private obligations. In principle, international environmental law only raises obligations to States. However, certain treaties may give direct rights to private persons. These treaties may be applied by tribunals. Similarly, certain treaties allow application of host State's law, including its environmental rules. Also, general principles of international environmental law, such as polluter-pays principle may find application to the environment related investment disputes, as well as international/transnational public policy. Under this Chapter we also discussed the social responsibility of corporations, as well as the application of the law of host State and law of home State of the investor.

Here we concluded that as a principle of international law investments must be made in conformity with the law of the host State and most of the investment treaties specifically point out this requirement. We further concluded that as a consequence of violation of the law of the host State during the establishment of the investment, in most cases, the investor will not be able to enjoy the rights offered to it under the investment treaty. More importantly we focused on the investor's possible breach of international or transnational public policy. We examined the results of a violation of public policy by the investor itself, which will result with no protection under investment treaty. Also, we examined the cases where the local partner of investor causes the breach without the investor's knowledge, where the investor may still enjoy treaty protection if the investor is completely innocent, or according to other tribunals, if the breach is minor.

In Part II, we focused on the breach of investor's right for the sake of environmental protection. In particular, we discussed the differences in between the most important treatment standards, FET, Expropriation, and general standard of

compensation. We also observed that the right to regulate can be a defence for the host State to regulate environmental matters and we analysed the limits and conditions for this defence. For this reason, we examined two extreme ends of the doctrine, namely sole effects doctrine and radical police powers doctrine. Then we discussed whether the purpose of the regulatory change might have any influence on the non-responsibility of the intervening state. In this context we discussed the concept of proportionality and non-discrimination of investors.

Finally, considering all these issues we reached the above mentioned conclusions.



ÖZET

Devletler ülkelerini geliştirebilmek amacıyla ülkelere uluslararası yatırım çekebilmek için yabancı yatırımlara iki veya çok taraflı yatırım anlaşmalarıyla uluslararası koruma sağlarlar. Bu anlaşmalar, normalde ev sahibi devlet hukukuna bağlı olan yatırım ve yatırımcılara uluslararası hukuk kapsamında bir koruma sağlar. Bu uluslararası yatırım hukuku koruması çerçevesi uygulanmadığı sürece bireylerin uluslararası hukuk korumalarından yararlanması mümkün değildir.

Devletler ülkelerinde çevre korumaya yönelik önlemler aldıklarında, uluslararası yatırımcının haklarını olumsuz yönde etkileyebilirler. Bu durumda yatırımcının ekonomik çıkarları, o Devletin ülkesinde yaşayan ve korumasında olan toplulukların genel çıkarlarıyla çatışır. Eğer yatırımcıyı herhangi bir yatırım uyuşmazlığında olduğu şekilde devlet müdahalesinden tamamen koruyacak olursak, devletin çevreyi koruma kapasitesinin ve istekliliğinin büyük ölçüde önüne geçmiş oluruz. Ancak, yalnızca çevreyi koruyup yatırımcının haklarını tamamen gözardı edersek, çevresel risklerin yüksek olduğu ülkeler yatırım çekme şanslarını tamamen kaybederler. Bu çatışmanın tek çözümü, yatırımcıya tanınan uluslararası hukuk koruması ile devletin çevreyi koruma çıkarlarının dengelenmesinden geçer.

Devlet tarafından çevrenin korunması, devletin yönetme hakkının kullanılmasıyla gerçekleştirilir. Bu hak, devletin en temel hakkıdır ve yadsınamaz. Ancak bu hakkın var olması tek başına uluslararası hukukça da korunan mülkiyet haklarına müdahaleyi hukuka uygun hale getirmez. Kural olarak devletin tek taraflı el koyma hakkı bulunmakla birlikte, bu el koymadan doğan zararlar orantılı bir tazminatla giderilmelidir.

Gelişmiş ülkelerde çevre koruma kültürü hukuk sistemine yansımıştır. Ancak gelişmekte olan ülkelere ilerlenecek çok konu bulunmaktadır. Gelişmekte olan ülkelerin gerçekleştirmesi gereken çevre reformları hem o ülke topluluklarına hem de tüm dünya topluluklarına fayda sağlayacaktır. Bu sebeple de tüm dünyanın yarar

sağlayacağı bir düzenlemenin olası yükünün tamamını o düzenlemeyi gerçekleştiren gelişmekte olan devlete yüklememiz beklenemez.

Uluslararası hukuk kapsamında, kirleten öder ilkesi, uluslararası çevre hukukunun yerleşmiş prensiplerinden biridir. Yatırımcı, devletin o anki izniyle kirleten bir aktivite yapmaya başlamış olabilir, veya devletin görmezden gelmesiyle yapılan aktivite kirleten bir hal almış olabilir. Bu durum, devletin daha sonra bu aktiviteyi engellemeye karar vermesine engel değildir. Devletin el koyma olarak değerlendirilebilecek müdahalesinin arkasında gözetilen kamu yararının önemine göre devlete, çok ağır finanslar sorumluluklar yüklenmesini önleme şansı verilmelidir. Aksi halde devlet çevre koruma kurallarını geliştirme konusunda gönülsüzleşecektir.

Bu kapsamda dikkat edilmesi gereken ilk nokta ev sahibi devletin amacıdır. Devlet iyi niyetli bir karar almadıysa, yatırımcının tüm zararlarını karşılamalıdır. Bu, devletin çevre sorunlarını bahane ederek farklı amaçlarını gerçekleştirmesini önleme gereğinin mantıksal bir sonucudur.

Bu ikilemin çözülmesinde dikkate alınması gereken en önemli nokta, orantılılıktır. Orantılılık kavramı idare hukukunda ve uluslararası insan hakları hukukunda geniş kabul gören bir kavramdır. Uluslararası yatırım hakem heyetleri birçok davada devletin müdahalesini incelemiş ve bu müdahalenin devletin amacına ulaşması için doğru araç olup olmadığını incelemiştir. Çevresel önlemler de orantılılık testiyle incelenmelidir. Eğer bir yatırım hakem heyeti, müdahaleyi incelerken devletin amacına erişmesinde yatırımcıya daha az verebileceği yöntemler olduğunu belirlerse müdahalenin devletin yatırım hukukundan doğan yükümlülüklerine aykırı olduğuna karar vermesi gerekir.

Bu amaçla incelenecek bir diğer nokta, ayırım yasağıdır. Özel olarak bir yatırımcıyı hedef alan bir müdahalenin, amaçla orantılı olsa dahi, yatırım anlaşmasının kurallarına uygun olduğunu kabul edemeyeceğimiz açıktır. Buna örnek gösterebileceğimiz tek aykırılık, amacın gerçekleştirilmesi için yalnızca bir yatırımcının hedef alınmasının zorunlu olduğu durumlardır. Benzer bir senaryo olarak geçerli bir sebep olmaksızın belli sektörlerin hedef alınmasını gösterebiliriz. Çevre farklı sektörler tarafından aynı şekilde kirletiliyorsa fakat devlet yalnızca bir sektöre müdahale etmişse, yatırımcı ayrımcılık yasağına aykırılık sebebiyle güçlü bir iddiaya sahip olacaktır.

Devlet müdahalesi hem orantılı hem de ayrımcı değilse, aynı şekilde iyi niyet kuralları çerçevesinde yapılmışsa, artık devletin yatırımcının zararlarını giderme zorunluluğu bulunmamalıdır.

Özetle devlet orantısız bir müdahalede bulunmuşsa (buna amacın meşru olmaması ve aracın amaca uygun olmaması da girer), yatırımcının tüm zararları giderilmelidir. Aynı şekilde devlet müdahalesi yatırımcı veya yatırım sektörü konusunda ayırım yapıyorsa, bir kez daha yatırımcının tüm zararları giderilmelidir.

Devletin tazminat ödeyip ödememesi, yatırıma yapılan müdahalenin orantılılığı ve ayrımcı olup olmamasına bağlı olduğu kadar, hukukun genel ilkelerine aykırı olup olmamasına da bağlıdır. Bu kapsamda yatırımcıya tazminat ödenmesi gerektiği sonucuna ulaşırsa, bu tazminatın miktarının hesaplanması sorunu ortaya çıkacaktır. Peki, tazminat miktarını hesaplarken hangi kriterleri dikkate almalıyız?

Devletin iyi niyetli hareket etmediği durumlarda yatırımcının zararlarının tamamının giderilmesi gerektiği açıktır. Bu tazminat, tüm yatırım giderlerini içerdiği gibi ayrıca elde edilemeyecek karları da kapsamaktadır.

Diğer taraftan devlet iyi niyetli hareket etmiş ve meşru bir amaç için hareket bir müdahale gerçekleştirirken orantılılık ya da ayırım yasağı kriterlerine aykırı davranmışsa, yalnızca yatırımcının yatırım giderlerini karşılamalıdır. Fikrimizce asıl amacın çevrenin ve dolayısıyla halkın korunması olduğu müdahalelerde genellikle bu çözüme ulaşılabacaktır.

Çevre hukukunun kirleten öder prensibine paralel şekilde, devletin çevreye zarar veren bir yatırıma, hiçbir kritere aykırı hareket etmeden müdahale ettiği durumlarda, kirliliğe sebep olan yatırımın giderlerinin yatırımcıya yüklenmesi gerekir. Yani devletin hiçbir zararı gidermesi beklenmemelidir.

Fikrimizce devletin yatırımcıya tazminat ödemesi gereken çevreyle bağlantılı yatırım uyuşmazlıklarının çoğunda iyi niyet kurallarına uygun şekilde hareket eden devlet, orantılılık veya ayırım yasağına aykırı hareketmiş olacaktır. Buna göre de devletin yalnızca yatırım giderlerini ödemesi gerekecektir. Böylece yatırımcı kaynaklarını kaybetmemiş olacak, ancak kazanmayı hedeflediği kardan mahrum

kalacaktır. Çevrenin korunmasının yükü, çevre kirliliğine sebep olan yatırımcı ile uluslararası yükümlülüklerini gözetmeyen devlet arasında paylaşılmış olacaktır.

Fikrimizce bu sonuç, yatırımcı ile devletin çıkarları arasında bir denge kurmaktadır. Çünkü bu sonuçlar yatırımların uluslararası korunması kurallarıyla devletin düzenleme hakkını, yatırımcının ekonomik çıkarlarıyla yerel toplulukların haklarını ve yatırımcının kirliliğe sebep olmasıyla devletin uluslararası yükümlülüklerine aykırılığı aynı anda dikkate almaktadır.

Bu çalışmanın Birinci Bölümünde uluslararası hukukun temel konseptleri ve bunların çevre ile alakalı uluslararası yatırım uyumsuzluklarıyla olan ilişkisini inceledik. Bu inceleme kapsamında uluslararası yatırım hukukunun bölünmesini inceleyip uluslararası yatırım hukukunun konumunu belirlemeye çalıştık. Özellikle.

Birinci bölümün II numaralı başlığında ise yatırım hukukunun kapalı bir hukuk sistemi olup olmadığını tartışıp, uluslararası hukukun bireyleri korumasının klasik yöntemi olan diplomatik korumayı inceledik. Daha sonra uluslararası yatırım hukukunda gerçekleşen modern doğrudan haklar kavramını inceledik ve bu iki yaklaşımın farklarını tartıştık. Akabinde, yatırımların hangi şartlar altında korunmaya layık olmadığını tartıştık. Bu kapsamda ulusal hukukun ihlali (hukuki olma zorunluluğu), uluslararası kamu düzeninin ihlali başta olmak üzere uluslararası hukukun ihlali ve hakkın kötüye kullanımını kirli eller doktrinini inceledik.

Birinci bölümün III numaralı başlığında ise, çevrenin korunmasına ilişkin kuralları inceledik. Bu bağlamda karşılıklı yatırımların korunması anlaşmalarının düzenlenmesinde karşılıklı korunmadan belli konuları kapsam dışında bırakmaya kadar ilerleyen anlaşma düzenlenmesindeki evrimi inceledik. Bu kapsamda hem Türk Model Anlaşmalarını hem de Türkiye'nin anlaşmalarında gerçekleşen değişimi de inceledik. Daha sonra, Türk hukukuna odaklanarak ulusal hukuklar ve özellikle çevre etki değerlendirmesi süreçlerini inceledik. Akabinde ise sosyal işletme lisansını inceledik ve Türk hukukundaki haliyle çevre etki değerlendirmesi sürecinin sosyal işletme lisansı olup olmadığını tartıştık.

Birinci bölümün IV numaralı başlığında ise çevreyle bağlantılı yatırım uyumsuzluklarında uygulanacak hukuku inceledik. Burada öncelikle sürdürülebilir kalkınma kavramını ve bu kavramın sorunu çözmede yetersiz kaldığını tartıştık. Daha

sonra bu uyuşmazlığa uygulanacak kuralların yatırım anlaşmasının hükümleri olduğunu belirledik. Ancak hukukun genel ilkeleri (özellikle VCLT) veya bu yatırım anlaşmasının gereği olarak ilgili diğer kuralların da uygulanabileceğini gösterdik. Bu kurallar arasında bireylere yükümlülük yükleyen uluslararası çevre anlaşmaları olabileceğini açıkladı. Prensip olarak uluslararası hukukun sadece devletler için yükümlülük doğurduğunu, ancak bazı sözleşmelerin istisna olarak bireylere de yükümlülük doğurduğunu, bunların da heyetler tarafından uygulanmasının mümkün olabileceğini belirttik. Benzer şekilde bu kaynakların, ev sahibi devlet hukukunun uygulanmasını işaret edebileceğini belirttikten sonra uluslararası çevre hukukunun genel prensiplerinin ve uluslararası kamu düzeninin de uygulanabileceğini açıkladık. Ayrıca şirketlerin sosyal sorumluluğu ile ev sahibi devlet ve yatırımcının vatandaşı olduğu devlet kanunlarının uygulanabilirliğini değerlendirdik.

Kural olarak uluslararası yatırımın ev sahibi devletin hukukuna uygun olması gereğini ve bu gereğin yatırım anlaşmaları tarafından özellikle belirtildiğini tespit ettik. Yatırımın kurulması sırasında ev sahibi devlet hukukuna aykırılığın sonucunun çoğu zaman uluslararası hukuk korumasından yararlanamama olacağını belirledik. Daha önemli olarak, yatırımcının uluslararası kamu hukukuna aykırı davranışlarının sonuçlarına odaklanarak, bu aykırılığın yatırımcıdan kaynaklandığı hallerde uluslararası korumadan yararlanamayacağını; yatırımcının yerel ortağından kaynaklandığı hallerde yatırımcının konudan haberdar olup olmamasına ve aykırılığın küçük ya da büyük olmasına göre hukuki korumadan yararlanabileceğini belirttik.

İkinci bölümde ise çevrenin korunması nedeniyle yatırımcıların haklarının ihlal edilmesi konusuna odaklandık. Özellikle adil ve hakkaniyetli davranma, kamulaştırma, tazminat gibi temel davranış standartlarını inceledik. Ayrıca devletin yönetme hakkının devlet için bir savunma olabileceğini belirleyip bu savunmanın sınırlarını ve koşullarını inceledik. Bu minvalde devletin düzenleme yapma hakkına bakıştaki iki farklı ucu tartışan yalnız sonuç doktrini (*sole affects doctrine*) ve radikal düzenleyici güç doktrinini (*radical police powers*) inceledik. Daha sonra devlet tarafından yapılan düzenlemenin yapılması saikinin müdahaleci devletin sorumluluğunu ortadan kaldırıp kaldırmayacağını tartıştık. Bu kapsamda orantılılık ve ayırım yapmama ilkelerini tartıştık. Son olarak bütün hususları değerlendirerek ulaştığımız sonuçları belirttik.



INTRODUCTION

Clash of economic and ecological interests in the sphere of international dispute settlement is a conflict that has become prominent in recent years, but it is by no means entirely new. As noted by Sands, disputes concerning economic and ecological interests in international arbitration go back to even 1800s.¹

Indeed, industrial revolutions, first starting with James Watt's steam engine in 1775, first and foremost require energy. This need has only intensified with the increased usage of the industrial machine and has achieved enormous levels with further industrial revolutions.

The need for energy, complied with the need for raw materials for increased production led to increased mining and other industrial activities, which are necessarily against environmental conservation.

There has been a significant attempt in the last decades to prevent and defuse this tension, namely the concept of sustainable development. The idea, which is discussed in further detail at Part 1/IV/A/1 aims for development that can be sustained economically, politically, socially and, last but not least, environmentally. Brundtland Report, which was commissioned by the UN, describes the concept as:

“Humanity has the ability to make development sustainable to ensure that it meets the needs of the present without compromising the ability of future generations to meet their own needs. The concept of sustainable development does imply limits - not absolute limits but limitations imposed by the present state of technology and social organization on environmental resources and by the ability of the biosphere to absorb the effects of human activities. But technology and social organization can be both managed and improved to make way for

¹ Philippe Sands, “Litigating Environmental Disputes: Courts, Tribunals and the Progressive Development of International Environmental Law” (herein after Sands, “Litigating...”), **OECD Global Forum on International Investment VII**, 27-28 March 2008, p. 3 <https://www.oecd.org/investment/globalforum/40311090.pdf> (last accessed 02.06.2019).

a new era of economic growth. The Commission believes that widespread poverty is no longer inevitable. Poverty is not only an evil in itself, but sustainable development requires meeting the basic needs of all and extending to all the opportunity to fulfil their aspirations for a better life. A world in which poverty is endemic will always be prone to ecological and other catastrophes.”²

However, the concept of sustainability has unfortunately not availed in most cases. Investment treaty arbitration, which is designed to protect the foreign investor particularly in developing countries, very often clashes with environmental concerns. Investment treaty arbitration cases discussed below, such as *Methanex*, *Copper Mesa*, *Metalclad* show that the protection offered under investment treaties sometimes allow foreign investor to be exempted from environmental and/or health concerns and host States end up compensating the losses of the foreign investor when they implement certain actions in favour of protection of the environment.

This thesis is aimed at providing a study of the most relevant protection offered in investment treaty arbitrations and the investors’ obligations for protection of the environment, and the relation between these two areas of law. For this purpose, we will first analyse the fragmentation of international law and the development of protection regimes for foreign investors, namely diplomatic protection and investment treaty arbitration. Then we will discuss the investments that are unworthy of protection.

Later, we will focus on the environment related rules that are relevant to investment disputes. We will examine developments in BITs, related environmental conventions and national laws, as well as social licence to operate and social responsibility of corporations.

We will then discuss the environmental law’s role in investment treaty arbitrations from three angles: first, application of international environmental law, second application of the law of host State (*i.e.* where the investment has been made),

² United Nations World Commission on Environment and Development, **Our Common Future** (Herein after “Brundtland Report”), A/42/427, 1987, para. 27.
<https://sustainabledevelopment.un.org/content/documents/5987our-common-future.pdf> (Last Access: 02.06.2019).

and third application of the law of the home State of the investor. We will then discuss the concept of legality of investments and we will focus both on violation of national and international law by the investor.

We will then move on to discuss two important treatment standards provided under BITs, namely ban of expropriation and FET. We will then discuss the standard of compensation in cases where host States do not act in conformity with these treatment standards. Later we will focus on the relationship between these standards and actions by the host State that are taken to protect the environment. We will particularly discuss the host State's right to regulate and how this right sets a limit to the protection offered in investment treaties. For this we will examine the concept and whether the purpose of the change may have an influence. Then, we will focus on the conditions to consider the public interest as a valid defence, including the proportionality requirement and the non-discrimination obligation.

In international investment law, municipal law finds very little application. The area is based on bilateral (or multilateral) investment treaties, because investor's protection is based on a promise between two (or more) states to protect each other's investment. The treaty protection will be applied by the investment tribunals (whether before an ICSID Convention tribunal or any other international investment tribunal) regardless of rules of domestic regulations, including most important rules such as mandatory rules or the public policy of the State, which are sacredly applied by domestic courts.

This is because the protection offered by the bilateral treaty signed by the states will be the only basis for the standard of treatment before international investment tribunals. Such treaties are usually very brief, but the interpretation of a single word may change the results of a case. Accordingly, the most important source for international investment law is the related caselaw. For this reason, the main focus of this thesis is the international investment caselaw. Even if the cited cases are not always on environmental matters, they set the principles that would be directly applicable for environment related disputes.

PART 1: FUNDAMENTAL CONCEPTS OF INTERNATIONAL INVESTMENT LAW AS APPLIED TO ENVIRONMENTAL DISPUTES

I. FRAGMENTATION OF INTERNATIONAL INVESTMENT LAW

International investment law has a *sui generis* character which cannot be specified uniquely as a part of domestic law or international law. It is a hybrid regime of domestic and international law carrying features of both.³ The jurisdictional basis of international investment arbitration, namely consent of the parties, might exist in different sources which are governed by different laws. Generally, we find consent in international treaties. As one of the (if not the most) significant sources of international investment law, bilateral or multilateral investment treaties contain contracting states' offer to arbitrate, which will be perfected by the acceptance of the investor either by addressing a formal acceptance or instituting arbitral proceedings. The second source of consent offered by the host State is unilateral actions. Either through a declaration or an investment law, the host State can provide a standing offer to arbitrate that can be taken up by the foreign investors. This source is governed both by municipal and international law. Third and the final source is contracts between host States and investors that contain arbitration clauses, which is governed by the law applicable to the contract and international law.

Accordingly, it is possible to say that international investment law is a special regime influenced by domestic and international law. But is it also possible to say that investment law is a self-contained regime?

The term self-contained regime could be described as a law regime with a set of primary rules as well as secondary rules of its own for non-compliance with the

³ Zachary Douglas, "The Hybrid Foundations of Investment Treaty Arbitration", **British Yearbook of International Law**, 74(1), 2003, p.151. (herein after "Hybrid Foundations...")
<https://oxia.oup.com/view/10.1093/law-iic/bybil15.document.1/law-iic-9780199267859-bybil15?prd=IC#law-iic-9780199267859-bybil15-div1-1> (last accessed 02.06.2019).

primary obligations.⁴ In that sense, a self-contained regime is a more complete form of *lex specialis*.

In the strict sense a self-contained regime would require non-application of other rules of international law. In the case of investment law, this would most importantly reflect to non-application of rules related to countermeasures. However, as detailed in the paragraphs below, courts and authors explain that even the most close-circuit examples of regimes require the application of general rules (such as rules related to interpretation), and that even in these strict regimes, if the secondary rules stop functioning efficiently, there should still be a possibility to apply to traditional rules on state responsibility.

The term self-contained regime was first used by the PCIJ in the *S. S. Wimbledon* case in order to define a special set of primary rules related to Kiel Canal within the treaty of Versailles on German watercourses.⁵ According to the Court, the aim of providing for special rules is to avoid application of rules regulating inland waterways

⁴ Primary rules are defined as rules on primary international obligations and rights, and secondary rules broadly refer to rules on creating and changing primary rules, responsibility and dispute settlement in case of breach of primary rules. Kuyper explains self-contained regimes with the following definition: “(...) the system’s countermeasures are not the normal countermeasures of international law, such as reprisals and the *exceptio non-adimplendi contractus* in treaty law, but are entirely separate from those normal countermeasures and are regulated so as to limit the freedom of States to have recourse to them.” Pieter Jan Kuyper, “The Law of GATT as a Special Field of International Law: Ignorance, Further Refinement or Self-contained System of International Law”, *Netherlands Yearbook of International Law*, 25, 1994, p 228.
<https://www.cambridge.org/core/journals/netherlands-yearbook-of-international-law/article/law-of-gatt-as-a-special-field-of-international-law-ignorance-further-refinement-or-self-contained-system-of-international-law/6542A946FE5F6AAE66D56EA4A9AC98B0> (last accessed 02.06.2019); Martti Koskeniemi, “Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law”, Report of the Study Group of the International Law Commission of 13 April 2006, A/CN.4/L.682, http://legal.un.org/ilc/documentation/english/a_cn4_l682.pdf (last accessed 08.09.2019), para. 128; Bruno Simma, Dirk Pulkowski, “Of Planets and the Universe: Self-contained Regimes in International Law”, *The European Journal of International Law*, 17, 2006, p. 490-494 <http://www.ejil.org/pdfs/17/3/202.pdf> (last accessed 02.06.2019); Davorin Lapaš, “Some remarks on fragmentation of international law: disintegration or transformation?”, *The Comparative and International Law Journal of Southern Africa*, Vol. 40, No. 1, 2007, p.3 https://www.jstor.org/stable/23252652?seq=1#page_scan_tab_contents (last access: 08.09.2019).

⁵ United Kingdoms, France, Italy & Japan v. Germany, “S.S. Wimbledon”, Judgment of 17 August 1923, PCIJ, para. 32.
http://www.worldcourts.com/pcij/eng/decisions/1923.08.17_wimbledon.htm (Last Access: 02.06.2019)

to Kiel Canal by analogy. In this case the court used the term “self-contained regime” in order to address the relationship between two sets of primary obligations.

First of all, diplomatic law is considered as a self-contained regime. Academic discussions on self-contained regimes focus only on secondary rules since the ICJ’s use of the concept in the *Tehran Hostages* case, where the court stated that

“(…) diplomatic law in itself provides the necessary means of defence against, and sanctions for, illicit activities (…)

“(…) The rules of diplomatic law (….) constitute a self-contained regime which (….) lays down the receiving State’s obligations (….) foresees their possible abuse (….) and specifies the means at the disposal of the receiving State (…). These means are, (….) entirely efficacious (….)”.⁶

According to the Court, in relation to state responsibility, diplomatic law is a self-contained regime, which means that in case of breach of obligations of diplomatic law, the receiving state may only resort to remedies of diplomatic law, not to state responsibility in general. The Court, however, did not decide that diplomatic law is entirely detached from international law.⁷ In other terms, nothing in diplomatic law or the Court decision preclude application of general law for reparation, for initiating countermeasures if the receiving state breaches immunities of diplomatic personnel in its territory or for persistent breach of diplomatic rules (for instance non-withdrawal of a diplomat that was declared *persona non grata*).⁸

⁶ United States Diplomatic and Consular Staff in Tehran, United States of America v. Iran “Tehran Hostages”, Judgment of 24 May 1980, ICJ, **ICJ Reports 1980**, para. 86.
<https://www.icj-cij.org/files/case-related/64/064-19800524-JUD-01-00-EN.pdf> (last accessed 02.06.2019)

⁷ Joost Pauwelyn, **Conflict of Norms in Public International Law**, Cambridge University Press, 2003, p.36.
<https://www.cambridge.org/core/books/conflict-of-norms-in-public-international-law/D2AB790E1082AF2F3E5C4A1174D4A19B> (last accessed 02.06.2019).

⁸ Simma, Pulkowski, *op. cit.*, pp. 513–514.

Article 50 of Draft Articles on State Responsibility addressing countermeasures obliges respect to diplomatic law when adopting countermeasures.⁹ However we should precise that this article does not preclude application to countermeasures but limits this possibility.

“(…) measures may be taken affecting diplomatic or consular privileges, not prejudicing the inviolability of diplomatic or consular personnel or of premises, archives and documents. Such measures may be lawful as countermeasures if the requirements of this chapter are met. (...) The exclusion of any countermeasures infringing diplomatic and consular inviolability is thus justified on functional grounds.”¹⁰

We could interpret this rule as an example of proportionality. According to Simma, countermeasures violating diplomatic immunities are deemed disproportionate.¹¹ Thus, diplomatic law is not truly a self-contained regime, but it has a high threshold for the application of countermeasures, especially for the countermeasures that affect diplomatic inviolability.

Secondly, WTO law is suggested as a self-contained regime. In the first place, we need to confirm that WTO law is indeed a part of international law: as soon as the states get into a contractual relationship with each other, international law automatically governs this relationship; thus, WTO law is a part of international law and “[i]t is not a ‘self-contained regime’ in the sense of a *regime existing outside of international law*.”¹² Just like all other branches of international law, WTO law

⁹ Art.50, International Law Commission (Herein After “ILC”), **Draft articles on Responsibility of States for Internationally Wrongful Acts**, with commentaries, United Nations, 2001. (Herein after “**Draft articles on State Responsibility**”) http://legal.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf (last accessed 02.06.2019).

¹⁰ *Ibid.* pp. 133–134.

¹¹ Simma, Pulkowski, *op. cit.*, p. 515.

¹² Pauwelyn, *op. cit.* p. 37; Petros C. Mavroidis, “Remedies in the WTO Legal System: Between a Rock and a Hard Place”, **Electronic Journal of Comparative Law**, vol. 11, No.4, 2000, p. 765. <http://www.ejil.org/pdfs/11/4/554.pdf> (last accessed 02.06.2019).

develops rules that deviate from general rules of international law by refining and adapting the principles of international law.¹³ WTO law designs a special system for the cessation of breach and countermeasures consisting of suspending concessions or other obligations under the covered agreements.¹⁴ The system aims to limit States' freedom to access general countermeasures.¹⁵ This approach is the reason why WTO is interpreted as a self-contained regime, in the less strict sense: a type of *lex specialis*. Party states must follow the procedure designed in WTO system instead of the general regime of state responsibility on cessation of breach and suspensions. On the other hand, the DSU, does not mention whether it is possible to access the general regime of state responsibility, for questions other than countermeasures such as reparation or restoration.¹⁶ Indeed, Article 23 of the DSU is silent on the recourse to additional remedies under international law. ILC interpreted this provision as a derogation from rules on State responsibility:

“In some cases, it will be clear from the language of a treaty or other text that only the consequences specified are to flow. Where that is so, the consequence will be ‘determined’ by the special rule and the principle embodied in article 55 [*lex specialis*] will apply. (...) An example (...) is the WTO Understanding on Rules and Procedures governing the Settlement of Disputes as it relates to certain remedies.”¹⁷

However, there are also authors asserting that related articles do not amount to a derogation. For instance, Mavroidis notes that article 19 of the DSU does not provide for remedies that the WTO bodies may suggest in order to implement

¹³ Kuyper, *op. cit.*, p.228.

¹⁴ See for instance Article 22(2) of the **WTO Understanding on Rules and Procedures governing the Settlement of Disputes** (herein after “DSU”), which requires the authorisation of Dispute Settlement Body to suspend concessions or other obligations, or Article 23 of the DSU, which requires having recourse to related rules to redress a violation of obligations.
https://www.wto.org/english/docs_e/legal_e/28-dsu_e.htm#22 (last accessed 02.06.2019).

¹⁵ Kuyper, *op. cit.*, p.228.

¹⁶ Simma, Pulkowski, *op. cit.*, p.501.

¹⁷ **Draft articles on State Responsibility**, *op. cit.*, p.140.

recommendations, and this requires application of the general rules, reflected in the ILC codification.¹⁸

International investment law can be given as a third example as a self-contained regime. The ICJ noted in the *Diallo* case that the fact that there are numerous investment treaties shows that international investment law has taken a somehow different route than the customary international law on protection of aliens.¹⁹ As Douglas explains, investment law creates a *sui generis* relationship between the players of international investment law.²⁰

As will be discussed further in this study, the specific nature of international investment law turns it into a unique discipline, where the general rules are found in its unique materials (BITs, local investment laws etc), and municipal law and international law heavily influence those rules. However, it does not mean that investment treaties operate in an isolated international law universe. It is indeed still a part of the general international law and most of the BITs indicate that they are applicable together with other international law.²¹

II. PROTECTION OF INVESTMENTS

A. Protection of investments under Public International Law: from traditional diplomatic protection to modern direct rights

Protection of subjects of the home States for their activities in the host State is not a new concept created with international investment law. It is possible to find academic writings on its as early as 1758.²² Borchard explained in 1913 that if rights

¹⁸ Mavroidis, *op. cit.* p. 765.

¹⁹ *Case Concerning Ahmadou Sadio Diallo, Republic of Guinea v. Democratic Republic of the Congo "Diallo"*, Judgment of 24 May 2007, ICJ, Preliminary Objections, para. 90.
<https://www.icj-cij.org/en/case/103/judgments> (last accessed 02.06.2019).

²⁰ Zachary Douglas, **International Law of Investment Claims**, Cambridge University Press, 2005 p.1. (Hereinafter **International Law...**)

²¹ Rahim Moloo, Justin Jacinto, "Environmental and Health Regulation: Assessing Liability under Investment Treaties", **Berkeley Journal of International Law**, vol. 29(1), p. 4.

²² John Dugard, "Articles on Diplomatic Protection", United Nations, 2013, p.1.
http://legal.un.org/avl/pdf/ha/adp/adp_e.pdf (last accessed 02.06.2019).

of an alien are violated by a host State, the home State is warranted the right to assist and diplomatically interpose to protect its national.²³ As Borchard further explains, the concept of diplomatic protection is an extension of the citizenship/nationality bond the alien has with his home State:

“When the citizen leaves the national territory, he enters the domain of international law. By residence abroad he not merely carries with him certain rights and duties imposed by the municipal law of his own state, but he enters into a new sphere of mutual rights and obligations between himself as a resident alien and the state of his residence. A failure on his part to comply with these newly created obligations is met by repression and punishment in the local courts. A failure of the state to fulfil its obligations toward the alien is met by repression on the part of his home estate. The extent of this obligation toward the resident alien has been measured by international law and practice, though the very nature of repressive action has permitted the element of physical power and political expediency at times to obscure and even obliterate purely legal rights”²⁴

As this study will focus on investment law and its relationship with environmental law, only the main differences between diplomatic protection and investment law will be pointed out.

The first difference is the owner of the right. Although it is the alien’s rights that are in question, the right to exercise diplomatic protection belongs to the home State.²⁵ The commentary on draft articles on diplomatic protections explains that “the State of

²³ Edwin M. Borchard, “Basic Elements of Diplomatic Protection of Citizens Abroad”, *The American Journal of International Law*, vol. 7(3), 1913, p.507.
<https://www.jstor.org/stable/pdf/2187430.pdf> (last accessed 02.06.2019).

²⁴ *Ibid.* p.516.

²⁵ ILC, **Draft articles on Diplomatic Protection**, with commentaries, United Nations, 2006, art. 3. (Herein after “**Draft articles on Diplomatic Protection**”)
http://legal.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf (last accessed 02.06.2019).

nationality of the injured person that is entitled, but not obliged, to exercise diplomatic protection on behalf of such a person”.²⁶

The second difference, which is a direct consequence of the holder of the right to exercise diplomatic protection, is the owner of the compensation received as a result of diplomatic protection. This principle is rooted in the *Mavrommatis* decision, where the home State is categorised as the sole claimant of the diplomatic protection.²⁷ Draft article 19 encourages the states to transfer this compensation to its injured citizen, but inevitably recognises the fact that the home State is not under such obligation.²⁸

The third difference is the exhaustion of local remedies. As article 14 of the draft articles indicate, the injured alien must exhaust all local remedies available to it in order to allow a diplomatic protection case to proceed. It is considered important in particular that the state must be given all the opportunity to correct the wrongdoing. This approach was also mentioned as the Calvo Doctrine. Calvo Doctrine, as developed by Argentinian jurist and diplomat Carlos Calvo, indicates that foreign investment disputes must be resolved before the host State courts and should not be treated any differently than the nationals of the Host State.²⁹ The investment treaty practice and the case law has moved away from the doctrine and agreed that the investor may apply to international treaty protection under BITs.³⁰ Under diplomatic protection, as stated by article 14, the investor is expected to apply to domestic forum first, however, as indicated by article 15, the injured alien is not obliged to pursue

²⁶ *Ibid.*, article 3, para. 1, p.29.

²⁷ *The Mavrommatis Palestine Concessions “Mavrommatis”*, PCIJ, Judgment of 30 August 1924, p. 2.

²⁸ **Draft articles on Diplomatic Protection**, *op. cit.*, art. 19.

²⁹ Patrick Juillard, “Calvo Doctrine/Calvo Clause”, in **MPEPIL**, paras. 1-5. <https://opil.ouplaw.com/view/10.1093/law:epil/9780199231690/law-9780199231690-e689> (last accessed 08.09.2019); Abraham Feller ‘Some Observations on the Calvo Clause’, *American Journal of International Law*, vol. 27, No. 3, 1933, pp. 461–468. https://www.jstor.org/stable/2189974?seq=1#page_scan_tab_contents (last accessed 08.09.2019); Lionel Morgan Summers ‘The Calvo Clause’, *Virginia Law Review*, vol.19, No. 5, 1933, pp. 459–484. https://www.jstor.org/stable/1066808?seq=1#page_scan_tab_contents (last accessed 08.09.2019);

³⁰ Juillard, *op. cit.*, paras. 15-16.

remedies that are not “able to provide effective redress” or that are unduly delayed.³¹ Same concept is found under article 44 of Draft articles on State Responsibility, and unless there is a fork-in-the-road clause in the BIT, the investor is still expected to apply to domestic forum first, as long as the local remedies are available and effective.³²

The main difference between diplomatic protection and investment law is the owner of the right. In international law involvement of the home State is quite limited. In case of a contract-based investment arbitration, the home State may not be involved at all. In a classical one, the home State’s involvement is only limited to the creation of the applicable BIT and offering of the consent. In both cases, the home State has no role in the proceedings and their outcome. The investor decides who to sue, how to do it, and whether to proceed with its claim until the end. It carries the consequences alone as well.

Switch from diplomatic protection to investment arbitration also allowed the situation to be depoliticised. As the home State is not involved in the process, it can simply detach itself from a dispute, to which it is not actually a party to. Investment arbitration allows the dispute to be resolved between its real parties. Even in cases where the states have the right to intervene, the state cannot control the claim.³³

This is recognised in the doctrine as “direct rights”.³⁴ It is accepted that the BITs and other international law instruments grant rights directly to the investors. These are

³¹ **Draft articles on Diplomatic Protection**, *op. cit.*, art. 14, 15.

³² **Draft articles on State Responsibility**, *op. cit.*, art. 44 and its commentary.

³³ NAFTA allows the Free Trade Commission to issue interpretation notes on its provisions, but even in that case NAFTA tribunals confirmed that the claim is still controlled by the claimant investor, see *Mondev*, paras. 111-125.

³⁴ Campbell McLahlan, Laurance Shore, Matthew Weiniger, **International Investment Arbitration**, Oxford University Press, 2010, paras. 3.52-3.64; David Gaukrodger, “Investment Treaties and Shareholder Claims: Analysis of Treaty Practice”, OECD Working Papers on International Investment, 2014/03, OECD Publishing <https://www.oecd-ilibrary.org/docserver/5jxvk6shpvs4-en.pdf?expires=1567980801&id=id&accname=guest&checksum=9E58549E898925A7ADA008EE97F54CCA> (last accessed 08.09.2019); Douglas, “Hybrid Foundations...”, Section II. E; Tillmann Braun “Globalization-Driven Innovation: The Investor as a Partial Subject in Public International Law – An Inquiry Into the Nature and Limits of Investor Rights”, New York University School of Law, Jean Monnet Working Paper 04/13, 2013 p. 25-26 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2286607 (last accessed 12.09.2019).

both substantive treatment standards and procedural rights, such as the consent offer by the states.

B. Investments unworthy of protection under modern investment protection

As discussed above, an investment treaty tribunal will apply both international law and law of the host State in deciding an investment dispute. This means that the investment in question must be established in conformity with both the laws of the host State and international law, in addition to fundamental principles of law such as abuse of rights.

1. Breach of national law

It is quite undisputed that an illegality concerning the investment in principle will have a negative impact on the investor's claims, either at the jurisdictional or merits stage of the dispute. This stems from the very concept of illegality: assets or economic benefits that are obtained through illegal activities will not enjoy legal protection. The fact that such benefits are held by a foreigner or a national of the host State will not change this conclusion.³⁵

The issue becomes complicated when such illegality is endorsed or disregarded by the host State before commencement of the arbitration. In such instances, two concepts start colliding. On the one hand, assets obtained through a breach of the host State law cannot be protected in national or international level. On the other hand, certain actions of the host State, which usually originate from the executive of the host State, may approve these illegalities either by turning a blind eye on them, not sanctioning them or even endorsing them.

One of the earliest examples of this problem is *Southern Pacific Properties*. The case concerned development of a touristic site. The investor entered into an agreement

³⁵ Zachary Douglas, "The Plea of Illegality in Investment Treaty Arbitration", *ICSID Review*, vol. 29, 2014, p. 155; <https://www.matrixlawinternational.com/wp-content/uploads/2014/09/The-Plea-of-Illegality-in-Investment-Treaty-Arbitration.pdf> (last accessed 14.09.2019); Stephan W. Schill, "Illegal Investments in International Arbitration", *The Law and Practice of International Courts and Tribunals*, vol. 11, 2012, p. 281-282. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1979734 (last accessed 14.09.2019).

with an Egyptian state agency to create a local joint venture company for creating complexes addressing tourist around the Pyramids area near Cairo and at Ras El Hekma on the Mediterranean coast.³⁶ The Respondent argued that certain aspects of the agreement in question were in breach of both 1972 UNESCO Convention for the Protection of the World Cultural and Natural Heritage and Egyptian law. The Tribunal concluded that such illegality did not matter in light of the acts of the Egyptian State. According to the tribunal, it does not matter whether certain acts of the Egyptian officials were legally invalid or even non-existent, because these acts were made under the governmental authority and the investor relied on them.³⁷ Even if these acts were not legal or have become null and void, they were made by high authorities of Egypt causing internationally protected expectations.³⁸ As a result, the tribunal found that the invalidity of these acts under domestic law would not resolve the problem of liability for damages that are caused by the investors' expectations that were based on these acts.³⁹

Kardassopoulos had a similar issue. The case concerned development and exploitation of natural gas resources in Georgia.⁴⁰ The claimants have entered into several contracts with Georgian state agencies, but these agreements were cancelled due to different exploitation plans. As multiple attempts to settle the claimants' claims failed, they started investment treaty arbitration.⁴¹

The tribunal concluded that the investor had every right to rely on representations that were given by State authorities, regardless whether they were

³⁶ *Southern Pacific Properties (Middle East) Limited v. Egypt, Award on the Merits of 20 May 1992*, "Southern Pacific Properties", para. 43.
https://www.italaw.com/sites/default/files/case-documents/italaw6314_0.pdf (last accessed 02.06.2019)

³⁷ *Ibid.*, para. 82.

³⁸ *Ibid.*, para. 83.

³⁹ *Ibid.*

⁴⁰ *Ioannis Kardassopoulos v. The Republic of Georgia "Kardassopoulos"*, Decision on Jurisdiction of 6 July 2007, ICSID Case No. ARB/05/18, para. 13.
<https://www.italaw.com/sites/default/files/case-documents/ita0444.pdf> (last accessed 02.06.2019).

⁴¹ *Ibid.*, 13-14.

entitled under the laws of the host State to give such representations. The tribunal stated that assurances and endorsements as to the validity of the joint venture agreement provided by senior government officials and elected politicians override the argument that joint venture agreement was void under the laws of the host State.⁴² The tribunal concluded that the Host State, through this behaviour, “created a legitimate expectation for Claimant that his investment was, indeed, made in accordance with Georgian law and, in the event of breach, would be entitled to treaty protection.”⁴³

It should be noted that *Paushok* tribunal took this analysis one step further. The dispute before the tribunal was whether changes in the taxation of the claimant’s gold mining business has violated Mongolia’s international obligations. The tribunal noted that whether the authority in question, namely MongolBank, had the right to represent the Mongolian State did not matter, since the claimant “in its right to assume that MongolBank was acting within the powers granted to it by the State.”⁴⁴

Accordingly, it can be concluded that an investment made in breach of the Host State law would not enjoy protections offered to it under the investment treaty. The case law shows that there can be two exceptions to it. First, formalistic violations of the Host State law, such as forgetting to file a form to the authorities, will not lead to dire consequences for the investor. Second, if the Host State has given assurances that such illegality will not create a problem, the Host State will not be allowed to back track and claim that such illegality is indeed problematic. These issues are very often at the heart of investment disputes as well. For instance, the assurances given by the central government were the main driver of the *Metalclad* Tribunal’s decision.

⁴² *Ibid.*, paras 190-191.

⁴³ *Ibid.*, para. 192.

⁴⁴ *Sergei Paushok, CJSC Golden East Company, CJSC Vostokneftegaz Company v The Government of Mongolia “Paushok”*, UNCITRAL Award on Jurisdiction and Liability of 28 April 2011, para. 607.
<https://www.italaw.com/sites/default/files/case-documents/ita0622.pdf> (last accessed 02.06.2019).

2. Breach of international law

Illegality can also occur on the international law level. This does not necessarily mean that the act in question will not be in breach of the municipal law.

It should be noted that private parties are not direct subjects of international law. It is therefore not easy to find a provision of international law that can be directly breached by the investor.

The most likely possibility for breach of international law by an investor with respect to the environmental law matters would be breach of transnational/international public policy. We will discuss related arbitration cases below.

Public policy can be defined as the core fundamental basics of a particular legal order.⁴⁵ Accordingly, international public policy is the fundamental basics of international law. For instance, corruption and breach of *jus cogens* obligations, would be good examples of breach of international public policy. Investment law has a good set of examples for corruption related cases. The most famous case is *World Duty Free*. The investor argued that Kenya had breached contractual obligations it owed the investor and had illegally taken the Claimant's property when, in relevant part, Kenyan officials ordered in 1989 that a court-appointed official take over management and control of the investment. As a remedy, the investor sought restitution and damages, including lost profits and exemplary damages. Funnily enough, the corruption issue emerged when the investor submitted a document suggesting that it had made an undercover payment to the then president of Kenya for conclusion of the investment agreement. When Kenya advanced a jurisdictional objection based on the illegal procurement of the contract, the tribunal decided to determine (1) whether a bribe was paid by the investor to the former Kenyan president, (2) if so, whether the investment agreement was procured as a result of the bribe and (3) if the investment agreement

⁴⁵ Dimitri Santoro, "Forum Non Conveniens: A Valid Defense under the New York Convention", 21 **ASA Bulletin**, vol. 21, 2003, p.721; Michael Pryles, "Reflections on Transnational Public Policy", **Journal of International Arbitration**, vol. 24(1), 2007, 3. For a discussion between transnational and international public policy, see Pieter Sanders, "Commentary", in 60 Years of ICC Arbitration: A Look at the Future, ICC Publishing, 1984, p. 260 *et. seq.*

had been obtained by the bribe, whether it was valid and enforceable under applicable domestic laws and public international law.⁴⁶

The tribunal first concluded that bribery and corruption was a part of the transnational public policy, after reviewing a series of conventions, declarations and arbitral awards that dealt with and condemned bribery.⁴⁷ The tribunal also noted that the particularities of the host State do not have an impact on this obligation. The tribunal concluded that an open bribery action cannot be tolerated. According to the tribunal, the case was not an example of incidental getting caught in illegality but of willing illegal conduct, even though the weight of illegality is heavier on the side of the Kenyan President.⁴⁸ The bribe was not the result of coercion, oppression, force, undue influence and there was no ‘hostage factor’ as regards to the investment, because the investment was not made yet. Accordingly, investing in the country and the bribe was the free choice of the investor. In such a case if the tribunal offers investment protection to the investor, this would be “an affront to public conscience” and the tribunal would be assisting and encouraging the illegal conduct.⁴⁹ The tribunal concluded that considering English and Kenyan law, the investor is in breach of public policy and cannot be entitled to maintain its claims and continue the proceedings on the ground of *ex turpi causa non oritur actio* (there can be no lawsuit of an illegal cause).⁵⁰

International or transnational public policy was discussed also in the *Liman Oil* case. The case concerned cancellation of a petroleum exploration and extraction agreement provided to the investor by the investment agency of the host State. As a defence against the claim, the host State alleged that the investor’s licence was

⁴⁶ *World Duty Free Company Limited v. The Republic of Kenya* “World Duty Free”, Award of 4 October 2006, ICSID Case No. ARB/00/7 para. 129.
<https://www.italaw.com/documents/WDFv.KenyaAward.pdf> (last accessed 02.06.2019).

⁴⁷ *Ibid.*, paras. 141-157.

⁴⁸ *Ibid.*, para. 178.

⁴⁹ *Ibid.*

⁵⁰ *Ibid.*, para. 179.

obtained “by fraudulent misrepresentation to the Ministry of Energy and/or by fraud on the minority shareholders.”

The tribunal confirmed that investments made in breach of international public policy cannot be protected because it does not have jurisdiction over such investments.⁵¹

However, the tribunal added that the burden of proving such violation rests with the host State.⁵² This is a logical conclusion as the burden of proving a fact usually lies with the alleging party and investors cannot be expected to prove that their actions have not violated public policy.

Plama concerned privatization of an oil refinery located in Bulgaria.⁵³ The oil refinery was in dire economic conditions – it was subject to bankruptcy proceedings – and it was able to resume its operation after it was sold to the investor.⁵⁴ However, the refinery was not able to recover, and it entered into insolvency proceedings and was shut down again.⁵⁵ Finally, refinery’s creditor recommenced the bankruptcy proceedings and the refinery’s assets were sold.⁵⁶ The investor argued that this end was a result of Bulgaria’s actions that “deliberately created numerous, grave problems for [the investor] and/or refused or unreasonably delayed the adoption of adequate corrective measures.”⁵⁷

⁵¹ Liman Caspian Oil BV and NCL Dutch Investment BV v. Republic of Kazakhstan “Liman Oil”, Excerpts of Award Dated 22 June 2010, ICSID Case No. ARB/07/14, para. 194. <https://www.italaw.com/sites/default/files/case-documents/italaw1429.pdf> (Last Access: 02.06.2019).

⁵² *Ibid.*

⁵³ *Plama Consortium Limited v. Republic of Bulgaria “Plama”*, Award of 27 August 2008, ICSID Case No. ARB/03/24, paras. 56-57. <https://www.italaw.com/sites/default/files/case-documents/ita0671.pdf> (last accessed 02.06.2019).

⁵⁴ *Ibid.*, paras. 66-67.

⁵⁵ *Ibid.*, paras. 68-69.

⁵⁶ *Ibid.*, para. 72.

⁵⁷ *Ibid.*

The tribunal found that during the purchase of the refinery the investor misrepresented to the host State who would own the investment. The tribunal noted that even if it was a misunderstanding, the investor and its agents have not done anything to correct the misunderstanding.⁵⁸ The tribunal further noted that has Bulgaria known the actual investors were different; it would not have gone ahead with the privatisation.⁵⁹

After finding the investment was established as a result of a misrepresentation, it concluded that despite the fact that the applicable treaty did not have a legality requirement, it could not be understood that protections provided under the treaty could extend to investment that are made contrary to law.⁶⁰ Then, the tribunal concluded that the investment was obtained through deceitful conduct and this is a violation of domestic law. Accordingly, granting treaty protection to the investor would be contrary to *nemo auditur propriam turpitudinem allegans* principle, as well as the general notion of international public policy that the tribunal should not enforce a contract that is obtained by wrongful conduct.⁶¹

The *Plama* tribunal also noted that violation of the good faith principle, *i.e.* acting in a deceitful manner at the establishment of the investment, would not only be a violation of municipal law, but also a violation of international public policy.⁶²

In case of a breach of transnational/international public policy in a matter relating to environmental law, the conclusions reached by the above tribunal would still be applicable. Thus, it is clear that an investor violating the transnational/international public policy in relation to an environmental matter will not be able to have its case adjudicated before an international tribunal.

⁵⁸ *Ibid.*, paras. 128-129.

⁵⁹ *Ibid.*, para. 133.

⁶⁰ *Ibid.*, para. 139.

⁶¹ *Ibid.*, para. 143.

⁶² *Ibid.*, para. 144.

The graveness of the fraud may influence the tribunal's decision. *Churchill* case is important in this context. The case, which was a result of consolidation of two cases, concerned the investors' claim in relation to a mining dispute. The host State argued that the mining licences that constituted the basis of the investors' claim were forged. The Tribunal, as a result of a document verification process which cost both parties a total of USD 15 million,⁶³ concluded that the documents were forged.

After this conclusion, the tribunal first expressed that as a matter of international public policy, if a claim is based on a deliberately made or unreasonably ignored fraud or forgery, these claims would be inadmissible.⁶⁴

The tribunal also noted that the issue was not only a concern of international public policy, but also a matter of principle of good faith and prohibition of abuse of process: The tribunal decided that the scope of the fraud is so serious that it taints the investment as a whole, and principles of good faith and prohibition of abuse of process requires barring the investment from benefiting from treaty protection.⁶⁵

Although the tribunal did not explicitly say that a "minor" fraud would not lead to inadmissibility of the claims, it noted that seriousness of the forgery had a role in its decision. According to the tribunal, the forgery in the case was serious because of the number and nature of documents and the aim of the forgery, which was gaining access to mining rights.⁶⁶

The same conclusion, albeit with some differences, would be applicable for the breaches committed by the local partner or the subsidiary of the foreign investor.

Minnotte case is worth mentioning in this context. The case concerns production of blood plasma derivatives in Poland, which is a medical product imported from other

⁶³ *Churchill Mining PLC and Planet Mining Pyy Ltd v. Republic of Indonesia "Churchill"*, Award of 6 December 2016, ICSID Case No. ARB/12/14 and 12/40, paras. 552-553. <https://www.italaw.com/sites/default/files/case-documents/italaw7893.pdf> (last accessed 02.06.2019).

⁶⁴ *Ibid.*, para. 508

⁶⁵ *Ibid.*, para. 528

⁶⁶ *Ibid.*, para. 515

countries into Poland due to lack of a local facility.⁶⁷ Following a complicated bidding process, the task was given to a local company, which would work with a foreign medical company from Sweden.⁶⁸ The investors invested in to this company as early as 1996 but were not in charge of its management as minority shareholders.⁶⁹ The investor had to obtain a state treasury guarantee for obtaining a large loan from a consortium of banks. The host State argued that such guarantee was provided under false representations by the investment.⁷⁰

Upon failure of the initiation of the production, the banks recalled the loan as the investment was not meeting its repayment obligations. As a result of these legal actions, the investment went bankrupt and Poland paid considerable amounts to the banks as a result of its guarantee.⁷¹ The investors argued that Poland's actions led to downfall of their investment and argued for an expropriation claim and an unfair and unequitable treatment claim.

The tribunal first decided that the legality requirement need not be clearly indicated in the applicable BIT, because it is generally accepted as a principle independent from the host State law's requirements that if an investment is based on a fraudulent conduct, it cannot benefit from BIT protection.⁷²

However, the tribunal noted that not all types of fraud should lead to inadmissibility of the investor's claims, and stated that it should apply to the circumstances where the fraud is very closely to facts which form the basis of the

⁶⁷ *David Minnotte & Robert Lewis v. Republic of Poland "Minnotte"*, Award of 16 May 2014, ICSID Case No. ARB(AF)/10/1, paras. 26-36.
<https://www.italaw.com/sites/default/files/case-documents/italaw3192.pdf> (last accessed 02.06.2019).

⁶⁸ *Ibid.*, paras. 37-49.

⁶⁹ *Ibid.*, para. 51.

⁷⁰ *Ibid.*, para. 70.

⁷¹ *Ibid.*, para. 111.

⁷² *Ibid.*, para. 131.

tribunal's jurisdiction, such as establishment of the investment, that it would not be possible to grant jurisdiction.⁷³

The tribunal also noted that as there was not an issue of manifest violation of the host State law and, unlike their local partner who was not a party to the proceedings, the investors did not have "actual knowledge of the facts that are alleged to prove that there was fraudulent conduct in the initial making and conduct of the investment."⁷⁴ The tribunal therefore concluded that the investors' situation could be, at best, negligence⁷⁵ and that there was not any international law principle which would bar jurisdiction of the tribunal in case of a negligent failure to inquire which may or may not result with the discovery of fraud.⁷⁶

The tribunal also considered whether fraud would have an impact on the investor's claims on the merits stage, *i.e.* whether it could be invoked as a merits defence by the host State.⁷⁷ The tribunal drew the conclusion that it is not possible to deny protection in each case where the claimant did not detect wrongdoings negligently during the establishment. However in some cases it is possible that the wrongdoing of the third party or the claimant's negligence may amount to the violation of the BIT, including cases of deliberate 'not seeing', serious misconduct or crime.⁷⁸ However, the tribunal did not judge the evidences to prove such a situation in the case, and decided that the nature of the allegations of negligence against the claimant did not amount to depriving them of the international investment protection.⁷⁹

These *Minnotte* and *Churchill* cases provide for an interesting analogy for environmental disputes and contrast in approaching violation of public international law. It should be noted here that this analysis applies to breaches of transnational/international public only by a third party, in most cases the local partner

⁷³ *Ibid.*, para. 132.

⁷⁴ *Ibid.*, para. 134.

⁷⁵ *Ibid.*, paras. 135-136.

⁷⁶ *Ibid.*, para. 139.

⁷⁷ *Ibid.*, paras. 157-158.

⁷⁸ *Ibid.*, para. 163.

⁷⁹ *Ibid.*, para. 164. It should be noted that the Claimants' claims were dismissed, and they were ordered to pay a part of the costs of Poland.

or subsidiary of the investor. In cases of a breach directly by the investor, the *Churchill* and *World Duty Free* analogy will apply: if the breach is serious, then the investor cannot enjoy the protections offered under the BIT.

In general, the act of a third party is actually a more likely scenario in environment related cases: It is very likely that a foreign investor, who is not familiar with the business environment of the host State, will work with a local entity in, at least, establishment of the investment. It is also possible that the local partner will commit an action that will, at least arguably, lead to a violation of international public policy.

According to *Churchill*, whether the foreign investor is aware of these breaches or not is the decisive factor. Breaches that are not serious, *i.e.* they do not affect the establishment of the investment, seems to be not affecting the investors' claims under *Churchill* approach. If the violation is a serious matter, such as forgery of official documents, that violation will taint the investors' claims regardless of whether the investors were tacitly or willingly involved in the scheme. This may change if the investor is completely innocent of the act in question: in such a case, the investors may still enjoy BIT protections.

On the other hand, according to *Minnotte*, the decisive factor seems to be whether the breach was serious, rather than awareness. In case of a serious breach, the tribunal seems to have not given weight to the issue whether the investor knew about the violation. However, if the breach is not serious, then the tribunal seems to have applied a less stringent test. In such a case, an investor may simply get away with the minor breach of public policy.

Although the end result does not seem to be different, two approaches have different starting points and starting point may have an impact on the conclusion. As to the environmental matters, it is more likely that the local subsidiary will commit a breach of public policy in relation to environmental matters, simply because that it will have more knowledge on the applicable environmental law rules compared to the investor. Under the *Churchill* approach, whether the foreign was aware of it may become decisive. On the other hand, under *Minnotte* approach, the tribunal will look at the seriousness of the illegality and not pay attention to the foreign investor's awareness of the illegality.

As the discussed case law establishes, while there is no clear definition of transnational/international public policy, the concept seems to be limited to extreme cases, such as forgery of documents during the establishment process or bribing the officials of the host State. It is entirely possible for these types of violations to occur for environmental matters. For instance, the investor may forge documents about the carbon footprint of its factory to meet the environmental standards set in the local regulations. The investor may also bribe the officials of the host State in order to stop them from conducting proper pollution controls. In these cases, the investor will have breached the transnational/international public policy and will not be able to enjoy the protections offered to it under the applicable BIT.

3. Abuse of rights and unclean hands

In cases where the host State failed to meet the relevant criteria, the investor may still not enjoy the protections offered to it under investment treaties, if it has not come before the tribunal with “clean hands”.

International law commission defines unclean hands doctrine as:

“an important principle of international law that ha[s] to be taken into account whenever there [i]s evidence that an applicant State ha[s] not acted in good faith and that it ha[s] come to court with unclean hands.”⁸⁰

The concept’s origins can be found in the principle of good faith. As the International Law Commission stated, its main premise is that holder of a right would not act in good faith. This suggests that the concept is similar to abuse of right but it’s different in a few aspects.

The theory of abuse of rights – also called the principle of good faith governing the exercise of rights - finds its roots in the general principle of good faith and - while not uncontested - has been recognised by commentators and referred to before or by

⁸⁰ Report of the ILC, 57th Session, UN Doc A/60/10, para. 236. http://legal.un.org/ilc/documentation/english/reports/a_60_10.pdf (last accessed 02.06.2019).

the Permanent Court of International Justice and the International Court of Justice, followed by the Iran-United States Claims Tribunal and many arbitral tribunals.⁸¹

According to Cheng⁸² manifestations of the principle of good faith in the exercise of rights include:

- **The malicious exercise of a right:**

A malicious exercise of a right, that is the exercise of a right for the sole purpose of causing an injury to another party, is prohibited.⁸³

- **The fictitious exercise of a right:**

The principle of good faith requires every right to be exercised honestly and loyally. A fictitious exercise of a right, that is the exercise of a right for the sole purpose of evading the law or a treaty obligation, is prohibited.⁸⁴ Also relevant in this context:

- **Evasion of the law/treaty obligations (*ex re sed non ex nomine*):**

By looking to the real state of things and not attaching decisive importance to the legal denominations which the parties may give to their actions, this principle *inter alia* precludes the form of the law from being used to cover the commission of what in fact is an unlawful act.⁸⁵ By application of the same principle, international law prohibits the evasion of a treaty obligation under the guise of an alleged exercise of a right.⁸⁶

In deciding whether or not a right was exercised in good faith, an international tribunal must examine whether the exercise of the right was in pursuit of the legitimate

⁸¹ Bin Cheng, **General Principles of Law as applied by International Courts and Tribunals**, Cambridge University Press, Reprint 2006, Chapter 4, p. 121.

⁸² *Ibid.*, p. 121.

⁸³ *Ibid.*, pp. 121-122.

⁸⁴ *Ibid.*, pp. 122-123.

⁸⁵ *Ibid.*, p. 122. See also, *Chorzow Factory*, *op. cit.*

⁸⁶ Cheng, *op. cit.*, p. 123.

interests protected by it and whether, in the light of the obligations assumed by the State, the exercise of the right was calculated to prejudice the rights and legitimate interests of the other party under the treaty. Thus, a fair balance is kept between the respective interests of the parties and a line is drawn delimiting their respective rights. Any overstepping of this line would constitute a breach of good faith, an abuse of right and a violation of the parties' obligation.⁸⁷ In addition, every right is subject to such limitations as are necessary to render it compatible both with a party's contractual obligations and with its obligations under the general law. Again, any overstepping of this limit would constitute an abuse of right.⁸⁸

The reasonable and *bona fide* exercise of a right implies a genuine exercise in pursuit of interests that the right is destined to protect and which is not calculated to cause unfair prejudice to the legitimate interests of another State, whether these interests are secured by treaty or by general international law.⁸⁹

It is a principle of good faith that "a man shall not be allowed to blow hot and cold-to affirm at one time and to deny at another [...] Such a principle has its basis in common sense and common justice, and whether it is called 'estoppel', or by any other name, it is one which courts of law have in modern times most usually adopted".⁹⁰

- ***Nullus commodum capere de sua injuria propria* (no one can be allowed to take advantage of his own wrong)**⁹¹

A manifestation of the principle *nullus commodum capere de sua injuria propria* is that "an unlawful act cannot serve as the basis of an action in law" (*delicto non oritur actio*)⁹². The principle *ex delicto non oritur actio* is generally upheld by

⁸⁷ *Ibid.*, pp. 128-129.

⁸⁸ *Ibid.*, p. 130.

⁸⁹ *Ibid.*, pp. 131-132.

⁹⁰ *Ibid.*, pp. 141-142.

⁹¹ Cheng, *op. cit.*, pp. 149-155.

⁹² *Ibid.*, pp. 155-158; ICJ Reports, 1950, p. 244.

international tribunals.⁹³ The principle, however, only applies in so far as the claim itself is based on an unlawful act. It does not apply to cases where, though the claimant may be guilty of an unlawful act, such act is juridically extraneous to the cause of the action.⁹⁴

- ***Fraus Omnia corrumpit***⁹⁵

Fraud is the antithesis of good faith and indeed of law, and it would be self-contradictory to admit that the effects of fraud could be recognised by law. What normally constitutes a right will not be upheld if it is either begotten by fraud or is used to dissemble the effects of another fraudulent act.⁹⁶

Cheng also states that parties' small exaggerations or factual misrepresentations may be tolerated, this by itself, will not invalidate the claim against the State. However, misleading the tribunal by fraud, collusion or suppression of evidence will result with invalidation because the results of such a fraud cannot be upheld by a judgment that calls for the highest of respects. If the fraud allegations have basis, tribunal would not allow decisions based on these frauds to stand. In that sense, tribunals have the power to reopen and review their decisions, but even if the tribunal can no longer intervene, state courts should refuse enforcement of such decisions.⁹⁷

Kiss identifies three distinct legal situations in which the concept of abuse of right may arise:⁹⁸

In the first case, a State exercises its rights in such a way that another State is hindered in the exercise of its own rights and, as a consequence, suffers injury. Such a situation can result, for example, from the inconsiderate use of a shared natural

⁹³ Cheng, *op. cit.*, p. 155.

⁹⁴ *Ibid.*, pp. 157-158.

⁹⁵ *Ibid.*, pp. 158-160.

⁹⁶ *Ibid.*, pp. 158-159.

⁹⁷ See for instance *La Abra Silver Mining Co. v. United States*, US Supreme Court decision dated 11 December 1899, 175 US 423 <https://supreme.justia.com/cases/federal/us/175/423/> (Last access: 08.09.219)

⁹⁸ Alexandre Kiss, "Abuse of Rights", *MPEPIL*, 2006, p. 2.

resource, or a migratory species, or the radio-electronic spectrum. Here the States sharing the same resource suffer a reduction in their enjoyment of the resource to which they are entitled.

In the second case, a right is exercised intentionally for an end which is different from that for which the right has been created, with the result that injury is caused.

In the third case, the arbitrary exercise of its rights by a State, causing injury to other States but without clearly violating their rights, can also amount to an abuse of right. In contrast to the preceding situation, bad faith or an intention to cause harm are not necessary to constitute this form. Broader objectives concerning the social function of the right which has been exercised are at stake here, *e.g.* in the case of unjustified if not illegal measures imposed upon aliens, including arbitrary expulsion.

Abuse of the ICSID mechanism is a defence which has appeared fairly recently in ICSID arbitration.⁹⁹ The context in which said abuse may arise is the following: in the course of an investor-State dispute, it appears the investor is or may be or may have been a national of the host State, but has dissimulated such fact.

a. Abuse of arbitral process

The abuse of arbitral process defence has also been raised for the first time fairly recently, but in two different situations.

The first alleged abuse consisted in the pursuit of the same remedies before two different arbitral tribunals under two different BITs by, on the one hand, a legal entity deemed to be the investor and, on the other hand, the majority shareholder of the entity. This situation has posed many problems as regards a potential abuse by the investor and/or its shareholder. A host State in such a situation might argue the two cases should be consolidated, for several reasons, such as the risks of (i) contrary decisions or (ii) double compensation. The arbitral tribunals in the *Lauder* and *CME* cases, the latter

⁹⁹ The decision on jurisdiction in *Tokios Tokelès* case is assumed to be the first time the argument was raised. *Tokios Tokelès v Ukraine* “*Tokios Tokelès*”, Decision on Jurisdiction of 29 April 2004, ICSID Case No. ARB/02/18. <https://www.italaw.com/sites/default/files/case-documents/ita0863.pdf> (last accessed 02.06.2019).

followed by the Svea Court of Appeals, however, rejected the Czech Republic's defence pertaining to the investor and its shareholder committing an abuse of process because the two arbitrations were brought on the grounds of different BITs.¹⁰⁰

Second, a host State might raise also the defence of abuse of process when it has reasons to believe the investor only commenced the arbitration proceedings to force the State to take certain measures. In the *Rompetrol* case for example, the host State argued that the investor's claims had been brought to arbitration for the sole purpose of pressuring the government to terminate pending criminal proceedings against managers of the group. The determination of whether there was such an abuse of process, however, was held to be very closely dependent on the special circumstances of the particular case.¹⁰¹ The tribunal accepted the possibility of starting arbitration procedures in order to block the State's inherent function in the fight against the crime and corruption, but it did not take this opinion any further in relation to the case.¹⁰²

We consider that this concern is equally valid for environmental matters: foreign investors must not be allowed to seize investment treaty tribunals to block the legitimate exercise of the right to regulate environmental matters.

In the *Phoenix* decision rendered on 15 April 2009, an ICSID Tribunal declined jurisdiction to hear claims submitted by Phoenix Action Ltd against the Czech Republic.

Phoenix, an Israeli company, purchased two Czech companies, Benet Praha and Benet Group, in 2002 while these two companies were involved in ongoing legal disputes. The Czech Republic challenged the jurisdiction of the Tribunal on the basis that Phoenix was a sham Israeli entity created by a Czech national in order to establish diversity of nationality and thereby invoke ICSID jurisdiction.

¹⁰⁰ *CME, op. cit.*, para. 412; *Lauder, op. cit.*, para. 174.

¹⁰¹ *The Rompetrol Group NV v Romania "Rompetrol"*, Award of 6 May 2013, ICSID Case No. ARB/06/3, para. 152. <https://www.italaw.com/sites/default/files/case-documents/italaw1408.pdf> (last accessed 02.06.2019).

¹⁰² *Ibid.*

The Award is of particular interest for the way that the Tribunal approaches the Claimant's alleged lack of *bona fide*, the issue on which the case really turns. While the Tribunal concluded that "the claimant's initiation and pursuit of the arbitration [was] an abuse of the system of international ICSID investment arbitration",¹⁰³ it did not go so far as to dismiss the Claimant's case as an 'abuse of process'. Instead, the Tribunal analysed the procedural question of whether the Claimant's ICSID proceedings were brought in good faith, by analysing the substantive issue of whether the Claimant's investment was made in good faith (it was satisfied that all other investment definition criteria, including compliance with the law of the host State were met).¹⁰⁴

The question of whether the notion of 'abuse of process' has a place in international law, and indeed in international investment arbitration law, remains open. In the *Phosphate Lands* case,¹⁰⁵ the International Court of Justice (ICJ) was requested to dismiss the claim as an abuse of process. The court dealt with this objection "rather summarily, although without denying that there might be some inherent power in the matter".¹⁰⁶

The question of whether the notion of abuse of process exists in international investment treaty law has, for example, been considered by the tribunal in *Waste Management* in which the tribunal noted that it was not necessary to decide whether tribunals possess inherent power to dismiss a claim over the abuse of process because

¹⁰³ *Phoenix Action Ltd v The Czech Republic "Phoenix"*, Award of 15 April 2009, ICSID Case No. ARB/06/5, para. 144.
<https://www.italaw.com/sites/default/files/case-documents/ita0668.pdf> (last accessed 02.06.2019).

¹⁰⁴ *Ibid.*, paras. 135-144.

¹⁰⁵ *Certain Phosphate Lands in Nauru (Nauru v. Australia) "Phosphate Lands"*, Judgment of 26 June 1992, ICJ Reports 1992, p.240.
<https://www.icj-cij.org/files/case-related/80/080-19920626-JUD-01-00-EN.pdf> (last accessed 02.06.2019).

¹⁰⁶ *Waste Management II*, Tribunal's Decision on Mexico's Preliminary Objection concerning the Previous Proceedings of 26 June 2002, ICSID Case No. ARB (AF)/00/3, para. 49.
<https://www.italaw.com/sites/default/files/case-documents/ita0898.pdf> (last accessed 02.06.2019).

no provision existed in NAFTA or ICSID Convention. However, if existed, such power would only be for the protection of the integrity of arbitral proceedings.¹⁰⁷

b. Entitlement of a tribunal to dismiss a claim where it amounts to an abuse of process

Because the doctrine of abuse of rights is a concept of international law, which is in principle binding upon States, the question whether it has a place in international investment treaty law arises.

As cited by the previous section, in *Waste Management*¹⁰⁸ the tribunal, relying on the *Case concerning certain Phosphate Lands in Nauru*,¹⁰⁹ held that it does not need to decide whether it possesses any inherent powers to dismiss a claim on the basis of abuse of process. It stated that if such power exists, it would be aimed at protecting the integrity of proceedings.¹¹⁰

This view has been upheld more recently in proceedings before the ICJ. In the *Avena*,¹¹¹ case counsel to the Respondent submitted, *inter alia*, that there was no doubt that the Court has an inherent power to regulate its own proceedings in the interests of justice and in order to safeguard the integrity of the Court. Indeed, “[t]he existence of those powers is a necessary corollary of the responsibility of the tribunal for the proper

¹⁰⁷ *Ibid.*

¹⁰⁸ *Ibid.*, paras. 48-50.

¹⁰⁹ *Phosphate Lands, op. cit.*, para. 38.

¹¹⁰ The tribunal also relied on the Respondent’s submission, wherein the Respondent agreed that “the doctrine of abuse of process could be applicable in appropriate circumstances, perhaps not as a general legal principle, but as an inherent authority of the tribunal to safeguard the process”. See *Waste Management II*, Preliminary Objections, *op. cit.*

¹¹¹ *Request for Interpretation of the Judgment of 31 March 2004 in the Case concerning Avena and Other Mexican Nationals (Mexico v. United States of America) “Avena”*, Judgment of 19 January 2009, I.C.J. Reports 2009, pp. 45-59.
<https://www.icj-cij.org/files/case-related/139/139-20090119-JUD-01-00-EN.pdf> (last accessed 09.06.2019) In its Judgment the Court did not find Mexico had abused the process. However, it did not deny either that it had an inherent power to dismiss a claim on the ground of abuse of process.

and orderly discharge of its responsibilities,” and it is necessary for “the sound administration of justice.”

Stating that “[i]t is almost tautological to say that a tribunal has the power to dismiss an application which is an abuse of its process,” he noted that “[t]he principle of abuse of rights is itself well established in international law, and may be regarded as one of the general principles of law recognized by civilized nations.” It has two distinct bases. First, the power to dismiss a claim on the ground of abuse of process is a corollary of the responsibility of a tribunal, which has to safeguard the integrity of its procedure. The second is the general duty of loyalty between the parties.

In recent cases, arbitral tribunals have decided on the existence of abuse of process by investors without addressing the issue of their entitlement to do so.¹¹² In the *Phoenix* case, for example, the arbitral tribunal addressed the issue of abuse of process as a requirement for qualification of the investment as a protected one, thus adding a requirement to the *Salini* test, thereby avoiding the question of its entitlement to dismiss a claim on the basis of the doctrine of abuse of rights.¹¹³ In other recent awards, arbitral tribunals have also avoided the issue.¹¹⁴

c. Application of the abuse of process doctrine in investment cases

Addressing the question of what amounts to an abuse of process, it has been pleaded that “within the undisputable core of that concept is the principle that tribunals, and procedural devices within judicial processes, may not be used for purposes that are alien to those for which they were established, which corresponds to a particular application of the broader application of *détournement de pouvoir*, or misuse of powers.”¹¹⁵ Therefore, it is submitted that a definition of abuse of process could be

¹¹² *Phoenix, op. cit.*, paras. 93-94,100.

¹¹³ *Ibid.*, para. 93.

¹¹⁴ See, e.g., *Cementownia "Nowa Huta" S.A. v. Republic of Turkey*, Award of 07 September 2009, ICSID Case No. ARB(AF)/06/2 <https://www.italaw.com/sites/default/files/case-documents/ita0138.pdf> (last access 08.09.2019) or *Europe Cement Investment & Trade S.A. v. Republic of Turkey*, ICSID Case No. ARB(AF)/07/2, Award of 13.08.2009, ICSID, <https://www.italaw.com/sites/default/files/case-documents/ita0311.pdf> (last access 08.09.2019).

¹¹⁵ *Avena*, Verbatim record of the hearing no 2008/15, para. 24.

the use of a procedural device within judicial process for a purpose other than that normally pursued by an investor in good faith.

Recent cases show that two “procedural devices” have been used by investors to abusively access international investment tribunals: mischaracterisation as an investor and multiplication of claim(s).

This concept is quite relevant to environmental disputes. The investor may have violated certain environmental or other rules during the course of the investment, such as the case in *Copper Mesa* dispute, which will be discussed in further detail below. In these cases, it could be said that the investor should not be allowed to take advantage of the investment protection system. However, as seen again in the *Copper Mesa* case, this type of concerns usually has an impact at the calculation of the compensation, rather than the merits of the claim. Therefore, it is likely to conclude that an investor with unclean hands may still enjoy investment treaty protections but may not receive its lost profits.

III. RELEVANT RULES ON ENVIRONMENT PROTECTION

In this chapter we will examine the BITs, in order to understand the direct role environment plays in these treaties. For this, we will briefly examine the trends prevailed in BITs in different time frames, giving particular importance to the related Turkish BIT practice.

We will then focus on the contents of environmental treaties that are most likely to be directly applied to individuals. We will further explore the possibility of application of these treaties in relation to investment arbitration disputes below at Part 1/IV/A/2.

Finally, we will focus on environment related national laws, paying particular attention to Environmental Impact Assessment process in order to understand the most important environment related tool available to States in protection of the environment

<https://www.icj-cij.org/files/case-related/139/139-20080619-ORA-02-00-BI.pdf> (last accessed 09.06.2019). Vaughen Lowe has provided testimony on this point before the ICJ.

related to investments. We will also discuss potential application of national rules in general, including the ones on environmental impact assessment below at Part 1/IV/C.

A. Developments in BITS

UNCTAD indicates that BIT drafting or investment protection in the modern era can be divided into five segments. First period, the era of so-called infancy, is between 1950s up to 1960s, where treatment of foreign investors was a concept of diplomatic protection and customary public international law, as discussed in Part 1/II/A above.¹¹⁶

The second period starts with the first BIT entered into between West Germany and Pakistan.¹¹⁷ The key concept in this period was the reciprocal protection of investments made by nationals or companies of both States in the jurisdiction of the other but investor-State dispute settlement mechanism was not available yet.¹¹⁸ The concept of removing investor-State disputes from the umbrella of the State-to-State dispute settlement and providing a platform solely designated to resolve investment disputes became a reality with the enactment of the Washington (ICSID) Convention.¹¹⁹ However, the trend of having investor-State dispute settlement mechanisms in BITs became the trend and the default only after 1970s.¹²⁰ The trend

¹¹⁶ United Nations Conference on Trade and Development, **World Investment Report**, 2015, p.122. https://unctad.org/en/PublicationsLibrary/wir2015_en.pdf (last accessed 11.09.2019).

¹¹⁷ *Ibid.*, p.121; Treaty for the Promotion and Protection of Investments, Germany and Pakistan, 25 November 1959, 457 U.N.T.S. 24 (entered into force 28 November 1962). [https://www.investorstatelawguide.com/documents/documents/BIT-0128%20-%20Germany-Pakistan%20BIT%20\(1959\)%20\(citation%20and%20source\).pdf](https://www.investorstatelawguide.com/documents/documents/BIT-0128%20-%20Germany-Pakistan%20BIT%20(1959)%20(citation%20and%20source).pdf) (last accessed 11.09.2019); Steffen Hindelang, Markus Krajewski, “Towards a More Comprehensive Approach in International Investment Law”, in Steffen Hindelang and Markus Krajewski (eds), **Shifting Paradigms in International Investment Law - More Balanced, Less Isolated, Increasingly Diversified**, Oxford University Press, 2016, p.3. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2721609, (last accessed 11.09.2019); J. Christopher Thomas, Harpreet Kaur Dhillon, “The Foundations of Investment Treaty Arbitration: The ICSID Convention, Investment Treaties and the Review of Arbitration Awards”, **ICSID Review**, Vol. 32, No. 3, 2017, p. 461, <https://cil.nus.edu.sg/wp-content/uploads/2018/01/2.-Thomas-Dhillon-The-Foundations-of-Investment-Treaty-Arbitration.pdf> (last accessed 11.09.2019).

¹¹⁸ Thomas/Dhillon, *op. cit.*, p. 461.

¹¹⁹ *Ibid.*, 463.

¹²⁰ Hindelang/Krajewski, *op.cit.*, p.3; Joachim Pohl, Kekeletso Mashigo, Alexis Nohen, “Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey”, **OECD Working Papers on International Investment**, 2012/2, p. 11.

in this second phase, or the so-called era of dichotomy by UNCTAD due to the different trend of emphasising the sovereignty in other aspects of international law,¹²¹ was an almost exclusive focus on protection of investors and investments, without giving enough emphasis on public policy concerns.¹²² This era was followed by the proliferation era, or the so-called second wave, in which the States entered into BITs that was still focused on the protection of the investors and investments, and not giving enough emphasis on public policy concerns.¹²³

The final era (the third wave or the balancing era) is the last 10-20 years and it is still ongoing. The key concept of this era is shifting of the focus from protection of investors and investment to a more balanced approach, in which public policy concerns such as protection of the environment or public health also comes into the discussion of international investment law.¹²⁴

One way of bringing such balance is providing in the treaty a carve-out (exception) provision. Korzun defines carve outs as provisions that leave out a specific type of measures or a subject altogether from the application of a treaty.¹²⁵

With such provisions the States can decide to express in the treaty that the treaty would not apply to environmental measures taken by the State. As noted by Segger,

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2187254 (last accessed 11.09.2019).

¹²¹ World Investment Report 2015, *op.cit.*, p. 122.

¹²² Hindelang/Krajewski, *op.cit.*, p.4; Zachary Elkins, Andrew T. Guzman, Beth A. Simmons, “Competing for Capital: the diffusion of Bilateral Treaties 1960-2000”, **International Organization**, vol. 60, Fall 2006, p. 818. <http://nrs.harvard.edu/urn-3:HUL.InstRepos:3017499> (last accessed 11.09.2019).

¹²³ Hindelang/Krajewski, *op.cit.*, p.5.

¹²⁴ James Zahn, “Investment Policies for Sustainable Development: Addressing Policy Changes in a new investment landscape” in eds. Roberto Echandi, Pierre Sauvé, **Prospects in International Investment Law and Policy**, Cambridge University Press, 2013, p. 22.

¹²⁵ Vera Korzun, “The Right to Regulate in Investor-State Arbitration: Slicing and Dicing Regulatory Carve-Outs”, **Vanderbilt Journal of Transnational Law**, vol. 50, No. 2, 2017, pp. 355-414, p. 395. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2950939 (last accessed 12.09.2019); Robert Stumberg, “Safeguards for Tobacco Control: Options for the TPPA”, **American Journal of Law & Medicine**, vol. 39, 2013, p. 401. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2848976 (last accessed 12.09.2019).

these exceptions can be of a general nature, such as WTO exception on environment,¹²⁶ or they can indicate that a specific obligation (*e.g.* most favourable nation clause) would not be applied under certain circumstances (*e.g.* national emergency).¹²⁷

It is indeed common in the investment treaties to see carveout provisions that leave certain areas out of the protection of the investment treaties.¹²⁸ It has been argued that this type of provisions is often modelled on GATT and other WTO treaties. Titi states that in international investment arbitration “security exceptions [are] modelled on Article XXI GATT and [other] exceptions [are] modelled after Article XX GATT- or the latter’s *mutatis mutandis* incorporation in IIAs- among the most conspicuous examples”¹²⁹ Similar regulations are to be found under EU law and human rights conventions.¹³⁰

The recent trend in BIT drafting can be seen in the new draft of the Dutch model BIT. In addition to the interesting change in the definition of the investor, one of the most significant changes made to the Dutch BIT practice concerns the State’s right to regulate. The new draft accepts that “the mere fact that a Contracting Party regulates, including through a modification to its laws, in a manner which negatively affects an investment or interferes with an investor’s expectations, including its expectation of profits, is not a breach of an obligation under this Agreement”.¹³¹ Given that the

¹²⁶ Marie-Claire Cordonier Segger, “Innovative Legal Solutions for Investment Law and Sustainable Development”, in **Bridging the Gap between International Law and Investment Law**, Eleven International Publishing, 2016, p. 11; GATT Article XX.

¹²⁷ Segger, *op. cit.*, p. 12.

¹²⁸ See Art 12 of US Model BIT (<https://www.italaw.com/sites/default/files/archive/ita1028.pdf>); Art 25 <https://www.italaw.com/sites/default/files/archive/ita1027.pdf>

¹²⁹ Aikaterini Titi, **The Right to Regulate in International Investment Law**, Nomos Verlagsgesellschaft, 2014, p. 56.

¹³⁰ *Ibid.*, pp. 57-58.

¹³¹ Art 2(2) of the new draft; Bart-Jaap Verbeek, Roeline Knottnerus, “The 2018 Draft Dutch Model BIT: A critical assessment”, Investment Treaty News of International Institute for Sustainable Development. <https://www.iisd.org/itn/2018/07/30/the-2018-draft-dutch-model-bit-a-critical-assessment-bart-jaap-verbeek-and-roeline-knottnerus/> (last accessed 11.09.2019).

previous model BIT did not have such clause, this is an important and positive development for the State's right to regulate environmental matters.¹³²

Turkish model BIT has also undergone a similar transition. The 2000 Turkish Model BIT provided for two exceptions: extension of treatment standards provided under existing or future customs unions or similar international arrangements, and treatments that are related to taxation in whole or in part.¹³³ We analysed one of the latest BITs Turkey has negotiated (but not yet executed) with Bolivia in order to compare with the Model BIT.¹³⁴ The draft treaty maintains the taxation and customs unions related exceptions.¹³⁵ In addition to these exceptions, it contains a whole new article, titled "General Exceptions".¹³⁶ The new exception article indicates that the BIT cannot be construed in a way that would prevent the contracting Parties from adopting, keeping or enforcing non-discriminatory legal measures that are designed and applied for protection of human, animal or plant life, or the environment in general.¹³⁷

The provision also indicates that the contracting States cannot be forced to disclose documents which are related to the essential national interests of the respective party.¹³⁸ Given that the political sensitivity, or State secrets have become a concern during document production phases of investment arbitration, the exception seems to be drafted with a protective mindset.¹³⁹ The concept of essential national

¹³² *Ibid.*

¹³³ Turkish Model BIT, 2000, art. III. 4.

¹³⁴ The copy of the draft treaty has been kindly provided by Ministry of Industry. See the press statement <https://www.iletisim.gov.tr/turkce/haberler/detay/turkiye-bolivya-ortak-bildirisi> (last accessed 12.09.2019).

¹³⁵ Article 4.

¹³⁶ Article 5.

¹³⁷ Article 5.1.

¹³⁸ Article 5.2(a).

¹³⁹ A summary of related cases can be found at <https://www.mayerbrown.com/en/perspectives-events/publications/2011/01/discovery-in-investorstate-disputes-a-different-ma> (last accessed 12.09.2019).

interests seems to be inspired from the 2004 USA Model BIT, which is also referred to in other exceptions.¹⁴⁰

Another exception is that the actions that are deemed by the contracting States necessary for protection of their respective essential national interests.¹⁴¹ Finally, the provision indicates that the exceptions clause cannot be applied in an unjustifiable manner and it will not govern the measures that constitute a disguised restriction on the investments or investors.¹⁴²

The current draft that is under negotiation with Bolivia is certainly an improvement on environmental matters, given the criticism earlier treaty practice of Turkey received.¹⁴³ Similar environmental exception clauses can be found in most of the recent Turkish BITS: The Cambodia-Turkey BIT (2018), Turkey-Uzbekistan BIT (2017), Rwanda-Turkey BIT (2016) are among the most recent examples.¹⁴⁴

¹⁴⁰ USA Model BIT, art 18. The provision is maintained in the 2012 version as well. For a detailed discussion of the content of the essential national interest see <https://www.oecd.org/daf/inv/investment-policy/40243411.pdf> (last accessed 02.09.2019); William J. Moon, “Essential Security Interests in International Investment Agreements” in *Journal of International Economic Law*, 15(2), April 2012. https://www.researchgate.net/publication/256017301_Essential_Security_Interests_in_International_Investment_Agreements (last accessed 02.09.2019).

¹⁴¹ Article 5.2 (b).

¹⁴² Article. 5.3.

¹⁴³ Banu Şit Köşgeroğlu, “Model İkili Yatırım Anlaşmaları ve Türkiye’nin Model İkili Yatırım Anlaşma Taslağı”, *Türkiye Barolar Birliği Dergisi*, 2013, p.165. <http://tbbdergisi.barobirlik.org.tr/m2013-107-1291> (last accessed 12.09.2019).

¹⁴⁴ Agreement Between the Government of the Republic of Turkey and the Government of the Kingdom of Cambodia on the Reciprocal Promotion and Protection of Investments art. 4, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5833/download> (last accessed 12.09.2019); Agreement Between the Government of the Republic of Uzbekistan and the Government of the Republic of Turkey Concerning the Reciprocal Promotion and Protection of Investments art. 5, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5846/download> (last accessed 12.09.2019); Agreement Between the Government of the Republic of Rwanda and the Government of the Republic of Turkey Concerning the Reciprocal Promotion and Protection of Investments art. 5, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5415/download> (last accessed 12.09.2019).

B. International environmental conventions

In this section we will discuss relevant international environmental treaties and try to determine the treaties that may create direct obligations on individuals due to their potentials for being applied in investment treaty disputes.¹⁴⁵

The first treaty we will discuss is the 1960 Paris OECD Convention on Third Party Liability in the Field of Nuclear Energy, to which sixteen States are party.¹⁴⁶ Although the treaty does not directly address environmental damages, it provides that the operator of the nuclear facility will be liable for damages to persons and property.¹⁴⁷ Sands explains the purpose of this treaty as harmonising different national legislations concerning nuclear risks and liabilities of third parties related to these risks.¹⁴⁸ The second treaty is the 1963 Vienna Convention on Civil Liability for Nuclear Damage, to which 40 States are party.¹⁴⁹ This treaty does not provide for environmental damage compensation either, but it authorises competent municipal courts for other damages, which includes environmental damages.¹⁵⁰ Accordingly, the technical possibility of foreign investor that operates the nuclear facility may be liable under 1960 Paris OECD Convention on Third Party Liability in the Field of Nuclear Energy for environmental damages. However, any environmental damage arising in the context of 1963 Vienna Convention on Civil Liability for Nuclear Damage will normally be litigated before the competent national courts. This may however be considered a counterclaim before the investment tribunal and may affect the calculations.¹⁵¹

¹⁴⁵ The possibility of applying these treaties are further discussed below at Part 1/IV/A/2.

¹⁴⁶ Status and the text of the convention can be found at <https://www.oecd-neo.org/law/paris-convention-ratification.html> (last accessed 10.06.2019).

¹⁴⁷ Article 3, 1960 Paris OECD Convention on Third Party Liability in the Field of Nuclear Energy.

¹⁴⁸ Philippe Sands, **Principles of International Environmental Law**, 3rd edition, Cambridge University Press, 2012, p. 739. (Herein after Sands, **Principles...**)

¹⁴⁹ Status and the text of the convention can be found at https://www-legacy.iaea.org/Publications/Documents/Conventions/liability_status.pdf (last accessed 10.06.2019).

¹⁵⁰ E.g. Articles IV, VI and XI of 1963 Vienna Convention on Civil Liability for Nuclear Damage.

¹⁵¹ However, we should note that counterclaims are not well established in international law.

Another possible area is oil transportation. 1992 International Convention on Civil Liability for Oil Pollution Damage is ratified by a large number of States and covers more than 97% of the world tonnage.¹⁵² As noted by the International Maritime Organisation, it only provides for compensation of the costs incurred during reinstatement of the contaminated environment.¹⁵³ As Sands notes, the damaged State must take the measures and only after that it can claim compensation for the costs.¹⁵⁴ It should be noted here that this convention does not extend to the exploitation of the oil, but only to its carriage through maritime means. Therefore, its application in the context of international investment will rather be limited. It may only be applied in circumstances like Tidewater, where the oil transport is considered as investment.¹⁵⁵

Although neither the convention nor its protocols create obligations directly applicable to the foreign investors, it is worth mentioning the United Nations Framework Convention on Climate Change. The global effort in treaty making to fight climate change became first visible with the United Nations Framework Convention on Climate Change. The convention was signed as a part of the Earth Summit in Rio at 1992. The convention established 5 main points: stabilising the greenhouse gas concentrations, forcing the developed countries to shoulder a larger portion of financial consequences of fighting climate change, setting up institutions, setting up principles and dispute settlement mechanisms for the disputes emerging between States.¹⁵⁶

The objective of the convention was indeed maintaining the greenhouse gas levels at a level which would not trigger a climate change, which was reflected by art.

¹⁵² Status of the convention can be found at <http://www.imo.org/en/About/Conventions/StatusOfConventions/Documents/StatusOfTreaties.pdf> (last accessed 10.06.2019)

¹⁵³ International Maritime Organisation's explanatory note on 1992 International Convention on Civil Liability for Oil Pollution Damage can be found at [http://www.imo.org/en/About/Conventions/ListOfConventions/Pages/International-Convention-on-Civil-Liability-for-Oil-Pollution-Damage-\(CLC\).aspx](http://www.imo.org/en/About/Conventions/ListOfConventions/Pages/International-Convention-on-Civil-Liability-for-Oil-Pollution-Damage-(CLC).aspx) (last accessed 10.06.2019).

¹⁵⁴ Sands, **Principles...**, p. 747.

¹⁵⁵ *Tidewater Inc., Tidewater Investment SRL, Tidewater Caribe CA et al. v. The Bolivarian Republic of Venezuela "Tidewater"*, Award of 31 March 2015, ICSID Case No. ARB/10/5, paras. 13-18. https://www.italaw.com/sites/default/files/case-documents/italaw4206_0.pdf (last accessed 02.06.2019).

¹⁵⁶ These points are summarised by Sands, **Principles...**, p. 276

1(2). Although the convention set up general commitments such as reporting and co-operation, it did not set precise goals, nor did it provide for any obligations for private parties. With respect to the dispute resolution, it provides for multiparty consultation but any binding dispute resolution method, such as arbitration, is still subject parties' additional consent.¹⁵⁷ The countries that accepted Annex I, which contained more ambitious and precise goals for greenhouse gas emissions, continued to discuss the matter further at Kyoto.¹⁵⁸

Kyoto Protocol is a protocol to the Framework Convention entered into between Annex I countries and sets forth binding obligations for States that opted for these obligations.¹⁵⁹ The Kyoto Protocol was not aimed at introducing new commitments but rather refining the commitments existed under Annex I of the 1992 Climate Change Convention.¹⁶⁰ It provided for emission targets to be achieved at different timeframes,¹⁶¹ provided for innovative mechanism of emissions trading, where countries with less emissions were allowed trade their credits with countries that were "over budget" with respect to their emissions.¹⁶² The latest extension of Kyoto Protocol, Doha Amendment valid between 2012 and 2020 has not entered into force due to not obtaining required 144 acceptances, thus currently the Amendment is not in force and the Protocol does not raise any obligations.¹⁶³ Turkey ratified the Kyoto Protocol on 5 February 2009 and joined the negotiations concerning the new agreement during 2009 for the post-2012 period (*i.e.* Doha Amendment), when the

¹⁵⁷ Arts. 13, 14, 24.

¹⁵⁸ Sands, **Principles...**, p. 280-281.

¹⁵⁹ Durcan French "Kyoto Protocol to the United Nations Framework Convention on Climate Change", **Journal of Environmental Law**, vol.10, 1998. <https://academic.oup.com/jel/article-abstract/10/1/215/487134?redirectedFrom=fulltext> (last accessed 12.09.2012); Farhana Yamin, "The Kyoto Protocol: Origins, Assessment and Future Challenges", *Review of European Community and International Environmental Law* vol.7, 1998.

¹⁶⁰ Decision, 1/CP.1, **Report of the Conference of the Parties on Its First Session**, Berlin, 1995, FCCC/CP/1995/Add.1 para. 2; Sands, **Principles...**, p. 284.

¹⁶¹ Article 3.

¹⁶² Sands, **Principles...**, p.287-293.

¹⁶³ See the current status of the Doha Amendment on https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=XXVII-7-c&chapter=27&clang=en (last access 08.09.2019).

emissions reduction commitments under the Protocol expired. It should be noted that Turkey is not party to the Annex II and therefore does not have mandatory greenhouse gas emission reduction targets. The relation of the Protocol to the investors maybe State imposed emission limits or emission trading. Based on the Protocol, the States may impose carbon emission limits to its subjects including foreign investors. Also, the Protocol allows private parties to enter into emission trading in order to pass the defined quotas, which may be regulated or limited by the host States, possibly causing breach of international investment standards.¹⁶⁴ Particularly, we believe that a breach of non-discrimination standard may be a concern in relation to the distribution of the credit limits.

Paris Agreement is the most recent advancement in treaty practice conducted under the Framework Convention. United Nations describes the purpose of the agreement as “keeping a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius”.¹⁶⁵ However, the agreement does not contain specific obligations towards private parties and given that Turkey is not party to the agreement, we will not examine it further.

C. National laws

In this section we will briefly examine the environmental protection through local legislations, taking the example of Turkish law. The reason for our brevity is the limited application of national law in investment arbitration. As it will be further explained below at Part 1/IV/B, national law’s direct role in investment is almost exclusively limited to the legality requirement at the establishment of the investment.

¹⁶⁴ With the obligations brought by the Kyoto Protocol, emission quota transfer from under-developed countries to developed countries created an important trade branch. We could summarise the trade as such: Following their commitments, States distribute carbon dioxide credits to their producers. Producers in these countries cannot exceed their credit limit. Traders reach producers in under-developed countries, improve the carbon emission of their production facilities (for instance by installing new carbon filters), free of charge, and in return create an excess of carbon emission quota. Then the trader buys this excess quota and sells it to the company that reached its credit limit in the developed country, creating an important money flow to the under-developed country and commission for herself.

¹⁶⁵ The Paris Agreement: essential elements, <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement> (last accessed 12.09.2019).

Of course, it continues to play an important indirect role in assessing the proportionality of the measure in question, but such role is more akin to facts, rather than law. For this reason, the below section on proportionality will focus on the tools assessing the proportionality of an action (to be taken by the State), rather than analysing the action itself.¹⁶⁶

In Turkish law, protection of the environment is a duty for the State as stipulated under Article 56 of the 1982 Constitution. Different means are available under Turkish administrative law for protecting the environment but for the sake of this thesis we will focus on the environmental impact assessment (EIA) process. This choice is driven by two reasons:

First, as it will be discussed in the below paragraphs, EIA is a global concept available in many countries, including Turkey. Accordingly, a focus on EIA will allow us to discuss environmental protection on a very wide basis compared to other administrative measures, which are not considerable in the international investment law scope of this thesis.

Second, given that EIA's purpose is achieving a full understanding of the environmental impacts of economical projects by the State and also, the fact that EIA allows for involvement of the local population, it is the most complete tool available to States for protection of the environment.¹⁶⁷ In addition, it is an important part of the conditions that allow the investment to be legally established.

EIA is a concept that has been hard to define,¹⁶⁸ which has been first introduced in the National Environmental Policy Act of 1969 in the United States.¹⁶⁹ United States Environmental Protection Agency indicates that the purpose of the act is ensuring that relevant environmental concerns are taken into consideration by all branches of the

¹⁶⁶ See Part 2/II/C/1.

¹⁶⁷ Ahmet Güneş, *Çevre Hukuku*, Adalet Yayınevi, 2019, p. 175; Sands, *Principles...*, p. 601.

¹⁶⁸ Abdurrahman Saygılı, *Çevre Hukuku Açısından Çevresel Etki Değerlendirmesi*, 2007, p. 87.

¹⁶⁹ Güneş, *op. cit.*, p. 178; Sarah E. Boslaugh, National Environmental Policy Act, <https://www.britannica.com/topic/National-Environmental-Policy-Act> (last accessed 12.09.2019).

United States' government.¹⁷⁰ The importance of the act was to oblige to anticipate the proposed action's impact on the environment and consider alternative actions.

Doctrine agrees on the fact that EIA identifies environmental problems that are likely to be caused by a project and proposes solutions to these problems before the problems arose.¹⁷¹ EIA has 4 distinct features: First, its purpose is protection of the environment. Second, it can be applied to activities that are in the form of projects. Third, it assesses potential adverse impacts of the project on the environment. Finally, fourth, it brings together (and sometimes against each other) the project, State and the local population.¹⁷² EIA allows the administration to take into account any adverse consequence a project may cause on the environment in its decision on whether or not to allow the project to take place.¹⁷³

There are two main ways to decide whether a project will be subject to an EIA. First, the North American approach, it is left to the administrations to decide, on the basis of a preliminary analysis, whether a project will be subject to an EIA. Second, the types of the projects that are subject to an EIA will be listed in the legislation.¹⁷⁴ Saygılı notes that the administration will have some discretionary power in deciding whether a project is subject to an EIA under both systems.¹⁷⁵

Saygılı indicates that EIA is composed of seven steps: screening, scoping, preparation of the report, analysis of the report by the administration, decision of the

¹⁷⁰ Summary of the National Environmental Policy Act, <https://www.epa.gov/laws-regulations/summary-national-environmental-policy-act> (last accessed 12.09.2019).

¹⁷¹ William R. Sheate, **Making an Impact: A Guide to EIA Law and Policy**, Cameron May Publications, 1994, p. 22; John Glasson, Riki Therivel, **Introduction to Environmental Impact Assessment**, Routledge, 2012, p. 3; Nükhet Turgut, **Çevre Hukuku Karşılaştırmalı İnceleme**, Savaş Yayınları, 2001, p. 476 (herein after Turgut, **Çevre Hukuku...**); Güneş, *op. cit.*, p. 175.

¹⁷² Saygılı, *op. cit.*, p. 89.

¹⁷³ Güneş, *op. cit.*, p. 182.

¹⁷⁴ Güneş, *op. cit.*, p. 181; Saygılı, *op. cit.*, p. 33.

¹⁷⁵ Saygılı, *op. cit.*, p. 34.

administration on the report and monitoring/auditing by the administration.¹⁷⁶ Each step will be briefly discussed below.

Screening is basically the process where the State decides if the project in question would be subject to EIA.¹⁷⁷ This decision is usually taken by considering the size of the project, its level of complication, its value, the environmental particularities of the project site and the benefits of the project.¹⁷⁸

As explained above, the screening process can be either done either by the legislator, on a list basis, or by the administration, through exercise of a discretion. In the context of investment arbitration, one can argue that problems are more likely to arise in the North American system of administration discretion due to the risk of mis or wrong use of the discretion. In the list-based system, the investor will not have much room to argue that the State did not afford him the treatment he is entitled to under the relevant BIT merely because of the fact that its investment is among the listed project that are subject to EIA.

Turkish law follows a hybrid approach in this respect. EIA Regulation contains two lists. The first list, *ek-1*, indicates that all projects that are listed therein are subject to EIA. The second list, *ek-2*, indicates the types of projects that will be evaluated by the ministry of environment and urban planning as to whether they will be subject to EIA.¹⁷⁹

Scoping is the second step of EIA after determination that the project should be subject to EIA, either due to the administration's decision or being a part of the list.¹⁸⁰ Saygılı defines this step as determination of possible environmental effects of the

¹⁷⁶ *Ibid.*, p. 163 *et seq.*

¹⁷⁷ *Ibid.*, p. 164; Jane Holder, **Environmental Assessment: The Regulation of Decision Making**, Oxford University Press, p. 35.

¹⁷⁸ Güneş, *op. cit.*, p. 186; Nükhet Turgut, **Çevre Politikası ve Hukuku**, İmaj Yayınevi, 2009, p. 222. (Herein after: Turgut, **Çevre Politikası...**)

¹⁷⁹ Turkish Regulation of Environmental Impact Assessment (ÇED Yönetmeliği), art. 7.

¹⁸⁰ Ayşe Öznur Özer, **Çevresel Etki Değerlendirmesine Giriş**, TMMOB Yayınları, 1996, p. 34; Christopher Wood, **Environmental Impact Assessment**, Longman Publications, 1997, p. 136.

project and determination of the physical and temporal limitations of the project.¹⁸¹ Güneş notes that scoping basically determines what should be included in the EIA report.¹⁸²

Preparation of the report is regarded by Güneş as one of the most important steps of the EIA process since it constitutes the basis for the administration's decision on the EIA.¹⁸³ There are two approaches with respect to preparation of the report. One way is the preparation of the report by the administration, which is followed by United States.¹⁸⁴ The first approach would also lead to elimination of the analysis step, as the administration in charge of analysis would be the one preparing it.

The second approach is asking the project owner to prepare the project and present it to the administration for approval. The second approach is used by the European countries, including Turkey.¹⁸⁵ Saygılı indicates that the report must contain the definition and the purpose of the project, location of the project, environmental qualities of the area that will be impacted and measures that will be taken against the impacts, ensuring the involvement of the local population,¹⁸⁶ followed by a summary of the project.¹⁸⁷

Submission of the report to the administration is followed by the next steps, namely the analysis of the administrator and the final decision on the EIA. Saygılı notes that the analysis could be done in two aspects. First, the administration reviews the report to understand if it is in compliance with the legal requirements, as well published rules/guidelines and principles. Second, the administration can look at if the

¹⁸¹ Saygılı, *op. cit.*, p. 168.

¹⁸² Güneş, *op. cit.*, p. 186.

¹⁸³ Güneş, *op. cit.*, p. 187; Saygılı, *op. cit.*, p. 172.

¹⁸⁴ Güneş, *op. cit.*, p. 187; Saygılı, *op. cit.*, p. 187.

¹⁸⁵ Güneş, *op. cit.*, p. 187.

¹⁸⁶ Involvement and approval of the local population is discussed in great details below as a part of the Social Licence to Operate, due to the importance given to the concept in a number of investment treaty arbitrations.

¹⁸⁷ Saygılı, *op. cit.*, p. 172-173; Emin Memiş, **Çevre ve Çevre İdare Hukuku**, Filiz Yayınevi, 2006, p. 308-320.

report is not against the purpose of EIA.¹⁸⁸ Saygılı suggests that third party review of the report and making the report public are important tools in ensuring that the analysis is done as objectively as possible.¹⁸⁹

The administration, after completing its analysis of the report, issues a decision finding the EIA report in line with the legal requirement, or rejecting it due to its deficiencies. Saygılı notes that, whether it is a negative or positive decision, the decision must be reasoned, and it must be published.¹⁹⁰ This is important in order to further ensure the objectivity of the process.

The project, or the investment by the foreign investor for the purposes of our thesis, would be admitted after a positive decision by the administration.¹⁹¹ Analysis of these steps and correct application of them is important in a potential investment dispute since any major problem at any of these steps could lead to the conclusion that the investment was not made in line with the laws of the host State. This will be further discussed in Part 1/IV/B below.

The State's final duty in the context of EIA is monitoring the project, in order to ensure that the project is executed as per the EIA report, which constituted the basis for the State's decision admitting the project. Saygılı notes that monitoring is important for applying the polluter pays principle as such monitoring will allow the State in determining if a project is operating against the EIA report and polluting the environment.¹⁹² It is important to note that Turkish law also provides for the monitoring of the admitted projects. EIA Regulation indicates that the Ministry of Environment and Urban Development would be in charge of such monitoring/audits.¹⁹³ In case the

¹⁸⁸ Saygılı, *op. cit.*, p. 189, Turgut, **Çevre Hukuku...**, p. 206.

¹⁸⁹ Saygılı, *op. cit.*, p. 189; Environmental Impact Assessment of Projects Guidance on the preparation of the Environmental Impact Assessment Report, European Commission, p. 61. https://ec.europa.eu/environment/eia/pdf/EIA_guidance_EIA_report_final.pdf (last accessed 12.09.2019). (Herein after EIA Guidance).

¹⁹⁰ Saygılı, *op. cit.*, p. 191. EU guidelines also suggest that the decision must be well reasoned. EIA Guidance, *op. cit.*, p. 83.

¹⁹¹ Assuming that the investment is not subject to further approval or licence processes.

¹⁹² Saygılı, *op. cit.*, p. 192; Wood, *op. cit.*, p. 198.

¹⁹³ Turkish Regulation of Environmental Impact Assessment, art. 18; Saygılı, *op. cit.*, p. 193.

ministry determines that the project is operated in breach of the EIA report, it gives a warning to the investor and asks the investor to correct the incompliant points. If the investor fails to correct the incompliant points in the time granted to it, then the project will stop.

Accordingly, monitoring is also an important aspect in the context of protection of investments, after they are admitted. In the context of investment treaty arbitration, the State's decision to halt the project will have to be analysed in the context of fair and equitable treatment. In other words, the arbitral tribunal will have to decide if the State's action taken in the context of EIA process remains in its power to regulate environmental matters or whether it exceeds the limits of such powers and constitutes a breach of the BIT in question. This will be further discussed in Part 2/II.

D. Social licence to operate

An investment project that will have an environmental impact must be accepted by the local population as well. This concept is called social licence to operate ("SLO") and has been mainly discussed in mining disputes. Although we will discuss mainly its application in mining disputes due to the availability of materials in this specific sector, we consider that the concept similarly carries relevance to all investment projects that will have an impact on the environment.

Although it is not as comprehensive as social licence to operate under Turkish law, introduction of the project to the local population is one of the steps of EIA as discussed above.¹⁹⁴ Indeed, it is regarded as a very important step by the Turkish judiciary. Grand Chamber of Administrative Lawsuits of Council of State indicated in one of its major decisions that it was not enough for the administration to prove that the local population was aware of the project. The court stated that unless the administration can prove that the project was officially announced through the local mayor's office (*muhtar*), the administration cannot approve the EIA report and allow the project to operate.¹⁹⁵

¹⁹⁴ See Part 1/ III/C.

¹⁹⁵ *Case concerning Hydroelectric Power Plant*, Turkish Grand Chamber of Administrative Lawsuits of Council of State, 2016/3317, 2016/2812, 03.11.2016.

Even though EIA is a step towards a SLO obligation, we cannot say that it covers a SLO concept as a whole. The only obligation in the EIA process is informing the local population. However, the SLO also requires the acceptance of the project by the local population. Considering the recent example of reactions from the locals and non-locals (artists, associations, political parties) to the gold mining activities of a Canadian company in *Kaz Dağları*, we can establish that despite the EIA approval (which can only be achieved after informing the local populations), a social reaction due to non-acceptance may still be possible.¹⁹⁶

As mentioned before, knowledge is one of the steps for social licence to operate. It also entails acceptance of the project by the local population.

1. In mining sector

The term social license to operate (“SLO”) was first discussed for the mining industry in March 1997 by Jim Cooney at a meeting at the World Bank in Washington, DC.¹⁹⁷

Following a series of well publicised accidents, including chemical spills, dam failures and eventual conflicts with local communities around mining projects, the mining industry became the least popular industry, just behind tobacco industry. Internationally, mining became a negative symbol of a problem industry, under heavy public surveillance, root of unwanted pollution and undesirable social impacts. This image is still installed on the general public and it causes a big problem to the mining industry.¹⁹⁸

¹⁹⁶ See for instance Mahmut Hamsici, Ege Tatlıcı, “Kaz Dağları: Tüm yönleriyle tartışmalı maden projesi”, BBC News Türkçe, 06.08.2019, <https://www.bbc.com/turkce/haberler-turkiye-49245614> (Last access: 08.09.2019).

¹⁹⁷ Jim Cooney, Reflections on the 20th anniversary of the term ‘social licence’”, **Journal of Energy & Natural Resources Law**, vol.35 (2), 2017, p. 1.

¹⁹⁸ Ian Thomson, Susan Joyce, “Changing Mineral Exploration Industry Approaches to Sustainability”, 2006, in **Wealth Creation in the Mineral Industry: Integrating Science, Business and Education**, Society of Economic Geologists Special Publication vol. 12, 2006, p. 5.

Cooney realised after several years of experiences in different countries that managing a mine required two different licences.

First a mining company needed to get legal approval for building and operating a mine, a governmental permit, which represented compliance with standards of human health, safety and environment.¹⁹⁹

According to him the permit alone was not enough to protect a mine against adverse developments such as public instabilities. The positive relation between the mine and the government and local administration should be maintained to protect the mine from future problems, by demonstrating continuous compliance with the mining permit and regulations, as well as interests of the country. This was the traditional risk management which included legal compliance and good relations with current and future governments.²⁰⁰

Yet, as Cooney observed, with the globalisation, mining companies could no longer ignore concerns of local communities who have the support of influential allies abroad, otherwise they would risk financial and reputational damage. Consequently, mining companies needed to engage with directly affected local communities and their supporters to seek their approval.²⁰¹

So, secondly, the mining projects needed a social license to operate. SLO is an intangible asset to be deserved and maintained to avoid problems that could stall or even potentially stop the projects.

The SLO concept became a well-established in mining sector, discussed heavily by doctrine, and always observed by the industry as a risk factor. It has been reflected, for instance, by the annual ‘Tracking the Trends’ report prepared by Deloitte as a risk factor.²⁰²

¹⁹⁹ Cooney, *op. cit.*, p. 2.

²⁰⁰ Cooney, *op. cit.*, p. 3.

²⁰¹ *Ibid.*, p. 3.

²⁰² Deloitte, *Tracking the Trends: The Top Ten Issues Mining Companies Will Face in the Next Year*, 2014, p. 24.

However, for many years it continued to be essentially a metaphor that both compared the power of communities with that of governments in terms of granting ‘permission’ for a project to proceed. It also described a desirable outcome, the consequence of developing positive relations between a community and a mining project.

The first step in gaining a social license is achieving legitimacy in the eyes of the local community. There are two aspects to legitimacy and hence acceptance: the legitimacy gained by providing a welcome benefit (Beneficial Legitimacy) and meeting accepted social norms, building a relationship (Social Legitimacy). While one or other may be sufficient to initiate a project, both need to be present to establish and then maintain a stable, meaningful social licence to operate, with the quality of the relationship ultimately the more important aspect.

SLO is an outcome of social processes between parties that have conflicting interests. The outcome and the processes should exhibit certain attributes for a stable SLO, such as trust.

The exploration phase of the mine life cycle is when companies and communities first get to know each other. The nature of the relationship and quality of SLO that ultimately develops is highly dependent on how legitimacy is established at this stage by the company. To contribute positively to the legitimacy of benefits, any such benefits must be perceived by the community to outweigh any negatives and be fairly and equitably available to all members of the population. Social legitimacy is strongly linked to the quality of engagement. As noted by the OECD, effective engagement should be “an interactive process with (all) relevant Stakeholders (...) characterized by two-way communications and (...) the good-faith of all the participants”.²⁰³

The SLO is a metaphor for the level of stakeholder acceptance of a project or operation. Community — individuals or groups that can influence or are influenced by the activities of an active agent, such as a government, corporation, project or

https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Energy-and-Resources/dttl-er-Tracking-the-trends-2014_EN_final.pdf (last accessed 02.06.2019).

²⁰³ OECD, 2011, OECD Guidelines for Multinational Enterprises, OECD Publishing, para. 25. <https://www.oecd.org/daf/inv/mne/48004323.pdf> (last accessed 02.06.2019).

organization— are defined as those who can affect the project or operation and those that are affected by it. The level or status of the social license to operate is dependent on the perceptions and opinions of this community. Gaining or losing a social license to operate is therefore dominantly, but not entirely, a product of the interactions between the project or operation and its community.

The concept of a SLO is based on the political reality of the relationship with community rather than moral or legal arguments. Whoever has the power to stand between the company's resources and its mining business, and at the same time who is willing and able to act towards blocking the company, could withdraw the SLO. This is very political.

At the first phase of the mine life cycle, the risk of opposing a mining project is greatest. At this stage the company explores and evaluates mineral deposits and exercises other activities up to the issue of the final permit for the construction. During this phase community activity can most easily block access to land and oppose the issue of permits.

So, in practice, while a legal license is a must for a mining project to be realised, it is also a necessity to obtain SLO as a parallel process, because community have an independent power to support or oppose the mining activity. The concept of community is used here to cover all stakeholders. This includes everyone that is directly or indirectly affected, as well as people who could affect the project. These could be local or non-local parties with political influence to advance or block the activity. Examples would include international activists, national government regulators, and criminal organizations.

2. In investment treaty arbitration

In recent cases the investment tribunals have also recognised that the fact that an investment project has met all the legal requirements may not be enough and the project would also need approval of the local population as explained in the previous section. In the context of mining projects this approval is called a social licence to operate and it has also been used by certain investment tribunals. Although the term mostly points to the local population's acceptance of the mining project, it certainly

covers the environmental concerns of the local population and it is therefore within the scope of this thesis.

Several tribunals have recognised that the social license is a fundamental requirement for the development of mining projects. One of these cases is the *Bear Creek*. The investor, a Canadian mining company, in this case has invested in the Santa Alena silver mine project. One of the problems with the project was the fact that the mining zone in the border area between Peru and Colombia and the Peruvian government was regulating the activities in the border areas and the investor has utilised a Peruvian national to become the initial owner of the concessions to prevent any delay to the project as a result of the aforementioned regulations.²⁰⁴ Another problem was, which is more relevant for this thesis, that how the project was perceived by the local population. There were even physical confrontations between the agents of the investor and the local population.²⁰⁵ These confrontations escalated even more when the project was more advanced, and the investor's facilities were set on fire by the members of the local population.²⁰⁶

Although the parties disagreed as to the reason for the attack, there was no disagreement that the events against the investor were taking place and they were done by the local population. In order address these concerns, the investor entered into a social support agreement with several local communities that will be affected by the project.²⁰⁷ The investor also conducted workshops to gather support from the local communities.²⁰⁸ Despite all these efforts, a majority of the community members demanded the host State to refuse the necessary final permits.²⁰⁹ In fact, the local

²⁰⁴ *Bear Creek Mining Corporation v. Republic of Peru "Bear Creek"*, Award of 30 November 2017, ICSID Case No. ARB/14/21, paras. 123-124. <https://www.italaw.com/sites/default/files/case-documents/italaw9381.pdf> (last accessed 02.06.2019).

²⁰⁵ *Ibid.*, paras. 152-153.

²⁰⁶ *Ibid.*, para. 155.

²⁰⁷ *Ibid.*, paras. 156-158.

²⁰⁸ *Ibid.*, para. 163.

²⁰⁹ *Ibid.*, para. 169.

populations even initiated attempts to block all mining activities in the area and this attempt created a political crisis in Peru.²¹⁰ Although the government of Peru may have given assurances to the investor, they could not resist the protestors any further and decided not to grant any new mining concessions. The decision did not have an impact on the investor's project at this stage.²¹¹ The protests ensued and finally forced the Peruvian government to cancel the project with a supreme decree.

Against this background, the tribunal in *Bear Creek* decided that the lack of social licence to operate had to be considered in the valuation of the project. The tribunal decided in this case that in the short term the project did not seem viable because given the opposition, no other investor might be able to obtain the necessary social licence.²¹²

It must be noted this reasoning did not cause the tribunal to refuse the claim but rather to discount the compensation and concluded that the calculation could not be based on the potential expected profitability of the project or the discounted cashflow method.²¹³

The concept was further discussed in another mining related case, namely *Copper Mesa* case. The case concerned a dispute arising from three mining concessions at Junín, Chaucha and Telimbela in Ecuador granted by the host State. During the arbitration, the project was disputed at every possible stage of it, including how the investor has won the tenders for these concessions.²¹⁴ For the purposes of this thesis, we will focus on the local population's concerns and troubles. One of the main

²¹⁰ *Ibid.*, paras. 170-175.

²¹¹ *Ibid.*, paras. 176-180.

²¹² *Ibid.*, para. 599. Joshua Paine, "*Bear Creek Mining Corporation v Republic of Peru: Judging the Social License of Foreign Investments and Applying New Style Investment Treaties*", ICSID Review, vol. 33(2), 2018, p. 342.
<https://academic.oup.com/icsidreview/article/33/2/340/5088311?searchresult=1>

²¹³ *Ibid.*, para., 604.

²¹⁴ *Copper Mesa Mining Corporation v. The Republic of Ecuador "Copper Mesa"*, Award of 15 March 2016, PCA Case No. 2012-2, para. 1.86.
<https://www.italaw.com/sites/default/files/case-documents/italaw7443.pdf> (last accessed 02.06.2019).

issues under discussion was whether the investor was entitled to start mining activities without or prior to consulting the local populations who would be affected by the mining activities.²¹⁵ In particular, the host State argued that the investor obtained the land in question mainly through “illegal land trafficking”.²¹⁶ In fact, the whole situation escalated to a level that the local population would arm and form militia groups, and the investor’s local agents would do the same by arguing that their lives were threatened by the local militias. This struggle was even documented in a documentary titled “Under the Rich Earth”.²¹⁷

The investor’s problems with the local communities escalated to a level including violence especially with the Junin communities.²¹⁸ These confrontations led the host State to issue a suspension decision.²¹⁹ These decisions later transformed to termination of the concessions.²²⁰ The investor argued that the host State was not concerned with the local populations but wanted to pursue the project with local and State-owned investors, but this allegation was denied by the host State.²²¹

In addressing the investor’s claims, the tribunal considered the reasons for the investor’s failure to obtain the social licence an important factor in its making process. It noted that it should decide: “[w]hether Ascendant Ecuador and the Claimant failed to obtain the required social licence to operate the Junín concessions; and whether such failure was wholly attributable to the Claimant?”.²²²

²¹⁵ *Ibid.*, para. 1.94.

²¹⁶ *Ibid.*, para. 1.96

²¹⁷ The documentary “Under the Rich Earth” can be watched at <https://www.youtube.com/watch?v=QRinnhejBIw> (last accessed 09.06.2019)

²¹⁸ *Copper Mesa, op. cit.*, para. 1.105.

²¹⁹ *Ibid.*, para. 1.108.

²²⁰ *Ibid.*, paras. 1.109-1.115.

²²¹ *Ibid.*, paras. 1.122-1.123.

²²² *Ibid.*, para. 2.16.

In its decision, the tribunal considered whether termination of the concessions was justified since it was “a legitimate response to a social and political problem confronting the nation as a whole, for which international law provides no remedy and in respect of which Article XVII(3) separately provides an express exception.”²²³

In its analysis, the tribunal referred to the American Law Institute’s Third Restatement of Foreign Relations Law, which stated that

“A State is not responsible for loss of property or for other economic disadvantage resulting from *bona fide* general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of States, if it is not discriminatory”²²⁴

After referring to the infamous *Methanex* and *Tecmed* decisions,²²⁵ the tribunal first concluded that the investor was not free of any risk of a potential change in the legislation and decided that the issue was whether the termination decisions were made “in accordance with due process and not in arbitrary manner.”²²⁶ The tribunal concluded that this standard was not met. It said that effective remedies were not available under Ecuadorian law and non-existence of such a remedy under domestic law was not an excuse compared to the higher standard imposed by the international treaty, to which the State voluntarily agreed.²²⁷

Surprisingly, and some can even regrettably, the tribunal did not follow through its promise in the beginning part of the award and did not discuss the concept of social licence but merely focused on the application of the legal standards. Instead, the tribunal considered the local populations’ reactions as a matter of contributory negligence and stated that whatever provocations happen from the local residents, the investor should not have resorted to using armed men, firing guns as a part of

²²³ *Ibid.*, para. 6.58.

²²⁴ See Part 2/II/A for further discussion on police powers.

²²⁵ *Copper Mesa*, para. 6.60.

²²⁶ *Ibid.*, para. 6.63.

²²⁷ *Ibid.*, para. 6.69.

premeditated and well-funded plans to be the law enforcer.²²⁸ The tribunal then established that senior personnel of the investor was guilty at directing the violent acts in violation of criminal law, which could have led to deaths, so further negative reactions from the communities were inevitable. However, the tribunal lightened the determinations by explaining that it bases its decision on the negligence of the investor rather than intentional act of senior management.²²⁹

Again, somewhat surprisingly, the tribunal concluded that committing activities like hiring paramilitary groups would only lead to a 30% discount in the awarded compensation.²³⁰ As Perrone puts it, an investor could not have been expected to act “less responsibly”²³¹ and such a small discount cannot justify the reckless behaviour.

The social license to operate was also discussed in *Pac Rim* case. The case concerned again a mining investment. The investor struggled to obtain necessary environmental permits for two years.²³² At the end of this process, the president of El Salvador allegedly applied a *de facto* ban on all metallic mining concessions, which destroyed the investor’s investment. The host State argued that the investor simply failed to follow the local legislation.²³³ Unfortunately, the issue of social licence or the general acceptance of the project by the local population did not play an important role in the tribunal’s decision.

It is noteworthy that a large portion of case materials are available publicly on ICSID’s website, including some of the submissions. Thanks to this transparency, we

²²⁸ *Ibid.*, para. 6.97.

²²⁹ *Ibid.*, para. 6.98.

²³⁰ *Ibid.*, para. 102.

²³¹ Nicolas Perrone, “The “Invisible” Local Communities: Foreign Investor Obligations, Inclusiveness, and the International Investment Regime”, **American Journal of International Law Unbound**, vol. 113, 2019.

²³² *Pac Rim Cayman LLC v. Republic of El Salvador “Pac Rim”*, Award of 14 October 2016, ICSID Case No. ARB/09/12, paras. 3.05-3.11.
https://www.italaw.com/sites/default/files/case-documents/italaw7640_0.pdf (last accessed 02.06.2019).

²³³ *Ibid.*, para. 3.23.

can say that some investors felt the need to mention its efforts for obtaining the social licence from the local population.²³⁴

South American Silver case also concerned a mining project. The investor obtained the mining concessions but then argued that the political change in the host State tried to force them out of the country. Interestingly, the investor argued that the host State tried dissuading the local community from supporting the investor's project and seek support from the government.²³⁵ In particular, the investor hired advisor to educate and train the local community about mining and controlling its impact on the environment.²³⁶ However, local community started raising environmental concerns later on.²³⁷ The local community's complaints reached its pinnacle later on with a resolution that the investor should leave definitively because it had caused violence, political unrest and abuses of women and it was 'destroying Mother Earth'.²³⁸

Further protests, violence and even abductions took place among the community members opposed and accepted the project.²³⁹ These events finally resulted in cancellation of the investor's concessions.²⁴⁰ Although this fact did not play a clear role in the tribunal's decision, it is noteworthy to mention that the area was promoted to investors at a high-level event in New York, after its cancellation.²⁴¹ It should be accepted that this promotion does not necessarily coincide with the state's defence presented in the case.

²³⁴ See e.g. *Pac Rim Cayman LLC v. Republic of El Salvador*, Claimant Memorial on Merits and Quantum of 29 March 2013, ICSID Case No. ARB/09/12, para. 109. <https://www.italaw.com/sites/default/files/case-documents/italaw1425.pdf> (last accessed 02.06.2018).

²³⁵ *South American Silver*, op. cit., para. 101.

²³⁶ *Ibid.*, paras. 104-111.

²³⁷ *Ibid.*, para. 113.

²³⁸ *Ibid.*, para. 125.

²³⁹ *Ibid.*, paras. 130-152.

²⁴⁰ *Ibid.*, para. 169.

²⁴¹ *Ibid.*, para. 181.

The tribunal accepted that the investor had to implement measures for obtaining the local communities' support since the mining project would undisputedly have an impact on them.²⁴² Interestingly, the tribunal noted that the investor erred in only trying to obtain support from a part of the local community and ignore the rest, especially the indigenous communities.²⁴³ Thus, the tribunal concluded that the social tension ensued throughout the life of the project was a result of the project.²⁴⁴ The tribunal based its decision on the facts that regardless of a community relations program the investor could not maintain established relations, that the oppositions to the project from the Indigenous government bodies, that the strategies focused on weakening the opposition which aggravated the situation and that the situation escalated to violent clashes.²⁴⁵

With this background, the tribunal concluded that the host State expropriated the concessions with the reversal decree, but “the premises mentioned in the Reversion Decree as causes for Reversion have been proven and such premises include the protection of human rights – the right to life and the right to peace, both expressly mentioned in the Reversion Decree – and the protection of the communities and the Ayllus against the difficulties resulting from the Project.”²⁴⁶

However, the tribunal concluded that this does not mean that the host State could expropriate without compensation.²⁴⁷ We should note that the tribunal did not accept the investor's valuation of the compensation as the project was not advanced,²⁴⁸ and only awarded compensation for the investor's costs.²⁴⁹

²⁴² *Ibid.*, para. 477.

²⁴³ *Ibid.*, paras. 480-482.

²⁴⁴ *Ibid.*, para. 491.

²⁴⁵ *Ibid.*, para. 507.

²⁴⁶ *Ibid.*, para. 561.

²⁴⁷ *Ibid.*, para. 610.

²⁴⁸ *Ibid.*, para. 823.

²⁴⁹ *Ibid.*, para. 866.

Although it is not an investment treaty arbitration award, *Baleni* judgment from the High Court of South Africa is worth mentioning due to its relevance to the matter of social licence. The case concerned a mining project to be undertaken by an Australian company. The local population opposed to the project as they did not any mining operation on a land that is sacred to them.²⁵⁰

The court did not directly refer to concept of social licence to operate, but it recognised the concept and its international status. It said that many international instruments recognise the locals' right to grant or refuse consent to any mining project that may significantly affect them.²⁵¹

To sum up, the social licence to operate is widely accepted as a business risk that needs to be taken into account by the mining companies. Although the concern can sometimes be religious, just like the *Baleni* case discussed above, it also extends to environmental concerns of the local population, such as the indigenous populations affected by the mining activities in *Copper Mesa*. Therefore, there is no reason for limiting the application of the concept to mining disputes and they should be applied to all cases that have an environmental element.

It has been also observed in the case law that arbitral tribunals are not keen on applying the concept directly and dismiss a case based on the reactions of the local population. However, they are not also keen on turning a blind eye on these, often tragic, events and attribute some part of the blame on the investor. The main problem with this approach is that it leaves the matter completely to the tribunal's discretion. For example, how the Copper Mesa tribunal reached the conclusion of 30% is completely unknown. Therefore, we suggest that the concept should be applied directly, and the tribunals must detail their reasoning on application of this concept.

²⁵⁰ *Duduzile Baleni and others v Minister of Mineral Resources "Baleni"*, Judgment of 22 November 2018, High Court of South Africa Gauteng Division, paras. 7-10.
<https://cer.org.za/wp-content/uploads/2018/11/Baleni-and-others-v-Minister-of-Mineral-Resources-and-others.pdf> (last accessed 02.06.2019).

²⁵¹ *Ibid.*, para. 37.

E. Social responsibility of corporations

Corporate social responsibility has been defined as a principle calling for the responsibility of corporations on health and environment matters, to the extent that those matters are affected by corporations' commercial activities.²⁵² The concept naturally applies to foreign investor companies as well as locals.

Placing some part of the environmental responsibility on international trade and investment players is not a new concept. The Rio Declaration on Environment and Development (the "Rio Declaration of 1992") is a widely accepted international declaration, issued at the end of 1992 United Nations Conference on Environment and Development. The Rio Declaration consists of 27 principles intended to guide countries in future sustainable development and it was signed by over 170 countries.

The Rio Declaration of 1992 not only declared environmental protection as an "an integral part of the development process",²⁵³ but also indicated that private parties shall bear responsibility for their polluting actions:

"National authorities should endeavour to promote the internalisation of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the cost

²⁵² William C. Frederick, James E. Post, **Business and Society. Corporate Strategy, Public Policy, Ethics**, McGraw-Hill College, 1992; Marcel Van Marrewijk, "Concepts and definitions of CSR and corporate sustainability: between agency and communion", *Journal of Business Ethics*, vol. 44, 2003, p. 96 https://www.jstor.org/stable/25075020?seq=1#page_scan_tab_contents; (last accessed 14.09.2019); Alexander Dahlsrud, "How Corporate Social Responsibility is Defined: an Analysis of 37 Definitions", *Corporate Social Responsibility and Environmental Management*, vol. 15, 2008, p. 5, 6 <https://onlinelibrary.wiley.com/doi/epdf/10.1002/csr.132> (last accessed 14.09.2019).

²⁵³ Principle 4, The Declaration on Environment and Development, The United Nations Conference on Environment and Development, Rio de Janeiro, 1992, http://www.unesco.org/education/pdf/RIO_E.PDF (Last accessed 02.06.2019).

of pollution, with due regard to the public interest and without distorting international trade and investment”.²⁵⁴

The Rio Declaration of 1992 is regarded as a “breakthrough” in establishment of sustainable development, hence placing the environment in the context of investment and trade.²⁵⁵ However, the success of the Rio Declaration of 1992 has not been visible in practice.²⁵⁶

1992 Rio Declaration was followed by the Global Compact initiative, which was announced by the late Secretary General of the UN, Mr Kofi Annan, during the 1999 World Economic Forum.²⁵⁷ Global Compact is a nonbinding pact under the auspices of the UN, which encourages private actors of foreign investment and trade in respecting human rights, labour rights, protection of the environment and anti-corruption.²⁵⁸

2002 Earth Summit, convened at Johannesburg, further emphasised the private parties’ role in protection of the environment. It was noted in the Johannesburg Declaration that the “responsibility to advance and strengthen” environmental protection was a “collective responsibility”.²⁵⁹ In particular, it noted that “there is a need for private sector corporations to enforce corporate accountability, which should take place within a transparent and stable regulatory environment.”²⁶⁰ Although, the

²⁵⁴ *Ibid.* Principle 16.

²⁵⁵ Esther Kentin, “Sustainable Development in International Investment Dispute Settlement the ICSID and NAFTA Experience”, in Nico Schrijver, Friedl Weiss (Eds.), **International Law and Sustainable Development, Principles and Practice**, Martinus Nijhoff Publishers, 2004, p. 311.

²⁵⁶ Asa Romson, **Environmental Policy Space and International Law**, Akta Universitatis Stockholmiensis, 2012, p. 24.

²⁵⁷ Kofi Annan, Global Compact Initiative (Press Release), SG/SM/6881, 01.02.1999.
<https://www.un.org/press/en/1999/19990201.sgsm6881.html> (Last accessed 02.06.2019).

²⁵⁸ The Ten Principles of the UN Global Compact.
<https://www.unglobalcompact.org/what-is-gc/mission/principles> (Last accessed 02.06.2019).

²⁵⁹ Article 5, Johannesburg Declaration on Sustainable Development, UN World Summit on Sustainable Development, 26.08-04.09.2002, A/CONF.199/20.
<http://www.un-documents.net/johannesburg-declaration.pdf>. (Last accessed 02.06.2019).

²⁶⁰ *Ibid.*, Article 29.

Global Compact does not attach, or advocate attaching, responsibility to the private actors of foreign investment and trade, it is an important tool in raising awareness of the corporations to non-commercial matters.

The idea of including actors of international trade and investment into the protection of the environment was further advanced by the International Law Association's 2002 New Delhi Declaration. It clearly spelled out the "polluter-pays" principle and corporations' responsibility by noting that "International organizations, corporations (including in particular transnational corporations), non-governmental organizations and civil society should co-operate in and contribute to this global partnership. Corporations have also responsibilities pursuant to the polluter-pays principle."²⁶¹

IV. APPLICABLE LAW

International investment disputes are, in most of the cases, disputes that emerge from investment treaties. Indeed, the dispute resolution clauses in most cases refer to disputes emerging from the application of the investment treaty in question.²⁶² Accordingly, the applicable law, at least in determination of the treatment standard to be followed by the host State, is the investment treaty itself.²⁶³

We will discuss in the section how other sets of rules, that are more related to environmental protection, can find place in investment arbitration.

²⁶¹ Art. 3.1, New Delhi Declaration of Principles of International Law Relating to Sustainable Development, International Law Association, Resolution 3/2002 of the 70th Conference of the International Law Association (Herein after "ILA").
<http://cisdl.org/public/docs/news/ILAdclaration.pdf> (last accessed 02.06.2019)

²⁶² See *e.g.* Turkey-Switzerland BIT art. 8(1) defines a dispute under the treaty as follows: "For the purposes of this article an investment dispute is defined as a dispute involving an alleged breach of any rights and obligations conferred or created by this Agreement".

²⁶³ Zachary Douglas, *International Law...*, *op. cit.*, Rule 10, para. 141.

A. International environmental law as applied to investment disputes

1. Sustainable development and its failure

Originally, the idea was that investment law and environmental law protections would go hand in hand. This was reflected in the general concept of “sustainable development” which was developed in 1980s by UN, as mentioned before. The history and the development of the concept will be briefly discussed in this section.

The term “sustainable development” was first used in the World Conservation Strategy report published in 1980 by the International Union for the Conservation of Nature.²⁶⁴ The report did not provide for a definition of the term but provided hints at what the term entailed. The report indicated that conservation of living resources was one of the key ingredients for the sustainable development of human race.²⁶⁵ The report noted that development of humans and conservation are “mutually dependent”.²⁶⁶ The report even argued that the problems affecting both development and conservation were same, suggesting that development cannot be achieved at the expense of living resources.²⁶⁷

Philippe Sands indicates that the concept of sustainable development usually refers to four principles in State practice. First, it refers to the principle of intergenerational equity, which is the preservation of the environment for future generations. Second, it refers to the principle of sustainable use, which is exploitation of natural resources in an appropriate, wise manner. Third, it refers to the principle of equity, which is States considering the needs of other in exploitation of the environmental resources. Fourth, the principle of integration, which is the integration of economic and environmental concerns in development plans.²⁶⁸ Memiş also

²⁶⁴ International Union for Conservation of Nature and Natural Resources, World Conservation Strategy: Living Resource Conservation for Sustainable Development, 1980. <https://portals.iucn.org/library/sites/library/files/documents/WCS-004.pdf> (last accessed 14.09.2019).

²⁶⁵ *Ibid.*, p. IV.

²⁶⁶ *Ibid.*, Section 1, point 10.

²⁶⁷ *Ibid.*, Section 20, point 1.

²⁶⁸ Sands, **Principles...**, *op. cit.*, p. 207.

indicates that sustainable development refers to the principle of precaution for protection of the environment during economic activities of private or public entities.²⁶⁹

As mentioned above, the term was further developed in the Brundtland Report, published in 1987. The Brundtland Report stated that sustainable development was a combination of two concepts. First concept is the concept of needs, *i.e.* the task of making available what is required by human beings living in the underdeveloped areas of the world, which must be prioritised over the needs of the developed countries. Second concept is the environment's ability to meet humanities' present and future needs.²⁷⁰ The report also notes that the idea of sustainable development is to change the manner in which resources are exploited and the investments are planned.²⁷¹ Shaw also indicates that the concept of sustainable development means that each State's competence to control its own development is somewhat restricted, in the sense that the State must make sure that its development is sustainable.²⁷²

The idea of sustainable development has been developed ever since with the landmark developments like Agenda 21, 2012 Rio Declaration.²⁷³ A further example is the 2030 Agenda for Sustainable Development, adopted at the UN general assembly dated 25 September 2015, (the “**2030 Agenda**”) which puts forward 17 different goals for sustainable development.²⁷⁴ These goals varied from ending poverty on a global scale to availability of clean water resource and to tackling climate change.²⁷⁵ The

²⁶⁹ Memiş, *op. cit.*, p. 270-271.

²⁷⁰ Brundtland Report, p. 41.

²⁷¹ Brundtland Report, p. 42; Segger, *op. cit.*, p. 4.

²⁷² Shaw, *op. cit.*, p. 631.

²⁷³ Segger, *op.cit.*, p. 4; Anna Joubin-Bret “Protecting the Investor and Protecting the Environment: conflicting objectives”, in eds. Yulia Levashova, Tineke Lambooy, Ige Dekker, **Bridging the Gap between International Law and Investment Law**, Eleven International Publishing, 2016, p. 35; see also, Saygılı, *op. cit.*, p. 99.

²⁷⁴ Resolution adopted by the General Assembly on 25 September 2015, p. 99 https://www.un.org/ga/search/view_doc.asp?symbol=A/RES/70/1&Lang=E (last accessed 14.09.2019).

²⁷⁵ *Ibid.*, p. 14.

2030 Agenda also recognised that foreign direct investment in the less developed countries was one of the tools in reducing the inequality among the countries.²⁷⁶

The idea of sustainable development, at least in 1980s, is accordingly providing the needs of the people, in particular the poor people, without jeopardising the environment. The emphasis on the development side was criticised to be result of the efforts for making the concept politically acceptable to the business world and governments.²⁷⁷ Comparison of the goals set out in the 1980 World Conservation Report and the 2030 Agenda actually shows that the criticism is not unwarranted. While checklist of priority requirements, national actions and international actions in 1980 World Conservation Report almost exclusively refers to conservation of living resources,²⁷⁸ the 2030 Agenda goals rarely refers to environmental issues and even states that those issues must be discussed somewhere else.²⁷⁹ Saygılı also notes that there has been some (rather exaggerated) criticisms towards the concept of sustainable development on the ground that it has been a concept that is imposed on developing countries by the countries that have developed without giving any regard to sustainability.²⁸⁰

The criticism is somewhat echoed in the international dispute resolution community. Although the concept of sustainable development seems to be the right solution to the conflict between environment and development, it turned out to be not as useful as hoped in environmental disputes.²⁸¹ Until recently, it was quite common

²⁷⁶ *Ibid.*, p. 21.

²⁷⁷ Alexander Perez-Carmona, “Chapter 3 Growth: A Discussion of the Margins of Economic and Ecological Thought”, in ed. Louis Meuleman, **Transgovernance Advancing Sustainability Governance**, 2013, p. 95, <https://www.slideshare.net/lucieevers1/growth-in-margin-of-ecological-thought-by-perez> (last accessed 14.09.2019).

²⁷⁸ World Conservation Strategy Report, *op. cit.*, Section 20.

²⁷⁹ The 2030 Agenda indicates that “the United Nations Framework Convention on Climate Change is the primary international, intergovernmental forum for negotiating the global response to climate change.”

²⁸⁰ Saygılı, *op. cit.*, p. 92-95.

²⁸¹ *SD Myers Inc v. Government of Canada “SD Myers”*, *Ad Hoc* (UNCITRAL), Partial Award of 13 November 2000, paras. 220-221; Moloo, Jacinto, *op. cit.*, p. 2. <https://www.italaw.com/sites/default/files/case-documents/ita0747.pdf> (last accessed 02.06.2019).

to see mere references to the concept of sustainable development in the preambles of BITs.²⁸²

It has been argued by the well-known commentator, Jorge E. Viñuales, that sustainable development is no longer a sufficient tool to resolve conflicts international investment law and international environmental law.²⁸³ Viñuales notes that the framework to be applied to an investment consists of three layers. The first layer is the contractual provision. Second layer is the domestic law of the host State (or potentially of another). The last layer is the international law of treaties and customs. Accordingly, environmental considerations may be included in the investment contract, in domestic regulations or in the applicable investment treaty. Also, international environmental treaties or general international law may give rise to applicable protection standards.²⁸⁴

It should be noted that despite these criticisms, sustainable development is seen as one of the “highlights” of modern treaty making.²⁸⁵ More than half of the international investment treaties concluded in 2018 contained carve out clauses leaving environment and health related matters outside the scope of the investment treaty in question.²⁸⁶ Romson also notes that the concept of sustainable development was not transformed into norms in investment treaties and its impact was mostly limited to references in the preambles of the BITs.²⁸⁷

²⁸² See 2007 Investment Agreement for Comesa Common Investment Area, in which the member States reaffirmed the importance of *sustainable* economic growth and development in the preamble. <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/3092/download> (last accessed 14.09.2019).

²⁸³ Jorge E. Viñuales, “Foreign Investment and the Environment in International Law- An Ambiguous Relationship” (Herein after “Viñuales, “Foreign... Ambiguous...””), **British Yearbook of International Law**, vol .80(1), 2009, p. 246.

²⁸⁴ Jorge E. Viñuales, **Foreign Investment and the Environment in International Law** (Herein after “Viñuales, **Foreign...**”), Cambridge University Press, 2012, p. 100.

²⁸⁵ World Investment Report, op. cit., p. 105.

²⁸⁶ *Ibid.*, p. 105.

²⁸⁷ Romson, *op. cit.*, p. 290; Segger, *op. cit.*, p. 26 suggests that sustainable development as a goal can be useful tool for new treaties or renegotiation of existing ones.

Accordingly, the important task is to understand how the applicable law and the environmental regulations can find a way to be applied in investment disputes.

2. Possibility of directly applying international environmental law

The subjects of international law are the States. International law, including international environmental law does not directly apply to private persons.²⁸⁸ As Sands notes, one of the main challenges international environmental law is to define the role of the private parties and encourage their intervention in the field.²⁸⁹ Most treaties on this topic are not in force and will probably never enter into force.²⁹⁰ We will only discuss the ones that are currently in force and may be relevant to investment disputes.

As discussed above in Part 1/III/B, there is a limited number of international instruments that can be applied to an investor in the context of investment disputes. We will now discuss how these rules can be applied to an investment treaty arbitration.

When determining the applicable law, it is clear that the treatment standards against which the host State's actions must be evaluated can be found only under the investment treaty in question. This means that in general we can only apply the treaty that gives rise to the dispute, in the case of investment disputes, the investment treaty. However, this does not mean that investment disputes are to be resolved by investment treaties in an isolated universe: other legal considerations find their way into the process under three possible ways: 1st through the VCLT art. 31's which includes relevant rules applicable between parties in the interpretation; 2nd through treaties that

²⁸⁸ This rule has exceptions such as application of international criminal law to import direct individual criminal responsibility or conferring rights to individuals by the states in treaties (e.g. international investment law). Malcolm N. Shaw, **International Law**, Cambridge University Press, 8th edition, 2017, 204.

²⁸⁹ Sands, **Principles...**, p. 92; Andrea Gattini, "International Responsibility of Environmental Damage", in eds. Yulia Levashova, Tineke Lambooy, Ige Dekker, **Bridging the Gap between International Law and Investment Law**, Eleven International Publishing, 2016, p. 123; Maljean-Dubois, "The Applicability of International Environmental Law to Private Enterprises" in eds. Pierre-Marie Dupuy, Jorge E. Viñuales, **Harnessing Foreign Investment to Promote Environment**, Cambridge, 2013, p. 74.

²⁹⁰ *Ibid.*, p. 737. Also, Gattini, *op. cit.*, p. 127 notes that there is a trend for civil liability before local courts.

taking into account relevant rules of international law; 3rd through treaties that refer to relevant domestic laws.

First, Article 31 of the Vienna Convention on the Law of the Treaties indicates “relevant rules of international law applicable in the relations between the parties” must be taken into account in interpretation of treaties.²⁹¹ As rightly noted by Bucheler, “Scholars usually consider the phrase ‘rules of international law’ in Article 31(3)(c) VCLT to refer to all sources of international law as reflected in Article 38(1) of the ICJ Statute. The practice of international courts and tribunals confirms this account. Adjudicators have resorted to external treaties, customary international law, and general principles to interpret a treaty under the heading of Article 31(3)(c).”²⁹²

Given that the VCLT’s customary international law status has been recognised by several investment treaty tribunals,²⁹³ it would be very difficult to expect an investment treaty tribunal to turn a blind eye on the relevant environmental law regulations applicable under international law. Accordingly, the technical possibility of applying the above discussed oil and nuclear treaties to investment disputes exists.

Secondly, certain treaties specifically indicate that other relevant rules of international law should be taken into account when deciding the dispute under the

²⁹¹ Article 31, Vienna Convention on the Law of Treaties, 23 May 1969. <https://treaties.un.org/doc/Publication/UNTS/Volume%201155/volume-1155-I-18232-English.pdf> (Last Accessed 02.06.2019)

²⁹² Gebhard Bucheler “Proportionality and the Concept of Systemic Integration”, **Proportionality in Investor-State Arbitration**, Chapter 4, Oxford Scholarship Online, 2015, p. 17. <https://www.oxfordscholarship.com/view/10.1093/acprof:oso/9780198724339.001.0001/acprof-9780198724339-chapter-4> (Last Accessed 02.06.2019); Bruno Simma, Theodore Kill, ‘Harmonizing Investment Protection and International Human Rights’ in eds. Christina Binder, Ursula Kriebaum, August Reinisch, Stephan Wittich, **International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer**, Oxford University Press, 2009, p. 695; Mark E. Villiger, **Commentary on the 1969 Vienna Convention on the Law of Treaties**, Martinus Nijhof Publishers, 2008, Article 31, para. 25; International Law Commission, Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law, A/CN.4/L.682, 13 April 2006, paras. 462–70 http://legal.un.org/ilc/documentation/english/a_cn4_l682.pdf (last accessed 14.09.2019). *Pulp Mills on the River Uruguay (Argentina v. Uruguay)*, Judgment of 20 April 2010, ICJ Reports 2010, para. 66. <https://www.icj-cij.org/en/case/135/judgments> (last accessed 14.09.2019).

²⁹³ See for instance: *Tulip Real Estate and Development Netherlands B.V. v. Republic of Turkey “Tulip”*, Decision on Bifurcated Jurisdictional Issue of 5 March 2013, ICSID Case No. ARB/11/28, para. 43. <https://www.italaw.com/cases/documents/1827> (Last Accessed 02.06.2019).

investment treaty in question.²⁹⁴ Although this may be regarded as stating the obvious that has been spelled out under Article 31 of the VCLT, it simply ensures that the investment treaty tribunal created under the relevant investment treaty takes these other relevant regulations into account. Article 42(1) of the ICSID Convention is a good example of these types of applicable law clauses: “The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.”²⁹⁵ Bucheler noted that this default rule on applicable law ensures that ICSID system is not a system that lives in a vacuum and its “self contained regime” status does not mean that it excludes application of general international law.²⁹⁶

Thirdly, certain treaties indicate that the laws of the host State must be taken into consideration as well.²⁹⁷ The possibility of applying the host State law is discussed further at Part 1/IV/B.

We should mention here that individuals may be subjected to international and transnational public policy. Accordingly, international and transnational public policy is also applicable to environment related investment disputes. The breach of international public policy is discussed further at Part 1/II/B/2. Similarly, general

²⁹⁴ See for instance Art. 26(6), Energy Charter Treaty http://www.europarl.europa.eu/meetdocs/2014_2019/documents/itre/dv/energy_charter_/energy_charter_en.pdf (Last Accessed 02.06.2019). Douglas, “International Law...”, *op. cit.*, Rules 4, 7, 12. See https://www.univie.ac.at/intlaw/wordpress/pdf/0101001_Schreuer_Jurisdiction-and-Applicable-Law-in-Investment-Treaty-Arbitration.pdf, p. 7 and 8.

²⁹⁵ Article 42, ICSID Convention. https://icsid.worldbank.org/en/Documents/resources/2006%20CRR_English-final.pdf (Last Accessed 02.06.2019).

²⁹⁶ Bucheler, *op.cit*, p. 16.

²⁹⁷ E.g. Art 1.2.a “in accordance with the host country's laws and regulations” <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/3332/download>; Art 1.1.a ““investment” means every kind of asset invested by investors of one Party and admitted by the other Party subject to its law and investment policies applicable from time to time” <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/166/download>; Art. 1.2. “in accordance with the legislation of the latter Party” <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/1979/download>

principles of international environmental law, such as the polluter-pays principle, may find application in international investment disputes.

B. Law of the host State (legality requirement)

Law of the host State usually finds its way into the investment treaty arbitration through legality requirement. One should note that the legality requirement is usually not presented as a carve out provision. In other words, it is not very common to see an investment treaty specifically noting it will not apply to investments that are made in a somewhat illegal manner. Instead, investment treaties usually indicate that an investment within its context must be made in accordance with the laws of the host State. *Salini* tribunal explains that the legality requirement concerns the validity, not the definition as these provisions' intention is the prevention of protecting illegal treaties by BITs.²⁹⁸

In case of a monist constitution,²⁹⁹ these laws will necessarily include the host State's environmental obligations arising from its international treaties. Turkish Constitution is a good example of monist constitutions, as Article 90 regulates that ratified international treaties shall have the power of legislation.³⁰⁰ A distinction shall be made here: application of the laws of the host State cannot be utilised to excuse or justify violation of a BIT provision, which would be against one of the principles of international law. The principle in question, as indicated in Article 3 of the Draft articles on Responsibility of States for Internationally Wrongful Acts, is as follows:

²⁹⁸ *Salini Costruttori SpA and Italstrade SpA v. Kingdom of Morocco "Salini"*, Decision on Jurisdiction of 31 July 2001, ICSID Case No. ARB/00/4, para. 46. <https://www.italaw.com/sites/default/files/case-documents/ita0738.pdf> (last accessed 02.06.2019).

²⁹⁹ Ololade O. Shyllon "Monism/dualism or self-executory: the application of human rights treaties by domestic courts in Africa" http://web.abo.fi/instut/imr/secret/kurser/Advanced09/Essays/Working-group4/Shyllon_Monism%20Dualism%20or%20Self%20Executory.pdf (last accessed 02.06.2019).

³⁰⁰ Article 90, **Turkish Constitution**. https://global.tbmm.gov.tr/docs/constitution_en.pdf (last accessed 02.06.2019).

“The characterization of an act of a State as internationally wrongful is governed by international law. Such characterization is not affected by the characterization of the same act as lawful by internal law.”

With this provision in mind, two possible applications of municipal law must be discussed. The first possibility is application of the municipal law as a part of the applicable law. In other words, a tribunal would apply both relevant rules of international law and the municipal law of the host State. Article 42 of the ICSID Convention is a good example in this respect:

“(1) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.”³⁰¹

This provision raises the question: how can we apply the municipal law of the host State, while accepting that the municipal law of the host State cannot constitute an excuse for not respecting the obligations arising from international law? Several solutions are offered to this question. First, it has been articulated that municipal law would be applied to the extent that it does not conflict with the relevant rules of international law. In *Saipem*, the tribunal decided to apply the municipal law of the host State in particular when the BIT itself refers to the laws of the host State.³⁰² According to *Santa Elena* tribunal, when there is inconsistency between laws of the host State and public international law, public international law must prevail, otherwise the investor would not benefit from international law in relation to takings of property, and the protection purpose of the ICSID Convention would fail.³⁰³ This is also in line with the approach taken by the ILC in Draft Articles on State Responsibility. Article 3

³⁰¹ Article 42, **ICSID Convention**, *op. cit.*

³⁰² *Saipem SpA v. The People's Republic of Bangladesh "Saipem"*, Award of 30 June 2009, ICSID Case No. ARB/05/07, para. 100.

³⁰³ *Compania del Desarrollo de Santa Elena SA v. Republic of Costa Rica "Santa Elena"*, Award of 17 February 2000, ICSID Case No. ARB/96/1, para. 64.
<https://www.italaw.com/sites/default/files/case-documents/italaw6340.pdf> (last accessed 02.06.2019).

indicates that “the characterization of an act of a State as internationally wrongful is governed by international law. Such characterization is not affected by the characterization of the same act as lawful by internal law.”³⁰⁴ The principle has been established under international law since the beginning of 1900s³⁰⁵ and it would extend all aspects of the national law in question, including mandatory rules of the host State. An investment arbitral tribunal (or any other international tribunal for that matter) will not find that mandatory rules of a municipal law would deserve more credit than other rules available under that municipal law. ILC also noted that the principle is well-settled under international law.³⁰⁶

It should be noted that a recent decision of the Turkish Court of Appeals (Yargıtay) suggests that a potential conflict in enforcement of foreign investment arbitration awards. Yargıtay decided last year that a foreign arbitral award, which disregards the provisions on genetically modified organisms, which constitutes part of mandatory rules of Turkish law cannot be enforced in Turkey as it would violate public policy.³⁰⁷

Although the decision may carry importance in relation to arbitrations that are based on non-treaty obligations, we do not consider that this will have an impact in investment arbitration which is based on international treaties for two reasons. a) the issue may not arise under ICSID Convention. Given the special enforcement regime provided under Article 54 of the ICSID Convention obliges the signatory States to enforce ICSID Awards as if they were final judgments of their own courts,³⁰⁸ domestic courts will not have the opportunity to analyse whether an ICSID Award is in line with

³⁰⁴ **Draft articles on State Responsibility**, *op. cit.*, art. 3.

³⁰⁵ *Treatment of Polish Nationals and Other Persons of Polish Origin or Speech in the Danzig Territory*, Advisory Opinion, 1932, P.C.I.J., Series A/B, No. 44, p. 4.

³⁰⁶ *Draft articles on State Responsibility*, *op. cit.*, p.36.

³⁰⁷ *Case Concerning GMO*, Turkish Court of Appeal (Yargıtay), 19 HD, E 2017/4228, K. 2018/1042, T. 28.2.2018.

³⁰⁸ Christophe Schreuer, Loretta Malintoppi, August Reinisch, Anthony Sinclair, “Article 54 - Enforcement”, in **The ICSID Convention: A Commentary**, Cambridge University Press, 2009, pp. 1115-1150; International Centre for Settlement of Investment Disputes, Recognition and Enforcement - ICSID Convention Arbitration, <https://icsid.worldbank.org/en/Pages/process/Recognition-and-Enforcement-Convention-Arbitration.aspx> (last accessed 14.09.2019).

public policy. b) even if domestic courts would find opportunity, there has not been a single known investment treaty arbitration seated in Turkey which gave the Turkish courts the potential to review the award within the context of public policy. Therefore, we consider that the recent decision of the Yargıtay or the issue of mandatory rules of Turkish law (or any host State) will continue to play an important role for commercial arbitrations but not for investment arbitrations.

Secondly, and more frequently, the municipal law does not come into play as a direct part of the applicable law, but rather governs the so-called legality requirement. In other words, it mostly governs the issue of whether the investor has breached the municipal law during the establishment of the investment project.

For example, Netherlands-Turkey BIT indicates that it shall apply only to the investments “established in accordance with the laws and regulations in force in the [host State]”.³⁰⁹ In theory, this would mean that an investment that has been established in violation of the environmental rules of the host State will not enjoy the protections offered under the relevant BIT. It has been discussed whether this issue should be taken into account as a matter impacting the tribunal’s jurisdiction to hear the claims before it, or as a matter impacting the merits of the claims and therefore leading to the claims’ dismissal.³¹⁰ Regardless of the result of this debate, it is clear that an investment established in breach of legal rules of the host State will not enjoy the protections offered to it under an investment treaty.

³⁰⁹ Article 2(2), Agreement on Reciprocal Encouragement and Protection of Investments between the Kingdom of Netherlands and the Republic of Turkey.
<https://investmentpolicyhub.unctad.org/Download/TreatyFile/2090> (last accessed 02.06.2019). Most of the Turkish BITs contain a similar wording on the legality requirement. Some example BITs are: art. 1.1 of Turkey – Uzbekistan BIT of 2017 <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5846/download>; art. 1.1 of Cambodia - Turkey BIT of 2018 <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5833/download>; art. 1.1 of Mali-Turkey BIT of 2018 <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5740/download>; art 1.2 of Czech Republic - Turkey BIT of 2009 <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/4954/download>. (last accessed 14.09.2019)

³¹⁰ Viñuales, “**Foreign... Ambiguous...**”, *op. cit.*, p. 259-261.

This does not mean that the host State will be able to *post facto* justify its actions by invoking the relevant environmental rules. Certain tribunals have decided that the host State cannot go back to application of its environmental rules after allowing for establishment of the investment in the first place.³¹¹ However, recent tribunals have considered the legality of an investment in the context of jurisdiction. For instance, *Inceysa* is important in that sense. The investor in this case invested in a project concerning inspection of contamination control vehicles.³¹² The investor participated in a bid for this investment and had to prove that he was the best candidate regarding financial position, financial capacity, experience in managing vehicle inspection stations, experience with machinery and construction of vehicle inspection stations, experience of the personnel, legal documentation, work plan, methodology and performance of the services, equipment and infrastructure, main machinery, additional equipment and work plan, and customer service plans.³¹³ The host State argues that its consent provided under the BIT does not extend to investments procured by fraud, forgery or corruption.³¹⁴ The tribunal accepted this argument and ruled that its jurisdiction does not cover disputes that relate to investments that are made illegally.

A further possibility is an illegality that has occurred not during the establishment of the investment, but during its operation.³¹⁵ This was the case in *Fraport*. The tribunal concluded that illegality after the establishment can only be considered as a substantive defence at the merits stage, and not as an objection to the Tribunal's jurisdiction.³¹⁶ The tribunal held that the term 'in accordance with the laws

³¹¹ See below Part 2/II/A for the details of the *Metalclad* award, which supports the conclusion referred above.

³¹² *Inceysa Vallisoletana S.L. v. Republic of El Salvador "Inceysa"*, English Translation of the Award of 2 August 2006, ICSID Case No. ARB/03/26, para. 23.
https://www.italaw.com/sites/default/files/case-documents/ita0424_0.pdf (last accessed 02.06.2019).

³¹³ *Ibid.* para. 26.

³¹⁴ *Inceysa*, paras. 45, 257, 264.

³¹⁵ Douglas notes that there is a consensus in the investment arbitration community that this illegality should be considered at the merits stage, Douglas, "The Plea of...", *op. cit.*, p. 185; Schill, "Illegal...", *op. cit.*, p. 286.

³¹⁶ *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines "Fraport"*, Award of 16 August 2007, ICSID Case No. ARB/03/25, para. 345.
<https://www.italaw.com/sites/default/files/case-documents/ita0340.pdf> (last access 02.06.2019).

and regulations of the Host State' related to the jurisdictional phase is limited to determining the legal types of assets. Accordingly, the legality of the conduct of the investor should be the subject of merits stage.³¹⁷

We should note that illegality after the establishment may not be considered as a substantive or jurisdictional bar to the investor's claims in all circumstances. In *Saba Fakes*, the tribunal concluded that only an illegality at the establishment or admission of the investment stage could have an impact on the tribunal's jurisdiction.³¹⁸ Considering these cases, Viñuales draws three conclusions:

First, he notes that the tribunal has acknowledged that some forms of illegality before the establishment may bar the jurisdiction. He notes as the second point that the tribunal was unclear as to which domestic laws would go to the nature of the investment and cause the drastic consequence, he noted as the first point. His main criticism is about the fact that any regulation that is different than a licencing procedure, such as environmental regulations, that apply to investment in a more general sense than the licencing procedures may not create the same result. As a third point, he notes that the trend in recent cases is to take into account other regulations into account in the same manner, *i.e.* in determination of the tribunal's jurisdiction.³¹⁹

In the context of the environmental issues, laws of the host State are the immediately applicable rules since it is the rule regulating the establishment and in addition as the investment will physically be in the territory of the host State. Pollution due to production in a factory, leakages or spills during the mineral extraction operations will by definition take place in the territory of the host State since the factory or the exploration site will be in that territory. However, we could mention here that laws of the home State of the investor can also have a role to play.

³¹⁷ “*Fraport*”, *op. cit.*, Dissenting Opinion of Cremades, para. 38.

³¹⁸ *Saba Fakes v. Republic of Turkey “Saba Fakes”*, Award of 14 July 2010, ICSID Case No. ARB/07/20, para. 119.
<https://www.italaw.com/sites/default/files/case-documents/ita0314.pdf> (last accessed 02.06.2019).

³¹⁹ Viñuales, *Foreign...*, *op. cit.*, p. 98-99.

C. Law of the state of the investor

As explained above, the crux of the issue is usually the law of the host State. However, this does not mean that laws of the home State of the investor cannot be applied.

The rules of the home State can force an investor to be mindful of certain human rights or environmental regulations, which are originally applicable in the home State territory, while doing business in other countries. However, law of the home State does not find an important application, thus will only be explained briefly in this section.

This kind of extra territorial application is one of the responses to the “race-to-the-bottom” problem.³²⁰ Multinational companies which are subjected to more sophisticated environmental and human rights, tend to transfer their operations to countries that have less interfering or no human rights or environmental regulations. In order to stop transferring of these problems to developing countries instead of eradicating them, certain home States force their multinational companies to observe at least some of the regulations that are applicable at home. However, it should be noted that there have been some concerns in the economic academia whether there is a strict correlation between less regulated jurisdictions and an increase in foreign direct investment.³²¹

The most important example to extra territorial application is observed in the USA where the State holds multinational companies responsible for acts outside USA, especially with regards to corruption. The United States Department of Justice indicates that the Foreign Corrupt Practices Act was enacted “for the purpose of making it unlawful for certain classes of persons and entities to make payments to foreign government officials to assist in obtaining or retaining business.”³²² Although the United States does not have a regulation that would bar its investors to go and seek

³²⁰ Segger, *op. cit.*, pp. 14-15.

³²¹ Peter M. Madsen “Does Corporate Investment Drive a “Race to the Bottom” in Environmental Protection? A Re-examination of the Effect of Environmental Regulation on Investment”, **The Academy of Management Journal**, vol. 52, no. 6, 2009, pp. 1297-1318.

³²² United States Justice Department on the Foreign Corrupt Practices Act, <https://www.justice.gov/criminal-fraud/foreign-corrupt-practices-act> (last accessed on 09.06.2019).

countries with limited environmental protection; the Foreign Corrupt Practices Act would still apply to cases where an American investor would bribe the officials of the host State to obtain favourable (and possibly illegal) treatment for its violations of environmental law of the host State.



PART 2: BREACH OF INVESTOR RIGHTS AFTER ESTABLISHMENT

Investors have a variety of rights made available to them, or host States undertake a variety of obligations towards the investors. Among these rights and obligations, the most important ones are the expropriation ban, fair and equitable treatment (herein after “FET”), national treatment, full protection and security and most favourable nation clause.

For the purposes of this thesis, we will not deal with most of these obligations, or the so-called “treatment standards”, but only with the expropriation ban and the FET, because these are the main obligations that can create conflict between the need to protect the environment and the obligation to protect the foreign investor. Indeed, it is not very probable that the host State will face a dilemma about protecting the environment only against the foreign investor (national treatment), or only against the foreign investors of a specific country but not the ones from other foreign countries (most favourable nation clause). It is similarly unlikely that the host State will refrain from providing the foreign investor physical protection for the sake of protecting the environment (full protection and security).³²³

However, this is not the case when it comes to FET and expropriation. It is very likely that a host State will terminate a concession won by a foreign investor, if the concession in question damages the environment. It is similarly likely that the conditions of an investment may change, if the host State changes its mind as to the environmental effects of the investment in question.

These conflicts find their origin in the host State’s change of mind as to the regulations applicable to a sector. Therefore, this chapter will be organised as follows: we will first analyse the concepts of expropriation ban and the FET, to the extent that they are relevant to the purposes of this thesis. Then we will discuss the host State’s

³²³ This thesis similarly will not enter into the discussion concerning whether the full protection and security clauses have evolved from their original meaning, namely physical protection, and now extends to legal protection as well.

right to regulate and its limits, in particular against the rights and obligations that are likely to be provided in BITs.

V. TREATMENT STANDARDS

As noted above, this section will focus on the concept of expropriation and the FET as well as the determination of a general standard of compensation. We will first analyse the concept of FET, especially in the sense of whether an increase in the burdens of the investor during the course of the investment could lead to unfair and unequitable treatment by the host State.

We will then look at the concept of expropriation, especially in the sense of whether termination of an investment agreement due to environmental concerns would mean expropriation and give rise to compensation.

Finally, we will discuss the concept of compensation and whether the motives of the host State for breaching its international investment obligations would create any difference in the methodology for calculation of the compensation.

Although some of the cases discussed under the treatment standards are not related to the environment protection, we still mention these cases as the standard of treatment has to be the same for environment related investment cases. In other words the standards and their application do not vary from an environmental related international investment dispute to any other international investment dispute.

A. Fair and Equitable Treatment

When the State takes a restrictive measure for the protection of the environment, this measure must meet the standard of fairness and equity in investment law in order to avoid liability under international investment law. As there are not many environment related cases to set a standard specific to the environmental disputes, we need to examine the concept in international investment disputes in general.

Fairness and equity are two very large concepts, which can entail quite a number of meanings for the host States. Tudor notes that fairness means right and reasonable

treatment which could lead to an equality among the concerned parties.³²⁴ He also indicates that equity means an equitable application of norms for avoiding and preventing unreadable legal results.³²⁵ UNCTAD further confirmed the wide variety of meaning of the term and stated that being treated fairly and in an equitable manner means to be treated consistently, transparently, reasonably, with clarity and without arbitrariness or discrimination, in an equal manner, to make sure that due process in decision-making is granted., along with a respect towards investors' legitimate expectations.³²⁶

The term's many faced meaning led it to be the standard that has the highest importance in practice and noted that most of the successful investment treaty claims were breaches of FET.^{327 328} As *Mondev* Tribunal indicated, "judgment of what is fair and equitable cannot be reached in the abstract; it must depend on the facts of the particular case."³²⁹

The very first case that concerned fair and equitable treatment was the *Neer* case. It should be noted that the facts of the case were actually a bit distinct from a standard investment case. It did not concern treatment of an investment but rather the

³²⁴ Ioana Tudor, **The Fair and Equitable Treatment Standard in the International Law of Foreign Investment**, Oxford University Press, 2008, p. 126; Thomas M. Franck, "Fairness in the International Legal and Institutional System, General Course on Public International Law", in **Recueil des cours de L'Academie de Droit International de La Haye**, vol. 240 (III), 1993.

³²⁵ Tudor, p. 128; for the relationship between fairness/equity and reasonableness see Federico Ortino "From 'Non-Discrimination' to 'reasonableness': A paradigm shift in international economic law?", Jean Monnet Working Paper 01/05, 2005, p. 35 *et seq.*

³²⁶ Fair and Equitable Treatment, UNCTAD Series on Issues in International Investment Agreements II, p. xiii, https://unctad.org/en/Docs/unctaddiaeia2011d5_en.pdf, (last accessed 14.09.2019). The host States cannot be allowed to create expectations in investors' minds through their legislations or actions and then violate those legitimate expectations Jeswald W. Salacuse, **The Law of Investment Treaties**, Oxford University Press, 2015, p. 253-261.

³²⁷ Rudolf Dolzer, Christoph Schreuer, **Principles of International Investment Law**, Oxford University Press, 2nd edition, 2012, p. 119; Katia Yannaca-Small, "Fair and Equitable Treatment Standard: Recent Developments", in ed August Reinisch, **Standards of Investment Protection**, Oxford 2008, p.111; McLahlan/Shore/Weiniger, *op. cit.*, paras. 7.76-7.79.

³²⁸ The caselaw discussed under this Section are aimed at providing a basic understanding of the FET concept. The more relevant decisions are discussed under Part 2/I/A.

³²⁹ *Mondev International Ltd. v. United States of America "Mondev"*, Award of 11 October 2002, ICSID Case No. ARB(AF)/99/2, para. 118. <https://www.italaw.com/sites/default/files/case-documents/ita1076.pdf> (last accessed 02.06.2019).

investigation, or lack thereof, after the murder of a US citizen in Mexico. The US-Mexico Claims Commission concluded that treatment of an alien may amount to international delinquency only when it amounts to an outrage, bad faith, wilful neglect or insufficient action that any reasonable person would recognise the insufficiency of the treatment.³³⁰

Although it concerned whether the acts committed by Italian authorities constituted “arbitrary action”, the ICJ in the *ELSI* case provided guidance in terms understanding the minimum standard available under international law, and stated that arbitrariness is a “wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety”³³¹

Early examples of the standard can be found in the trade and commerce treaties of 1950s. For instance, US-Germany Treaty of 1954 indicates that “Each Party shall at all times accord fair and equitable treatment to the nationals and companies of the other Party and to their property, enterprises and other interests.”³³² Although the text more or less remains, certain modifications appear in different treaties. The OECD Draft Negotiating Text for a Multilateral Agreement on Investment, which serves as a good draft document for other treaties, contained the following wording:

“Each Contracting Party shall accord to investments in its territory of investors of another Contracting Party fair and equitable treatment and full and constant protection and security. In no case shall a Contracting

³³⁰ *L. F. H. Neer and Pauline Neer (USA) v. United Mexican States*, Award of 15 October 1926, Reports of International Arbitral Awards, Vol. IV, 60-66, para.4.
http://legal.un.org/riaa/cases/vol_IV/60-66.pdf (last accessed 02.06.2019).

³³¹ *Case Concerning Elettronica Sicula S.P.A. (United States Of America v. Italy)* “*ELSI*”, Judgment of 20 July 1989, International Court Of Justice, Reports Of Judgments, Advisory Opinions and Orders, para. 128.
<https://www.icj-cij.org/files/case-related/76/076-19890720-JUD-01-00-EN.pdf> (last accessed 02.06.2019).

³³² Treaty of Friendship, Commerce and Navigation between United States Of America and Federal Republic Of Germany, Article 1(1).
<https://treaties.un.org/doc/publication/unts/volume%20273/volume-273-i-3943-english.pdf> (last accessed 02.06.2019).

Party accord treatment less favourable than that required by international law.”³³³

One of the main differences in the texts of the standard under different treaties is whether the fair and equitable treatment has a connotation by linking itself to international law. A classic example is “fair and equitable treatment in accordance with the principles of International Law”³³⁴ and another example is “shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment.”³³⁵

It has been argued that linking the FET with international norms should not demote FET back to the minimum treatment standard under international law. The term of FET goes far beyond the minimum standards of protection, and in determining the FET, the tribunal would not deal with the minimum, maximum or average standard of treatment but it would deal with whether in all circumstances the conduct is fair and equitable or not.³³⁶

As to the purpose of an FET standard, it has been argued in the doctrine that “the purpose of the clause as used in BIT practice is to fill gaps that may be left by the more specific standards, in order to obtain the level of investor protection intended by the treaties.”³³⁷

³³³ Article 1.1, The OECD Draft Negotiating Text for a Multilateral Agreement on Investment (Herein after “MAI”) of 1998.
http://www1.oecd.org/daf/mai/pdf/ng/ng987r1e.pdf#_ga=2.266690382.1712420748.1559494563-1064394396.1559494563 (last accessed 02.06.2019).

³³⁴ Article 3, French Model BIT.
<https://www.italaw.com/documents/ModelTreatyFrance2006.pdf> (last accessed 02.06.2019). The draft Bolivia-Turkey BIT provides for the following wording “Investments of investors of each Contracting Party shall at all times be accorded treatment in accordance with international law minimum standard of treatment, including fair and equitable treatment and full protection and security in the territory of the other Contracting Party.”

³³⁵ Article 14.6, North American Free Trade Agreement (Herein after “NAFTA”).
https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/14_Investment.pdf (02.06.2019)

³³⁶ Dolzer/Schreuer, *op.cit.*, p. 124.

³³⁷ *Ibid.*, p. 122.

It has been also said that the standard is meant to impose an obligation of good faith on the part of the host State.³³⁸ This is in fact correct as the concept of legitimate expectations, which will be addressed in detail below, basically serves to prevent the host to act in an inconsistent manner towards the foreign investment, which is a concept available under both continental and common law systems. It is the principle of *venire contra factum proprium* in civil law (or *çelişkili davranma yasağı* in Turkish) and estoppel in common law systems.³³⁹

Several investment tribunals submitted definitions or descriptions of what FET meant. In *Genin*, the case was brought under the 1994 bilateral investment treaty between the United States and the Republic of Estonia (the BIT). The dispute concerned the cancellation by the Central Bank of Estonia of an operating license held by Innovation Bank, a financial institution incorporated under the laws of Estonia in which the Claimants were shareholders. The *Genin* tribunal concluded that “acts showing a wilful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith”³⁴⁰ would be in breach of the FET standard.

In *MTD*, the investor was a Malaysian company, investing in a project for developing a satellite city in the Pirque region of Chile. The project was designed on an agricultural land, but the government had assured the investor that the area would be properly re-zoned. The dispute emerged after it became apparent that the rezoning could not be done in light of the Chilean law. The tribunal noted that FET is the

³³⁸ *Ibid.*, p. 122.

³³⁹ For a description and comparison of the different understanding of the estoppel and *venire contra factum proprium* concepts see Thiago Luis Sombra, “The Duty of Good Faith Taken to a New Level: An Analysis of Disloyal Behavior”, *Journal of Civil Law Studies*, p. 29 *et seq.* <https://digitalcommons.law.lsu.edu/cgi/viewcontent.cgi?article=1167&context=jcls> (last accessed 14.09.2019).

³⁴⁰ *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. the Republic of Estonia “Genin”*, Award of 25 June 2001, Case No. ARB/99/2, para. 367. <https://www.italaw.com/sites/default/files/case-documents/ita0359.pdf> (last accessed 02.06.2019).

standard of a just and even-handed treatment for promoting foreign investment, which is a proactive standard rather than a passive avoidance of negative conduct.³⁴¹

LG & E tribunal determines the content of the FET as a consistent and transparent behaviour that is free of ambiguity within a predictable legal framework.³⁴²

It should be noted that the legal status at the time of the making of the investment will be outer limits to the legitimate expectations of an investor. As noted by Dolzer and Schreuer, according to the recent jurisprudence the legitimate expectations of the investor will be grounded as it stands in the legal order of the host State at the time when the investor establishes the investment.³⁴³

However, the FET standard does not mean that any investor who considered that it was not treated fairly by the host State can immediately start investment arbitration against the host State. Recent case law accepts that the investor should first seek redress from the courts of the host State. It should be mentioned here that this is different than the exhaustion of local remedies principle. As this is not a major discussion point for this thesis, we will only provide an example, which presents an example for this school of thought.

The case to be mentioned here is the *Waste Management II* case, in particular due to the fact that it is an environment related dispute.³⁴⁴ The case concerned a concession regarding a waste disposal facility located in Acapulco, State of Guerrero, Mexico. The concession was won by the Mexican subsidiary of the investor in question. The investor undertook to conduct municipal waste disposal and street cleaning, and this was an important task given the importance of the tourism in the

³⁴¹ *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile "MTD"*, Award of 25 May 2004, ICSID Case No. ARB/01/7, para 113.
<https://www.italaw.com/sites/default/files/case-documents/ita0544.pdf> (last accessed 02.06.2019).

³⁴² *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc v. Argentine Republic "LG&E"*, Decision of Liability of 3 October 2006, ICSID Case No. ARB/02/1, para. 131.
<https://www.italaw.com/sites/default/files/case-documents/ita0460.pdf> (last accessed 02.06.2019).

³⁴³ Dolzer/Schreuer, *op.cit.*, p.134

³⁴⁴ It should be noted this thesis only discusses the second arbitration filed in this dispute and does not discuss the annulled first arbitration.

city.³⁴⁵ One of the obligations of the administration was not to interfere with the rights of the concessionaire.³⁴⁶

The investor immediately ran into problems with the local population, who were not very keen on paying fees for the disposal services provided. The investor further complained that local authorities were not respecting the exclusive status of the concession and were granting permits to third parties.³⁴⁷ The investor's problems worsened as the City of Acapulco did not pay the fees regularly.³⁴⁸ Due to these difficulties, the investor stated later on that it would suspend provision of its services under the concession agreement.³⁴⁹ At the same time, the investor started local proceedings for collecting its unpaid fees and the investment treaty arbitration with main the argument that it was not afforded a fair and equitable treatment under the NAFTA.³⁵⁰

With respect to the situation of the local remedy sought by the investor, the tribunal concluded that “the availability of local remedies to an investor faced with contractual breaches is nonetheless relevant to the question whether a standard such as Article 1105(1) has been complied with by the State”.³⁵¹

This provides a useful analysis for environment related investment disputes. If the investor has been negatively affected by an environmental regulation, or by an administrative act directed towards it (that has been taken with environmental concerns), it would be ideal for the investor to first seek redress from the national courts. Provided that the local courts in the host State do not present a futile and

³⁴⁵ *Waste Management Inc v. United Mexican States “Waste Management II”*, Award of 30 April 2004, ICSID Case No ARB(AF)/00/3, para. 40.
<https://www.italaw.com/sites/default/files/case-documents/ita0900.pdf> (last accessed 02.06.2019).

³⁴⁶ *Ibid.*, para. 42.

³⁴⁷ *Ibid.*, para. 54.

³⁴⁸ *Ibid.*, para. 58.

³⁴⁹ *Ibid.*, para. 68.

³⁵⁰ *Ibid.*, paras. 68-71.

³⁵¹ *Ibid.*, paras. 116, 159.

useless litigation for the investor, solving the problem at the local level will be more beneficial for the investor. Local litigation will not be as costly as international investment arbitration. It will also allow the investor to continue with its business after the dispute is resolved by the local courts, provided that the applicable BIT does not have a fork-in-the-road clause, which can be summarised as the investor “[being] precluded from, simultaneously or subsequently, resorting to any other potentially available dispute resolution mechanism” once it selects one of the *fora* listed in the BIT’s dispute resolution clause to litigate its dispute³⁵².

It should also be noted here that potential changes in the law does not necessarily mean a breach of the FET standard. The Tribunal in *El Paso* reasoned that a presidential decree establishing that the participants in the wholesale electricity market “shall operate pursuant to the regulations issued for such purpose by the Energy Department” meant that “it is the Tribunal’s view that the legitimate expectations of any investor entering the energy market had to include the real possibility of reasonable changes and amendments to the procedures governing the [wholesale electricity market].”³⁵³

This is also particularly important for environment related investment disputes. A similar scenario can be considered for a coal power plant. The tribunal’s reasoning about legitimate expectations will apply to this hypothetical investor as well: given, for instance, the issue of global warming, it would be completely absurd for any investor owning coal power plants to expect the legal regime to remain stable. It is almost inevitable that every State will adopt measures that will negatively impact this sector.

Therefore, FET is relevant to the environmental matters, mostly in the sense that whether the host State can improve its environmental regulations. The issue is a

³⁵² Yves Derains, Josefa Sicard-Mirabal, **Introduction to Investor-State Arbitration**, Kluwer Law International, 2018, p. 113.

³⁵³ *El Paso Energy International Company v. Argentine Republic*, Award of 31 October 2011, ICSID Case No. ARB/03/15, paras. 397-398.
<https://www.italaw.com/sites/default/files/case-documents/ita0270.pdf> (Last access: 02.06.2019); Gabriel Cavazos Villanueva, “El Paso Energy International Company v Argentine Republic”, **ICSID Review**, vol. 27 (1), 2012, p. 30.
<https://academic.oup.com/icsidreview/article/27/1/27/636577?searchresult=1> (last accessed 14.09.2019).

tension between the host State's right to change and improve its legislations and the investor's right to have the host State to respect its legitimate expectations. The issue is further discussed at Part 2/II below.

B. Expropriation

State's measures for the protection of environment may reach to a gravity that the rights of the investors would be deemed expropriated. In these cases, we need to refer to the general concept of expropriation under international investment law in order to determine the legality of the expropriation and the necessity of a compensation.

Expropriation simply means taking of a property by the State with the use of State power.³⁵⁴ The key point and main difference between an expropriation and a transaction, is the fact that the party losing its property does not have a say in the expropriation: State simply forces the transaction upon the private party.

As Dolzer and Schreuer explains, expropriation is a right for the States which comes with the notion of territorial sovereignty, so fundamental that even modern investment treaties do not change their approach. The modern law addresses the conditions and consequences of expropriation while leaving the right to expropriate intact.³⁵⁵

The main distinction between types of expropriation is the so-called direct and indirect expropriation. Direct expropriation occurs when the host State directly terminates the foreign investor's ownership of the investment and takes it.³⁵⁶ Indirect expropriation is defined by UNCTAD as slow destruction of rights related to ownership of the investment.³⁵⁷

³⁵⁴ The act in question must be attributable to the State. Salacuse, *op. cit.*, p. 318.

³⁵⁵ Dolzer/Schreuer, *op.cit.*, p. 98; McLahlan/Shore/Weiniger, *op. cit.*, para. 8.03.

³⁵⁶ Anne Hoffman, "Indirect Expropriation", in ed. August Reinisch, **Standards of Investment Protection**, Oxford University Press, 2008, p .150.

³⁵⁷ United Nations Conference on Trade and Development, Taking of Property, UNCTAD Series on Issues in International Investment Agreements, 2000, p. 18 <https://unctad.org/en/Docs/psiteiid15.en.pdf> (last accessed 14.09.2019); Rudolf Dolzer, "Indirect Expropriations: New Developments", NYU Environmental Law Journal, vol. 11, 2002, p. 64; R.

Although the concept of taking is clear, regardless of it being direct or indirect, there is no clear definition of expropriation that is agreed upon in the doctrine and practice.³⁵⁸ This has led to a number of conditions to determine whether an expropriation is lawful or not.³⁵⁹

Indeed, most investment treaties lay down three (or four) conditions to be filled cumulatively for an expropriation to be legal. This is considered to be a part of customary international law. First, the measures must be taken for a public purpose (while the investors do not usually question the broad meaning of public purpose, tribunals sometimes limit the concept). Second, the measures must not be arbitrary or discriminatory. This also implies that the procedure of expropriation must follow principles of due process, corresponding to the minimum standards under customary international law and fair and equitable treatment (Considering this, it's possible to discuss whether we can consider an additional requirement for the legality of the expropriation). Last, the measure must be promptly, adequately and effectively compensated (market value of the investment is generally accepted as adequate compensation).³⁶⁰

As this thesis is not dedicated to a detailed analysis of the concept of expropriation and the limitations to it provided in investment law, we will simply discuss the caselaw that are relevant to environmental matters, either directly or as a matter of analogy. It should be noted that this section is dedicated to providing the basic understanding of the concept of expropriation to the extent that it will be a reference point for environment related cases.

For the purposes of this thesis, the legality of an expropriatory act here rather refers to the legality conditions, except prompt and just compensation.³⁶¹ In other

Doak Bishop, James R. Crawford, W. Michael Reisman, *Foreign Investment Disputes: Cases Materials and Commentary*, Kluwer Law International, 2005, p. 837.

³⁵⁸ McLahlan/Shore/Weiniger, *op. cit.*, para. 8.03.

³⁵⁹ *Ibid.*, para. 8.04; August Reinisch, "Legality of Expropriations" in August Reinisch, "Legality of Expropriations" in ed. August Reinisch, **Standards of Investment Protection**, Oxford University Press, 2008, p. 178 *et seq.* (Herein After "Legality...").

³⁶⁰ Dolzer/Schreuer., p. 99-100; Reinisch, "Legality...", p. 174-175.

³⁶¹ See *supra* p.94.

words, the question is whether there should be a difference between the amount owed by the legally expropriating State and illegally expropriating State. As noted in the World Bank Guidelines on the Treatment of Foreign Direct Investment,³⁶² states have the right to expropriate a foreign investment, but four conditions apply: it must be done “in accordance with applicable legal procedures, in pursuance in good faith of a public purpose, without discrimination on the basis of nationality and against the payment of appropriate compensation.”³⁶³ The guidelines also note that the compensation must be adequate, effective and prompt.

We will first analyse awards that concern violation or termination of an investment contract. Principles that are highlighted in these cases are of course applicable to expropriation cases that do not involve an investment contract, for example direct establishment of a factory in the territory of the host State. We will in particular focus on measures that lead to termination of a concession, as we consider that these cases are more likely to occur in the context of an environment related investment arbitration, such as the *Azinian* case explained below.

In *Azinian*, which concerned an investment for waste disposal,³⁶⁴ the claimant argued that the State’s termination of a concession contract constituted a fundamental breach of that contract. As a result, the claimant asserted that Mexico had expropriated its contractual rights in contravention of applicable investment treaty protections. The tribunal rejected this position noting that labelling an issue cannot substitute the analysis of that issue and considering the point of view of the investor is not satisfactory because the breaches are of course egregious for the investors.

³⁶² World Bank Guidelines on the Treatment of Foreign Direct Investment (Herein after World Bank Guidelines”) <https://www.italaw.com/documents/WorldBank.pdf> (last accessed 02.06.2019).

³⁶³ *Ibid.*, Section IV, para. 1.

³⁶⁴ *Robert Azinian, Kenneth Davitian, & Ellen Bacacclaimants v. the United Mexican States* “*Azinian*”, Award of 1 November 1999, ICSID Case No. ARB(AF)/97/2, para. 25. <https://www.italaw.com/sites/default/files/case-documents/ita0057.pdf> (last accessed 02.06.2019).

Accordingly, tribunal decided that it should determine the basis of distinguishing expropriations from ordinary breaches.³⁶⁵

In *Swisslion*, the tribunal similarly explained that a State's lawful termination of a contract does not necessarily entail an expropriation in breach of an international treaty, because otherwise States cannot exercise their contractual rights as any other contractual parties.³⁶⁶ In other words, the tribunal explained that not all terminations by the state constitute a breach of international obligations.

In *Parkerings* the tribunal offered a cogent analysis of the limited circumstances that could transform the termination of a State contract into an expropriation actionable under an investment treaty. The claimant in *Parkerings* was a shareholder in a Lithuanian company that had contracted with the City of Vilnius to provide parking services. Ultimately, the City terminated the concession contract, and the claimant applied to investment arbitration alleging expropriation, among other breaches. The tribunal rejected the claim stating that State's ordinary breach of a contract, even if it was gross or wrongful, is not expropriation if it is made as any other contracting party.³⁶⁷ The tribunal explained that the State's or State agents' bad performance of a contract is not a breach of international treaties, and it should be brought before the appropriate forum with jurisdiction on the contract, unless the state passed the threshold of acting as a mere contract party and acted within the functions of a

³⁶⁵ *Ibid.*, para. 90.

³⁶⁶ *Swisslion DOO Skopje v. The Former Yugoslav Republic of Macedonia*, Award of 6 July 2012, ICSID Case No. ARB/09/16, para. 314.
<https://www.italaw.com/sites/default/files/case-documents/ita1080.pdf> (Last access: 02.06.2019).

³⁶⁷ *Parkerings-Compagniet v Lithuania 'Parkerings'*, Award of 11 September 2007, ICSID Case No ARB/05/8, paras. 443.
<https://www.italaw.com/sites/default/files/case-documents/ita0619.pdf> (last accessed 02.06.2019). (See also *Vigotop v Hungary*, Award of 1 October 2014, ICSID Case No ARB/11/22, paras. 327-331, 508-510; *Gold Reserve v Venezuela*, Award of 22 September 2014, ICSID Case No ARB(AF)/09/1, paras. 663-664; *Malicorp v Egypt*, Award of 7 February 2011, ICSID Case No ARB/08/18 paras. 103 and 126; *Biwater v Tanzania*, Award of 24 July 2008, ICSID Case No ARB/05/22, paras. 491-493; *Impregilo v Pakistan*, Decision on Jurisdiction of 22 April 2005, ICSID Case No ARB/03/3, para. 260; *Suez v Argentina*, Decision on Liability of 30 July 2010, ICSID Case No ARB/03/19, paras. 153-156).

sovereign.³⁶⁸ In most cases, contractual breach must be determined under domestic law before applying to arbitral tribunal. If the investor is deprived of accessing the domestic court or is not allowed to claim, only then the tribunal may decide on the basis of international treaties.³⁶⁹

Thus, the *Parkerings* tribunal set out a three-part test for determining when termination of a State contract could amount to expropriation under international law:

- the termination was wrongful, amounting to a breach of the contract;
- the termination was achieved by a sovereign act, rather than one performed as a contractual party; and
- the unlawfulness of the termination was established by the contractually selected forum for dispute settlement, or access to that forum was blocked *de jure* or *de facto*.

As these three arbitral awards establish, as a matter of international law, the termination of a State contract can constitute expropriation only where such termination is, at a minimum, carried out: (a) by the State in its sovereign capacity, rather than as a contracting party; and (b) in breach of the terms of the contract. *Parkerings* add a third one, the verdict of the selected forum by the contracting parties on the legality of the State's act.

ADC decision deserves a mention here.³⁷⁰ Although the case does not concern an environment related dispute, it is worth discussing here as it concerns cancellation of an investment agreement via legislative act. Since it is quite possible for an environmentally sensitive project to become illegal with a legislative act, we will briefly explain the tribunal's decision.

³⁶⁸ *Ibid.* p. 444, 445.

³⁶⁹ *Ibid.* p. 445-449.

³⁷⁰ *ADC Affiliate Limited and another v. Republic of Hungary 'ADC'*, Award of 2 October 2006, ICSID Case No. ARB/03/16, para. 304 <https://www.italaw.com/sites/default/files/case-documents/ita0006.pdf> (last accessed 02.06.2019).

In this case, a crucial factor in the tribunal's finding of expropriation was that the contract in question had not been terminated by either contracting party, but that it was annulled by legislative act.³⁷¹ The tribunal in that case was therefore faced not with an assessment of whether the State's conduct pursuant to a contract was tantamount to expropriation, but rather whether the State's legislative interference from outside the contractual relationship had effectively expropriated the private party's contractual rights.³⁷² As environmental matters can enter the radar of the parliaments, such as the very recent declaration by the British parliament,³⁷³ ADC tribunal's test can provide useful analysis to future tribunals: accordingly, to legislative interference, we need to apply the same test that we apply to any other intervening act.

Thus, the discussion above shows that if an investment contract is terminated with the State powers, then it will probably constitute an expropriation. In the context of an environmental dispute, this may be the case, for instance, where the electricity sale contract of a coal powered power plant is terminated. Legality of the expropriation will be assessed against the condition cited above.

This brings us back to the difference of "legal" and "legitimate" expropriation. In fact, the term "legal expropriation" is used incorrectly. An expropriation is legal when the previously mentioned conditions are met, including the payment of adequate compensation. Accordingly, if an expropriation is legally made, there would be no compensation to be awarded as it had already been paid. However, when the State has acted legitimately, without any wrongful act, violation of law or breach or contract, the State would not be obliged to compensate. After making the distinction, however, for sake of consistency, we will not depart from the doctrine and we will use the term

³⁷¹ *Ibid.*, paras. 179-184, 264-266.

³⁷² *Ibid.*, paras. 423-425. Similarly, the tribunal in *Biwater* concluded that the applicable investment treaty had been violated in relation to a concession contract only because the State – particularly by deporting the foreign investor's managers – had interfered with the investment project outside the framework of the contractual relationship. ("*Had not the events starting on 13 May 2005 (or similar ones) taken place, the dispute would in all likelihood have been purely contractual, involving only issues such as whether or not termination of the Lease Contract was justified by City Water's breaches thereof, such issues leading to a negotiation, or a contractual arbitration as necessary. However, starting on 13 May 2005, the normal course of the contractual termination was disrupted.*") at paras 488-489.

³⁷³ BBC News, "UK Parliament declares climate change emergency", 1 May 2019 <https://www.bbc.com/news/uk-politics-48126677> (Last access: 02.06.201).

“legal expropriation” to mean “legitimate expropriation”, *i.e.* expropriations that are done with a legitimate purpose, such as protection of the environment.

In the following section we will discuss how compensation should be calculated and whether legality, or the legitimacy, of the expropriation would have an impact on the amount.

C. General standard of compensation

One of the most important aspects of environment related investment disputes is determining the content of related compensation, because we believe that in such cases the content must be different than the standard compensation calculation. For this reason, we will start by examining the concept under general investment law disputes and elaborate on the issue of the great public interest in environmental disputes.

Although it is not possible to say that the compensation standard is applied universally with a consensus,³⁷⁴ the so-called Hull Doctrine and the *Chorzow factory* standard are the most commonly applied ones. They will be explained below in turn.

The famous *Chorzow factory* case concerned a nitrogen factory which was located in the eastern part of Silesia. The area had become subject to territory changes between Germany and Poland after the Great War. As the factory remained in the Polish territory in the end, Germany requested reparations from Poland. After stating the international law principle that breach of engagement raises the obligation for the reparation in an adequate form, the PCIJ stated that there is no need for an explicit provision regarding the reparation in the treaty because that is an indispensable part of the breach of the treaty.³⁷⁵

It is also worth noting that the PCIJ made a distinction between a taking and an expropriation, the former referring to an illegal expropriation, if one were to adopt the

³⁷⁴ McLahlan/Shore/Weiniger, *op. cit.*, para. 9.09. Rudolf Dolzer, “New Foundations of the Law of Expropriation of Alien Property”, *American Journal of International Law*, vol. 75, 1981, p. 554.

³⁷⁵ *Case Concerning the Factory at Chorzow “Chorzow Factory”*, Judgment of 26 July 1927, PCIJ, p. 47.
https://www.icj-cij.org/files/permanent-court-of-international-justice/serie_A/A_09/28_Usine_de_Chorzow_Competence_Arret.pdf (last accessed 02.06.2019).

modern language. The Court decided that Poland's action against Geneva Convention was not an expropriation which could become lawful only with the payment of fair compensation but was a taking of rights and interests which could not be expropriated even if it was made against a compensation.³⁷⁶

The PCIJ concluded that the amount of compensation in the case of a taking, or an illegal expropriation, must be different than the amount of compensation that would be due in case of a legal expropriation. The Court concluded that if the amount of compensation in case of an illegal expropriation is limited to the compensation that would be due in case of a legal expropriation "such a limitation [...] would be tantamount to rendering lawful liquidation and unlawful dispossession indistinguishable in so far as their financial results are concerned."³⁷⁷

It could be argued that the key term of the purposes of compensation here is adequate. World Bank Guidelines note that a compensation is adequate "if it is based on the fair market value of the taken asset as such value is determined immediately before the time at which the taking occurred or the decision to take the asset became publicly known."³⁷⁸ McLahlan indicates that the International Law Commission also accepted this principle in adoption of the Draft Articles on State Responsibility.³⁷⁹

The term "adequate" has been widely interpreted as to mean "prompt, adequate and effective compensation". This interpretation has also been referred to as the Hull Doctrine, since it was phrased by the State Secretary of United States Mr Cordell Hull, in a letter to Mexican Foreign Minister.³⁸⁰

³⁷⁶ *Ibid.*, p. 46.

³⁷⁷ *Ibid.*, p. 47.

³⁷⁸ World Bank Guidelines, *op. cit.*, Section IV, para. 3.

³⁷⁹ McLahlan/Shore/Weiniger, *op. cit.*, para. 9.07.

³⁸⁰ Saverio Di Benedetto, "The Standards of Compensation for Foreign Investment Expropriations in International Law: Internalising Environmental Costs", in eds. Helene Ruiz Fabri, Ruediger Wolfrum, Jana Gogolin, **Select Proceedings of the European Society of International Law**, vol. 2, Hart Publishing, 2010, p. 668; *Ibid.*, para. 9.04.

This approach, although it has been widely accepted by investment tribunals, has attracted some criticism for its “all-or-nothing” result. Benedetto has argued that the willing buyer-willing seller approach ignores the concepts of market failure and negative externality, *i.e.* in the cases where the market is distorted.³⁸¹ We can consider pollution and the depletion of natural resources for the distortion of a market system by a negative externality. The approach implies that environmental assets have an economic value, but this value does not is not relevant to the demand and supply.³⁸² A uniquely market based approach cannot quantify the values such as health or biodiversity. However, these goods have economic value due to rareness, among others. Their relevance in compensation-calculation should be performed by technical experts using legal tools.³⁸³

As to the method of determining the fair market value, the World Bank Guidelines notes that the first solution would be a method accepted by both the host State and the investor.³⁸⁴ If such agreement cannot be reached, then the World Bank Guidelines advise that the following method should be applied for the calculation:

“an amount that a willing buyer would normally pay to a willing seller after taking into account the nature of the investment, the circumstances in which it would operate in the future and its specific characteristics, including the period in which it has been in existence, the proportion of tangible assets in the total investment and other relevant factors pertinent to the specific circumstances of each case.”³⁸⁵

Several cases that address this aspect of compensation are discussed below.

In the *Rumeli* case, the tribunal decided that the fact that a compensation was offered for the expropriated shares does not on its own render the expropriatory act

³⁸¹ *Ibid.*, p. 673.

³⁸² *Ibid.*

³⁸³ *Ibid.*, p. 674.

³⁸⁴ World Bank Guidelines, *op. cit.*, Section IV, para. 4.

³⁸⁵ *Ibid.*, Section IV, para. 5.

legal. It should be noted that the tribunal emphasised that the offered amount was “manifestly and grossly inadequate compared to the compensation which the Tribunal there holds to be necessary in order to afford adequate compensation”.³⁸⁶

The *Mobil* case concerned investment of the investor in the Cerro Negro and La Ceiba projects, both of which were oil exploration sites located in Venezuela.³⁸⁷ The investor claimed to have invested billions of dollars and planned to have invested even more for realisation of the projects.³⁸⁸ The investor argued that the host State expropriated its investments in this project by termination of its investment agreements, removal of the incentives that were granted at the outset of the projects and seizure of its interest and the assets related to the projects.³⁸⁹

The tribunal concluded that the mere inexistence of compensation is not enough on its own to conclude that an expropriation was unlawful. The tribunal noted that “[a]n offer of compensation may have been made to the investor and, in such a case, the legality of the expropriation will depend on the terms of that offer.”³⁹⁰

The tribunal concluded in its decision, after concluding that Venezuela has offered some sort of compensation during its negotiations with the investor, that the expropriation in question was not unlawful.³⁹¹ Unfortunately, it is not possible to tell the conclusion that were drawn from this decision, as the tribunal indicated that such distinction would not matter as to the applicable standard of compensation since the

³⁸⁶ *Rumeli Telekom AS and Telsim Mobil Telekomunikasyon Hizmetleri AS v. Republic of Kazakhstan* “*Rumeli*”, Award of 29 July 2008, ICSID Case No. ARB/05/16, para. 706. <https://www.italaw.com/sites/default/files/case-documents/ita0728.pdf> (last accessed 02.062019).

³⁸⁷ *Venezuela Holdings, B.V., et al (case formerly known as Mobil Corporation, Venezuela Holdings, B.V., et al.) v. Bolivarian Republic of Venezuela* “*Mobil*”, Award of 9 October 2014, ICSID Case No. ARB/07/27, para. 45. <https://www.italaw.com/sites/default/files/case-documents/italaw4011.pdf>

³⁸⁸ *Ibid.*, para.69, 84.

³⁸⁹ *Ibid.*, para. 86.

³⁹⁰ *Ibid.*, para. 301.

³⁹¹ *Ibid.*, para. 306.

relevant article of the BIT would be applied regardless of the qualification of the expropriation.³⁹²

Tidewater case also concerns similar set of facts. Tidewater was not involved in exploration of oil, but it was providing marine transport services to the national oil company of Venezuela, for a period of 50 years.³⁹³ Following a change in the applicable Venezuelan legislation (the same change that affected the investor in the *Mobil* case) the investor's contracts and assets were seized by the Venezuelan government. *Tidewater* tribunal, interpreting the *Chorzow factory* judgment, concluded that according to the principle as laid down by the PCIJ, illegality of an expropriation "must stem from a circumstance beyond the mere absence of compensation."³⁹⁴

The *Tidewater* tribunal, after discussing other international law cases, opinions of scholars and the World Bank Guidelines, concluded that "[a]n expropriation only wanting fair compensation has to be considered as a provisionally lawful expropriation, precisely because the tribunal dealing with the case will determine and award such compensation."³⁹⁵

Conoco saga also provides a good analysis with respect to the role of legality of the expropriation and its impact on the amount of compensation. The case concerned exploration of crude oil in two regions of Venezuela under three different projects that were owned by the investors.³⁹⁶ Tribunal, in its quite recent decision noted that compensation granted as a result of an expropriation must not disadvantage the investor comparing to the situation where he would be if the expropriation had never

³⁹² *Ibid.*

³⁹³ *Tidewater, op.cit.* paras. 13-18.

³⁹⁴ *Ibid.*, para. 130.

³⁹⁵ *Ibid.*, para. 141.

³⁹⁶ *Conoco Phillips Petrozuata BV, Conoco Phillips Hamaca BV, Conoco Phillips Gulf of Paria B.V., Conoco Phillips Company v. Bolivarian Republic of Venezuela "Conoco"*, Decision on Jurisdiction and Merits of 3 September 2013, ICSID Case No. ARB/07/30, paras. 3-5. <https://www.italaw.com/sites/default/files/case-documents/italaw1569.pdf> (last accessed 02.06.2019).

been made.³⁹⁷ Because if the investment continued, the investor would enjoy full benefits, right and interests, but in the case of an expropriation it would generally receive a “just compensation” which is lower than the benefits of the ongoing investment.

The Tribunal also noted that the expropriating State must not be allowed to enjoy the profits of the expropriated investment for free. According to the tribunal, the reparation aims to make the investor whole. While calculating the compensation if we consider only the amount that should have been paid at the taking plus the interest, we would ignore the benefits of the investment that accrued since the taking, until the end of the lifetime of the investment. In such a case the State would acquire the profits that should have been available to the investor for free, which would not add up to a just compensation that could make the investor whole.³⁹⁸

Following the same approach, majority of the case law establishes that the expropriating State will have to compensate all losses of the investor, including lost profit.³⁹⁹ However, as rightly pointed out by Benedetto, this will not produce a just result for environment related cases. Indeed, if the host State uses its right (and duty) to regulate environmental matters properly by meeting the criteria as discussed in the next chapter, then holding it fully responsible of all possible losses of the investor is not a just solution. If anything, this interpretation will dissuade the States from taking progressive environmental matters. Obviously, if the host State expropriates the investment for purely commercial and economic reasons, like in the *Mobil* case, then it should compensate all the losses of the investor. In fact, the host State should not be allowed to hide behind alleged environmental concerns in these types of cases.

For instance, if Turkey decided today to ban nuclear power plants in its territory without any new scientific data, for instance as to the increase in risk of earthquakes, it should be obliged to pay compensation to the investors of nuclear power plants that

³⁹⁷ *Conoco Phillips Petrozuata BV, Conoco Phillips Hamaca BV, Conoco Phillips Gulf of Paria B.V., Conoco Phillips Company v. Bolivarian Republic of Venezuela “Conoco”*, Award of 8 March 2019, ICSID Case No. ARB/07/30, para. 212. <https://www.italaw.com/sites/default/files/case-documents/italaw10402.pdf> (last accessed 02.06.2019).

³⁹⁸ *Ibid.* para. 227.

³⁹⁹ *E.g. ADC, op. cit.*, paras 497–9; *Biwater, op. cit.*, paras 775, 788.

are under construction. However, considering the gravity of the risks on the health and the environment, the amount in question should not cover the lost profit but should be limited to the investor's expenses.

We will discuss below in further detail the conditions that need to be satisfied by a State regulating an environmental matter, in order to comply with its investment treaty obligations at the same time.

VI. RIGHT TO REGULATE ENVIRONMENTAL MATTERS

States have the right to regulate as part of their *imperium*. They can regulate their territory as they see fit. The ultimate question here is whether the state interventions to investments that have the aim of protecting the environment should be compensated. Further on, Kentin asks, which depreciations of foreign investments that are caused by measures concerning public interests (such as environmental concerns) should be compensated.⁴⁰⁰

The right to regulate foreign investment is not a new concept. It has been clearly spelled out in the United Nation texts since 1970s:

“Each State has the right: (a) To regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities. No State shall be compelled to grant preferential treatment to foreign investment; (b) To regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies”⁴⁰¹

⁴⁰⁰ Kentin, *op. cit.*, p. 327.

⁴⁰¹ Art. 2.2, Charter of Economic Rights and Duties of States, United Nations General Assembly, Resolution 3281 (XXIX), 12 December 1974.
[https://www.un.org/ga/search/view_doc.asp?symbol=a/res/3281\(XXIX\)](https://www.un.org/ga/search/view_doc.asp?symbol=a/res/3281(XXIX)) (Last access 02.06.2019).

The issue becomes more important in developing countries: developed countries has stable legal environments; therefore, dramatic changes are less likely to be expected. On the other hand, developing countries usually need regulatory reforms in sectors that effect environment or health.⁴⁰² These reforms are likely to change the legal environment foreign investors operate in, creating disputes. Joubin-Bret states that right to regulate is the first line of battle in the tension between environmental law and investment law.⁴⁰³

Kentin argues that sustainable development can provide for a guidance here. On one hand the concept of sustainable development provides the States with the right to manage their own resources according to their own environment and development policies. On the other hand, it also provides for respect for right to property. Accordingly, the interest of sustainable development is balancing these two aspects.⁴⁰⁴

The limits of the regulatory powers of the state is quite open to discussion and *CME/Lauder* saga is probably the best demonstration.⁴⁰⁵ These cases relate to the exact same set of facts.⁴⁰⁶ They both relate to an investment made in a local television channel in Czech Republic. The giving of the licence to the foreign investor has created a political sensitivity but, in the end, it was granted under a so-called split structure system. Due to increasing political pressure, the arrangement was reviewed by the media council and the foreign investor's contract was terminated at the end. *CME* Tribunal concluded that this set of facts led to a breach of the FET clause.⁴⁰⁷

⁴⁰² Kentin, *op. cit.*, p. 327.

⁴⁰³ Joubin-Bret, *op. cit.*, p. 40.

⁴⁰⁴ *Ibid.*, p. 327.

⁴⁰⁵ *Obiter dictum*, we would like to mention here that in our opinion, *CME/Lauder* conflict reflects one of the weakest points of arbitration where two decisions based on different jurisdictions may result in two conflicting but still binding decisions.

⁴⁰⁶ *CME Czech Republic BV v. The Czech Republic "CME"*, Partial Award of 13 September 2001, *ad hoc*, UNCITRAL, paras. 302-310.
<https://www.italaw.com/sites/default/files/case-documents/ita0178.pdf> (last accessed 02.06.2019).

⁴⁰⁷ *Ibid.*, para. 611.

In particular, the tribunal noted that as a result of the review and termination of the broadcasting agreements and licences that the investor suffered from substantial depreciation with respect to its exclusive use of the broadcasting licence. The tribunal also found that the local partners and competitors of the foreign investor benefited from the termination. However, *Lauder* tribunal found that the acts in question were simply within the regulatory powers of the media council and found that there was no breach of the FET clause.⁴⁰⁸

Environment is indeed an area that needs to be governed and regulated by the States. It is in certain respects not very different from public health. But as the small purview of the case law and doctrine shows that the understanding of the limits of the right to regulate is not a straightforward issue.

We will discuss in the next section first the two opposite understandings of the matter, namely the sole effects doctrine and the police powers doctrine. We will then discuss the role of the purpose of the act in question and the conditions that need to be satisfied for utilising the purpose of the act as a defence by the State.

A. Extreme ends of the spectrum

As noted above, on one end of the spectrum of regulatory rights of the States stands sole effects doctrine, while on the other end stands radical police powers doctrine.

Sole effects doctrine practically implies that the State's right to regulate cannot lead to expropriation of an investment. When describing sole effects doctrine, Kriebaum notes that even though States have noble motivations, these are irrelevant to the compensation related to the interference with the property rights of the investor.⁴⁰⁹

⁴⁰⁸ *Roland S. Lauder v. The Czech Republic "Lauder"*, Final Award of 3 September 2001, *ad hoc*, UNCITRAL, paras. 295-296. <https://www.italaw.com/sites/default/files/case-documents/ita0451.pdf> (Last accessed 02.06.2019).

⁴⁰⁹ Ursula Kriebaum, "Regulatory Takings- Balancing the Interests of the Investor and State", *World Investment & Trade*, vol. 8, 2007, p. 724.

On the same line, the Iran-US Claims tribunal noted in *Starrett Housing* case that even though the State did not expressly expropriate property rights and even if the property remains with the original owner, international law accepts that State interference with the property rights might reach a level to render the rights useless.⁴¹⁰ In such a case, we should consider the rights expropriated.

Metalclad is the best example of the sole-effects doctrine. The case concerned operation of waste disposal site in rural Mexico. For determining a breach of NAFTA Article 1110, the tribunal simply ignored the motives of the local authorities for denying the landfill permit stating that it did not need to consider the motives of regulatory action but only whether it constitutes an act tantamount to expropriation.⁴¹¹

This approach has been criticised heavily (in our opinion rightly) and actually practically abandoned by the tribunals after *Metalclad*. Because when we apply the sole effects doctrine with the all or nothing approach, we have to decide that the investor should receive full compensation (or full damages in case of an illegal expropriation) each time the State interference exceeds a certain level.⁴¹² The result of this approach is to ignore certain public interests which are worthy of protection but which should also be basis of a certain amount of compensation.

The *Metalclad* award has also been criticised for overlooking certain facts. It became apparent in the NGO submissions that the local company acquired by Metalclad had a disturbing history of illegal waste dumping and leakages, which led to blockage of the site by local people as early as 1991. Therefore, it has been said that local resistance was no surprise to the investor. Instead of dealing with these facts, the tribunal simply said that the local authorities had no valid reason for not giving the

⁴¹⁰ *Starrett Housing Corporation v. Islamic Republic of Iran "Starrett"*, Interlocutory Award of 19 December 1983, Iran-US Claims Tribunal, No. ITL 32-24-1, para. 66. <https://jsumundi.com/en/document/decision/en-starrett-housing-corporation-starrett-systems-inc-and-others-v-the-government-of-the-islamic-republic-of-iran-bank-markazi-iran-and-others-interlocutory-award-award-no-itl-32-24-1-monday-19th-december-1983> (last accessed 02.06.2019).

⁴¹¹ *Metalclad Corporation v. The United Mexican States "Metalclad"*, Award of 30 August 2000, ICSID Case No.ARB(AF)/97/1, para. 111. <https://www.italaw.com/cases/671> (last accessed 02.06.2019).

⁴¹² Kriebaum, *op. cit.*, p. 725.

necessary permits.⁴¹³ One further criticism concerns the tribunal's failure to even consider whether the decision to refuse construction permits served a legitimate purpose.⁴¹⁴⁴¹⁵

A similar problem arose in the *Santa Elena* case. The case concerned expropriation of a large piece coastal land in Costa Rica, which was bought by the investor for creating a touristic resort, for the purpose of adding the piece of land in question to the neighbouring national park.⁴¹⁶ The tribunal indicated that

“Expropriatory environmental measures—no matter how laudable and beneficial to society as a whole—are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state’s obligation to pay compensation remains”.⁴¹⁷

Newcombe criticises this approach because it consecrates property rights. According to him, there is a rationale behind non-compensation which is the inherent limitation of property rights. As property rights serve a social function, they should never be absolute. He says that using property rights should never result in serious harm to environment, health or public order.⁴¹⁸ We agree with this criticism that lies

⁴¹³ Kentin, *op. cit.*, p. 330.

⁴¹⁴ *Ibid.*, p. 333; Mark F. Rosenberg, Michael A. Cheah, “Arbitrating Environmental Disputes” *ICSID Review*, vol. 16 (1), 2001, p. 58 <https://academic.oup.com/icsidreview/article/16/1/39/629619?searchresult=1> (last accessed 14.09.2019).

⁴¹⁵ In the PBS documentary “Bill Moyers Reports: Trading Democracy” we can clearly see the reason the authorities denied the permit and the suffering caused by the related environmental damage. In fact, this documentary inspired us to choose the topic for this thesis. A short clip from the documentary can be watched at <https://billmoyers.com/content/trading-democracy/> (last accessed 02.06.2019).

⁴¹⁶ *Santa Elena*, *op. cit.*, paras. 15-26.

⁴¹⁷ *Ibid.*, para. 72.

⁴¹⁸ Andrew Newcombe, “The Boundaries of Regulatory Expropriation in International Law”, *ICSID Review Foreign Investment Law Journal*, vol. 20 (1), p. 27. <https://academic.oup.com/icsidreview/article-abstract/20/1/1/899534> (last accessed 02.06.2019).

on the basis of all cases relevant to the environment. If we take the example of coral reefs, if a beach-side touristic facility creates a serious risk for the coral reefs because of the over-crowd of the beach, the State may (and should) interfere to limit access to a certain number per day, or may, for instance ban the use of sun screens⁴¹⁹ or ban access to these beaches.⁴²⁰ All these restrictions have an effect on the beach side touristic facilities that may reach to the level of expropriation, and the rights of the private owners could not be held sacred against the right of the whole world (including humans, animals and plants) to enjoy the environment.

On the other end of the spectrum, the radical police powers doctrine lies. This doctrine has been dubbed as a rather reactionary move to the sole effects doctrine.⁴²¹ According to Kriebaum, if the intervention to rights serve a legitimate purpose, there is no expropriation, so no compensation will be due even if the intervention amounts to a direct expropriation.⁴²² Viñuales summarised the doctrine as giving the favourable position to the environmental measure against the investment, as long as it has been adopted in pursuit of a public purpose and it has not been an *ultra vires* act.⁴²³

This end of the spectrum has been criticised as well. Entirely favouring environment against investment may result problematic situations for the investment protection in general. Because in all cases there is no doubt that the interference had been in the public interest. Accordingly, it would become impossible to find a case where the expropriation triggers compensation. In each case, investor would bear the

⁴¹⁹ Maritza Moulite, “Hawaii bans sunscreens that harm coral reefs” CNN health, 03.07.2019. <https://edition.cnn.com/2018/07/03/health/hawaii-sunscreen-ban/index.html> (last access: 08.09.2019).

⁴²⁰ Hannah Ellis-Petersen, “Thailand bay made famous by The Beach closed indefinitely, The Guardian, 03.10.2018, <https://www.theguardian.com/world/2018/oct/03/thailand-bay-made-famous-by-the-beach-closed-indefinitely> (last access: 08.09.2019).

⁴²¹ Kriebaum, *op.cit.*, p. 725.

⁴²² *Ibid.*, p. 726.

⁴²³ As Viñuales notes, specific assurances given to the investor pose further problems for the host State, see Viñuales, **Foreign...**, *op. cit.*, pp. 371-373; George H. Aldrich, “What Constitutes a Compensable Taking of Property? The Decision of the Iran-United States Claims Tribunal”, *American Journal of International Law*, vol 88, 1994, p. 609.

burden of regulatory measures that had been made with a public interest, and the meaning of indirect expropriation would be lost.⁴²⁴

The correct approach, as it is usually the case, lies somewhere between these two ends. As explained above, the sole effects doctrine cannot be the answer: it sets an impossible task for the governments and therefore acts as discouraging factor for the States that want to improve their environmental regulations. The answer cannot be the police powers doctrine either; this would mean that any regulation, almost without any limitation, will allow the State to circumvent its obligations arising from investment treaties. We will explore below the approach, which we believe to be correct when applied to environment related investment disputes. We will start with exploring the role of the State's purpose for adopting the act in question.

B. Purpose of the regulatory change

Customary international law sources usually recognise that non-discriminatory and non-targeted general regulatory acts such as “*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” will not lead to compensation.⁴²⁵ Newcombe confirmed that legitimate and *bona fide* exercise of sovereign police powers would not incur responsibility for the State.⁴²⁶

Another commentator, Caroline Henckels noted that measures would not lead to a compensable expropriation as long as they have a legitimate purpose, they are aimed at the general welfare, they are non-discriminatory, and they fall within the state's general regulatory or administrative powers.⁴²⁷

Environmental measures also fall within this sphere but as discussed below, it is not always clear whether these measures lead to compensation responsibility. We will

⁴²⁴ *Ibid.*, p. 727.

⁴²⁵ Moloo, Jacinto, *op. cit.*, p. 15.

⁴²⁶ Newcombe, *op. cit.*, p. 3.

⁴²⁷ Caroline Henckels, “Indirect Expropriation and The Right to Regulate”, **Journal of International Economic Law**, vol. 15(1), 2012, p. 1.

first discuss the case law where the host State's intentions, or its purpose, in adopting an interventionist act or regulation are examined.

The *Rumeli* tribunal noted that the intent of the State in taking the action in question is indeed relevant, but it is not decisive since the applicable BIT did not mention the intent of the State.⁴²⁸ The tribunal concluded that the State acted for a public purpose, “namely the administration of justice and the execution of the laws of the host State”, when it redeemed the shares in question.⁴²⁹ However, the tribunal did not explain or show the relevance of the purpose of the act: it did not take this into consideration when deciding on the legality of the act in question or in the amount of compensation.

Same principle has also been applied by other tribunals. The *Methanex* case concerned banning of gasoline additive known as “MTBE” by the State of California. The investor, as the largest producer of methanol (the base material for MTBE) argued that it suffered damages almost in the amount of USD 1 billion because of this ban. According to the investor, the ban, contrary to the claims of the State of California and the United States, was not imposed out of environmental concerns.⁴³⁰ The investor argued that the ban was imposed because “Archer-Daniels Midland, the principal U.S. producer of ethanol, misled and improperly influenced the State of California with respect to MTBE.”⁴³¹

We could establish that as a principle, non-discriminatory regulation for a public purpose which is made following due process cannot be taken as an expropriation. However, following the approach of *Methanex* tribunal this cannot be the case if the

⁴²⁸ *Rumeli, op. cit.*, para. 700.

⁴²⁹ *Rumeli, op. cit.*, para. 705.

⁴³⁰ *Methanex Corporation and United States of America “Methanex”*, Final Award of the Tribunal on Jurisdiction and Merits on 3 August 2005, Part I, page 1, para. 1. <https://www.italaw.com/sites/default/files/case-documents/ita0529.pdf> (last accessed 02.06.2019).

⁴³¹ *Ibid.*, Part I, page 2, para. 5.

State made specific commitments that such regulations would not be made, and in such cases the regulation must be deemed expropriatory and compensable.⁴³²

Newcombe noted that determination of the risk and the measures to be employed against such risk are two important aspect in dealing with a *Methanex* like situations. According to him we need to distinguish between the concepts of risk assessment and risk management. Risk assessment aims to determine if there is a legitimate government goal. The legitimacy depends on whether the investment raises a risk to human health or the environment. Risk management, however, focuses on the regulatory response to deal with the risk⁴³³ and it should be considered as to proportionality.

A hypothetical example to this approach may be given for the nuclear power plants. When the State changes its policy that authorises nuclear power plants and completely bans this type of production, the investors that previously obtained would be seriously harmed. However, if the State bases this decision on recent scientific data that determines the risks and applies the ban to all nuclear plants in similar situation without discrimination, then the investors could not obtain compensation for their damages. For instance, if a decision was taken to ban all nuclear plants in Japan after the Fukushima accident (where it was understood that the actual incidents may surpass the scientifically expected risk) then the State should be able to take such decision without compensations. We consider that this may not be the case for Turkey's currently under construction nuclear power plants. If Turkey was to revoke construction licences today without any scientific findings discovered after providing authorisations, Turkey would be obliged to pay compensation.

Feldman tribunal followed a rather nuanced approach. The case concerned excise taxes applicable to exportation of cigarettes from Mexico. In particular, it involved cancellation of tax rebates for the Claimant's business, which was mainly exportation of cigarettes produced in Mexico.⁴³⁴ In *Feldman*, the tribunal stated that

⁴³² *Ibid.*, Part IV - Chapter D-Page 4, para. 7.

⁴³³ Newcombe, *op. cit.*, p. 34.

⁴³⁴ *Marvin Roy Feldman Karpa v. United Mexico States "Feldman"*, Award of 11 December 2002, ICSID Case No. ARB(AF)/99/1, paras. 6-23.

reasonable regulatory acts of government cannot reach their aims if every affected party could seek compensation, thus when the measure is a “*bonafide* regulation of general application, within the legitimate exercise of the state's police powers” tribunals will not award compensation.”⁴³⁵

Accordingly, it can be said that the purpose of the regulatory change will undoubtedly have a role in the tribunal’s analysis when faced with an environmental measure. However, it will not grant a free ride to the host State: the host State cannot do anything it wants in any form and shape it wants simply because that it has good intentions or motivated by high moral values. The host State must still show that the measure it implements is proportional to the goal it seeks, and it is not discriminating against the foreign investor. These conditions are discussed in further detail in the next section.

C. Conditions to consider public interest as a valid defence

As discussed above, purpose of the regulatory change may have an impact on the legality of the change. This purpose can also be identified as public purpose. Indeed, it would be practically impossible to argue that a State may have a legitimate purpose for a regulatory change, but such change would also be against public purpose. For that reason, we will analyse below the conditions that need to be observed in implementation of the public purpose, but not in the implementation of legitimate purpose.

1. Proportionality

Proportionality means that the State adopts the measure that will be least interventionist to the foreign investor’s business, but at the same time will allow the host State to achieve the goal it pursues. Vadi notes that it is a balance between the public and the private interests and restriction of the latter in a reasonable manner.⁴³⁶

<https://www.italaw.com/sites/default/files/case-documents/ita0319.pdf> (last accessed 02.06.2019).

⁴³⁵ Moloo, Jacinto, *op. cit.*, p. 16.

⁴³⁶ Valentina Vadi, **Proportionality, Reasonableness and Standards of Review in International Investment Arbitration**, Edward Elgar Publishing, 2018, p. 54.

Vadi further notes that proportionality test is generally composed of three parts. First, determination as to whether the measure in question serves the host State's interest. Second, determination as to whether such interest would be served in a less disruptive manner to the private interest. Third, whether a balance has been struck between the host State's and private party's interest.⁴³⁷

Proportionality is applied by the investment tribunals as an international law principle. As Bucheler explained whether proportionality is regarded as a rule of international law or a principle of international law does not carry a significance since both of them constitute a source of international law, as indicated in the ICJ Statute.⁴³⁸

When alternative measures exist, Henckels says that proportionality requires choosing the option that intrudes least upon the interests of the investor. Also, if the limitation of interests is greater, the proportionality requires higher social needs.⁴³⁹

Such finding can be based upon three premises, namely suitability, necessity, and whether the desired result could be achieved with less interfering measures.⁴⁴⁰ The last criteria, namely whether a less interfering measure could lead to the desired result, also has its basis in the WTO law. WTO tribunal in the *US v. Thailand* case has concluded as early as 1989 that a measure "could be considered to be 'necessary' in terms of Art. XX b) [of the GATT] only if there were no alternative measure consistent with the General Agreement, or less inconsistent with it, which [a State] could be reasonably expected to employ to achieve its health policy objectives."⁴⁴¹ Benedetto stated that this could (and should) be applied in the investment law context when it comes to environmental issues. According to him, if an aim can be reached by a

⁴³⁷ *Ibid.*, p. 55; Grainne De Burca, "The Principle of Proportionality and its application in EC Law", *Yearbook of European Law*, vol. 13, 1993, p. 113.

⁴³⁸ Bucheler, *op. cit.*, p. 17; Aurelien Portuese, "Principle of Proportionality as Principle of Economic Efficiency", *European Law Journal*, vol. 19, 2013, p. 612.

⁴³⁹ Henckels, *op. cit.*, p. 2.

⁴⁴⁰ *Ibid.*, p. 2.

⁴⁴¹ *US v. Thailand, Restriction on Importation of and Internal Taxes on Cigarettes*, Report of the Panel of 7 November 1990, GATT Panel, DS10/R - 37S/200, para 75.
<http://www.sice.oas.org/dispute/gatt/90CIGAR2.asp> (last accessed 02.06.2019).

measure which would not be an expropriation, but regardless the measure taken for the same aim is an expropriation, the compensation will be calculated as any other expropriation without discounting environmental costs.⁴⁴² For instance, if the State starts a forestation campaign and takes the lands of farmers for this aim while the unoccupied area around is left out of the scope of the campaign, the measure cannot be considered necessary, thus compensated without discounting environmental costs.

We will now examine the application of this principle in investment arbitration cases.

a. Investment treaty arbitral awards on proportionality

We consider that it is appropriate to take the *Tecmed* decision as the milestone in understanding and application of the proportionality test in investment arbitration. As it will be discussed in detail below, *Tecmed* tribunal started with good intentions but ended up with creating a test that would almost certainly ensure that any measure based on public purpose (such as protection of environment) would inevitably lead to breach of international investment law obligations of the State. As further discussed below, the *Tecmed* test received heavy criticism in the investment law world and it eventually left its place to an approach that allows the host States more breathing room.

The most relevant jurisprudence in this respect will be discussed below.

i. Pre-Tecmed caselaw

In the *Tecmed* case, the environmental concerns were at the centre: the case concerned “the sale of real property, buildings and facilities and other assets relating to “Cytrar”, a controlled landfill of hazardous industrial waste.”⁴⁴³ The investor’s claims were based on the rejection of the application for renewing the landfill operation licence and the resolution that aims to completely close the landfill.⁴⁴⁴ This

⁴⁴² Benedetto, *op. cit.*, p. 676.

⁴⁴³ *Tecnicas Medioambientales Tecmed SA v. United Mexican States “Tecmed”*, Award of 29 May 2003, ICSID Case No. ARB(AF)/00/2, para. 35.
<https://www.italaw.com/sites/default/files/case-documents/ita0854.pdf> (last accessed 09.06.2019), para. 35.

⁴⁴⁴ *Ibid.*, para. 39.

was a classic case of environment protection: despite having agreed with the authorities to change the location of the facility, the investor eventually lost its permit when the authorities decided not to allow continuation of the operation due to environmental concerns.

Doctrine also accepted the test applied by *Tecmed* tribunal which is: **the measure must have a legitimate aim for the public interest, the measure must be appropriate to achieve this aim, the effect of the measure on the investor must be proportional to the aim, and the measure should be considered proportionate only if there are no excessive individual burdens.**⁴⁴⁵

The *Tecmed* tribunal concluded that the relevant community's concerns and pressure as to the location of the waste disposal was not a legitimate public interest as it did not amount to a crisis, serious emergency or other urgent situation. In order to reach this conclusion, the tribunal first established that there was indeed community pressure however also established that the reasons causing the pressure are beyond the control of the investor or even the State. Later the tribunal considered the gravity of the pressure and weighing these factors decided that it was not so serious to create an emergency situation, social crisis or public interest.⁴⁴⁶

The *Tecmed* test, although one argue that it ended up not understanding the test altogether, was heavily influenced by the ECtHR's proportionality test, therefore it is important to understand the ECtHR's understanding of proportionality.⁴⁴⁷ ECtHR's *JNC James* case concerned forced sale of a property by the landlords to the tenants that have been residing in the premises for more than 20 years.⁴⁴⁸ The landlords were practically forced to sell some of the real estate they hold to these tenants.⁴⁴⁹ The

⁴⁴⁵ Henckels, *op. cit.*, p. 3.

⁴⁴⁶ *Tecmed*, para. 133.

⁴⁴⁷ Kriebaum, *op.cit.*, p. 728.

⁴⁴⁸ *JNC James and others v United Kingdom "James v UK"*, Decision of 11 May 1984, ECHR, Application no 8793/79, para. 11.
<https://hudoc.echr.coe.int/app/conversion/pdf/?library=ECHR&id=001-73433&filename=JAMES%20v.%20THE%20UNITED%20KINGDOM.pdf> (last accessed 02.06.2019).

⁴⁴⁹ *Ibid.*, para. 27.

landlords claimed that the compulsory transfer of properties breached Article 1 of Protocol No. 1 to the ECHR, the discriminations were contrary to Article 14 and the lack of appeal mechanism breached article 13.⁴⁵⁰

The Court decided that the State's intervention to provide a private benefit to a private party cannot be "in the public interest". However, depending on the circumstances this could constitute a legitimate means for achieving a public interest.⁴⁵¹ To clarify, the court added that even if the general public does not have any direct enjoyment of the property that is taken, there might still be a legitimate social, economic or other related policy.⁴⁵² The Court also noted that, while a certain degree of deference concerning the public interest must be granted to the State in question, it will limit its review to understanding "whether the legislature's assessment of the relevant social and economic conditions came within the State's margin of appreciation."⁴⁵³

The Court made an important observation as to the correct amount of compensation in case of a taking on which we base our thesis:

"Legitimate objectives of "public interest", such as pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value."⁴⁵⁴

Based on the same reasoning we believe that measures taken in the frame of an environmental reform may require a lower (if any) compensation than the market value which should be granted in takings with any other motivation.

⁴⁵⁰ *Ibid.*, para. 30.

⁴⁵¹ *Ibid.*, para. 40.

⁴⁵² *Ibid.*, para. 45.

⁴⁵³ *Ibid.*, para. 46, 49.

⁴⁵⁴ *Ibid.*, para. 54.

By taking this principle into account, the Court decided that the taking in question did not violate Article 1 of the Protocol No 1 to the European Convention on Human Rights.⁴⁵⁵ It is important to note that the Court stated in quite detail that general principles of international law were not applicable in this case as the case did not concern a taking from an alien but from a national.⁴⁵⁶

ECtHR's proportionality test can be summarised as determining whether a fair balance between general interests and the protection of individual's fundamental rights was achieved.⁴⁵⁷

One should bear in mind that this test is applied by the ECtHR only after establishing that a taking/expropriation has taken place. So we can argue that this test is rather about the aftermath of the expropriation, not about its legality. In any case, the investment tribunals apply the modified version of this test in order to decide whether a taking has taken place. In addition to the technical legal difference, the former approach allows the ECtHR to order compensation proportional to the outcome of the application of the test. The latter approach, which we can call moderate police powers doctrine, still falls short of providing this nuance.⁴⁵⁸ Accordingly, none of the three schools we have mentioned, namely sole effects, radical powers or moderate police powers doctrines, provide a solution to the all or nothing problem. Under all these systems, either the investor receives full compensation or simply nothing.⁴⁵⁹

Although the tribunal has been credited for introducing the proportionality test into the investment treaty arbitration, it has been criticised for application of its test in the manner quoted above, in two aspects. First, the tribunal jumped over the first two

⁴⁵⁵ *Ibid.*, para. 72.

⁴⁵⁶ *Ibid.*, paras 58-66.

⁴⁵⁷ Laurent Sermet, **The European Convention on Human Rights and Property Rights**, Council of Europe Publishing, 1st edition reprinted, 1999. pp.34-35.
[https://www.echr.coe.int/LibraryDocs/DG2/HRFILES/DG2-EN-HRFILES-11\(1998\).pdf](https://www.echr.coe.int/LibraryDocs/DG2/HRFILES/DG2-EN-HRFILES-11(1998).pdf) (last accessed 02.06.2019).

⁴⁵⁸ Kriebaum, *op.cit.*, p. 730.

⁴⁵⁹ *Ibid.*, p. 728.

aspects of the test and immediately dealt with the question whether the desired result could be achieved with a less interfering measure.⁴⁶⁰

Secondly, the tribunal put an impossible threshold to meet by requiring the situation to escalate to “a crisis, serious emergency or other urgent situation.” The purpose of the proportionality test is not relieving States’ from liability or compensation responsibility in extreme situations or circumstances. This is already codified in international law as the rules on necessity. Article 25 of the ILC Draft Articles on State Responsibility indicates that measures that addressing a “grave and imminent peril”, such as a crisis, serious emergency or other situation, the State in question can invoke necessity. ILC noted that necessity can be invoke against all kinds of obligations, including treaty obligations, which, by definition, covers investment treaty obligations.⁴⁶¹

The tribunal’s decision was also criticised because it gave an impossible task to the host States. According to the tribunal, the State must act in such a consistent and transparent manner that the investor should be able to see beforehand any regulation that may cover its investor as well as understand any goal of relevant policy and practices.⁴⁶²

In the words of Douglas, this is “a description of perfect public regulation in a perfect world, to which all states should aspire but very few (if any) will ever attain.”⁴⁶³ It has been also argued that “the tribunal's finding as to the effect of the measure played a dominant role in its reasoning, effectively setting the scene for a finding that nothing could outweigh it”.⁴⁶⁴

⁴⁶⁰ Henckels, *op. cit.*, p. 4.

⁴⁶¹ Article 25, **Draft articles on State Responsibility**, *op. cit.*, art. 25, p. 83, para. 14.

⁴⁶² *Tecmed*, para. 154.

⁴⁶³ Zachary Douglas, “Nothing If Not Critical for Investment Treaty Arbitration: Occidental, Eureko and Methanex”, **Arbitration International**, vol. 22 (1), 2006, p. 28.

⁴⁶⁴ Henckels, *op. cit.*, p. 4.

Azurix case did not directly concern environmental matters but it is worth mentioning as it also followed the *Tecmed* test. It rather emerged from privatization of potable water and sewage system in the Province of Buenos Aires.⁴⁶⁵ The investor claimed that its investment was expropriated as it was not allowed to recoup the canon it paid through changing of the tariffs.⁴⁶⁶ The case is among the several cases that has resulted from Argentina's economic crisis. The tribunal relied heavily on the *James* judgment of the ECtHR.⁴⁶⁷ After discussing the criteria set out by the ECtHR, the tribunal stated that the criteria "provide useful guidance for purposes of determining whether regulatory actions would be expropriatory and give rise to compensation."⁴⁶⁸

The *LG&E* tribunal also did not depart much from the *Tecmed* tribunal when deciding on the content of the FET and stated that the FET consists of a consistent and behaviour with transparent aims which comes with a stable and predictable framework that could fulfil the legitimate expectations of the investors.⁴⁶⁹

LG&E case also did not directly concern environmental issues. The Claimants held shares in gas distribution companies in Argentina.⁴⁷⁰ The claimants argued that they ended up investing a total of half a billion USD.⁴⁷¹ Things went sour as the infamous economic crisis hit Argentina and the claimants started having difficulties in adjusting the tariffs.⁴⁷² These difficulties led to forced renegotiation of the public

⁴⁶⁵ *Azurix Corp. v. The Argentine Republic "Azurix"*, Award of 28 December 2007, ICSID Case No. ARB/01/12, para. 38. <https://www.italaw.com/sites/default/files/case-documents/ita0061.pdf> (last accessed 02.06.2019).

⁴⁶⁶ *Ibid.*, para. 43.

⁴⁶⁷ *Ibid.*, para. 311.

⁴⁶⁸ *Ibid.*, para. 312.

⁴⁶⁹ *Ibid.*, para. 131.

⁴⁷⁰ *LG&E, op. cit.*, para. 2.

⁴⁷¹ *Ibid.*, para. 53.

⁴⁷² *Ibid.*, paras. 58-60.

service contracts, and eventually the claimants brought an investment claim before an ICSID tribunal.⁴⁷³

When deciding on the expropriation claim, *LG&E* tribunal indicated that it “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.”⁴⁷⁴ The tribunal also put a specific emphasis on the measure’s economic impact, in the sense of its degree of interference with the investor’s expectations, and the duration of the measure.⁴⁷⁵ The tribunal further noted that a measure having a social or general welfare purpose will impose liability, only if “the State’s action is obviously disproportionate to the need being addressed.”⁴⁷⁶ The tribunal concluded that since the deprivation suffered by the claimants was neither permanent or substantial, the measures in question did not amount to expropriation.⁴⁷⁷

The tribunal also concluded that Argentina did not accord fair and equitable treatment to the claimants. In particular, the tribunal noted that Argentina offered certain incentives to the investors in its pre-crisis legislation and the claimants rightly relied upon these guarantees in making their investments.⁴⁷⁸ The tribunal also concluded that Argentina did not treat different sectors consistently during the crisis and gas distribution sector suffered from worse measures.⁴⁷⁹ The tribunal also found that Argentina’s actions with respect to tariffs and forced renegotiation of the contracts was unfair and inequitable.⁴⁸⁰ The tribunal recognised the economic troubles and

⁴⁷³ *Ibid.*, paras. 61-75.

⁴⁷⁴ *Ibid.*, para. 189.

⁴⁷⁵ *Ibid.*, para. 190; Claudia Frutos-Peterson, “LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic (ICSID Case No. ARB/02/1): Introductory Note”, **ICSID Review**, vol. 21 (1), 2006, p. 154.

⁴⁷⁶ *Ibid.*, para. 195.

⁴⁷⁷ *Ibid.*

⁴⁷⁸ *Ibid.*, para. 133-134.

⁴⁷⁹ *Ibid.*, para. 135.

⁴⁸⁰ *Ibid.*, paras. 136-137.

realities that caused the State reaction and agreed that the investor was aware of inherent risks, but still found that Argentina went to far and completely dismantled the whole legal framework of attracting foreign investment.⁴⁸¹

ii. *Post-Tecmed case law and the positive change in the understanding of proportionality*

Following the Tecmed test's downfall, investment tribunals started granting the host States more manoeuvre area for implementation of decision based on serving public purpose. As discussed below, although the standard applied did not change very much, the results started changing. One further change was that tribunals started accepting that local authorities would be better placed to judge the needs of the local population compared to an investment tribunal.

PL Holdings case is worth noting with its recent award. Although the case did not concern environmental issues, it is worth discussing as it focuses on proportionality of host State's measures against the investor. PL Holdings invested in Polish bank in December 2010 and made a further investment in the same bank in July 2012.⁴⁸² The claimant made further investment in another Polish bank in June 2013 and merged these two investments into a single bank a month later.⁴⁸³ The claimant argued that the Polish State's financial institutions started taking measures against its investment which lacked any basis under Polish law, did not pursue any legitimate aim or public purpose and that were manifestly disproportionate.⁴⁸⁴

PL Holdings tribunal in its recent decision reaffirmed that the proportionality test has three steps: **“measure must (a) be one that is suitable by nature for achieving a legitimate public purpose, (b) be necessary for achieving that purpose**

⁴⁸¹ *Ibid.*, para. 139. It should be noted the tribunal limited liability of Argentina, by indicating that Argentina is exempt from liability during the crisis between 1 December 2001 and 26 April 2003.

⁴⁸² *PL Holdings Sarl v. Republic of Poland “PL Holdings”*, Partial Award of 28 June 2017, SCC Case No. V, 2014/163, para. 9.
<https://www.italaw.com/sites/default/files/case-documents/italaw10467.pdf> (last accessed 02.06.2019).

⁴⁸³ *Ibid.*, paras. 10-11.

⁴⁸⁴ *Ibid.*, para. 15.

in that no less burdensome measure would suffice, and (c) not be excessive in that its advantages are outweighed by its disadvantages.”⁴⁸⁵ Following this test, the tribunal determined that the objective of the measures had undoubtedly legitimate and substantial public interest and these measures would be appropriate if the circumstances justified.⁴⁸⁶

Deutsche Bank case also decided on the importance of public interest in the proportionality test. The case concerned a hedging agreement concluded between the investor and the state-owned petroleum company. The agreement aimed at protecting the host State against the impact of the rising oil prices. As the tribunal noted, the agreement was probably motivated by the sharp increase of oil prices between 2003 and 2008.⁴⁸⁷ Although the agreement worked in the State’s favour in the early stages of the agreement as the oil prices continued to increase, the State ended up financially not benefiting from the agreement as oil prices started going down. When the restructuring attempts failed, the investor terminated the contract and requested compensation. In a rather complicated litigation process before different levels of the host State’s courts, the court decided that the agreement was not concluded properly and did not grant compensation to the investor.⁴⁸⁸

The tribunal stated, as a general rule, that **the State would be prevented from taking measures that “severely impact an investor unless such measures are justified by a substantial public interest.”**⁴⁸⁹ The tribunal noted that the acts in question could not meet the proportionality test as the motive was improper, there was excess of powers and there were breaches of due process, principle of good faith and transparency.⁴⁹⁰ Considering these, the tribunal concluded that the action’s motive was

⁴⁸⁵ *Ibid.*, para. 355.

⁴⁸⁶ *Ibid.*, para. 356.

⁴⁸⁷ *Deutsche Bank AG v Democratic Socialist Republic of Sri Lanka “Deutsche Bank”*, Award of 31 October 2012, ICSID Case No. ARB/09/2, paras. 12-14.
<https://www.italaw.com/sites/default/files/case-documents/italaw1272.pdf> (last accessed 02.06.2019).

⁴⁸⁸ *Ibid.*, paras. 15-62

⁴⁸⁹ *Ibid.*, para. 522.

financial and the State was not impartial, accordingly it was an illegitimate regulatory expropriation.⁴⁹¹

Saluka case was another case that dealt with the concept of proportionality. It concerned an investment made in the Czech banking sector, which had to go under administration when the Czech finance sector was affected as a whole. The investor argued that the host State, by refusing to grant Saluka's investment the relief it granted to other big banks it forced it into administration. In deciding the case, tribunal also recognised that purpose of the host State's actions had a role to play and stated that it is accepted in international law that **if the State adopts a non-discriminatory and bona fide regulation which aims to serve general welfare in usual exercise of its State powers, it will not be liable to pay compensation.**⁴⁹² However, the tribunal also added that the circumstances around the measure is "critical" in understanding its validity.

Bilcon is also worth mentioning. The case concerned a US Investor's planned investment in a mine located at Nova Scotia. According to the investor, it was first encouraged by the provincial authorities to invest in a mine, but the federal authorities did not allow the project to advance under the guise of environmental concerns.⁴⁹³ In particular, the investor argued that it was practically barred from conducting blast tests which "would assist in planning the project and making the case to regulators and the

⁴⁹⁰ *Ibid.*, para. 523.

⁴⁹¹ *Ibid.*, para. 525. Gladwin Issac, "SCC tribunal finds Poland liable for expropriation over divestment order to Luxembourg investor", Investment Treaty News, 27 June 2019, <https://www.iisd.org/itn/2019/06/27/scc-tribunal-finds-poland-liable-for-expropriation-over-divestment-order-to-luxembourg-bank-gladwin-issac> (last accessed 14.09.2019).

⁴⁹² *Saluka Investments BV v. The Czech Republic "Saluka"*, Partial Award of 17 March 2006, *ad hoc*, UNCITRAL, para. 255. <https://www.italaw.com/sites/default/files/case-documents/ita0740.pdf> (last accessed 02.06.2019). Stephan W. Schill, "Cross-Regime Harmonization through Proportionality Analysis: The Case of International Investment Law, the Law of State Immunity and Human Rights", ICSID Review, vol. 27(1), 2012, p. 107. <https://academic.oup.com/icsidreview/article/27/1/87/636563?searchresult=1> (last accessed 14.09.2019).

⁴⁹³ *Bilcon of Delaware et al. v. Government of Canada "Bilcon"*, Award on Jurisdiction and Liability of 17 March 2015, PCA Case No. 2009-0414, para. 14. <https://www.italaw.com/sites/default/files/case-documents/italaw4212.pdf> (last accessed 02.06.2019).

public that the quarry would be safe for the environment.”⁴⁹⁴ The investor also argued that similar permits to other mining projects in the area were granted without causing any problem and the decision affecting itself was politically motivated.⁴⁹⁵ The investor initiated investment treaty arbitration proceedings under the NAFTA Convention as the local proceedings to get its project up and running, has been conducted in an allegedly unfair manner and has eventually failed.⁴⁹⁶

Bilcon Tribunal emphasised that when it comes to matters of local character, it is important to give credence to the local authorities: **“third-party adjudicators must, in applying the international minimum standard, take into account that domestic authorities may have more familiarity with the factual and domestic legal complexities of a situation.”**⁴⁹⁷

The tribunal took specific issues into consideration in its decision. First, the legal environment surrounding the investment did not bar the investor from contemplating the project. Second, the investor received constant encouragement from the local provincial authorities. Third, the tribunal specifically noted that the encouragement was not only about generally investing in the province, but specific to the project itself. According to the tribunal, the State created expectations by policy pronouncements and through its officials that an environmental assessment of the project would be made fairly within the legislative framework; and the investors could reasonably rely on these expectations which was critical for them to get involved in the project.⁴⁹⁸ The tribunal concluded that regardless of these created expectations, the local assessment was done in an impartial manner and the permits were refused based on the concept of community core values in a way that the investor could not seek clarification or challenge the decision.⁴⁹⁹

⁴⁹⁴ *Ibid.*, para. 13.

⁴⁹⁵ *Ibid.*, paras. 15, 16.

⁴⁹⁶ *Ibid.*, paras. 17-24.

⁴⁹⁷ *Ibid.*, para. 439.

⁴⁹⁸ *Ibid.*, para. 470.

⁴⁹⁹ *Ibid.*, para. 514.

Vigotop case concerned an investment in a very large-scale casino business by the investor, which included hotels, amusement parks, spa facilities etc.⁵⁰⁰ following the initial attempts to obtain site for the project, the state audit office found that there were important irregularities in these attempts.⁵⁰¹ Following the changing of the method to obtain the site through tender, which also eventually failed, a concession agreement was signed between the investor and the host State.⁵⁰² Following a change in the government, the government terminated the agreement as the investor failed to obtain a project site and failure to post security.⁵⁰³ The investor, after losing a lengthy litigation battle, commenced ICSID arbitration.

The tribunal noted that, **in determining the proportionality of termination of an investment agreement, one must look at the performance stage of the agreement.** The tribunal decided as the host State terminated the investment agreement before any substantial performance of it and after several breaches of it by the investor, the termination act was proportional to the breaches in question.⁵⁰⁴

Although proportionality did not impact the tribunal's decision and the related section remained *obiter dictum*, *South American Silver* case is worth mentioning here. The tribunal assessed the proportionality based on the existence, seriousness and duration of the public disorder. Then the tribunal determined the statute of the project

⁵⁰⁰ *Vigotop Limited v Hungary "Vigotop"*, Award of 1 October 2014, ICSID Case No. ARB/11/22, para. 88.
<https://www.italaw.com/sites/default/files/case-documents/italaw4047.pdf> (last accessed 02.09.2016).

⁵⁰¹ *Ibid.*, para. 121.

⁵⁰² *Ibid.*, para. 140.

⁵⁰³ *Ibid.*, para. 193.

⁵⁰⁴ *Ibid.*, para. 631. Dávid Pusztai, "Vigotop Limited v Hungary: (Re)defining the threshold of expropriatory contract termination", ICSID Review, vol. 30 (2), 2015, p. 388
<https://academic.oup.com/icsidreview/article/30/2/384/759882?searchresult=1> (last accessed on 14.09.2019).

which was at the initial stage thus at this stage the damage could not be more than the invested amounts.⁵⁰⁵

b. Assessing the proportionality of an environmental measure

The good news is that the days where investment tribunals expected the host State to strike the impossible perfect balance between the public good and individual rights in an impossible fashion is long gone. Considering the criteria applied by the post-*Tecmed* tribunals, it is clear that a regulation change for protection of the environment must be proportional to the goal it is pursuing and the tribunals' have put the main emphasis in understand whether the goal pursued by the host State could have been achieved with a measure that would be less detrimental to the foreign investor. If the investment tribunal concludes that the goal could be achieved with a less interfering regulatory change, then the host State will probably be liable for the loss of the effected foreign investor.

As to a regulatory measure that is applicable to a sector or a product (such as interdiction of asbestos in construction, or coal-based electricity production), we need to take into account the proportionality test as explained above⁵⁰⁶ that the measure should (a) be one that is suitable by nature for achieving a legitimate public purpose, (b) be necessary for achieving that purpose in that no less burdensome measure would suffice, and (c) not be excessive in that its advantages are outweighed by its disadvantages. If we take the example of interdiction of coal based electricity production, it is clear that the ban is suitable for achieving a low carbon emission, that it is necessary as the very high emission rates can only be reduced to the necessary levels by taking this type of action and that it is not excessive considering the advantages of slowing climate change outweigh the interests of a coal-based electricity producer.

As to the reactionary measures adopted by the host State, the foreign investor's original act must be taken into account as well. For example, if the host State decides

⁵⁰⁵ *South American Silver Limited v. Plurinational State of Bolivia* "South American Silver", Award of 22 November 2018, PCA Case No. 2013-15, para.570.
<https://www.italaw.com/sites/default/files/case-documents/italaw10361.pdf> (last accessed 02.06.2019).

⁵⁰⁶ Part 2/II/C/1/a/i.

to shut down a factory due the damage it causes to the environment, the investment tribunal seized by the investor will look at (i) the level of the damage done by the investor, (ii) whether it has any fault in the occurrence of the damage and finally, (iii) whether the host State's decision is proportional to the first two points considered.

Another scenario could be considered in case of cancellation of EIA approval of an investment, after the administration finding out that the investor has not implemented the measures which were supposed to be implemented according to the EIA report. As discussed in Part 1/III/C, the project owner would be asked to take the measure and warned that the EIA approval would be revoked, if it fails to implement the measure in a certain amount of time. It is worth noting that, at least in Turkey, the administration does not have a second option, such as taking the measure on its own initiative and charging the project owner for the costs: the regulation obliges the administration if the project owner insists on not taking the relevant measure. Accordingly, a strict application of the proportionality test as discussed may yield the conclusion that host State's cancellation of the EIA approval would be in breach of the BIT. Obviously, such result would not be fair.

However, in this scenario, one can argue that the host State's act in question can be regarded as compliant with its BIT obligations in two respect. First option would be to tackle the issue at the jurisdictional level. One can argue that the investor's breach of its promise for taking the measure protecting the environment retroactively affects the very basis of the investment's legality and excludes the investment from the protection framework of the BIT. Indeed, it can be said that the administration would not have approved the EIA process and admitted the investment if the investor had not promised to take the measure. Therefore, it can be argued that the investment becomes illegal (*i.e.* not made pursuant to the laws of the host State) as a result of the investor's action or inaction.

Second option is to deal with the matter at the merits level. Again, we can argue that if the investor did not take the promised measure, this would create a ground for revoking the EIA approval based on non-compliance with the investment regulations. In this case we need to assess whether this revocation constitutes a basis for state responsibility based on the breach of BIT. As the conditions related to the authorisation is clear and unchanged, the investor already knows that non-compliance results with

the revocation, and revocation rests within the regulatory powers of the State. This methodology will not apply to cases where the investor can prove that it cannot be expected to take the measure in question. However, given that in European legal systems EIA reports are prepared by the investor, it cannot be easy to establish that the investor has a reasonable explanation.

2. Non-discrimination

In addition to the measure being proportional, it also must not single out the investor. As explained below, this is called the non-discrimination principle.

Viñuales explains that discrimination may happen in the context of environment related investment disputes from three angles. First, where the foreign investor in question is compared to other foreign investors (MFN type). Second, the foreign investor in question is compared to local investors (National treatment type). And third, comparison between any entity and the foreign investor (customary international law type).⁵⁰⁷ Particularly important for potential environment related investment disputes, Joubin-Bret notes that an example of discrimination in this context can be unequal application of investment screening processes, such as environmental impact assessment analyses.⁵⁰⁸

Viñuales further notes that three conditions apply to all these types of discrimination. First, the investor must establish that the other entities that it is comparing itself to are in a similar position, the co-called likeness. This condition has been discussed in a number of investment arbitration decisions: For instance, *CMS* tribunal explained that a treatment which is arbitrary or discriminative is in itself a breach of FET, but it also established that the standard is also related to the impairment, which means the operation, management or use of the investment needs to be impaired for a breach.⁵⁰⁹

⁵⁰⁷ Viñuales, *Foreign...*, *op. cit.*, p. 317.

⁵⁰⁸ Joubin-Bret, *op. cit.*, p. 42.

⁵⁰⁹ *CMS Gas Transmission Company v. The Republic of Argentina "CMS"*, Award of 12 May 2005, ICSID Case No. ARB/01/8, para. 290.

Critical question at this stage is determining the comparable situations. The case law shows that in order to determine comparable situations regarding discrimination, we need to check whether the comparator was **subject to the same legal regime** as the claimant. A very good example in this regard could be seen in NAFTA decisions where the courts interpreted the “like circumstances” condition by giving weight to the “like legal requirements”, meaning that they were subject to the same legal rules.⁵¹⁰

We should note here that even where two companies operate in the same industry and are subject to same kind of rules, they are not necessarily in a like situation. Tribunals must therefore look carefully at the circumstances of each company to determine whether they are indeed in like circumstances.

Thus, if an investor effected by a regulatory change for protection of the environment can establish that other companies that similarly damage the environment are not affected by the change, then such investor will probably be compensated for all of its losses.

Second condition is the foreign investor must establish that it has received a somewhat inferior treatment than the comparators.⁵¹¹ If these two conditions are met, then the host State may still avoid being in breach of its obligations if it can prove that there is a justification for the different treatment among the compared entities.⁵¹²

To provide a concrete example, we can take Renault’s diesel car production in Turkey. If Turkey enacts a law banning the use of diesel-powered cars, Renault would

<https://www.italaw.com/sites/default/files/case-documents/ita0184.pdf> (last accessed 02.06.2019).

⁵¹⁰ Grand River Enterprises Six Nations, Ltd and others v United States of America “Grand River”, Award of 12 January 2011, ad hoc, UNCITRAL. <https://www.italaw.com/sites/default/files/case-documents/ita0384.pdf> (last accessed 02.06.2019); Marvin Roy Feldman Karpa v. United Mexico States “Feldman”, Award of 16 December 2002, ICSID Case No. ARB(AF)/99/1. <https://www.italaw.com/sites/default/files/case-documents/ita0319.pdf> (last accessed 02.06.2019); Methanex Corporation and United States of America “Methanex”, Final Award of the Tribunal on Jurisdiction and Merits on 3 August 2005. <https://www.italaw.com/sites/default/files/case-documents/ita0529.pdf> (last accessed 02.06.2019).

⁵¹¹ Viñuales, *Foreign...*, *op. cit.*, 317-318.

⁵¹² *Ibid.*, 319.

be indirectly affected. The production of Renault would still be authorised but its market would be considerably limited. If Renault would like to seek international investment protection, it would be obliged to prove that it was targeted by the measure or it received inferior treatment compared to its uniquely un-leaded gas producer comparators without a valid reason. In this case we would have to determine whether a diesel car producer is in a like-to-like situation with an un-leaded gasoline car producer. The balance shifted to the advantage of gasoline powered cars due to the new technological developments⁵¹³ and as the pollution levels are considerably different thus we could argue that the two producers are not in a like-to-like situation and that there is no discrimination.

To sum up, the host State adopting an environmental measure must first make sure that it is adopting the most business-friendly method and at the same time allowing the host State to achieve the environmental goal it pursues. In other words, it must strike a good balance between the goals it pursues and the rights of the investor. Secondly, it must also make sure that it is not discriminating the foreign investor in question, compared to other business players that are in a like-to-like situation with it. If meeting these conditions prove to be impossible for the host State, then it must be able to provide a justification for the different treatment.⁵¹⁴ Failing to do so is likely to lead to compensation of the investor's losses.

⁵¹³ Gary Fuller, "Pollution watch: petrol, not diesel, is less polluting in the short term", The Guardian 29.03.2018, <https://www.theguardian.com/environment/2018/mar/29/pollutionwatch-petrol-not-diesel-is-less-polluting-in-the-short-term> (last access 08.09.2019).

⁵¹⁴ *Ibid.*, 330.

CONCLUSION

We discussed above how environmental concerns and investment protection clash in a number of cases. In particular, we observed that the host State's efforts to protect its environment are dependent on its inherent right to regulate. On the other side of the conflict lies the concerns of a foreign investor, whose interests are protected by investment treaties. We have seen that several international tribunals and courts have pointed to two limitations on the host State's right to regulate, namely proportionality and non-discrimination. We have also seen that the investor's actions may lead to breach of transnational/international public policy or, in particular, application of the principles of abuse of rights or unclean hands.

Below, we discuss four potential situations involving variations of the two criteria (i.e. proportionality and discrimination), as well as the general principles also cited above, and propose solutions that we consider to be justified in these situations.

1. When the regulation is both proportional and non-discriminatory, there is little that the host State can be criticised for. It definitely has the right to adopt a regulation on environmental concerns. If the State has adopted a *bona fide* general regulation and has observed that its intervention in the sector in question is proportional to the goal it pursues, then the foreign investor cannot argue that its property has been expropriated illegally or that it has not been afforded fair and equitable treatment. Thus, no compensation should be awarded.

A good example for this group of disputes is the *Methanex* case. As discussed above, the State had decided to ban a gasoline additive that led to a considerable loss for the investor. Although the concern of the State was public health, it can similarly be applied to environmental matters. The administration looked into the substance in question and came to the conclusion that a ban would serve the public. Indeed, the investor spent considerable time and money in arguing that the ban was not proportional to the goal sought by the administration. However, the tribunal concluded that it was proportional.

We submit that a similar conclusion should be applied in environment-related disputes as well. A regulation concerning protection of the environment, which (i) is a *bona fide* regulation, (ii) is not targeting a specific investor, and (iii) adopts measures

proportional to the goals it seeks, should not be considered a breach of investment treaty obligations. If the regulation in question misses one of these three criteria, as we will describe under the following situations, then the inevitable conclusion will be that investor's rights under the investment treaty have been violated.

2. It can hardly be disputed that a regulation that is not *bona fide* will be regarded as coming within the scope of the right to regulate. Such an act will first fail the purpose question: if the State is not truthful about its intentions, then it will generally mean that the regulation is not intended to serve a public purpose. In this case, the State will clearly breach its obligations stemming from the investment treaty and the investor will be entitled to recover all of its losses.

3. The question becomes more complicated when it comes to proportionality. As explained in Part 2/II/C/1 this is due to the fact that it would be very difficult to provide scientific certainty as to the necessity of the measure in question, or in fact as to the existence of the need itself. This is precisely the case, for instance, with global warming: despite the overwhelming evidence of the existence of man-made global warming, a considerable number of people argue that it does not exist.⁵¹⁵

Therefore, the battle for the host State is likely to be fought on two fronts. First, it will have to establish that the goal it pursues — such as reducing the carbon footprint of the whole country — is a legitimate one. Then, it will face a more challenging battle: the host State will need to establish that the measure it has adopted is proportional to the goal it pursues. If there is another less interventionist measure that could be taken which could achieve the same result, then the state should be responsible. If the State fails on one of these, then full compensation should be awarded.

4. The non-discriminatory nature of a regulation is rather easier to establish and decide. As explained in Part 2/II/C/2 the crux of the matter is to see if the investor is receiving similar treatment compared to other sector players that are in a similar situation. This not only complies with the case law discussed in Part 2/II/C/2, but also creates a justified solution. If the investor (or its sector) is being singled out despite

⁵¹⁵ For a basic summary of the evidence on the global warming and its reasons, see: https://climate.nasa.gov/evidence/?_sm_au_=isVHPTjFwDWnn25F

the fact that other players (or similar sectors) are similarly damaging the environment without a valid reason, then the host State must compensate the investor for its losses.

In addition to these four situations, the method for rectifying a breach of investment treaty obligations is important. If the host State has not enacted the regulation in good faith, then it must compensate the investor for all its losses, including its lost profits. If, however, the host State is acting in good faith, it should not be required to pay for lost profits. Indeed, in cases where the State has acted to protect the environment, the host State (and eventually the taxpayer) should not be forced to cover the lost profits of the investor. However, it would equally be unfair on the investor to require it to carry all the burden. A just solution seems to be that the investor should be able to recover its costs, so that at least it does not lose money on its project. Or at the least, the tribunal should make a considerable discount over the compensation amount.

If the investor has abused its rights or has come to the investment treaty tribunal with unclean hands, for example by hiring armed militias to threaten the local population opposing the investment project (just like *Copper Mesa* case) then we submit that the investor should not be able to profit from the protections offered by investment treaties. Anything contrary to this solution would be unfair. Even if the tribunal compensates the investor for only part of its loss, the investor will still obtain compensation effectively paid by the taxpayers of the host State. Having the people who were oppressed by the investor compensate the “losses” of the investor, cannot be considered a just solution.

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Ürün Tekin was born in Antalya in 1985. After graduating from Antalya Anadolu Lisesi, she studied at Faculty of Law at Galatasaray University. She has an LL.M. degree in International Dispute Settlement at MIDS (Geneva Master of International Dispute Settlement). She is a registered lawyer at Union of Turkish Bars, and a Certified Anti-Money Laundering Specialist (ACAMS).

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Hazırlayanın Adı Soyadı : Ürün Tekin
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JÜRİ ÜYELERİ

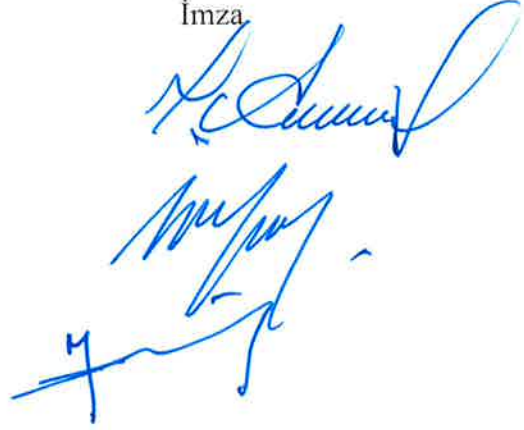
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