

Public Interests in International Investment Law:

*Balancing Protection for
Investor and Environment*

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By

Qiang Ren

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- Vienna Convention on the Law of Treaties* (concluded on 23 May 1969)

ABSTRACT

This research aims to evaluate the scope of environmental protection in host states against the states' obligations to protect and promote foreign investments, and to identify how the existing international investment treaty practice and dispute settlement practices are insufficient in light of considering the environmental interests of host states in the standards of treatment, including fair and equitable treatment, national treatment, the most-favoured-treatment, and the non-expropriation standard. This research argues that the existing regime of international investment law does not provide an appropriate framework for the protection of host states' environmental interests, especially in the countries with an economic and social transition (like China) where the domestic need for environmental protection is emerging and growing significantly. In contributing to the means through which host states are able to regulate foreign investments without otherwise violating treaty obligations, this research proposes: (1) interpreting investment treaty provisions by introducing more environmental consideration; and (2) rethinking and reshaping the current pro-investor mechanism of international investment law through embracing the provision of broad environmental exceptions.

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PREFACE

This book addresses important questions about foreign investment laws and regulations can support both the economic growth aspirations and the environmental protection concerns of states. International economic law instruments have, over several decades, promoted non-discriminatory approaches which establish a level playing field between international investors *inter se* and, increasingly also between international investors and national companies in certain respects. But in the desire to pursue these goals and to establish the kind of legal regime seen as desirable to help attract foreign investors, other policy issues, including environmental protection have received less attention. Important questions about how those issues are addressed in both international and national foreign investment rules are addressed here, with particular attention to China's legal practices. With increasing attention being paid around the globe, including in China, to ways in which states can regulate both domestic and foreign investors to reduce environmental damage stemming from their activities, this study is very timely.

The tensions between investment protection and state regulation of investors are not new. Foreign investment protection treaties – and customary international law – have long recognised a distinction between the normal, everyday regulation of economic activity by government, and conduct impacting on foreign investors which goes beyond the normal and which is the primary target of both treaty-based and customary restraints.

However, fuelled by economic neo-liberalism since the 1980's, by accelerating globalisation and by the consolidated reach of WTO trade rules and concepts, foreign investment treaties have more and more laid down standards of investment for foreign investors which impinge on host state regulatory power to a far greater degree than in the past. Modern Bilateral Investment Treaties and Investment Promotion and Protection Agreements (collectively international investment agreements, or IIAs) go far beyond laying down a minimum standard of treatment for foreign investors protecting them from egregious misuse of power or blatant discrimination by the host state, or from denial of access to regular legal remedies. Modern agreements incorporate higher standards modelled on

GATT/WTO disciplines, such as national treatment or most-favoured nation treatment, as well as the broader and more loosely-defined 'fair and equitable treatment'. Moreover these standards now often apply not only to investors already located within the host state but also to potential investors, with the basic sovereign right to decide who can operate within a state frequently now displaced or reduced by guaranteed rights of entry to the host state economy.

These moves towards the creation of a 'right of establishment' or 'right to invest' are often accompanied by a culture of challenge to state regulation which imposes burdens on private economic actors – the pursuit of so-called 'regulatory takings' which attempts to call into question any state measures which have the effect of restricting the freedom of investors to operate in particular ways, or which impose additional costs on investors in pursuit of societal goods.

A further trend evident in international foreign investment is a changing geography of home and host state, with increasing volumes and proportions of international investment flowing from developing states to developed states. Thus states which previously looked as home states to international investment rules to protect their own investors when they invested abroad are now often also host states, to an increasing degree. Yet at the same time it is in more developed states that political demand and will to regulate investors is often at its strongest, as developed states seek higher standards of environmental protection, health and safety, consumer and labour protection. While these issues may be fiercely contested in the domestic political arena, there is still, often, a wide regulatory gap between standards in developed states and those which predominate in less developed states. One result is that developed states can now face challenges from foreign investors to their regulatory activities to a much greater degree than in the past.

Moreover, this regulatory gap between developed and developing states is starting to close in some cases so that investors from developed states can now also face high levels of regulation in developing states as their regulations more frequently mirror the policies of more developed states, for example to improve air quality or prevent child labour.

It is within this sometimes fraught legal space, and the interplay between IIAs and domestic regulation, that issues such as environmental protection, protection of public health and conservation of natural resources must be played out and resolved. Appropriate compromises must be struck

between the desires of host states on the one hand to signal to foreign investors their openness and stability and, on the other hand, to remain flexible and responsive to national policy concerns, which may be more or less volatile within the domestic political process.

One weakness in existing foreign investment regime is that a pattern has emerged in which the emphasis has been almost entirely on the protection of investors, with the regulatory rights of states dealt with almost entirely by way of exceptions and carve-outs. Moreover, IIAs typically provide denationalised options for dispute resolution for investors who claim violations of their rights, in turn creating a body of international practice – the rulings and awards of now hundreds of arbitral tribunals interpreting broadly similar provisions of IIAs with frequent reference to common principles and earlier practice. Host states concerned about investor behaviour, on the other hand, must invoke their own domestic laws, regulations and enforcement provisions, yet run the risk, when they do, of international claims by disgruntled investors, as well as the threat of diplomatic representation by the investors' home states. This can have a regulatory chill effect on host states, making them more cautious than is necessary in economic sectors where foreign investors are active, despite the fact that the regulatory space preserved for states under IIAs is often very poorly defined or circumscribed. This in turn can, in theory at least, lead to sub-optimal approaches to regulation, shaped by the risk flowing from legal uncertainty rather than by the genuine substantive policy questions at issue.

This book focusses on these questions. In Chapters Two, Three and Four, Qiang sets out in detail the key concepts in international investment law through which the issues of environmental protection must be mediated: the legitimate expectations of investors, the degree to which different investors or investments will be regarded under law as 'like' investments, and expropriation – the point at which normal regulation is regarded as tipping over into a taking of the investment and the circumstances under which that might be legally justifiable. Qiang offers a thorough review of treaty practice and of the decisions of arbitral awards to show how these concepts have developed and been shaped, and what their limitations are in practice. These three key concepts are also tested in relation to real-life environmental scenarios which are used to fully tease out the implications of one view or another of how they should be interpreted and applied in practice. Whether the discussion is about coal-powered heating boilers in Datong, or the car lottery system used to reduce pollution in Beijing, these real-life examples help Qiang to fully demonstrate not only the

complications involved in law-making in this area, but also the urgency to find robust legal solutions to the regulatory impasses which are often revealed. Also evident, and equally problematic, is the high level of uncertainty which is demonstrated in relation to many of the central points. International investment agreements, above all, need to offer stability and security to foreign investors and host states alike: Qiang demonstrates clearly that on many environmental questions they fail to do so.

In Chapters Five and Six, Qiang turns to China's modern practice in foreign investment treaties and domestic legislation, and the ways in which environmental concerns are addressed (or not addressed) in these provisions. This enables him to build on the problems identified in the earlier chapters to offer proposals for reform. An important conclusion is that given greater activity on environmental protection in the domestic sphere, failure to offer greater clarity on how these provisions mesh with international investment protection provisions will inevitably lead to greater (and more frequently occurring) tensions.

The concerns explored in this book are not new but the evidence and arguments presented here highlight the need for renewed efforts to develop robust solutions. China's emergence as a global economic power adds a new dimension to these debates and, as this book starts to demonstrate, brings a fresh voice to the table. With the much-vaunted Washington consensus coming under increasing strain, and with foreign investment between developing states playing a much larger role in the international economy, there is both an opportunity and a case for legal innovation on foreign investment regulation originating not in the West but in the East. Given the growing presence of China as both source and host of foreign investment and China's increasing focus on environmental matters, it is increasingly clear that China is likely to play an important role in developing and promoting new approaches.

Qiang illustrates how recent foreign investment treaties such as the China-Japan-Korea Trilateral Investment Agreement begin to tease out what a more holistic approach to trade and the environment might look like but stop short of offering a new model which fully integrates environmental concerns into treaty practice. Progress towards a more integrated approach may be inhibited for some time to come by states' reluctance to break with existing practice for fear of being seen as unwelcoming towards inward investment. However this book adds to the growing body of evidence that current legal practice, through persistent uncertainty and ambiguity, fails to serve either economic or environmental interests well. It makes the case

that the time is ripe for new solutions and shows, though this is not its purpose, that China can play a key role in helping to shape such solutions.

Professor Fiona Beveridge, LL.B., M.Phil., FRSA
Pro-Vice-Chancellor
University of Liverpool

LIST OF ABBREVIATIONS

APEC—Asian Pacific Economic Cooperation
ASEAN—Association of Southeast Asian Nations
BIT—Bilateral Investment Treaty
BP—Balance of Payments
CEPA—Closer Economic Partnership Agreement
CFIUS—Committee on Foreign Investment in the United States
CIB—China, India and Brazil
CNOOC—China National Offshore Oil Corporation
CNPC—China National Petroleum Corporation
DA—Dictionary of Accounting
DE—Dictionary of Economics
ESCAP—Economic and Social Commission for Asia and the Pacific
EC—European Commission
EU—European Union
FA—Framework Agreement
FAT—Free Trade Agreement
FDA—US Federal Drug Administration
FDI—Foreign Direct Investment
FET—Fair and Equitable Treatment
FTA—Free Trade Agreement
FTZ—Free Trade Zone
GATS—General Agreements on Trade in Services
GATT—General Agreement on Tariffs and Trade
GDP—Gross Domestic Product
ICSID—International Centre for Settlement of Investment Disputes
IEA—International Energy Agency
IIA—International Investment Agreement
IIF—International Investment Forum
IIL—International Investment Law
IIP—International Investment Position
IISD—Institute for Sustainable Development
IIT—International Investment Treaty
IM—Imperfect markets
IMF—International Monetary Fund
LNS—Liquefied Natural Gas

MAI—Multilateral Agreement on Investment
MFN—Most-Favoured-Nation Treatment
MIT—Multilateral Investment Treaty
MNE—Multinational Enterprise
MOC—Ministry of Commerce of the PRC
NAAEC—North American Agreement on Environmental Co-operation
NAFTA—North American Free Trade Agreement
NGO—Non-government Organization
NPC—National People’s Congress of the PRC
NPCSC—Standing Committee of the National People’s Congress of the People’s Republic of China
NT—National Treatment
OECD—Organization for Economic Co-operation and Development
PI—Portfolio Investment
RIT—Regional Investment Treaty
SC—State Council of the PRC
SDGs—Sustainable Development Goals
SINOPEC—China Petroleum and Chemical Group
SNA—System of National Accounts
SOEs—State Owned Enterprises
TCA—Trade and Economic Cooperation Agreement
TIA—Trilateral Investment Agreement
UNCITRAL—United Nations Commission on International Trade Law
UNCTAD—United Nations Conference on Trade and Development
VAT—Value Added Tax
WENGTP—West to East Natural Gas Transmit Plan
WIR—World Investment Report
WTO—World Trade Organization

CHAPTER I

INTRODUCTION

1. Introduction

The origins of international investment law (IIL) are manifested in customary international law theory,¹ but investment treaty laws have developed continuously with substantial changes since 1959, when the Germany-Pakistan investment treaty was concluded.² A spin-off of these developments is the need to address the public interests of host states (e.g. the environmental interests) to generate a balanced IIL regime (between investors and host states).³ Against such a background, governments, international organizations and researchers have made efforts to preserve the environmental interests of host states in IIL.⁴

¹ Dolzer, R., and Schreuer, C., *Principles of International Investment Law* (Oxford University Press, 2008), 7; Newcombe, A., and Paradell, L., *Law and Practice on Investment Treaties: Standards of Treatment* (Kluwer Law International, 2009), 38.

² Mann, H., “Reconceptualizing International Investment Law: Its Role in Sustainable Development” (2013) *Lewis and Clark Law Review* 17(2): 521.

³ UNCTAD, “Towards a New Generation of International Investment Policies: UNCTAD’S Fresh Approach to Multilateral Investment Policy-making” (2013) IIA Issues Note (5).

⁴ Some recent contribution to environmental protection under the regime of international investment law can be found as follows: Viñuales, J. E., “Foreign Investment and the Environment in International Law: An Ambiguous Relationship” (2009) *British Yearbook of International Law* 80(1): 244; Romson, Å., *Environmental Policy Space and International Investment Law* (Acta Universitatis Stockholmiensis, 2012); Segger, M. C., Gehring, W. M., and Newcombe A., *Sustainable Development in World Investment Law* (Kluwer Law International, 2011); Gordon, K., and Pohl, J., “Environmental Concerns in International Investment Agreements” (2011) OECD Working Papers on International Investment, available at http://www.oecd.org/investment/internationalinvestmentagreements/WP-2011_1.pdf, accessed 12 July 2013; for a summary of international investment cases in

However, the protection and promotion of international investments have been the main features of the current IIL and the provisions stipulating host states' obligations dominate international investment treaties (IITs).⁵ Notwithstanding the fact that the current IIL regime has been designed and construed as a pro-investment regime, the imbalance between international investors/investments and host states, has received critical attention,⁶ partially due to the fact that host states' interests are largely overlooked under this regime.⁷ Environmental interests have been explored in the

which the environmental issues are concerned, please see Bernasconi-Osterwalder, N., and Johnson, L., *International Investment Law and Sustainable Development: Key Cases from 2000-2010* (International Institute for Sustainable Development, 2011).

⁵ Salacuse, J. W., "BIT by BIT: The Growth of Bilateral Investment Treaties and their Impact on Foreign Investment in Developing Countries" (1990) *The International Lawyer* 24(3): 661. ("The movement to conclude BITs has been initiated and driven by Western capital-exporting states. Their primary objective has been to create clear international legal rules and effective enforcement mechanisms to protect investment by their nationals in the territories of foreign states. The essence of this protection is to defend the investment and the investor from exercises of state power by host governments"); Vandeveld, K. J., "Political Economy of a Bilateral Investment Treaty" (1998) *The American Journal of International Law* 92(4): 630. ("BIT protections apply only to foreign investment, the BIT investment protection provisions actually serve to undermine the principle of investment neutrality"); Douglas, Z., "Property, Investment and the Scope of Investment Protection Obligations" in Douglas, Z., Pauwelyn, J. and Vinuales, J. (eds.), *The Foundations of International Investment Law: Bringing Theory into Practice* (Oxford University Press, 2014), 359. ("The substantive obligations of protection in the investment treaty are formulated in terms of a relationship between the conduct of the state and its impact upon an investment or rights closely connected to an investment. If the host state has breached a substantive obligation of protection ... the appropriate reparation is due from the host state.")

⁶ E.g. Barnali argues that if the IITs continue the over-protection of foreign investors, more states will be forced to denounce the current IITs, as Bolivia and Ecuador have done. Barnali, C., "International Investment Law as a Global Public Good" (2013) *Lewis and Clark Law Review* 17(2): 520.

⁷ Bilateral investment treaties (BITs) favour foreign investment and the inequalities brought will make the application of the BITs difficult. Chung, O., "The Lopsided International Investment Law Regime and Its Effect on the Future of Investor-state Arbitration" (2007) *Virginia Journal of International Law* 47: 956; Brower, C. N., and Schill, S. W., "Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?" (2009) *Chicago Journal of International Law* 474-475 ("Criticism of assets that investment treaties and investment-treaty arbitration institutionalize a pro-investor bias that casts the