‘Investment Arbitration and Environmental Protection: A Critical Look?’

I. Introduction

‘Neither environmental protection nor investment protection is subservient to the other; they must co-exist in a mutually beneficial manner’, recently stated the *Eco Oro v Colombia* tribunal, and whether this constitutes a pragmatic remark or just wishful thinking is the subject matter here. Indeed, reconciling the two core State objectives at hand, namely attracting foreign investment and curbing climate change has been troubling policymakers and tribunals alike, with differing views to date. Upon examining the reasons giving rise to this legal conundrum (**II**), the author will advance some suggestions to establish an equilibrium between the two ostensibly colliding, but arguably synergetic objectives (**III**).

II. The nebulous relationship between investment arbitration and environmental protection

On the face of it, the evolution of international environmental law largely evinces the uneasiness to delineate its dispute resolution trajectory. From piecemeal legislation to combat pollution, preserve endangered species and fragile habitats, environmental regulation has moved forefront to mitigate climate change and promote sustainable development globally. However, the increased momentum to shift from a resource-inefficient and polluting socio-economic model to one with a lower environmental footprint resulted in significant State regulatory change, with States often intervening in investment activities, either directly in environmental markets (e.g., landfilling, energy, emissions-reduction), or in other activities, whose environmental impact is part of the dispute (e.g., tourism, chemicals, water extraction). This reality may lead to a misleading perception where the investor is portrayed as a ruthless, money-driven player whose sole purpose

is to harm the environment, and the State as a protectionist actor who sacrifices foreign investment in the name of sustainability. And even though these two extremes are more of a caricature, tribunals are often asked to resolve the Gordian knot between the two fields. The emerging issues will be classified in two heads: the threshold of environmental coverage in investment agreements (**A**), and the way environmental concerns are handled by investment tribunals (**B**).

A. The 'green economy' objective in international investment agreements

We can roughly distinguish between three varying degrees of environmental coverage within investment agreements. First, we have preambular provisions which refer to environmental protection in general terms as an objective. This is especially the case in pre-2000 signed BITs, which essentially tried to reorient the interpretive role of the preamble into a more balanced approach that required a greater recognition of State rights and responsibilities, even in the presence of investors' rights. This was a modest but welcome change, especially considering the preamble's interpretative weight under Article 31(2) VCLT.

The second line of environmental concerns is more explicit, acknowledging the State's right to regulate, or encompassing exclusions from substantive treaty protections. This came in the aftermath of several claims by investors for breaches of environment-related regulations by States, necessitating some degree of regulatory space for host States. Other investment agreements go even further, culminating in the 2016 Morocco-Nigeria BIT, which was the first to incorporate sustainable development in the definition of 'investment', alongside imposing post-establishment obligations concerning the environment upon investors, as well as in CETA, under which non-discriminatory measures designed to protect legitimate public welfare objectives do not constitute indirect expropriations.

The third line shifts the focus, moving away from the host State and placing certain CSR or ESG standards and guidelines upon the investor during the life of the investment. In these agreements, such standards are usually of soft, non-binding nature (e.g., EU-Korea FTA), with some recent treaties increasing their stringency (e.g., Brazil-Malawi BIT).

B. Environmental matters before investment tribunals

Foreign investment disputes are being increasingly permeated by human rights considerations. Nonetheless, environment-related disputes are peculiar, in that they have no compulsory adjudication system where they can be brought, thereby having to 'borrow' fora devoted to other disputes, such as investment arbitration. Furthermore, the envisaged 'green' transition is expensive, and it often cannot be funded by the public sector alone which made it attractive for investors, leading to the augmentation of environment-related investment disputes. Faced with this, investment tribunals are now frequently asked to decide on such claims by investors (**1**) and host States (**2**).

1. Foreign investor v State

a. Actions taken by States to combat climate change

Traditionally, investment tribunals have considered environmental measures by States suspicious, essentially constituting protectionism in disguise. This is evinced in *Metalclad v Mexico*, where the tribunal seemed sceptical as to the grounds for declaring the land of the investor part of a natural preserve and simply disregarded the purpose behind the measure. In *SD Myers v Canada* the tribunal went further, stating that there was actually no legitimate environmental reason for Canada's actions, with the *Tecmed v Mexico* tribunal underlining that Mexico's measures were political, not environmental. This scepticism is corroborated by the superficial, if

any, coverage of such issues in investment treaties. Nonetheless, with the wording of investment agreements gradually encompassing environmental considerations, as well as with international environmental obligations States undertook, it became clear that tribunals had to reassess their stance and consider the State's regulatory objectives. And the legal vehicle was often the police powers doctrine, used by tribunals to shield both general (*Methanex v USA*) and targeted environmental measures (*Chemtura v Canada*). Of course, such assessment can easily get politicised, especially when it touches upon the investor's legitimate expectations and their alleged frustration, and a recent example is RWE and Uniper's actions against The Netherlands for the latter's coal phase-out legislation.

b. Changes or revocation of State legislative regimes designed to address climate change

The first half of the last decade saw a remarkable surge in foreign investment in new renewable electricity installations, culminating in EU-wide reforms to renewable energy legislation. When governments later altered that legislation, investors instituted several claims under the ECT, with rather inconsistent outcomes. Some tribunals found that, under the sole effects doctrine, the State intent behind a measure was irrelevant, and compensation should be paid if the investment is harmed (*Isolux v Spain*), while others held that legitimate regulatory activity in the public interest does not amount to breach if non-discriminatory, even if it adversely affects investments (*Belenergia v Italy*), thereby being within the 'margin of discretion' of the government's right to regulate (*Antaris v Czech Republic*), which a diligent investor should have anticipated (*Plama v Bulgaria*).

2. State v foreign investor

Even though investment arbitration is often criticised as being one-sided, establishing obligations for States and rights for investors, the field of environmental protection disrupts these dynamics, making investment arbitration a level playing field for States to raise claims against the investors through the back door. The legally conventional way to do this is using the aforementioned arguments as defences, claiming that the environmental measure does not breach State investment law obligations, or that the measure is justified for pursuing a legitimate purpose.

Importantly, the more contemporary way States use to tackle investors' claims is to raise their own counterclaims to seek compensation for the investors' actions vitiating the environment. For a counterclaim to be admitted, it must be connected to the subject-matter of the dispute and to fall within the consent of the parties. But due to the inherent asymmetries in investment treaties, the tricky part is to establish a substantive obligation of the investor to respect environmental regulations of the host State. Respondent States devised two vehicles; first, arguing that the investor is obliged to comply with domestic laws governing environmental protection and, second, that the investor is liable pursuant to directly applicable international environmental law rules. Interestingly, tribunals have oftentimes been open to such arguments. The tribunals in *Burlington v Ecuador* and *Perenco v Ecuador* accepted Ecuador's counterclaims, ordering investors to compensate Ecuador for the costs of restoring the environment, being obliged to comply with Ecuadorian law which provided for strict liability in case of environmental damage. Similarly, in *Aven v Costa Rica*, the tribunal accepted the counterclaim that the works undertaken by the investor caused considerable environmental damage, which it should restore. Finally, even though not strictly an environmental law case, *Urbaser v Argentina* might have ample ramifications here, given that the tribunal held that the investor could, in principle, be bound by international human rights obligations concerning the right to water. It could thus be argued that investors are also

directly subject to obligations arising from international environmental treaties, such as the Paris Agreement, even absent relevant domestic legislation.

III. Time for (climate) change in investment arbitration

The foregoing analysis illustrates two welcome changes. First, investment agreements gradually incorporate environmental considerations, and tribunals are engaging more into policy and legal assessments pertaining to sustainability. Indeed, to bridge the gap between international investment law and environmental protection, the question about the place of environmental law within investment law is important, but the reverse question about the place of investment law within environmental law should also be clarified. To this end, the author argues that more is required:

A. Balancing State regulatory power with environment-related investor obligations

The State's regulatory powers should be accentuated at the very level of BIT drafting, either as a manifestation of the police powers doctrine, or as GATT-like exceptions from substantive treaty provisions. Moreover, it is essential to reformulate BITs to explicitly include sustainability-related performance requirements for investors, such as environmental impact assessments. And to give this argument legal teeth, investment agreements may limit the causes of action that investors have against governments in such a way that investment protection is harmonised with the State interest in protecting its resources.

Reversing the coin, if the investors are to bear such sustainability-related duties, they certainly cannot be passive in the passing of inter-governmental environmental regulations. To this end, private players should be more involved in the process of environmental negotiations, as was the case, for instance, in the Addis Ababa Action Agenda.

B. Advancing environmental interests in the quantum phase

When it comes to investment activities, the strongest driving force for behavioral change is the threat of liability. Thus, even when investment agreements do not expressly bind investors to sustainability-related commitments, they could require tribunals to take into consideration the investor's lack of compliance with its environmental obligations in assessing any compensation for a State violation of its treaty obligations. For example, the India Model BIT directs tribunals to reduce damages to reflect mitigating factors, such as any harm the investor has caused to the environment or local communities. This view was propagated in Philippe Sands' dissent in *Bear Creek v Peru*, arguing that the investor's failure to obtain a 'social license' from the local community should be factored into the calculation of the requested damages.

C. Bringing investor diligence centre-play for a 'green economy' transition

The 'green economy' concept essentially goes beyond the conventional understanding of sustainability. Being 'green' is no longer presented as a matter of responsibility, but as one of profitability in the future economy. From recycling to decarbonisation and renewable energy, investors seem eager to contribute to such profitable projects, but not as eager to comply with the environmental concerns associated with them. Nonetheless, as the *Mafezzini v Spain* tribunal put it, BITs 'are not insurance policies against bad business judgments', and this especially applies to industries heavily relying on State intervention, as are the ones at stake. This is not to exonerate State liability in case of egregious or arbitrary measures but, contrariwise, to accord legal meaning to investor due diligence as a factor to evaluate, for instance, the reasonableness of its risk or impact assessments, or the legitimacy of its expectations.

IV. Conclusion: Failing to prepare means preparing to fail

We are way past the stage when tribunals treated environmental measures as a simple object, the legality of which was to be assessed under investment disciplines. Environmental policies have become an integral part of the global economy; they gradually moved away from a 'cutting trees' rhetoric, and now include complex issues such as renewable energy sources, carbon and climate change policies, many of which constitute investments themselves. As such, all stakeholders, from investors and States to policymakers and tribunals should act pre-emptively and recalibrate the dynamics between foreign investment and environmental protection.