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International Investment Agreements: Regulatory Chill in the Face of Litigious Heat?

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Abstract

In 1999, the Battle of Seattle dragged International Investment Agreements briefly into the limelight. This moment of notoriety passed quickly, however, and International Investment Agreements (IIAs) have quietly continued to be drafted, signed, and enforced. These agreements have a profound impact on the environmental regulations of countries subject to IIAs, with a pronounced effect on developing countries' regulatory schemes.

This paper explores the impact of IIAs on environmental regulation, using two case studies to suggest that IIAs do indeed prevent some countries from developing or enforcing effective environmental policies.

Keywords

International Investment Agreements, Environmental Regulation

INTERNATIONAL INVESTMENT AGREEMENTS: REGULATORY CHILL IN THE FACE OF LITIGIOUS HEAT?

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INTRODUCTION

International investment agreements (IIAs) govern the relationship between foreign investors and host governments, and are largely dry documents filled with vaguely worded provisions. They appear, at first instance, to have little interest to those not party to the agreements. However, IIAs in fact play a significant role in many countries' public spheres. IIAs govern foreign investments like mines, which have a direct impact on citizens living in the mine's environs. Furthermore, because IIAs contain provisions on how investors and investments must be treated, they also govern, to a certain degree, what laws can be passed in a host country.

Environmental legislation and regulations are laws that must change over time in order to keep pace with scientific and technological developments. Some of these changes can have a significant impact on certain industries. For instance, a law stipulating that pollution emitters curb their emissions by a certain percentage might require these emitters to refit their equipment, likely at considerable cost. The terms of IIAs, however, constrain a government's ability to create legislation that might prejudice an investor. Because environmental legislation cannot be static, there have been several instances where environmental legislation and investors' rights have conflicted, resulting in international arbitration.

This paper focuses on whether IIAs discourage governments from creating or changing environmental legislation. This possible phenomenon is called 'regulatory chill' throughout the paper. It considers the several problems with IIAs as they exist now, investigates two case studies of countries in which IIAs and environmental legislation have come into conflict, and finally looks at possible solutions to the difficulties associated with IIAs. A final consideration of the issues and case studies presented leads to the conclusion that, though it is difficult to prove that IIAs cause regulatory chill, there is a strong common sense inference to be made based on the arguments presented that they do. It should be noted that while there is a body of work that uses economic models and statistical studies to investigate this issue, such analyses lie outside the scope of this article (and of this author's expertise). For that reason, this

* Julia Brown recently completed her third year at Western Law. She wrote "International Investment Agreements" for her Environmental Law class. Julia would like to thank Professor Sara Seck for her inspiring course and for all her guidance and insight in helping craft this article.

article focuses on the laws and arbitration mechanisms governing the drafting and application of IIAs.

I. INTERNATIONAL INVESTMENT AGREEMENTS

The term 'international investment agreement,' or IIA, refers to a broad group of international agreements regulating investor rights. The term encompasses treaties between multiple states, like the North-America Free Trade Agreement, bilateral investment treaties (BITs), which are agreements between two states, and other agreements, like Contracts of Work, that are between specific foreign investors and a state.[1] These last agreements are called foreign investment contracts (FICs).[2]

In most instances, IIAs are drafted based on templates that have been developed in the last few decades. Most countries have template BITs that they use in negotiations with other countries.[3] This means that many of the clauses that appear in IIAs are 'stock clauses' and are included in almost all international investment agreements. These clauses include provisions relating to 'National Treatment', 'Stabilization', 'Most-Favoured Nation', and other issues. These clauses will be discussed further in Part 2.

The Evolution of IIAs

IIAs are designed to protect investors engaged in 'foreign direct investment' (FDI) against having their investments compromised by the actions of the host nation.[4] FDI refers simply to a direct investment by a foreign entity in a host nation; for example, a Canadian mining company creating a uranium mine in Namibia. Foreign direct investment can be lucrative for both investors and for host-states, and many countries go to great lengths to make their nations attractive to foreign investors.[5]

IIAs were developed in response to the wave of expropriation of FDI in socialist countries and countries newly freed from colonial rule following the Second World War.[6] The agreements were meant to protect investors from once again having their investments "directly taken by host governments without compensation, or … closed

[1] Kyla Tienhaara, *The Expropriation of Environmental Governance: Protecting Foreign Investors at the Expense of Public Policy* (Cambridge: Cambridge University Press, 2009) at 115; UNCTAD, "Systemic Issues in International Investment Agreements" *IIA Monitor No 1* (2006), online: <http://www.unctad.org/> [UNCTAD, *Systemic Issues*].
[2] Tienhaara, *supra* note 1 at 115.
[3] *Ibid* at 63.
[4] International Institute for Sustainable Development & World Wildlife Fund, *Private Rights, Public Problems* (Winnipeg: International Institute for Sustainable Development, 2001) online: <http://www.iisd.org/pdf/trade_citizensguide.pdf> [Private Rights].
[5] Tienhaara, *supra* note 1 at 48.
[6] *Ibid* at 41-43.

down [with] their assets stripped in less direct ways."[7] IIAs, at their inception, were used as shields rather than swords, giving investors some measure of security that their investments would not be taken from them in the night.

Two bodies designed to help regulate IIAs have developed since IIAs began to proliferate in the post-war years. The World Bank set up one of these bodies, the International Centre for Settlement of Investment Disputes (ICSID). This body is governed by the ICSID Convention, and it offers dispute settlement arbitration for issues arising under IIAs, as well as guidance on creating and implementing IIAs.[8] Another IIA-oriented body is the United Nations Commission on International Trade Law (UNCITRAL). UNCITRAL was created over forty years ago to help promote trade and development.[9] It offers model laws, legal guides, and other tools meant to help countries and investors create IIAs. UNCITRAL does not provide arbitration services. Together, these two bodies have helped shape IIAs into their standard modern form, and the ICSID has created much of the case law available on international investment arbitration.

IIAs continued to develop in the post-war years, and at the present day, there are over 5,200 IIAs in effect.[10] Many of these IIAs have been entered into by developing countries with developed countries as a means of attracting FDI.[11] This means that IIAs today are often negotiated between parties of unequal bargaining power. Developed countries entering into BITs or treaties with developing countries often use template BITs in the negotiations, with many of the stock clauses being non-negotiable.[12] One might draw the comparison to non-negotiable standard form contracts, except that whereas standard form contracts are to be read in the powerless consumer's favour, BITs are not read in the less-powerful developing country's favour. This imbalance of negotiating power has become even more problematic in the past two decades, as investors have increasingly used BITs not as a shield, but instead as a sword.[13] Claims under IIAs are overwhelming directed against developing countries' governments, with very few filed against developed countries.[14] What's more, not only are the vast

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[7] Private Rights, *supra* note 4.
[8] International Centre for Settlement of Investment Disputes, *About ICSID* (2013) online: About ICSID <http://icsid.worldbank.org/>.
[9] United Nations Commission on International Trade Law, *About UNCITRAL*, online: About UNCITRAL <http://www.uncitral.org/uncitral/en/about_us.html>.
[10] UNCTAD, *Systemic Issues*, *supra* note 1.
[11] Tienhaara, *supra* note 1 at 48.
[12] *Ibid* at 14.
[13] *Ibid* at 54 (on the current use of BITs). It is difficult to determine the number of cases brought to international arbitration under BITs because these hearings are often confidential or unpublished. The number of known treaty-based cases went from five in 1994 to 390 by the end of 2010. See UNCTAD, "Latest Developments in Investor-State Dispute Settlement" (March 2011) *IIA Monitor No 1*, online: United Nations Conference on Trade and Development <http://www.unctad.org/> at 1.
[14] Tienhaara, *supra* note 1 at 15.

majority of claims directed against developing countries, but investors from developing countries have filed only eleven claims against host nations.[15]

In terms of the enforcement of awards made by arbitration tribunals, Gus Van Harten has written that, "the awards of arbitrators are more widely enforceable than any other adjudicative decision in public law."[16] There are at least two routes successful claimants may take in order to have their awards enforced. Firstly, IIAs generally include a clause stipulating that awards must be recognized by a state, and hence a state's courts.[17] This means that awards are enforceable through the losing state's own court system. In one interesting case, *M/S Bremen v Zapata Offshore Co*,[18] the United States Supreme Court enforced an arbitration award despite the fact that the award conflicted with US securities regulations. The court stated in its decision that, "The expansion of American business … will hardly be encouraged if … we insist on a parochial concept that all disputes must be resolved under our laws…"[19] Scholar Robert Wai theorizes that this case, along with *Mitsubishi Motors Corp v Soler-Chrysler Plymouth*, demonstrates the willingness of domestic courts to participate in private international law.[20] Certainly it provides an example of an arbitration award that contravened a country's domestic laws being enforced.

Secondly, if the IIA stipulates that enforcement under the ICSID Convention shall be provided, the successful claimant may use any country that is part of the ICSID Convention's court in order to have the arbitral award enforced.[21] Together, these two options ensure that investors are almost always successful in receiving their awards.[22]

Taken together, the power imbalance involved in the negotiation of IIAs and the preponderance of claims against developing countries suggest that IIAs in their current form create inequitable results—results that are generally complied with. The possibility that IIAs create inequitable results for developing countries will be explored further in the last section of this paper.

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[15] Accurate as of 2005. UNCTAD, "Investor-State Disputes and Policy Implications" *Trade and Development Board* (March 2006) at 4.
[16] Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford: Oxford University Press, 2007) at 5.
[17] Tienhaara, *supra* note 1 at 130.
[18] *M/S Bremen v Zapata Offshore Co*, 407 US 1, 92 S Ct 1907 (United States Supreme Court 1972).
[19] *Ibid* at 9.
[20] *Mitsubishi Motors Corp v Soler-Chrysler Plymouth*, 473 US 614, 105 S Ct 3346 (United States Supreme Court 1985) cited in Robert Wai, "Transnational Liftoff and Juridical Touchdown: The Regulatory Function of Private International Law in an Era of Globalization" (2002) 40 Columbia Journal of Transnational Law 209 at 227.
[21] Tienhaara, *supra* note 1 at 130.
[22] *Ibid.*

II. CURRENT ISSUES WITH INTERNATIONAL INVESTMENT AGREEMENTS[23]

I. Stock Clauses

As suggested above, the use of stock clauses in IIAs can be problematic. The reason lies less with the clauses, and more with the interpretation of these clauses. Take, for example, the stock "National Treatment" clause. This clause stipulates that foreign investors be treated in the same manner as national investors,[24] and is meant to ensure that foreign investors are not discriminated against. However, many 'national treatment' clauses are vaguely worded, and it has been open to tribunals to interpret the clause widely or narrowly. A wide interpretation of the clause would encompass *de facto* discrimination as a breach of the clause, which means that if the government were to act in a manner that resulted in prejudice to a foreign investor, it could be found to have violated this clause even if there were no evidence of intent to discriminate.[25] A narrow interpretation would require evidence of discrimination to find a breach. The discrepancy between the interpretations demonstrates the difficulty faced by host nations under IIAs: they cannot know how an arbitration tribunal will interpret the law. This same problem occurs with other stock clauses used in IIAs, such as the 'Most-Favoured Nation' clause.

A stock clause that is less open to interpretation than the one discussed above is the 'stability clause.' Stability clauses are used to ensure that investors will be guaranteed stability in terms of the laws affecting them—with the result that host countries are limited in their ability to alter current legislation.[26] This is problematic because many IIAs are meant to be in force for extended periods of time, generally around thirty years for FICs.[27] This means that governments could be restricted from altering laws that were appropriate in the 1970s, but which are currently outdated.

In terms of environmental legislation, scientific developments in the past twenty years have altered regulations in most developed countries dramatically. One need only think of the Clean Air Act in the United States, legislation that altered the regulation of sulfur emissions, to see what the possible outcome of keeping 1970s environmental legislation on the books might look like.[28] In countries bound by IIAs, however, should they choose to alter legislation despite the existence of stabilization clauses, they face

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[23] A discussion of possible solutions to these problems follows the case studies.
[24] See e.g. *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States*, 17 December 1992, Can TS 1994 No 2, 32 ILM 289 (entered into force 1 January 1994) at Article 301 [NAFTA].
[25] Tienhaara, *supra* note 1 at 66.
[26] Howard Mann, "Stabilization in investment contracts: Rethinking the context, reformulating the result", *Investment Treaty News* (7 October 2011) online: <http://www.iisd.org/itn/>.
[27] Tienhaara, *supra* note 1 at 116.
[28] Paul G Rogers, "The Clean Air Act of 1970", online: (January/February 1990) Environmental Protection Agency Journal <http://www.epa.gov/aboutepa/history/topics/caa70/11.html>.

potential international arbitration. It is interesting to note that Howard Mann of the International Institute for Sustainable Development (IISD) believes that stabilization clauses would be considered unconstitutional in most developed countries.[29] Their presence in FICs is suggestive of developing countries being placed at a disadvantage in the IIA world.

II. Arbitration Tribunals

Yet another issue with the current IIA models is the presence of clauses stipulating the availability of international dispute resolution to foreign investors. The rationale that led these clauses to be included in IIAs was the fear that courts in developing countries might be biased in favour of their own countries.[30] For this reason, investors wished to avoid domestic court systems, and instead insisted on access to international arbitration, which was held up as a neutral, unbiased forum.

There are, however, several problems with international arbitration tribunals as they now operate. These are: decisions made by the tribunals have no precedential value; there is no right to an appeal; arbitrators are hired on a per-case basis by the parties involved; and arbitrators have little or no expertise in many of the issues they rule on. These issues will be dealt with individually in the order given above.

Precedent is a live issue with arbitration panels. Currently, the interpretations of stock clauses vary greatly, as do interpretations of domestic laws. This is problematic because it creates "high-stakes uncertainty in the evaluation of policy space and litigation risk."[31] Neither claimant nor respondent can ever be certain whether the tribunal will find them to be correct in law, because the law is not clear—a situation that would never be allowed in a domestic court system. Currently there are many instances where neither party can know the law because the law has been interpreted differently in different tribunals.[32]

Giving tribunal decisions precedential value would resolve some of the uncertainty with which international arbitration is presently fraught, but there is still a dilemma: on the one hand, it would be problematic for decisions to be binding because there is currently no way to appeal a tribunal's decision. Giving a poor interpretation of a clause precedential value would not promote more equitable decisions. On the other hand, the current state of interpretation of provisions is such that some certainty might be preferable to the current lack of certainty, even if that certainty came from a poorly

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[29] Mann, *supra* note 26.
[30] Tienhaara, *supra* note 1 at 121.
[31] Gus Van Harten, "Thinking twice about a gold rush: *Pacific Rim v El Salvador*", online: (2010) 23 Columbia Federal Direct Investment Perspectives <http://www.vcc.columbia.edu/content/publication> [Harten, "Thinking Twice"].
[32] *Ibid*.

reasoned decision. One way to resolve this dilemma would be to give litigants the right to appeal tribunal decisions.

The right to appeal: Currently, there are only very limited remedies in place for dissatisfied litigants. Under ICSID, revisions of awards can be requested where new information has come to light, or where the interpretation of the award is problematic.[33] Parties can also seek the annulment of a decision, but only on procedural grounds.[34] There is no mechanism through which parties can seek review of the interpretation of law—a glaring issue, given the inconsistency of arbitration tribunals' interpretations of law, and the possibility that tribunals might be biased in favour of foreign investors (discussed further in Part 4). The lack of an effective appeal mechanism for tribunal decisions is currently a serious issue.

Arbitrators in the present model of international investment arbitration are hired by the parties engaged in litigation. In many arbitration models, each party hires its own arbitrator, and these two appoint a third, who acts as President.[35] Arbitrators are hired by parties, and can be, in a manner of speaking, fired by the same parties. If a party does not like an arbitrator's decision or manner of reaching a decision, there is no reason that the party would use that arbitrator again. If an arbitrator develops a reputation for deciding matters in a certain way (i.e. interpreting vague clauses broadly and in favour of investors), it is likely that investors will seek out that arbitrator. Conversely, should an arbitrator make a decision that is not in the interests of the party that hired him or her, it is unlikely that that arbitrator will be hired by other parties, for fear that the same thing should happen to them.[36] In such a system, it is impossible that arbitrators could be considered as disinterested and free from bias. This is a serious problem in the current arbitration model.

Furthermore, arbitrators hearing international investment disputes are often well-respected international trade lawyers and professors who tend to share an investor-friendly attitude.[37] They do not typically have expertise in public policy. Nevertheless, they are routinely called upon to make determinations with regards to domestic law,

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[33] Tienhaara, *supra* note 1 at 284.
[34] *Ibid*.
[35] *Ibid* at 125.
[36] This situation would be especially irksome to a party given the high ICSID arbitrator fees of $3,000 per day. *Ibid* at 128.
[37] *Ibid* at 143. See e.g. *Pac Rim Cayman LLC v The Republic of El Salvador* (2010) (International Centre for Settlement of Investment Disputes), (Arbitrators: Dr Guido Santiago Tawil, Professor Brigitte Stern, V. V. Veeder Esq), online: <http://icsid.worldbank.org/ICSID/> (This case, discussed in Part 4, can be used as a non-representative example. The arbitrators in *Pac Rim* were: a former trade and commercial lawyer; an academic with a background in international law; and a lawyer/professor specializing in international arbitration).

including environmental policy.[38] Directly and indirectly, these investment law arbitrators affect the manner in which countries legislate and enforce laws.

Conclusion

The issues raised above with regards to stock clauses and arbitration tribunals are important because they inhibit a country's ability to create legislation freely. Rather than being able to create laws based purely on domestic interests like good environmental governance, health, or sustainable development, countries subject to IIAs are forced to consider whether their legislation will contravene the IIA's vague provisions. In most developed countries, governments are less beholden to the pressures of the international community than their developing country counterparts, at least with regards to domestic legislation. While developed countries may be blasted in the international media for 'protectionist' policies from time to time,[39] the international community does not have the same power over them as they do over developing countries. This is because developing countries are often reliant on developed countries for loans through the International Monetary Fund (IMF) or World Bank, for FDI, and for international aid.

It must also be remembered that developing countries are far more likely to face claims under IIAs than developed countries, which makes them better acquainted with the expense, inconvenience, and the impact of an international arbitration tribunal's decision than their developed country counterparts.[40] All these factors would suggest that developing countries are likely to be influenced when drafting legislation by their awareness that the terms in IIAs will hold them to certain external standards.

Creating or changing environmental legislation is especially problematic when faced with the various IIA provisions and their accompanying obligations. This is because best practices for environmental stewardship change over time, and legislation and regulations must be altered to reflect this. Consequently it is unreasonable to expect a country's environmental legislation to remain static. Any changes that inhibit an investor's ability to develop his or her investment, however, might expose governments to the claim of indirect expropriation.[41] Bans on mining are a good example of governments attempting to create legislation to protect the environment that result in

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[38] See e.g. *Metalclad Corporation v United Mexican States* (2000), ICSID Case No ARB (AF)/97/1 (International Centre for Settlement of Investment Disputes).
[39] See e.g. Rod Mickleburgh, "Canada has a place in trans-Pacific free trade zone, Harper maintains," *The Globe and Mail* (25 November 2011), online: The Globe and Mail <http://www.theglobeandmail.com/news/politics/canada-has-a-place-in-trans-pacific-free-trade-zone-harper-maintains/article4201119/> (on the recent controversy surrounding Canada's tariffs on dairy and poultry).
[40] See Part 1 above.
[41] See e.g. *Metalclad*, *supra* note 38.

arbitration, where the ban affects international investors. Terms of IIAs may consequently reduce a government's likelihood to create environmentally protective legislation, causing a regulatory chill.

III. DO IIAS CREATE A REGULATORY CHILL?

The issues raised in Part 2 with regards to the role of arbitration tribunals and the terms of IIAs beg the question, 'Do IIAs create a regulatory chill in countries that are part of these agreements?' The serious economic and policy consequences of being engaged in international arbitration under an IIA suggest a link between investor-focused IIAs and arbitration tribunals, and a corresponding fear in a host country's government to change or implement regulations that might adversely affect these investors. It seems likely that a country that knows it will be dragged into a high-stakes arbitration should it change its environmental regulations would be less likely to make those changes.

However, regulatory chill, though it seems like a logical outcome of investor-focused IIAs, is difficult, if not impossible, to prove. The exercise involves trying to prove the existence of a lack: the lack of regulation. In order to attempt to prove that something has not been done, and that it has not been done for a specific reason (namely the fear of international arbitration), one must look closely at the evidence available, and draw conclusions by inference.

Compiling and organizing the reams of evidence required to make a thorough investigation into an instance of apparent regulatory chill would require extensive resources and time. Such investigations are not feasible for this paper, and instead the focus will be on one case study of regulatory chill that was investigated by Kyla Tienhaara, and on the notorious case of *Pac-Rim v El Salvador*,[42] which will be used to illustrate why countries might choose to avoid arbitration, even at the cost of sacrificing environmental regulation.

Indonesia and its open-pit mines

The Situation

The first case study concerns open-pit mining in Indonesia's protected forests. Indonesia's forests have been at risk for many years due to over-logging and the

[42] *Pac Rim*, *supra* note 37 at para 75.34.

presence of many resource extraction-heavy industries.[43] Open-pit mining is one of these industries which has significant environmental consequences. These consequences can include: disrupting the ecosystem,[44] contaminating rivers and lakes with run-off from the mine,[45] negatively affecting the ecosystems in the rivers and lakes with this contamination,[46] building roads through sensitive areas,[47] etc.

In 1999, after the fall of the New Order Regime,[48] a regime not known for its good governance and sound environmental policies, Indonesia reformed many of its laws, including its environmental protection laws. Under the New Order Regime, mining contracts had been accorded to international investors under contracts-of-work (CoWs).[49] These CoWs determined land rents and other responsibilities owed by the investors to the government, but also gave investors special rights, such as the right to international dispute resolution, conjunctive title, and *lex specialis*.[50] Conjunctive title ensured that investors would be able to continue the project from the exploration through to the extraction phases.[51] *Lex specialis* in the Indonesian CoW context denoted a special agreement in the CoW stipulating that the terms of the CoW superseded any laws that might conflict with the agreement, essentially making the investor immune from changes in Indonesian laws.[52] Consequently, investors were insulated from changes in environmental regulations.

Some of the CoWs gave investors exploration rights (and because of conjunctive title, extraction rights as well) within protected Indonesian forests. In 1999, the new, democratic government implemented law reforms, which included a forestry law that stipulated that no open-pit mining would be allowed in protected forests.[53]

This law, however, conflicted with the CoWs that had been entered into with many international investors under the New Order regime.[54] These investors held

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[43] David Fogarty, "Risks remain despite Indonesian forest moratorium: study", *Reuters* (20 October 2011) online: Reuters <http://www.reuters.com/article/2011/10/30/us-indonesia-climate-moratorium-idUSTRE79T0OR20111030>.
[44] Tienhaara, *supra* note 1 at 218.
[45] "Behind Gold's Glitter: Torn Lands and Pointed Questions", *The New York Times* (14 June 2010) online: The New York Times <http://www.nytimes.com/2005/10/24/international/24GOLD.html>.
[46] *Ibid*.
[47] Tienhaara, *supra* note 1 at 218.
[48] Paul Jepson et al, "The End for Indonesia's Lowland Forests?" (2001) 292:5518 Science 859 at 859.
[49] Tienhaara, *supra* note 1 at 218.
[50] *Ibid.*
[51] *Ibid* at 219.
[52] Danièle Barberis, *Negotiating Mining Agreements: Past, Present and Future Trends* (The Hague: Kluwer Law International 1998) at 47.
[53] Law no. 41 Year 1999 *Stipulation to the Act on Forestry*, online: Environmental Law Alliance Worldwide <http://www.elaw.org/node/2644>.
[54] Tienhaara estimates that the conflict with the CoWs affected over 150 companies. Tienhaara, *supra* note 1 at 219.

exploration rights in the protected forests.[55] The terms of these CoWs had stated that investors would be insulated from changes to the law; consequently, investors initially continued their exploration and developments as if nothing had changed.[56] However, public outcry led the government to stop issuing permits for work in protected areas, essentially ending open-pit mining in protected forests.[57] Investors responded by threatening the government with international arbitration.[58]

The threat of international arbitration must be taken seriously by host countries. Not only are the costs of arbitration prohibitive and far beyond the resources of many developing nations, but host nations must also consider whether being taken to an international arbitration will make them less attractive to other foreign investors. For Indonesia in 1999, a country whose government had just collapsed and been reformed, and which was struggling with a relatively weak economy reliant on extraction industries,[59] the fear of investor-flight cannot be discounted.

Indonesia's government did not choose to face arbitration. Instead, in 2002 the Indonesian government set about making exceptions to its Forestry Law 1994/41, giving twenty-two companies the right to continue with their open-pit mine plans in protected forest areas.[60] This number was eventually whittled down to thirteen companies, and another law was passed stating that these companies would not operate under the habitual forestry laws, but instead would operate under a special decree from the Ministry of Forestry.[61] The coming into force of this law was accompanied by allegations that government officials had been bribed to pass the law.[62]

Whether or not the mining companies would have won at arbitration, had the Indonesian government resisted, is, in many ways, a moot point. The cost of entering into arbitration, the fear of losing and having to pay compensation and costs, combined with the reluctance to scare away other investors, makes arbitration an unattractive option for governments. When considering what the best alternative is in the face of

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[55] Kyla Tienhaara, "What You Don't Know Can Hurt You: Investor-State Disputes and the Protection of the Environment in Developing Countries" (2006) 6:4 Global Environmental Politics 73 at 89 [Tienhaara, "What You Don't Know"].
[56] Tienhaara, *supra* note 1 at 219.
[57] Tienhaara, "What You Don't Know," *supra* note 55 at 89. Protests against mining operations continue. See e.g. JATAM's, an Indonesian NGO focusing on resource extraction, article on the environment and human rights: "JATAM condemns the violence at a proposed Australian-owned iron mine" *JATAM* (23 October 2009) online <http://english.jatam.org/content/view/119/11/>.
[58] Siti Maimunah, "Mining Companies Invade Indonesia", (2002) online: Friends of the Earth International <http://foei.org/en/resources/link/101/e1011415.html>.
[59] This was, after all, very soon after the Asian Financial Crisis of 1997.
[60] Tienhaara, *supra* note 1 at 222.
[61] *Ibid* at 223.
[62] *Ibid* at 224; Fitri Wulandari, "Lawmakers Smell Fishy Deal behind Mining Regulation", *The Jakarta Post* (24 July 2004) online: The Jakarta Post <http://www.thejakartapost.com/news/2004/07/24/lawmakers-smell-fishy-deal-behind-mining-regulation.html>.

angry, litigious investors with deep pockets, it is a bold and self-assured government that chooses not to settle and/or amend its laws.

After Indonesia passed the law allowing certain companies to continue with their extraction plans, a group of NGOs challenged the law and took it to the Constitutional Court for judicial review.[63] Interestingly, although the court concluded, as one would expect, that the government was permitted to legislate as it saw fit, the court's president was reported to have added that the court understood and sympathized with the government's "overriding need to improve the investment climate in the mining sector."[64] Although the government's attitude towards fostering a welcoming investment climate might not be unexpected, to have the president of the court acknowledge 'investment climate' as a factor to be considered is surprising.

Analysis

Indonesia's choice to make exceptions to a law that offered protection to one of its most valuable and environmentally significant resources cannot be attributed solely to the government's fear of international arbitration. Other considerations, such as sources of revenue and employment, undoubtedly came into play as well.[65] However, the question remains: had the CoWs not included international arbitration clauses, would the government have been motivated to re-work its legislation in order to give effect to the terms of the CoWs? After all, why should the government have felt bound to honour the terms of the CoWs? The contracts were put in place under an authoritarian regime with no moral authority in the newly democratic country—a regime that did not care to be a proper custodian of its resources, as evidenced by the free manner in which it gave away CoWs for open-pit mining in environmentally significant forests.

It seems plausible that had the government known that their new forestry law was going to be challenged only in their domestic court system, they might have chosen

[63] Tienhaara, *supra* note 1 at 223.

[64] "The law in the mining sector", *The Jakarta Post* (11 July 2005) online: The Jakarta Post <http://www.thejakartapost.com/news/2005/07/11/law-mining-sector.html/>.

[65] This is evidenced by the ongoing tensions between large-scale open-pit mines, the government, and human rights/environmental groups. Take, for example, the notorious PT Freeport Grasberg Mine, a gold and copper mine located in the Papua province of Indonesia. The Indonesian Department of the Environment has repeatedly asked the mine to clean up its operations (one example of an order issued: stop dumping tailings into the lake), but has not enforced its requests. Furthermore, the government has in fact stationed an army post at the mine-site in order to protect the mine operations from local opposition groups. The government, judging by these facts, has an ambivalent relationship with the mine, disliking its pollution, but unwilling to alienate its parent companies for fear of losing a valuable source of revenue. For more information, see WALHI, *The Environmental Impacts of Freeport-Rio Tinto's Copper and Gold Mining Operation in Papua* (2006) online: <http://www.walhi.or.id/en/>.

to act differently than they did. The stakes in international arbitration are much higher than in a domestic court: not only is there likely to be less international publicity, but the cost to the host nation is lower as well. Perhaps for this reason, Indonesia passed a new law on mining in 2008, which stipulates that foreign investors have to apply for and be granted licences, rather than CoWs, in order to mine, and that legal action will occur only through the domestic court system.[66] It remains to be seen whether the change will result in less mining in protected forests.

Conclusion

Although there appear to have been several factors at play in Indonesia's decision to allow some open-pit mining in its protected forests, it is clear that the threat of international arbitration played a part in this decision. As argued above, the threat of arbitration is not a threat to be taken lightly by a new government with a fragile economy. In this instance, the threat was effective, and the government moved away from its environmentally sensitive laws in order to give effect to investors' CoW.

Pac Rim Cayman LLC v The Republic of El Salvador: Why Nations Might Wish to Avoid Arbitration

The Situation

El Salvador is a small, densely populated country in Central America.[67] It has limited water resources, and it is reported that up to 95% of the water sources are contaminated.[68]

Pacific Rim (a.k.a. Pac Rim), a mining company based in Canada, acquired an exploration permit from the Salvadoran government in 2002.[69] In El Salvador, there is a two-step permitting process, which requires companies to get an exploration permit, and then later to apply for an extraction permit. Receiving an exploration permit does not guarantee that a company will be permitted to continue with their project through to the

[66] Tienhaara, *supra* note 1 at 226.
[67] Central Intelligence Agency, *The World Factbook* (updated 15 November 2011), online: Central Intelligence Agency <https://www.cia.gov/library/publications/the-world-factbook/geos/es.html>.
[68] R Steiner, "El Salvador: gold, guns, and choice," *Report for the International Union for the Conservation of Nature and the Commission on Environmental, Economic, and Social Policy* (February 2010) at 5.
[69] *El Dorado Case (Pac Rim Cayman LLC v Republic of El Salvador)*, "Notice of Arbitration, *Pac Rim Cayman LLC v Republic of El Salvador*," (30 April 2009) at para 8, online: <http://www.pacrim-mining.com/i/pdf/2009-04-30_CAFTAF.pdf>.

extraction phase.[70] In order to be given a permit for extraction, a company must submit an Environmental Impact Assessment (EIA) and a financial feasibility report.[71] Pac Rim, after exploring with a legitimate permit, applied in 2004 for an extraction permit for its El Dorado site. Pac Rim intended to create a large, underground gold mine at this site.[72] The proposed mine was close to the capital of the Cabanas region, and close to the Rio Lempa, El Salvador's largest river.[73] Pac Rim intended to use "water-intensive cyanide ore processing" to extract the gold from this site.[74]

Pac Rim submitted its EIA in 2005, and was asked to address several issues.[75] Pac Rim reworked the EIA, and it was put forward in the local community for public consultation.[76] This resulted in more questions concerning the EIA, which Pac Rim claims to have answered,[77] though local groups and an independent scientist hired by them found that the EIA lacked detail with regards to the use and probable contamination of water.[78]

Local groups were concerned about the use of cyanide so close to one of the few water sources in El Salvador.[79] They organized themselves and pressured the government not to approve the mine on environmental and health grounds.[80] The government responded at first by delaying its response to Pac Rim, and finally, in 2008, by issuing a freeze on the approval of all pending mining permits.[81] The government's freeze was motivated by the wish to allow itself time to create new mining legislation and to do an environmental study of the whole country, in order better to understand the possible effects of mining on the environment.[82]

The Legal Issue

Even before the government had come to this decision in 2008, Pac Rim appears to have had international arbitration in mind: in December 2007, Pac Rim re-incorporated one of its subsidiaries based in the Cayman Islands as a Nevada

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[70] *Pac Rim*, *supra* note 37 at para 75(34).
[71] Public Citizen, "CAFTA Investor Rights Undermining Democracy and the Environment: Pacific Rim Mining Case" (25 May 2010) online: Public Citizen <www.citizen.org/documents/Pacific_Rim_Backgrounder1.pdf>.
[72] *Pac-Rim*, *supra* note 37 at para 75(35).
[73] Public Citizen, *supra* note 71 at 1.
[74] *Ibid*.
[75] *Pac Rim*, *supra* note 37 at para 75(58).
[76] *Ibid* at para 60.
[77] *Ibid* at para 61.
[78] Public Citizen, *supra* note 71 at 2.
[79] *Ibid* at 2.
[80] *Ibid*.
[81] *Pac Rim*, *supra* note 37 at paras 75(73-75).
[82] *Ibid* at para 75(78).

corporation.[83] Pac Rim is a Canadian company, and as Canada is not a party to the CAFTA-DR trade agreement (CAFTA),[84] Pac Rim had to move part of its company to the United States in order to be able to rely on the agreement. Although domestic Salvadoran mining law has provisions like those discussed in Part 2 that stipulate that foreign investors receive the best treatment and not have their investments expropriated, these Salvadoran laws are enforceable only through Salvadoran courts. Pac Rim, having expressed a distinct lack of respect for the Salvadoran President at the time, President Saca,[85] was not eager to wade into a legal battle with the judicial branch of the Salvadoran executive. Instead, it chose to make CAFTA, with its international arbitration clause,[86] available to itself.

Under CAFTA, investors are entitled to international arbitration, and to other established protections under IIAs. In December 2008, Pac Rim availed itself of its option to take the Salvadoran government to international arbitration, and filed a Notice of Intent.[87]

Pac Rim's Notice of Intent named several CAFTA articles that it claims El Salvador has breached:

(i) Article 10.3 – National Treatment
(ii) Article 10.4 – Most-Favoured Nation Treatment
(iii) Article 10.5 – Minimum Standard of Treatment
(iv) Article 10.7 – Expropriation and Compensation
(v) Article 10.16.1(b)(i)(B) – Investment Authorization[88]

Pac Rim claims that the Salvadoran government discriminated against it, because other industries with similar environmental impacts, like "power plants, dams, ports, and fishing operations" received environmental permits at the same time that Pac Rim was denied one.[89] Pac Rim is claiming that because of El Salvador's breaches, it

[83] Public Citizen, *supra* note 71 at 3.
[84] CAFTA-DR stands for Dominican Republic-Central America-United States Free Trade Agreement, but it is commonly referred to as CAFTA. The parties entered into the agreement between 2006 and 2009, when Costa Rica was the last country to join. *Dominican Republic-Central America-United States Free Trade Agreement Between the Government of Costa Rica, the Government of El Salvador, the Government of Guatemala, the Government of Honduras, the Government of Nicaragua and the Government of Dominican Republic,* 5 August 2004, Washington, DC, online: http://www.ustr.gov/trade-agreements/free-trade-agreements/cafta-dr-dominican-republic-central-america-fta/final-text [CAFTA].
[85] *See* Pac Rim's Statement of Claim, reproduced in *Pac Rim*, *supra* note 37 at paras 75(76-77), which expresses incredulity at the President's new 'policy' [sic].
[86] CAFTA, *supra* note 84 Article 10.17.
[87] Public Citizen, *supra* note 71 at 3.
[88] *Pac Rim*, *supra* note 37 at para 16.
[89] *Ibid* at para 221. It is interesting to note that these 'industries' are in fact mostly providers of necessities like power, rather than pure economic pursuits like mining.

has lost hundreds of millions of dollars in lost profits, as well as investment expenses of $77 million, plus interest.[90]

El Salvador has responded to Pac Rim's claims by vehemently denying that it has breached any of its obligations to Pac Rim, and by stating that Pac Rim has misrepresented El Salvador's mining laws and regulations.[91] It has also hired an American law firm, Dewey & LeBoeuf of Washington, DC, to represent it.[92] In response to Pac Rim's Notice of Intent, El Salvador made preliminary objections to the international arbitration panel hearing the matter, composed of three members from the ICSID. It essentially asked for what would be called a 'directed verdict' in a criminal trial, in which the defence puts forward a motion after hearing the Crown's case, alleging that insufficient evidence has been put forward to prove the Crown's case beyond a reasonable doubt. This motion was rejected by the panel, which stated that although it was not prepared to weigh evidence at a preliminary hearing, Pac Rim had put forward sufficient evidence to make a prima facie case.[93]

The hearing of the case has not yet occurred.

Cost

In total, El Salvador had five lawyers from El Salvador and eight lawyers from Dewey & Le Boeuf representing it at the hearing for the preliminary objection from May 31, 2010 to June 1, 2010. Pac Rim had six lawyers.[94] Thus far, there have been approximately thirty exchanges with regards to documents, jurisdictional issues, amicus curiae and other issues, as well as four days of oral hearings.[95] Although no award for costs has yet been made (the tribunal chose not to award costs for the preliminary objections hearing), one can only imagine how high the legal fees for the dispute are at this point, although the hearing of the matter has not yet been held.

Furthermore, should Pac Rim be successful in the matter, and be awarded damages for its expenditures in El Salvador, it is likely that other mining companies in similar situations to Pac Rim's might be encouraged to take El Salvador to the tribunal. Already there is one other CAFTA claim being brought against El Salvador, by the Commerce Group Corporation.[96]

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[90] *Ibid* at para 19.
[91] *Ibid* at paras 20 and 125.
[92] International Centre for Settlement of Investor Disputes, "Case Details", online: <http://icsid.worldbank.org/ICSID/FrontServlet> [ICSID, "Case Details"].
[93] *Pac Rim*, *supra* note 37 at paras 244-254.
[94] *Ibid* at para 46.
[95] ICSID, "Case Details", *supra* note 92.
[96] Harten, "Thinking Twice", *supra* note 31.

Analysis

Up to this point, El Salvador has stood by its commitment to investigate the environmental consequences of mining before awarding any new mining permits. Given the country's density of population and scarcity of drinking water, this would seem to be the responsible course for the government to take. However, the government faces enormous pressure from mining investors to change its policy, and allow them to proceed from the exploration to the extraction phase.

El Salvador faces all the same pressures that Indonesia faced concerning its forest protection laws: it must worry about being branded 'anti-investor,' as well as scaring away FDI dollars. The case has, after all, garnered widespread media attention, alerting all and sundry that El Salvador is reconsidering its environmental policies.[97]

The cost of the dispute, however, goes beyond the costs of litigation and the cost to El Salvador's reputation with investors: several anti-mining activists have been killed in El Salvador since the beginning of the dispute.[98] Although local police have decided that these deaths are not linked with the activists' activities, attributing them instead to local gangs,[99] the coincidence of these deaths is troubling.

The stakes for El Salvador in this dispute between investors and environmental policy are extremely high, and a great deal depends on the arbitration panel's decision. As discussed in Part 2 above, arbitration panels are composed of arbitrators hired by the parties to the dispute, who are often experts in investment law. As argued in Part 2, such panels do not have the requisite expertise to make decisions with profound impacts on domestic law. In El Salvador's case, it is facing the possibility of a decision which holds Salvadoran laws to be illegitimate because they come into conflict with El Salvador's duties under an IIA. This would be a very difficult and disappointing outcome, especially given the fact that the impugned policy decision is one that was made due to public outcry, and which is aimed at protecting natural resources and developing a sustainable development plan.

Conclusion

El Salvador's situation is one that would make any country wary of creating legislation or regulations that might be held to breach an obligation under an IIA. Not only are the costs of arbitration very high and difficult to justify in an impoverished nation, but there is also the fear of gaining a reputation for being 'unfriendly' to investors to be considered. Though El Salvador has taken a bold stance and has decided

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[97] *See* Randal C Archibold, "First a Gold Rush, Then the Lawyers," *The New York Times* (25 June 2011) online: The New York Times <http://www.nytimes.com/2011/06/26/world/americas/26mine.html>.
[98] *Ibid*; Public Citizen, *supra* note 71 at 3.
[99] Archibold, *supra* note 97.

to defend its mining policies from Pac Rim's claims, it is to be imagined that other countries in like circumstances might choose to settle the matter, or to change the impugned laws in order to avoid arbitration.

Opening one's domestic laws to arbitral review by inexpert arbitrators carries substantial risk. A country faces the possibility of finding their democratically, legitimately passed laws impugned in an international forum, with no chance for an appeal. What's more, given the investor-favouring bias discussed in Part 2, a country cannot even face this review confident that its laws will be considered fairly and neutrally. It must be concluded that the only reason to expose one's laws to such critique is if there are no better alternatives available.

Conclusion on Regulatory Chill

While regulatory chill is a difficult concept to prove, the two case studies above illustrate: a) a circumstance where threat of arbitration was likely a factor in a country's choice not to enforce environmentally sensitive legislation, and b) a circumstance in which a country has decided to stand by its environmental policy with regards to mining, and is now facing serious consequences. These case studies suggest that countries' governments are sensitive to the difficulties encompassed by a threat to arbitrate. Developing countries' governments would likely have a heightened sensitivity to this threat and what it entails, not only because they are more economically vulnerable than developed countries, but also because they have had far more cases brought against them than developed countries have.[100]

This awareness of the high stakes and poor chances of winning with international arbitration, coupled with the fear of scaring away FDI dollars by being involved in international investment arbitration, must impact the manner in which countries, especially developing countries, draft their laws and regulations. The pressures that are brought to bear on governments faced with a claim that they have breached an IIA are numerous. There is a government's reputation on the world stage, its relationship with international organizations like the World Bank, and its relationship with its investors—not to mention its relationship with its citizens. Legislation is not passed in a vacuum, and legislators are not immune to external pressure. This can cause environmentally sensitive decisions to be made, as in the Pac Rim case, and it can also cause governments to be wary when drafting environmental legislation likely to impact foreign investors, as in Indonesia.

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[100] See Part 2 above.

PART 4: HOW CAN IIAS BE IMPROVED?

Part 2 above discussed the various issues posed by IIAs: they constrain a nation's ability to regulate the environment, they undermine a nation's sovereignty by exposing legitimately passed legislation to review by arbitration tribunals, and whereas formerly IIAs were employed as a shield to protect investors from illegitimate expropriation, they are now used as a sword to impugn laws that affect them negatively. Furthermore, the arbitration tribunals used to hear international investment disputes are composed of arbitrators hired by the parties to the dispute, they are hired on a per-case basis, they have power to rule on domestic laws despite their lack of expertise beyond investments, and their decisions have no binding precedential value.

Several academics have considered ways in which IIAs could be improved. Their suggestions range from altering the composition of the tribunals to changing the terms of the IIAs themselves. Several different ideas will be analysed, after which the question "Should arbitration be improved?" will be considered.

Improving International Investment Agreements

Stock Clauses

Among critics of IIAs, there is seemingly universal agreement that vague provisions, such as "Minimum Standard of Treatment" clauses, should be altered. Model agreements either provide clarification of these terms[101] or omit them completely, opting instead for a re-shaping of commitments and responsibilities under IIAs.[102]

The International Institute for Sustainable Development (IISD) has developed a model IIA, one that retains many features of current IIAs, with some interesting additions. The IISD model suggests a framework for state-to-state IIAs like BITS. This model includes the common clauses that have proved to be so problematic to interpret consistently, but with expanded definitions. For instance, the clause dealing with National Treatment, instead of being two scant clauses without any definitions, as in CAFTA, is several clauses long. [103] The IISD model carefully lays out specific investor rights.[104] The IISD model's commentary states that it is essential for parties carefully to

[101] See e.g. Howard Mann et al, *Model International Agreement on Investment for Sustainable Development* (April 2005), online: International Institute for Sustainable Development <www.iisd.org/investment/model_agreement.asp> [IISD Model].
[102] See e.g. International Bar Association, *Model Mining Development Agreement Project* (2011) online: <http://www.mmdaproject.org/> [MMDA Model].
[103] CAFTA, *supra* note 84 at Article 3.2.
[104] IISD Model, *supra* note 101 at 12.

lay out exactly what an investor's rights consist of in terms of national treatment, because although it has often been assumed that the national treatment clause means that investors have the same rights as nationals, this is not in fact the case.[105] Clearly stating exactly what an investor's rights consist of may help to avoid litigation by removing the vagueness that some investors have been able to exploit.

The IISD model is interesting in that it lays out investors' responsibilities alongside state responsibilities to investors. For instance, Article 12 of the model IIA stipulates that investors must conduct environmental and social impact assessments to domestic or international standards, whichever is highest.[106] Although many of the investor obligations detailed in the model IIA exist already under host nations' laws, having the clauses in the IIA itself would likely impact the manner in which arbitration tribunals interpreted the weight of those obligations.

The Model Mining Development Agreement Project also offers an interesting model IIA, this one mining-specific and providing a framework for investor-state agreements like FICs. This model IIA was created by the Mining Law Committee of the International Bar Association, which invited Howard Mann of the IISD to help in its drafting.[107] This model agreement is quite different from the IISD's: it omits the stock clauses that have proved so problematic, and instead incorporates the necessary protections for investors in various parts of the agreement, as well as in a brief 'Company Rights' section.[108] The 'Company Obligations' section is much longer than the 'Company Rights' section, and includes provisions relating to community health, labour standards, local development, and several other matters.[109]

The MMDA model IIA is a promising document, not only in terms of the progressiveness and thoroughness of its terms, but also in terms of the authors of the agreement. Not only was Howard Mann of the IISD involved, his involvement was sought by a group of mining lawyers who were clearly seeking a better alternative to the problematic IIAs currently in existence. After all, the IIAs used now cost the investors as well as the host states significant amounts of money for litigation—litigation which could potentially be avoided by more equitable and clearly laid out obligations on the part of both the state and the investor. The MMDA model seeks to clarify obligations and rights, as well as create a better balance between the rights of states versus investors.

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[105] *Ibid* at 13.
[106] *Ibid* at 21-22.
[107] Investment Treaty News, "The IBA's Model Mining Development Agreement: A new paradigm for natural resource projects" September 23, 2010 International Institute for Sustainable Development, online: <http://www.iisd.org/itn/>.
[108] MMDA Model, *supra* note 102 at Article 19.
[109] *Ibid* at Article 20-27.

International Arbitration

Both the IISD and the MMDA model IIAs provide for international arbitration.[110] While the MMDA model gives investors the right to arbitration through the ICSID, the IISD model envisions a very different international arbitration model, one that is transparent and that has limited powers.[111] Its vision of an international arbitration forum is one completely separate from the ICSID, one in which arbitrators are placed on hearings in which they have no stake, on a lottery basis.[112] In this model, circumstances are fostered for arbitrators that allow them to be unbiased in their decisions. It outlines an arbitration process in which litigants can be assured of transparency, accountability and consistency.[113]

Arbitrators

Any effort to reform international arbitration must include changes to the arbitrators who make up the arbitration tribunals. The current model of arbitration is somewhat perverse, in that it gives non-independent arbitrators the power to rule on aspects of domestic law that most countries' judges would not feel themselves able to comment on. As an illustration: judges in Canada are bound by precedent to defer to parliamentary intent, except where a law conflicts with the Charter. The reason for this is that Parliament is a democratically elected body with the power to make public policy decisions and to create legislation furthering these policy decisions. Judges, on the other hand, are not in a position to be creating public policy, as they lack the expertise and the legitimacy to do so. A Canadian court would be loathe to state that a law was invalid or illegitimate simply because it conflicted with the government's contractual obligations to a corporation.

Arbitration tribunals are not required to defer to legislation in at all the same way, which means that they are able to rule on domestic public policy in a way that a country's court would likely find highly improper. An article in The New York Times explained arbitrators' power this way: "the way a small group of international tribunals handles disputes between investors and foreign governments has led to national laws being revoked, justice systems questioned and environmental regulations

[110] *Ibid* at Article 32.2; IISD Model, *supra* note 101 at Article 45.
[111] IISD Model, *supra* note 101 at 46.
[112] *Ibid* at Article 40.
[113] *Ibid* at Article 40 Commentary.

challenged."[114] To think that the arbitrators making decisions with such widespread importance are not subject to the usual basic safeguards used to prevent bias in courts is astonishing. Arbitrators cannot be said to be independent, as discussed in Part 2 above. If arbitrators are to remain part of the dispute resolution process for international investment disputes, certain basic changes must be made.

In order that arbitrators may be unbiased, they must be appointed for fixed terms, with fixed salaries, and must be placed on panels for hearings in which they have no stake.[115] The pool of arbitrators must also be composed of arbitrators from a greater diversity of countries. Tienhaara notes in her book *The Expropriation of Environmental Governance* that there are a "disproportionate number of investor-state arbitrators from the US, UK, France, Switzerland and Canada."[116] Randal C Archibold points out in his article "First the Gold Rush, Then the Lawyers" that in the ICSID "Latin American governments make up 9 percent of the court's 155 members but about 55 percent of the cases, according to the Institute for Policy Studies, a left-leaning research group in Washington."[117] Such a composition cannot be expected to result in fair outcomes for all parties, and indeed a working paper from Tufts University suggests that there may be a bias against developing countries in investment-treaty arbitration.[118] Clearly, for equitable outcomes to exist, a more representative body of arbitrators must be created.

Precedent

Another issue discussed earlier in the paper was the issue of precedent. Currently, arbitration tribunal decisions do not have precedential value. This means that neither states nor investors can ever be sure what to expect from tribunals. In a scheme of reforms for IIAs, it would be necessary for tribunal decisions to be accorded precedential value.

However, according precedential value to tribunal decisions raises the stakes for tribunals to get their interpretation of the laws 'right.' A poor interpretation of a clause would cause many problems for future litigants. Consequently, establishing precedential value for arbitration tribunal decisions would require another change to IIAs: the right

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[114] Anthony DePalma, "Nafta's Powerful Little Secret; Obscure Tribunals Settle Disputes, but Go Too Far, Critics Say" *The New York Times* (11 March 2001), online: The New York Times <http://www.nytimes.com/2001/03/11/business/nafta-s-powerful-little-secret-obscure-tribunals-settle-disputes-but-go-too-far.html>.
[115] See Harten, "Thinking Twice", *supra* note 31.
[116] Tienhaara, *supra* note 1 at 144.
[117] Archibold, *supra* note 97.
[118] Kevin P Gallagher and Elen Shrestha, "Investment Treaty Arbitration and Developing Countries: A Re-Appraisal" (May 2011) [unpublished working paper from Tufts University] online: <http://www.ase.tufts.edu/gdae/>.

to appeal. This right would, in theory, serve as a safeguard against inequitable precedents.

Appeal

In order to create more equitable IIAs, an appellate body would be essential. Parties must have the ability to challenge a tribunal's interpretation of the law, especially if that interpretation had binding precedential value, as it has been argued it ought. The right to appeal is a basic safeguard that prevents poorly-reasoned decisions from standing and ensures that litigants have recourse to a remedy where a decision has been inequitable. It also encourages lower bodies clearly to account for their decisions with well thought-out written decisions. If no other change were to be made to the IIA arbitration process, this change alone would make the process more fair and transparent.

Should Arbitration Be Improved?

While the various improvements to IIAs listed above would no doubt create more equity for developing countries and countries wishing to improve and change their environmental regulations, the question remains, should arbitration be improved? IIAs and international investment arbitration at the present time are problematic and lead to inequitable outcomes. In part for these reasons, several countries have chosen to do away with the international arbitration clauses in their IIAs.

These countries include Australia[119] and Argentina.[120] Bolivia has recently withdrawn from the ICSID Convention, with the Bolivian trade ambassador suggesting that "ICSID arbitration is expensive and biased against developing countries."[121] Ecuador has terminated several BITs, including its BIT with the United States.[122] It has also, quite radically, changed its constitution so that it is "now unconstitutional for the country to submit to arbitration unless it is with a Latin American citizen and in a Latin American forum."[123] It is likely that the motivation for this dramatic change was that Ecuador was frustrated with having to submit its laws and decisions to an investor-friendly arbitration panel for review.

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[119] Kyla Tienhaara and Patricia Ranald, "Australia's rejection of investor-state dispute settlement: Four potential contributing factors", *Investment Treaty News* (12 July 2011) online: <http://www.iisd.org/itn/>.
[120] Tienhaara, *supra* note 1 at 279.
[121] *Ibid* at 280.
[122] *Ibid*.
[123] *Ibid* at 281.

It is a live question whether IIAs do more good than harm. Tienhaara writes that there is little evidence tying BITs to increased FDI.[124] Furthermore, it is open to question whether having increased FDI flowing into one's country is worth sacrificing some part of that country's sovereignty in the shaping of its domestic laws. These two grave questions place the efficacy and desirability of IIAs under question. Knowing the myriad problems that accompany IIAs and their international arbitration clauses, it is no wonder that some countries are choosing to turn their backs on aspects of IIAs.

Although it is not practicable to suggest that IIAs should be done away with completely, it is reasonable to suggest that it might be in the interest of some countries to excuse themselves from BITs if they are able, or to stipulate some or all of the changes to IIAs discussed above be made if they are to remain in the BIT. Until IIAs undergo the reforms necessary to make them more equitable, it would seem prudent to attempt to limit their presence in one's country.

Conclusion

While investors ought to be given fair treatment by host countries, there is no reason that the governments hosting them should not be accorded the same. The current IIA scheme does not give governments the same rights as those given to investors. Governments are not entitled to stabilizing clauses that ensure that arbitration tribunals do not change the meaning of vague clauses. They are not entitled to arbitrators who share their public policy perspective and expertise. In fact, governments do not have many protections or rights under IIAs at all.

This paper has demonstrated that IIAs place constraints on a government's ability to create legislation where that legislation might prejudice an investor. This is particularly problematic in the context of environmental law because environmental legislation must be able to change in order to reflect developments in scientific knowledge and best practice techniques. Because environmental legislation must change over time, it has often conflicted with investor rights and resulted in international arbitration. To have necessary environmental legislation at risk of being deemed 'indirect expropriation' is a regrettable situation, and one which should be remedied.

This paper has argued that the result of the conflicts between environmental legislation and investor rights has been to create an awareness amongst host nations, which are more often than not developing countries, that they must be careful in creating environmental legislation. This perception is particularly problematic in developing countries, because they are often the countries most in need of legislative reform on environmental issues.

[124] *Ibid* at 59.

Although it is not easy to prove that conflicts between environmental legislation and investor rights have resulted in regulatory chill, the case studies presented in Part 3 amply illustrate why host countries are likely to be loathe to face international arbitration. The costs of international arbitration are high and several: not only are the costs of litigation prohibitive, but the cost to a country's 'investor-friendly' reputation is also significant. To balance between *these* costs and the costs of failing to create environmentally sensitive legislation is no easy task, but it is one that governments the world over are forced to on a regular basis. Unfortunately, it would appear that it is not always the environmental legislation that is prioritized, as the case study of Indonesia demonstrates.

In a world facing daunting climatic change in the coming decades, it is unacceptable for arbitral tribunals and IIAs to shape domestic environmental law. The suggestions for improvement of IIAs offered need to be implemented before IIAs could be considered neutral in terms of their impact on nations' power to create or change environmental legislation. Until this time, it would appear that countries ought to endeavor to avoid or alter IIAs, following the suggestions listed above. Given the many ecological challenges the world faces, these changes cannot be implemented soon enough.