ENVIRONMENTAL REGULATION, INVESTMENT PROTECTION AND 'REGULATORY TAKING' IN INTERNATIONAL LAW

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I. INTRODUCTION

THIS article addresses a currently very controversial issue—the question of environmental regulation of foreign investment and the limits on such national regulation by international law, in particular by recently completed and negotiated multilateral investment Treaties (MITs). It contributes to the emerging discussion on how and where to draw the line between legitimate non-compensable national regulation aimed at protecting the environment, or 'human, animal or plant life or health'[1] on one hand, and regulation which is 'tantamount' to expropriation requiring compensation, on the other. It is a question that is largely responsible for the 1998 collapse of the negotiations for a Multilateral Agreement on Investment (MAI) within the OECD.[2] This experience is currently the main obstacle for negotiating multilateral investment agreements—and it has already become a problem for the proper implementation of the already existing ones—in particular the novel and far-reaching investor-state arbitration under Chapter XI of NAFTA and Art. 26 of the Energy Charter Treaty.[3]

This question has recently become important for a number of reasons. First, concern over the environment—from the activities of multinational corporations in particular and international trade and investment generally—is now high on the economic policy agenda of governments, financial institutions, and business leaders. Secondly, the previously socialist/statist attitude to foreign investment popularly expressed through the New International

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1. Modern trade and MITs (eg GATT, the North American Free Trade Agreement—NAFTA, the Energy Charter Treaty—ECT, and the 1998 draft of the Multilateral Agreement on Investment—MAI) allow Member States to impose otherwise objectionable trade and investment measures to protect human, animal or plant life or health. See section III below.

2. P. M. Dupuy/Ch. Leben, *UN Accord Multilateral sur l'investissement* (Paris: Pedone 1999); for an informed post-mortem: David Henderson, *The MAI Affair: A Story and its Lessons*, (London: Royal Institute of Int'l Affairs, 1999); Edward M. Graham, National Treatment of Foreign Investment: Exceptions and Conditions (1998) 31 *Cornell Int'l LJ* 599.

3. See Bridges *Weekly Trade News Digest*, 5 July 1999: 'Canada proposes to NAFTA ministers to narrow investor–state provision.'

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Economic Order (NIEO) in the 1970s and its emphasis on national sovereignty—but which has lost its appeal[4]—has been reincarnated in the environmentalist movement, with the environmental cause being used as a Trojan horse by statist/bureaucrats, protectionists, environmentalists and others who oppose continuing trade and investment liberalisation and the role of global markets.[5] Because of the moral high ground it occupies, concern over the environment provides a convenient platform for even the most unlikely bedfellows to challenge the emerging institutions of the global economy under environmental, human rights, protectionist, nationalist and sovereignty-based, statist and communitarian headings.[6]

Thirdly, recent arbitration suits filed by (mainly) American companies[7] under the investment chapter of the North-American Free Trade Agreement (NAFTA)—the Ethyl, Metalclad, Myers, Pope-Talbot and California/MTBE cases)—challenging regulatory measures adopted by Canadian, Mexican and Californian authorities based, at least on the face, on health and environmental grounds, have focused NGO opposition to the newly created rights of foreign investors to subject the sovereign right of democratic governments to legislate for the 'good' of their citizens to international judicial scrutiny.[8]

Finally, the question about what measures short of direct and formal taking of private property amount to expropriation ('de-facto', 'indirect', 'creeping', 'constructive', 'tantamount to' or 'equivalent to' , 'partial' or 'expropriation de fait') of foreign investment has bedevilled governments, international tribunals,[9] and international lawyers.[10] The debate is far from resolution. It is in fact likely to intensify following the privatisation of many functions hitherto

4. Walde, '*Requiem for New International Economic Order*', in G. Hafner, *et al*. (eds.), *Liber Amicorum I. Seidl-Hohenveldern, 771* (The Hague, Kluwer Int'l., 1998); S. Neff, *Friends but No Allies: Economic Liberalism and the Law of Nations*, (New York, Columbia UP, 1990) 178–98.

5. D. Henderson, *Wincott Lecture, Anti-Liberalism 2000* on: <www.iea.org.uk>.

6. Walde, 'Sustainable Development and the 1994 Energy Charter Treaty: Between Pseudo-Action and the Management of Environmental Risk,' in F. Weiss, *et al*. (eds.), 223 (1998) above, n. 4.

7. See below nn. 99–103 and accompanying text.

8. Juli Abouchar, 'Environmental Laws as Expropriation under NAFTA' (1999); 8 RECIEL 209–15; J. Martin Wagner, 'International Investment, expropriation and environmental protection', 29 *Golden Gate U L Rev* 465 (1999); H. Mann and K. von Moltke, *NAFTAs chapter XI and the Environment* (Winnipeg: Intl Institute for Sustainable Development, 1999), 39–40; J. Soloway, 'Environmental Regulation as Expropriation' (1999) 33 Can Bus LJ 92.

9. One of the latest tribunals to be faced with the question was the Iran–US Claims Tribunal, on which see, A. Kolo, Between Legitimate Regulation and Taking of Foreign-Owned Property under International Law with Particular Reference to the Jurisprudence of the Iran–US Claims Tribunal (Ph.D. dissertation, CPMLP, Dundee, 1994); G. Aldrich, *The Jurisprudence of the Iran-US Claims Tribunal* (1996); C. Brower and J. Brueschke, *The Iran-United States Claims Tribunal* (The Hague, Martinus Nijhoff, 1998).

10. eg R. Higgins, 'The Taking of Property by the State: Recent Developments in International Law' 176 RDC-Collected Courses (1982-III) 259; B. Weston, 'Constructive Taking Under International Law: A Modest Foray into the Problem of "Creeping Expropriation" ', (1975) 16 Virg, J. Int'l. L. 103; R. Dolzer; 'Indirect Expropriationn of Alien Property', 1 ICSID-Rev./FILJ (1986) 41. UNCTAD has published a small study on 'taking of property' in its existing series on international investment agreements (2000).

regarded as exclusively and naturally a public service. With economic regulation taking the role of public ownership as the now key method to pursue public service and other public policy objectives, and with private, in particular foreign investors, entering the hitherto closed areas of public infrastructure investment,[11] the definition of the boundary between legitimate regulation expressing inherent limitation of property and the State's police powers on the one hand and excessive regulation equivalent to a full or partial expropriation on the other will be a major challenge for international economic lawyers.[12] Many policies requiring what used to be a clear-cut 'taking' of tangible property are now being operated by 'regulation'. As a result, the focus of attention in international investment law needs to shift from reasonably well-established principles of 'no taking without compensation' to new forms of regulation which, even if formally no longer involving a clear-cut transfer of formal property title, may have an equivalent economic effect. It is therefore rather a material and functional analysis of the effect of regulation on the commercial function of property that is required than the traditional analysis focusing on the formal, title-based aspect of a 'taking' by the government from the owner of a thing. With the question at issue we therefore stand at the frontline of developments in international economic law—the question of international law-based controls on national regulatory powers.[13] This paper is intended as a first contribution to this, as yet inchoate and beginning debate

The main objective here is to address the question in the context of modern Multilateral Trade and Investment Treaties (MITs) especially the Energy Charter Treaty (ECT), the North American Free Trade Agreement (NAFTA), GATT, and the almost completed, but then aborted Multilateral Agreement on Investment (MAI) of 1998. One needs to pay due regard to the precedent set by the over 1500 bilateral investment treaties (BITs) already in existence.[14]

Section III examines the investment and environmental protection provisions of modern MITs and comments on the arguments being raised by environmentalists against modern MITs. Modern MITs contain provisions (even though some are 'soft law') which will be interpreted to reinforce the case

11. T. Waelde, 'International Treaties and Regulatory Risk in Infrastructure Investment', (2000) 34 JWT 1–61; S. Rose-Ackerman and J. Rossi, 'Disentangling Deregulatory Takings', (2000) 86 Virginia LRev 1441, 1451.

12. As liberalisation continues, it is likely that issues such as public health regulation (eg the various food-related crises) and taxation—especially environmentally motivated taxes, labour and social legislation (which may be used by governments as measures to regulate foreign investment), competition and intellectual property law could come under closer legal scrutiny and raise similar challenges of 'regulatory taking' as are now being raised by environmental measures. An Oct 2001 colloquium at NYU Law School on this topic should lead to publication in 2002.

13. T. T. Waelde and P. Wouters, 'State Responsibility in a Liberalised World', in (1996) 27 *Neth.YbkIntlL*, 143–94.

14. R. Dolzer and M. Stevens, *Bilateral Investment Treaties*, (Dordrecht, Kluwer/Nijhoff, 1995); J. Salacuse, 'The Energy Charter Treaty and Bilateral Investment Treaty Regimes', in: T. Waelde (ed.) *The Energy Charter Treaty* (Kluwer, 1996); K. Vandevelde, 'The Political Economy of Bilateral Investment Treaties', 92 (1998), AJIL 621.

of—legitimate—environmental regulation.[15] Section III focuses on environmental expropriation. In addition to the recent awards in NAFTA Chapter XI cases, an analogy drawn from the jurisprudence of the European Court of Justice (ECJ), the European Court of Human Rights, WTO panel decisions and national court decisions (in particular from the US dealing with 'regulatory takings'), suggest that a legitimate, proportionate and non-discriminatory environmental measure which did not render the foreign investor's proprietary rights economically useless, nor was imposed in clear violation of a prior commitment, will not amount to expropriation. Our comparative survey of authoritative international precedent and writing concludes that legitimate environmental regulation is unlikely to be challengeable under the investment rules of modern MITs—irrespective of exaggerated claims made so far for advocacy purposes in arbitral litigation and equally exacerbated anxieties expressed by NGOs.

II. MULTILATERAL INVESTMENT TREATIES: INVESTMENT PROTECTION PLUS REFERENCE TO ENVIRONMENTAL STANDARDS

The basic underlying policy objective behind modern MITs is to promote prosperity through trade and investment liberalisation. This is achieved by eliminating or reducing barriers to trade and investment, such as reducing barriers to entry, enhancing the stability of investment terms and eliminating State aids and other forms of protectionist treatment of domestic competitors. International treaties set up a system of self-imposed disciplines on States to counter the natural tendencies of governments to be captured by protectionist and narrow ideological special interest groups with an influence that is stronger in the domestic political process than non-voting and politically and emotionally always easily exploitable 'foreign' companies. One can view such international treaties as steps towards a proto-constitutional order of the global economy, to prevent this prosperity- and civilisation-creating machine being damaged by the centrifugal forces of domestic politics. However, none of the modern MITs has even come close to reaching the liberalisation level already achieved, for example, by the European Union. Instead, they all represent compromises between the reality of the persisting nation States and the goal of bilateral, regional and ultimately global liberalisation. Modern multilateral economic treaties now include as a rule—different from most bilateral treaties (BITs)[16]—an environmental element, though this is not their core—environmental matters are usually handled in special multilateral environmental

15. For a similar argument on the asserted tension between human rights and WTO law: Hoe Lim, 'Trade and Human Rights', *JWT* (2001, forthcoming).

16. Bilateral treaties are less in the public eye than multilateral negotiations; as a result, BITs are negotiated under less environmental pressure. Multilateral treaties also have a more policy- and public-relations-orientated character and as a result contemporary attitudes enter more easily than in the—at least hitherto—more technical treaties where familiarity and interest is restricted to very few specialists in the ministries of the major economies.

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treaties.[17] The main contribution of multilateral economic treaties to environment is through their contribution to setting up a legal framework supporting prosperity. Prosperous societies are those that maximise their integration into the global economy—while those that insulate themselves tend to be the most impoverished ones with the lowest environmental standards. Prosperity inevitably engenders much higher societal expectations for environmental quality of life—and makes available the resources required to afford the pursuit of such expectations.

The investment regime of the Energy Charter Treaty (ECT)—a multilateral investment and trade treaty for fifty countries plus the European Union (EU)[18]—covers both pre-investment and post-investment phases, with the former mainly providing for soft-law obligations as compared with the latter's hard-law obligations of Member States. The basic difference between the two is that while the post-investment obligations are subject to the investment arbitration of Article 26, the pre-investment and other obligations do not generally come within the article; they are subject to the gentler procedure of intergovernmental dispute settlement. In other words, while a foreign investor can directly sue a host State for breach of the Treaty's core investment regime obligations under Part Three (eg national treatment and most favoured nation treatment; sanctity of governmental commitments; compensation for expropriation) (Art. 13);[19] a breach of the pre-investment access obligations may only be actionable through government-government dispute settlement procedure.[20]

Much of the investment provisions of the ECT were influenced by BITs and NAFTA (US, Canada, Mexico), more especially NAFTA's innovative provision which accords foreign investors a direct right of action against a host State and State agencies/enterprises exercising regulatory and administrative authority without the requirement of a prior arbitration agreement between the investor and the host State (Art. 1116 & 1117). This method greatly improves on traditional customary international law under which only the home State of the foreign investor could initiate a diplomatic protection action.[21] Chapter 11

17. On the challenge of managing the relationship by reciprocal interpretative approximation of both environmental and economic treaties: Ronald Brand, 'Sustaining the Development of International Trade and Environmental Law' (1997) 21 Vermont Law Review 823–72; H. Lim (2001, op. cit.); Waelde (1998, in: F. Weiss, op. cit.; *Myers v. Canada* award on the merits (including separate opinion by B. Schwartz, <www.naftaclaims.com>; <www.appletonlaw.com>. J. Cameron in ICLQ 2001; G. Marceau in JWT, 2001.

18. C. Bamberge, J. Linehan, and T. Waelde, 'Energy Charter Treaty in 2000' (2000) 18 JENRL 331.

19. 'Investments . . . shall not be nationalised, expropriated or subjected to a measure . . . having effect equivalent to nationalisation except where such expropriation is . . . accompanied by the payment of prompt, adequate and effective compensation.'

20. R. Happ, *Schiedsverfahren zwischen Staaten und Investoren nach Artikel 26 Energiechartavertrag* (Frankfurt, Peter Lang, 2000).

21. L. Hermann, NAFTA, and the Energy Charter Treaty (1997) 15 JENRL 129, 148. On the overall NAFTA investment arbitration mechanism: R. Dearden, 'Arbitration of Expropriation Disputes between an Investor and the State and the NAFTA' (1995) 29 JWT 113–127; R. Zedalis, 'Claims by Individuals in International Economic Law: NAFTA Developments' (1996) 7 Am.

of NAFTA contains the core investment obligations of the contracting States which aim at investment protection and promotion, fair treatment of foreign investment and investors, and provide for an effective dispute settlement between an investor and the host State. The contracting States undertook to pay compensation in case of expropriation (Art. 1110),[22] to accord each other's nationals the better of national treatment or most favoured nation treatment (Art. 1104) and 'fair and equitable treatment' (Art. 1105) in the area of establishment, operation or disposal of investment (Art. 1102 and 1103); not to impose performance requirements (Art. 1106) and to allow for free repatriation of capital (subject to Chapter 21) arising from investment (Art. 1109).

In much the same manner as the ECT and NAFTA, the now aborted Multilateral Agreement on Investment (MAI)[23]—conceived in a first phase for all OECD countries, and in a second for all other countries mirrored—and improved on—the investment protection regime of both NAFTA and the ECT. It was designed to guarantee non-discriminatory treatment of foreign investors by Member States.[24] It failed through a lack of political support, protectionist opposition of the influential French cultural industries and NGO-criticism related to the widespread anti-globalisation campaigning against international economic organisations.[25]

In recognition of the importance of the environment, modern multilateral economic agreements do not only permit member countries to impose otherwise objectionable measures aimed at protecting human, animal or plant life or health, but also oblige them to maintain high environmental standards. Article XX(b) & (g) of the GATT allows Member States to impose measures 'necessary to protect human, animal or plant life or health' or 'relating to the conservation of exhaustible natural resources' provided 'such are not applied in a manner which could constitute a means of arbitrary or unjustifiable discrimination between countries . . . or a disguised restriction on international trade'.[26] This sovereignty of States, albeit limited,[27] over environmental policies is also

Rev. Int' L Arb 115; Todd Weiler, 'Arbitration Under the NAFTA: Remedies for Poor Regulatory Treatment' (2000) 6 International Trade Law and Regulation, 84–92 on direct investor-State arbitration in general: A. Parra, 'Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment' (1997) 12 ICSID Rev/FILJ 287.

22. 'no government can directly or indirectly nationalise or expropriate an investment of an investor of another party; or take a measure tantamount to nationalisation or expropriation . . . except . . . on payment of compensation'.

23. For the latest draft text of the MAI: <www.oecd.org>.

24. Sol Picciotto, 'Linkages in international investment regulation: the antinomies of the draft multilateral agreement on Investment' (1998) 19 in: U of Pennsylavnia J. of Int'l. Economic Law, 731.

25. D. Henderson, above (1999).

26. P. Mavroides, 'Trade and environment after the shrimps-turtles litigation' (2000) 34 JWT 73–88.

27. Similar to other forms of exercise of sovereignty, environmental sovereignty is also limited by customary international law and treaty commitments. C. Shine, 'Environmental Protection Under the Energy Charter Treaty', in Waelde (ed), *The Energy Charter Treaty* (1996), 520, 522–5; id., 'Environmental Policies Towards Mining in Developing Countries' (1992) 10 JENRL 327, 335–6.

recognised by the ECT (Art. 18 in relation to natural resources); Art. 24(2) allows a Member State, subject to the provisions on compensation for losses and expropriation, to adopt or enforce any measure 'necessary to protect human, animal or plant life or health'. Art. 19 enjoins Member States to, among other goals, 'strive to take precautionary measures to prevent or minimise environmental degradation', and to 'take account of environmental considerations throughout the formulation and implementation of their energy policies'. The obligations contained in Article 19 are not mandatory (ie they are soft law) and are deliberately based on imprecise criteria such as, 'the public interest', 'cost-effectiveness', etc.[28] Nevertheless, the ECT is said to have 'broken new ground by coupling its trade and investment provisions with emphasis on the importance of environmental protection in all aspects of the energy industry'. Although the ECT represents (as most treaties of this type) a political compromise between the need to protect the environment on one hand, and the economic logic of global energy markets on the other, the environmental obligations may be relied upon by an international tribunal in interpreting other provisions of the treaty (eg the expropriation or sanctity-of-contract provisions).[29] Since the distinction between 'normal' regulation and a compensable 'regulatory taking' is not easy and requires a balancing process, the environmental standards recognised in a treaty are suitable to serve as factors to be taken into account in such balancing process. They help to define the legitimacy of environmental policies underlying national regulation.

The environmental 'teeth' missing from the GATT and the ECT is found in the NAFTA, described by one commentator as the 'greenest' trade agreement ever negotiated.[31] That observation is supported by the fact that, not only did the contracting States affirm their concern for the environment and aim to promote sustainable development through measures aimed at ensuring that investments are undertaken in an environmentally sensitive manner, but most importantly, committed themselves not to encourage investment by relaxing health, safety, or environmental standards (Art. 1114).[31] That legal commitment was strengthened by the North American Agreement on Environmental Cooperation of 14th September 1993 (NAAEC).[32] As a result of NAFTA,

28. Shine, in Waelde (ed.), (1996), above, n. 22, 537; Waelde, in Weiss, *et al*. (1998), above n. 6, 240–5; Regina Axelrod, 'The European Energy Charter Treaty' (1996) 24 *Energy Policy* 497–505.

29. Waelde, in F. Weiss, (1998) op. cit., 240–5.

30. D. Esty, 'Integrating Trade and Environmental Policy Making: First Steps in the NAFTA', in Zaelke, *et al*. (eds.) *Trade and Environment—Law, Economics and Policy*, (Washington, Centre for Environmental Law (1993) 45, 50; B. Mall, 'The Effects of NAFTA's Environmental Provisions on Mexican and Chilean Policy', (1998) 32 Int'l. Law. 153, 154; S. Moreno and J. Rubin *et.al*. 'Free trade and the environment: The NAFTA, the NAAEC' (1999) 12 Tulane Intl LJ 405, 458 (1999); separate opinion of arbitrator B. Schwartz in *Myers v Canada* NAFTA award of 12 Nov 2000, paras. 92–143.

31. Also note arts. 1106(2) and 1114 (1).

32. Among other things, the NAAEC created the institutional and administrative framework for the enforcement of domestic environmental law. Above all, it provided for significant public

Mexico (and lately, Chile) have been said to have improved on their environmental laws and standards.[33] NAFTA illustrates not just the complementarity between trade and environmental protection, but also that modern multilateral economic agreements can provide both the material resources—something that is usually missing in the much more ambitious and loftier environmental treaties—and the legal means to raise environmental standards of practice. It also demonstrates that high environmental standards might be achieved and maintained in developing countries with the help of MITs.

As regards the now buried MAI, it should be noted that the initial draft did not contain environmental provisions.[34] This was a serious political mistake reflecting prior insulation of the OECD negotiators from the political processes of modern 'civil society'. Environmental language entered later following mounting political pressure and criticism of the project by NGOs and trade unions, particularly from the OECD member countries.[35] In response to the criticism, the MAI negotiating text released in April 1998 contains a number of proposals on how to incorporate environmental protection into the agreement.[36] Apart from the proposals on clarification of expropriation and compensation, and the annexed Guidelines on MNEs, most if not all of the other proposals were borrowed from NAFTA (in particular Art. 1114). If such proposals had been effectively incorporated into the MAI, its effect would have been to create a truly international investment and environmental code for the first time. So far, there are regional (eg NAFTA, ASEAN; Mercosur) or sectoral treaty systems (eg ECT), but no global investment investment code as originally envisaged under the 1948 Havana Charter as yet.[37]

Given the open-ended character, not yet narrowed down by precedent, of much of the investment, but in particular the environmental language in modern MITs, the specific legal impact of these provisions can only emerge from a prolonged period of interpretation, debate and application by its users. This process has now been started vigorously by the new NAFTA Chapter XI

participation, including the right of legal action by private individuals and NGOs against a State party for failing to effectively enforce its environmental law (Arts. 14 and 15). A. Lucas, 'The North American Agreement on Environmental Co-operation: International Environmental Jurisdiction over the Energy Sector' (1998) 16 JENRL 84; D. Lopez, 'Dispute Resolution Under NAFTA: Lessons from the Early Experience' (1997) 32 Texas Int'l LJ 163, 184–92.

33. Lopez, ibid. 168–9, 180–6.

34. P. Muchlinski, 'Towards a Multilateral Investment Agreement (MAI)', in F. Weiss, *et al*. (eds.) (1998), above, 428, 435–37.

35. These organisations and groups made effective use of the internet to influence the negotiation process. See <http://www.islandnet.com/~ncfs/maisite/guerilla.htm>; Joint NGO Statement on the MAI to the OECD, <http://www.islandnet.com/~ncfs/maisite/C/NGOmai.htlm>.

36. See, OECD, Chairman's Proposals on Environmental and Related Matters, annexed to: The MAI Negotiating Text, as of 24 April 1998, at 140–5, at <http:// wwww.oecd.org/daf/cmis/maitext.pdf>; OECD, Ministerial statement on the MAI, Issued in Paris on 28 April 1998 <http://www.oecd.org/news-and-events/release/nw98–50a.htm>.

37. Friedl Weiss, 'The GATT 1994: environmental sustainability of trade—environmental protection sustainable by trade', in K. Ginther (ed.), *Sustainable development and good governance* (Nijhoff, Dordrecht, 1995) 382.

and similar ICSID cases. Our discussion demonstrates the complementarity between trade and environment policy and treaty-based law. It raises in particular the need to construct and apply the environmental and investment protection regimes not separately, but as an integrated and internally consistent regime. The investment rules will therefore have to impact on the way the broad environmental principles are interpreted and applied, and the environmental principles will play a role in legitimising regulation subject to the scrutiny of the investment protection rules. Both set of rules, conceptual approaches and values—and the relevant professional and academic communities—have to merge under the sign of mutual respect.

III. ENVIRONMENTAL EXPROPRIATION OF FOREIGN INVESTMENT—AN ISSUE OF DISAPPOINTMENT OF LEGITIMATE EXPECTATIONS

The major concern of the foreign investor is not with environmental regulation per se but rather it is with the uncertainty and surprise aspect of environmental regulation in particular and regulatory changes generally which upset the fiscal and regulatory regime under which the investment was made.[38] Investors are ready, and can be expected to be ready, to accept the regulatory regime in situations in which they invest. Investment protection rather turns around the issue of unexpected change with an excessive detrimental impact on the foreign investor's prior calculation, and the—in domestic politics natural—favouring of national competitors. This theme pervades the philosophy underlying modern investment treaties, but also national debate on 'regulatory takings'[39] and the string of recent NAFTA awards. No foreign investor will complain about an existing high-level environmental regime prior to making the investment. That is because the investor is in a position to make a risk/reward assessment of the project's fiscal and regulatory regime and then take an informed decision on whether to commit his capital in the potential host country or go elsewhere.

If a company decides to invest, then it expects that the legal and fiscal conditions will remain relatively stable for some time. This is especially so for the natural resources, energy and infrastructure projects where investment is long-term, high risk, capital intensive and highly dependent on the exercise of government's regulatory powers. Stability of key investment conditions and protection against abuse or excess of regulatory powers is then of essence to the foreign investor.[40] Hence, where the investment has been made and

38. Walde and Ndi, 'Stabilising International Investment Commitments' (1996) 31 Texas Int'l. LJ 215; G. Verhoosel, 'Foreign Direct Investment and Legal Constraints on Domestic Environmental Policies (1998) 29 Law & Policy in Int'l. Bus. 451 (noting that 'stricter environmental standards as such are not likely to deter MNEs from investment, but uncertainty regarding changes in the regulatory framework are').

39. Rose-Ackerman and Rossi, op. cit. 2001, above.

40. R. Buckley, 'International Trade, Investment and Environmental Regulation' (1993) 27(4) JWT 101, 117–18; Walde and Ndi, (1996), above n. 33.

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acquired a 'hostage' status, imposition of new environmental obligations which impact on the investment[41] will be viewed with concern, if not resisted by the foreign investor. This is the more so if the investment was made based on promises given by the host Sstate in an agreement with the investor[42] or contained in the country's investment laws.

There is a legitimate need to adapt environmental regulation to the evolution and mainstream acceptance of policy trade-offs and technology. But environmental law is very prone to post-investment regulatory surprise as national and even more so international environmental law are typically open-ended and very responsive to public opinion pressure easily mobilised by NGOs hungry for a suitable target. Given the political legitimacy of environmental causes, regulation that is in substance protectionist will be politically more acceptable if it appears on the scene clothed in environmental dress. All of the current batch of pertinent NAFTA awards, and much of the discriminatory national regulation struck by enforcement of EU law involve acts of protectionism or mistreatment of unwary foreign investors, often blatant, but camouflaged in the much more palatable clothes of sacred environmental causes.[43] Not-so-holy alliances between protectionist interest and environmental idealism, seasoned with a dose of natural xenophobia, are therefore quite common. In that case, the foreign investor may well wish to consider the possibility and suitability of challenging such subsequent and unexpected imposition as 'tantamount' to expropriation under the relevant MIT[44] or customary interna-

41. This may take the form of environmentally motivated taxes, refusal by a government department to allow development or operation of the project on environmental grounds, denial of export licence to export mineral products mined in environmentally sensitive locations, or judicial decision imposing fines for past environmental liabilities. See *Commonwealth of Australia v State of Tasmania* (1983), vol. 46, ALR, 625 (prohibition against a hydro-electric project in a wilderness area), commented on in R. Pritchard (ed.), *Economic Development: Foreign Investment and the Law* (Kluwer/IBA, London, 1996), 106; *Murphyores v Commonwealth of Australia* (1976), vol. 136, CLR 1 ((denial by the federal government to issue export licence for the export of rutile mined on an attractive island), in ibid., 105; *Mining Journal*, 7 Feb, 1997, 106 (a decision by the Ghanaian authorities to prohibit mining activities in woodland reclassified as forest reserve); *Bennett, et al v. Spear, et al.*, decision of the US Supreme Court , 19 March 1997 (imposition of minimum water levels in reservoirs to protect two endangered fish species would adversely affect petitioners irrigation project), <http://supct.lawcornell.edu/supct/html/95–813.ZS.html>.

42. E. Paasivirta, 'The Energy Charter Treaty and Investment Contracts': Towards Security of Contracts, in Walde (ed.), (1996), above n. 12, 349, 360–62; Waelde and Ndi (1996) above n. 33.

43. See, eg, the extensive discussion of the Canadian Minister for Environment's explicit instruction to reserve domestic wastage processing industries 'for Canadians in Canada'—even if environmentally more harmful than transportation to geographically close US locations in the award and separate opinion of the *Myers v Canada* (above) case or the perhaps even more suspect actions of a Mexican local government in undermining federally granted permits by dubious obstruction—dressed up as environmental permitting in: *Metalclad v Mexico*, ICSID tribunal (Lauterpacht, Civiletti, and Siqueiros) decision of 25 Aug 2000, <www.worldbank.org/ icsid>.

44. Modern MITs classify expropriation to include: 'measures having effect equivalent to nationalisation' (Art.13(1) ECT); 'direct or indirect nationalis(ation) or . . . measure tantamount to nationalisation' (Art. 110 NAFTA); 'nationalise directly or indirectly an investment . . . or measures having equivalent effect'—see Section IV of the MAI preceded by a reference to a right to be protected from unreasonable and discriminatory regulation; Art. 11 of the 1985 MIGA Convention; the Commentary to Art. 3 of the OECD Draft Convention on Protection of Foreign

tional law. Since environmental regulation comes within the expropriation provision of modern MITs thereby triggering an investor-host Sstate arbitration right,[45] the question will then arise as to whether the impositions are legitimate non-compensable regulation of foreign investment or if they amount to expropriation of the foreign investor's property; following US practice, one can term such expropriation a 'regulatory taking'.[46]

In attempting to answer this question, it should be noted that the issue of environmental expropriation emerged first as a constitutional issue in national law.[47] It has now acquired an international law relevance.[48] But so far, there are only few international cases—mainly the first NAFTA-based already decided or still pending).[49] One will also have to rely on precedent and analogy with earlier US-Iran cases raising the distinction between 'normal regulation' expressing the State's police powers and 'regulation' amounting to a 'taking' due to its ultimately expropriatory effect, the jurisprudence of the European Court of Justice, the European Court of Human Rights and other international arbitral decisions on related questions. But the main source of case experience on this matter is the by now quite extensive US experience

Property of 1967 defines creeping nationalisation as measures otherwise lawful 'applied in such a way as to deprive ultimately the alien of the enjoyment or value of his property, without any specific act being identifiable as outright deprivation. As instances may be quoted excessive or arbitrary taxation; prohibition of dividend distribution coupled with compulsory loans; imposition of administrators; prohibition of dismissal of staff; refusal of access to raw materials or of essential export or import licenses'; see also, the US Restatement (third) Foreign Relations Law of the US (1987) Sec. 712 (g); generally P. Norton, 'Back to the Future: Expropriation and the Energy Charter Treaty', in 'Investment Arbitration Under the Energy Charter Treaty' above n. 12, 365.

45. T. Waelde, 'Investment Arbitration Under the Energy Charter Treaty', (1996) 12 Arbitration International 429.

46. The term 'regulatory taking' has as yet not been formally used in international treaty-making; but the evolution from traditional expropriation to modern forms 'tantamount', 'equivalent to' etc—see the references to the ECT, MAI and NAFTA language above—suggests that modern MITs have clearly added 'regulatory takings' as a non-conventional and modern form of expropriation to their list of compensable actions of government for which the treaty affords protection.

47. First naturally, in the United States, and particularly so in the natural resources industries (oil and gas, mining) and land development. M. Graf, 'Application of Takings Law to the Regulation of Unpatented Mining Claims' (1997) 24 Ecol. L.Q. 57; R. Percival, *et al*., *Environmental Regulation: Law, Science and Policy* (Boston: Little, Brown & Co., 1996), 995–1038; G. Laitos, 'Regulation of Natural Resource Use and Development in Light of the "New"' Takings Clause' (1998) 34 Rocky Mt. Min. L. Inst. 1–1; Id., 'Judicial Protection of Private Property in Natural Resources: The American Experience', (1996) 14 JENRL) 262; M. Lisker, 'Regulatory Takings and the Denominator Problem' (1996) 27 Rutgers L.J. 663; Rose-Ackerman and Rossi (1999), above. B. Barton, *Canadian Law of Mining* (Calgary: Canadian Institute of Resources Law, 1993), 169–91 and Dearden (above, p. 119) on Canadian experience; Pritchard (ed), (1996) above, on Australian cases.

48. Verhoosel, (1998), above; Zedalis, (1996), above; D. Schneiderman, 'NAFTA's Taking Rule: American Constitutionalism Comes to Canada' (1996) 46 Univ. Toronto LJ 499; Todd Weiler, 'Regulatory Reform Obligations in International Law' (2000) 34 JWT 71–94.

49. *Azinian* (Nov 99, decided, with ICSID); *Metalclad*, decided (with ICSID); *Ethyl* (jurisdiction accepted and then settled); *SD Myers v Canada* (Final Award Nov 2001); *California-MTBs* (*Methanex v US*) (pending); *Pope-Talbot*, (as of Jan 2001 still pending) with the current state of play on: <www.naftaclaims.com> for other cases under the ICSID Convention—ie various Argentine infrastructure cases: <www.worldbank.org/icsid>.

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and debate on 'regulatory taking'.[50] The developments in US law are not only relevant because the US is at present, in power, business and culture, the only hegemonial power, with the logic of such role giving extra authority to its law even within the debate of other national legal systems or international law.[51] The US, with the influential role of environmental NGOs in law-making contrasting with the equally important role of property in the system of constitutional guarantees, both at federal and state levels, and the largest machinery for doctrinal debate, is the natural laboratory for the formulation and testing of new legal doctrines dealing with the tension between property and regulation. Comparative constitutional law seems to provide the most suitable analogy and precedent since treaties in effect set up a similar system of higher-ranked controls over domestic law-making—and multilateral treaties in particular are now the closest in function to national constitutional law, constituting proto-constitutional rules for the global economy.

In this emerging debate, the front lines are relatively clear: The side of extensive property protection against excessive regulation is taken by an increasingly globalised business community, and to some extent by the treaty negotiators (essentially the international units of economic affairs or industry ministries). Multilateral treaty-making can be explained as a strategy by the governmental negotiators to constrain the legislation process in their own countries—to counter-balance the risk of national lobbies capturing the domestic regulatory process and thereby undermining the emergence and acceptance of international rules which are necessary to make the global economy function properly as a machine to generate prosperity, peace and civilisation on the global level.[52] The transnational business community will therefore emphasise the importance of clear protection of property rights against erratic, discriminatory and protectionist intervention by State regulation. It will look rather towards the material intention and effect of regulation than at its pretended legitimate purpose. Modern public choice theory casts doubts over the true representation of public interest by State-issued regulation. It is in the logic of the public-choice approach to seek in international law protection against the capture of the State machinery by special-interest or special-value groups not able to impose their interest or values in a transparent and competitive election or market setting.[53] It is in the interest of global

50. Rose-Ackerman and Rossi, op. cit. above, 2000 provide an up to date survey with extensive references.

51. On the influence of the most authoritative and respected legal culture on other legal cultures: Alan Watson, *Society and Legal Change* (Edinburgh: Scottish Academic Press, 1977).

52. Robert D. Putnam, 'Diplomacy and domestic politics: the logic of two-level games', (1988) 42 *International Organisation* 427–60; Mancur Olson, *Power and Prosperity* (New York: Basic Books, 2000).

53. P. Stephan, 'Barbarians Inside the Gate: Public Choice Theory and International Law' (1995) 10 Am Univ J. of Int'l Law & Policy, 745; J. Rossi, 'Public Choice Theory and the Fragmented Web of the Contemporary Administrative State' (1998) 96 Mich LRev. 1746; EU Petersmann, 'National Constitutions and International Economic Law', in Meinhard Hilf and Ernst-Ulrich Petersmann, *National Constitutions and International Economic Law*, (Kluwer Deventer, 1993), 1.

markets to have accepted international standards which constrain regulatory misconduct—and which simultaneously allow governments to enhance their credibility and attractiveness in regulatory/institutional competition with other governments by signing up to such external disciplines.[54]

Opposed to this liberal and global perspective, adherents of State and therefore bureaucratic primacy against the economic sphere will under the cover of environmental legitimacy seek to extend, or in historic terms rather re-formulate the grip of the machinery of the nation State over commercial activities. The argument here is that democratic and communitarian values (not always the same) should prevail over the more selfish purposes of commerce and industry. It is now in particular the environmental movement which inherits the mantle of the socialist and statist philosophy. The argumentative strategy is to define all rights as already constituted, bounded and periodically re-defined by regulation[55] so that regulation does no more than define, rather than affect and undermine proprietary rights.

One might take a predictive approach and forecast the decision of a court or arbitral tribunal by its professional background and orientation. Commercial arbitrators are providers of service to the global business communities. They tend to adopt a property-friendly approach and award compensation in a regulatory situation where the value of property has been substantially affected, where the regulation intervened unexpectedly after the investment was made and where it did not articulate 'normal' safety issues to deal with risks/dangers inherent in the property or was in excess of accepted international environmental standards. On the other hand, a court composed of more statist or environmentalist members is likely to be more supportive of extensive regulation unencumbered by compensation requirements. Here, the approach would be much more regulation-friendly. Compensation would only be awarded if the value of the property were completely destroyed or if the environmental regulation were a mere pretext, or discriminatory without legitimate reason.[56] This is why the contest is not only about the substance of relevant standards, but also

54. Manfred Streit and Michael Wohlgemuth, 'The Market Economy and the State: Hayek and ordoliberal conceptions', in P. Koslowski (ed.), *The Theory of Capitalism in the German Economic Tradition* (Springer-Verlag, 2000), 224–71—also in cepmlp internet journal: <www.cepmlp.org/journal>; T. Waelde, 'Law, Contract & Reputation in International Business: What works', in: cepmlp internet journal, <www.cepmlp.org/journal>

55. Michael Graf, 'Application of Takings Law to the Regulation of Unpatented Mining Claims' (1997) 24 Ecology Law Quarterly 57.

56. This proposition is made with reference to an analogy drawn from domestic court decisions and the opinion of commentators on those cases. eg contrast the majority with the dissenting opinions in: *Lucas v South Carolina Coastal Council*, 112 SCt 2886 (1992); *Dolan v City of Tigard*, 114 SCt 2309 (1994); *Eastern Enterprises v APFEL, Commissioner of Social Security et al*., US Supreme Court decision of 25 June, 1998, <http: caselaw.findlaw.com/scripts/getcas…>& court=/data/us/000/97% 2D42.htlm>; *Nollan v California Coastal Commission*, 483 US 825 (1987); *Keystone Bituminous Coal Association v DeBenedictis*, 480 US 470 (1987); L. Raymond, 'The Ethics of Compensation: Takings, Utility and Justice' (1996) 23 Ecol. LQ 577; J. Byrne, 'Ten Arguments for the Abolition of the Regulatory Takings Doctrine' (1995) 22 Ecol. L.Q 89; contrast in particular: R. Epstein, '*Lucas v South Carolina Coastal Council*: A Tangled Web of

about the right forum and the right way of organising participation in, access to and procedure of the competent adjudicatory forum.

But we wish to move beyond a merely predictive approach and develop out of the precedent material a set of normative standards that would help both to guide and to predict how a reasonably impartial tribunal would, and should, deal with the issue of 'environmental taking' under modern MITs. A cursory look at the jurisprudence of the European Court of Human Rights and the European Court of Justice suggests that the courts have in the past shown great deference to States in such matters of public concern. Generally, they have been reluctant to award compensation unless the State measure destroyed all economic value of the property or was found to be discriminatory, disproportionate or lacked legitimate State objective. But it may be that such a pro-regulation bias needs corrective modernisation as the much more extensive US practice—and the tendency manifest in modern multilateral economic treaties—has already accepted.

The proper analysis as indicated by practice and precedent will focus on the extent to which subsequent regulation (which may be by change in the law or by change in the interpretation and application of existing law) undermines legitimate proprietary rights and expectations of the investor and to what extent such change in applicable environmental law is reasonable. One cannot postulate that the environmental regime should be absolutely frozen, especially in the case of large-scale economic development projects and of technological innovation and consequent changing environmental expectations and accepted standards.[57] The question is rather to identify the threshold of

Expectations' (1993) 45 *Stan. L. Rev.* 1371, with R. Lazarus, 'Putting the Correct "Spin" on Lucas', in ibid, 1411. In the context of international arbitral awards such as those issued by the Iran–US Claims Tribunal, the differences in approach may be discerned by contrasting the decisions of Judges Lagergren and Virally on one hand, and those issued by other members of the Tribunal, on the other. One will discover that in general terms, the former two were more reluctant to find expropriation than the other members. See G. Aldrich, *The Jurisprudence of the Iran–US Claims Tribunal* (1996), 182–4.

57. The evolving nature of environmental risks (which changes as a result of new scientific knowledge and greater awareness of the risks for mankind) and the need to take into account such new norms and standards in the planning and implementation of development projects, is acknowledged by Petersmann, in: Meinhard Hilf and Petersmann (1993), above ('If the Treaty was to operate for decades into the future, it could not operate on the basis of environmental norms as though they were frozen in time when the Treaty was entered into . . . Environmental concerns are live and continuing concerns whenever the project under which they arise may have been inaugurated. It matters little that an undertaking has been commenced under a treaty of 1950, if in fact that undertaking continues in operation in the year 2000'); also *Fredin v Sweden* (1991) 13 EHRR 784, at para. 46 (stressing the changing attitude towards restricting exploitation of gravel); *Lucas v South Carolina Coastal Council*, above at 2901 (where the court acknowledged the fact that 'changed circumstances or new knowledge may make what was previously permissible no longer so'); *Pennsylvania Coal Co. v Mahon*, 260 US 393 (1922), dissenting opinion of Justice Brandeis ('[land] uses, once harmless, may, owing to changed conditions, seriously threaten the public welfare'); *Euclid v Ambler Co.*, 272 US 365, 387 (1926); *Dolan v City of Tigard*, above, (dissenting opinion of Stevens J). See also the analysis of the—relative—binding value of 'stabilisation clauses' by Waelde and Ndi (above) which concludes by the suggestion of a necessary balancing between contract-reinforced legitimate expectations on one hand and the need to respect the

unexpected regulatory change and of its impact on the investor's legitimate expectation which require that the investor be paid compensation. It is not, one needs to emphasise against frequent misconception, a question of prohibiting regulatory change, often a legitimate way of evolving the regulatory regime in tune with new knowledge, new standards and the demands of public opinion, but rather to determine when the society, rather than the individual company, should pay the price for it.[58] In other words, while acknowledging the fact that, 'government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law', nevertheless, it should also be accepted that 'if regulation goes too far it will be recognised as a taking'.[59] Whether regulation goes 'too far' is a question of degree. Thus, the central question is: how to draw the line between regulation that is normal, non-discriminatory and which defines with legitimacy what economic operators can do on one hand, and, on the other, when does regulation become so exorbitant that it in effect destroys the economic stability and functions of proprietary rights—and triggers the compensation obligation.

One needs, in the context of such analysis, to be careful with older precedents. The current decade has witnessed an extensive re-writing of the relationship between the State and the markets.[60] Much of what is now operated by and within markets, used to be in State-ownership or under direct and close State control and not subject to full, or to any, competition. With privatisation and deregulation, the role of the State(s) is now seen to be limited to correcting 'market failure', itself an ambiguous concept.[61] The instrument of State interaction with the economy is now primarily the method of economic regulation, ie setting a framework condition and in correcting in particular areas where externalities or incomplete competition exist (eg for reasons of natural,

evolution of environmental standards in line with scientific understanding of risk and risk management techniques; Rosalyn Higgins, *Problems and Process* (Clarendon Press, Oxford, 1994), 142.

58. *Dolan v City of Tigard*, above ('One of the principal purposes of the Takings clause is "to bar government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole" '); referring to *Armstrong v US*, 364 US 40 at 49; *Nollan v California Coastal Commission*, 483 US 825 at 835 n. 4 (1987); *Eastern Enterprises v EPEL, et al*., (1998), above at p. 7 of 19; *Pumpelly v Green Bay Co.*, 80 US (13 Wall) 166 (1987) at 177–7; ; G Laitos, 'Judicial Protection of Private Property in Natural Resources: The American Experience' (1996) 14 JENRL 262, 293–94.

59. *Pennsylvania Coal Co. v Mahon*, 260 US 393 (1922), dissenting opinion of Brandeis J.

60. D. Yergin and J. Stanislaw, *The Commanding Heights* (Simon & Schuster: New York, 1999; Susan Strange, *The Retreat of the State: The Diffusion of Power in the World Economy*, (Cambridge: CUP, 1996).

61. 'Market failure' is considered to occur when due to externalities or lack of competition the market is considered, from an economic perspective, not to function as it is expected to do. In a wider sense, market failure is generally invoked when markets do not produce the results desired from a social or ideological perspective. But rare is the reference to market failure which then sets out to demonstrate persuasively that another, typically State-based command-and-control method, will achieve the same or better results at less cost. So 'market failure' needs to be set against the contrast of 'State failure'.

legal or otherwise founded monopoly). The scope for government action is therefore much smaller, and constitutional and procedural controls are placed on it, both domestically and internationally. But as economic regulation is the novel and principal instrument of State action impacting on business, its scope and limits are as yet untested. The current debate therefore reflects the need to test the scope, boundaries and effectiveness of economic regulation of market forces.[62]

A survey of mainly US court decisions[63] and the jurisprudence of international tribunals suggests no simple answer. Instead, our analysis identifies a number of questions which are to be considered in view of the circumstances of each situation.[64] Among those questions are:

— the intensity of the economic impact of the regulation on the owner;
— the extent to which the legislation interferes with distinct investment-backed expectations;
— the nature of the government action;[65]
— did the regulatory action produce a protectionist effect in favour of domestic groups and is it perhaps even possible to identify an underlying, though formally disguised, protectionist policy intention?[66]

62. For a more extensive analysis: T. Waelde, 'Multilateral Investment Agreements in the Year 2000', Contribution to Melanges Philippe Kahn (ed.) Charles Leben *et.al*., (Paris: Pedone, 2000); earlier version published in: 1 (1999) Business Law International 50–79; an excellent monograph on this topic can be expected from Todd Weiler, University of Toronto.

63. See Rose-Ackerman and Rossi, 2000, op. cit. above, also with references to the German concept of 'special sacrifice' ('Sonderopfer', BVERFGE 367 (1968); Rossi (1998) op. cit. above. For doctrinal writings: R. Epstein, *Takings: Private Property and the Power of Eminent Domain* (Harvard: Harvard UP, 1985); F. Michelman, 'Property, Uutility and Fairness: Comments on the Ethical Foundations of Just Compensation Law' (1967) 80 Harv L Rev (1967) 1163; for a comparative survey of constitutional provisions (though not their actual interpretative and application practice): Van der Walt, *Reducing Regulatory Risk in infrastructure by requiring compensation for regulatory takings*, (World Bank Rome 1999 conference), <www.worldbank.org/ riskconference>.

64. In *Connolly v Pension Benefit Guaranty Corpn.*, 475 US 211 at 224, the court said the definition of a taking was not controlled by 'any set "formula", but was dependent on ad hoc, factual inquiries into the circumstances of each particular case'. *Papamichalopoulos v Greece*, (1993) 16 EHRR 440, concurring opinion of Mr Pellonpaa, ibid. 454 at 455. A similar approach seems to have been adopted by the Iran–US Claims Tribunal on q.v.); C. Brower and J. Brueschke, *The Iran–United States Claims Tribunal* (The Hague: Martinus Nijhoff, 1998), 376–441. Rose-Ackerman and Rossi (2000) op. cit. criticise the "ad-hocery" of US courts' takings' jurisprudence.

65. See *Penn Central Transport Co. v New York City*, 438 US 104 (1978); *Keystone Bituminous Coal Ass'n., v DeBenedictis* (1987), above; *Hodel v Irving*, 107 S-Ct 2076 (1987); *Eastern Enterprises v. Epfel, et al*., (1998), above; *Kaiser Aetna v US* 444 US 164 (1979); *Connolly v Pension Benefit Guaranty Corpn.*, 475 US 211 (1986); *Babbit, Secretary of the Interior, et al. v Youpee-Youpee*, Supreme Court of the US decision of 21 Jan 1997, <http://caselaw.findlaw.com/cgi-bin/getcase.p1?court=us&vol=000&invol/=U97 01015>

66. While it is not easy to identify a clear 'intention' of a social organisation such as a governmental body, formal statements of the responsible Minister or a series of circumstances pointing to the protectionist intent being the main motivator for a policy can be taken to indicate the 'intention'—see on this in particular the award and separate opinion of B. Schwartz in the *Myers v Canada* case, above. A formal statement of the Minister, disregard of technical advice by the environmental civil servants and a series of lobbying actions relating to governmental action were here seen as indicating a manifest protectionist intention of government. On evidence of organisational 'intention' by e-mail: K. Auletta, 'Microsoft and Its Enemies', 2001 at p. 294.

— did the law substantially advance legitimate State interest, and
— did it deny the owner economically viable use of his property?[67]

With these questions in mind, our analysis allows us to identify the following standards:[68]

— An environmental regulation needs to be 'proportionate and necessary' for a 'legitimate purpose'; and
— it must in law and practice not be discriminatory; and
— it must not be in breach of an agreement or of legitimate, investment-backed expectations—with reasonable adjustment of regulation to evolving and accepted environmental standards being a legitimate exercise of regulatory police powers.

A subsequent environmental regulation which meets the above tests but which effectively or totally renders the investment/property without any economically beneficial use or imposes on the owner a special sacrifice in favour of the community at large is compensable.[69] In such situations, the regulation may be perfectly legitimate, but the sacrifice should not be borne by the victim, but the community at large. These standards are not the end, but only the beginning of an analysis where balancing of relevant standards is necessary—and some discretion unavoidable.

A. The Proportionality/Necessity test

A regulation does not amount to expropriation if it 'substantially advance(s) legitimate state interests' and does not 'den(y) an owner economically viable use of his [property].'[70] What is a legitimate State interest is determined by reference to the society's current standard of reasonably acceptable behaviour. Thus in view of present day public awareness and concern over the environment, a law aimed at the protection of nature and the environment is prima

67. *Agins v Tiburon*, 447 US 255 (1980); *Nollan v California Coastal Commission*, above; *Lucas v South Carolina Coastal Commission*, above, *Stevens v City of Cannon Beach*, 114 SCt 332 (1994); *Ehrlich v City of Culver*, 12 Cal. 4th 854 (1996).

68. Such regulatory standards are not only relevant for a 'regulatory taking'—ie an action 'tantamount to expropriation', but also other breaches of regulatory conduct duties under MITs—see: Todd Weiler, 'Regulatory Reform Obligations in International Law' 34 (2000); 'Investor–State Arbitration Under the NAFTA: Remedies for Poor Regulatory Treatment' 6 (2000) *International Trade Law and Regulation*, 84–92 and 'The Ethyl Arbitration: First of Its Kind and a Harbinger of Things to Come' 10 (2000) American Review of International Arbitration (under publication); T. Waelde, JWT (April 2000), op. cit. above.

69. So the 'Sonderopfer' (Special sacrifice—similar to the French concept of 'rupture d'egalite devant les charges publiques') concept of the German Constitutional court, also aplied by the European Court of Justice (First Instance) in the *Dorsch* case, 93 *AJIL* 685, 687 (1999). US jurisprudence has already dealt with difficult situations where only one part of a property is rendered useless raising the issue of 'partial expropriation', see: Rose-Ackerman and Rossi, op. cit. (2000) above.

70. *Agins v Tiburon*, 447 US 225, 260 (1980).

facie a legitimate aim; [71] so also is enforcing planning legislation,[72] preventing land subsidence[73] or flooding;[74] building new sections of a major road.[75]

Generally speaking, national authorities have a margin of appreciation; they enjoy wide discretion in determining matters of legitimate national or public interest.[76] This is premised on the assumption that, as elected representatives of the people, national authorities (legislators) are better placed than an international judge in determining what is in the public interest. Thus, in *Hentrich v France*, the applicant's contention that the government's exercise of the right of pre-emption in accordance with a general tax code was arbitrary and so, served no public interest, was rejected by the European Court of Human Rights which held that, the notion of 'public interest' is necessarily extensive and that States have a certain margin of appreciation to frame and organise their fiscal policies and make arrangements—such as the right of pre-emption—to ensure that taxes are paid. Thus, for example, the prevention of tax evasion is a legitimate objective which is in the public interest.[77]

In order to prevent abuse of the public interest doctrine, courts have set an objective test by requiring that the measure adopted be reasonable and proportionate to the aim pursued. Hence, the measure must not lack a reasonable basis—including in 'sound science'[78]—and must be necessary. If the measure of control selected is more severe than is needed to achieve the legitimate objective, or there was a less severe option, then the measure adopted may not be regarded as necessary.[79] In *Penn Central*, the US Supreme Court stated that 'a use restriction may constitute a taking if not reasonably necessary to the

71. *Fredin v Sweden* (1991) 13 EHRR 784.

72. *Pine Valley Developments Ltd & Ors. v Ireland* (1992), 14 EHRR 319; Matos E Silva, *LDA & Ors. v Portugal* (1997) 24 EHRR 573.

73. *Keystone Bituminous Coal Assn.*, above.

74. *Lucas v California Coastal Commission*, above; *Dolan v City of Tigard*, above.

75. *Tsomtsos & Others v Greece*, and *Katikaridis & Others v Greece*, decision of the ECHR on 15 Nov 1996, *summarised in Bulletin of Legal Developments* (13 Jan 1997). 9.

76. P. Muchlinski, *Multinational Enterprises and the Law* (Oxford: Blackwell,1995) 504; N. Schrijver, *Sovereignty Over Natural Resources: Balancing Rights and Duties* (Cambridge: CUP, 1997), 344–6.

77. (1994) 18 EHRR 440, para. 39. Earlier in the case, the European Commission of Human Rights ruled that 'national authorities are in principle in a better position than the international judge to appreciate what is "in the public interest", and that, under the European Convention on Human Rights, it is for the authorities to make the first assessment both of the existence of a problem of public concern warranting deprivation of possession and of the remedial action to be taken. Accordingly, they enjoy a wide margin of appreciation', at para. 112; *The National Provincial Building Society, et al. v U.K.* (1998) 25 EHRR 127, at para. 80; *GasundDosier-undFordertechnik v Netherlands* (1995) 20 EHRR 403, at para. 60; *The Trustees of the Late Duke of Westminster's Estate v UK* (1983) 5 EHRR 440 at 456.

78. T. Weiler, 'When to compensate for a regulatory taking: Employing a sound science standard in interpretation of NAFTA', Art. 1110 (2) (Manuscript 2000).

79. See the *Handyside* case, in which the European Court of Human Rights stated that what 'necessary in a democratic society' means is that 'every formality, condition, restriction or penalty imposed in this sphere must be proportionate to the legitimate aim pursued', Judgment of 7 Dec 1976 Ser. A, no. 24, referred to by Higgins (1994) *Problems and Process*, 235.

effectuation of a substantial government purpose'.[80] The reasonable relationship test was applied in *Nollan v California Coastal Commission*, where the commission demanded that the Nollans formally dedicate a public access easement in front of their beach-front cottage as a condition for permitting them to upgrade it to a larger home. The court held that the access rationale was itself a legitimate aim, nonetheless in this case the easement condition had no relation ('essential nexus') to the reason for which the original regulations were passed.[81] It concluded that the condition was just a method of pressure by which the Coastal Commission could achieve an objective that it could not obtain directly without paying compensation.The decision was probably influenced by the court's perception of regulatory manipulation by government agencies to take private property without paying compensation.[82] But in contrast, Justice Brennan's dissenting opinion recognises a much wider scope for discretion for the commission to regulate all forms of access within the coastal zone.[83] The dissenting opinion reflects a generally deferential attitude towards regulators.[84] Taken together, the majority and minority opinions in *Nollan* reflect the opposing perceptions of the extent of regulatory authority of government *vis-à-vis* private proprietary rights. While the majority opinion accords more protection to individual right, the minority subjects the individual's right to the public interest.

The court's 'essential nexus' standard was taken a step further when it adopted the 'rough proportionality' standard in *Dolan v City of Tigard*. The city planning commission conditioned approval of Dolan's application to expand her store and pave her parking lot upon her compliance with dedication of the land for a public greenway to minimise flooding that would be exacerbated by her proposed development, and for a pedestrian/bicycle pathway intended to relieve traffic congestion in the area. She alleged that the land dedication requirements were not related to the proposed development and therefore constituted a taking of her property. The court held that in evaluating Dolan's claim, it must be determined whether an 'essential nexus' exists between a legitimate State interest and the permit condition, and whether the degree of the exaction demanded by the permit condition bear the required relationship to the projected impact of the proposed development. It found that preventing flooding and reducing traffic congestion in the area are legitimate public purposes and a nexus exists between the purposes and limiting development within the area. However, it concluded that no reasonable relationship exists between the flood plan easement and the claimant's proposed new

80. 438 US 104, 127 (1978).

81. 107 SCt 3141 at 3149–50 (1987). The reasonable relationship test has been adopted by many other state courts. See Morosoff, 'Take My Beach Please!: *Nollan v California Coastal Commission and a Rational-Nexus Constitutional Analysis of Development Exactions*' (1989) 69 B U L Rev 823.

82. G. Alexander, 'Takings, Narratives, and Power' (1988) 88 Col L Rev 1752, 1764–7.

83. Nollan, above, at 3152–4 (Brennan J Dissenting).

84. Alexander, (1988), above, 1768. See also *Penn Central*, above, at 124–5.

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building.[85] The court reached that conclusion by applying what it termed 'a rough proportionality' standard. If it is apparent that an 'essential nexus' exists between the legitimate State interest and the permit condition exacted, according to the court, the agency imposing the exaction must then show 'some sort of individualised determination that the required dedication is related both in nature and extent to the impact of the proposed development'.

But in his dissenting opinion, Justice Stevens rejected the majority's finding as too demanding on public authorities. He argued that the decision would have the effect of undermining the authorities' ability to respond to new environmental problems if they will have to prove that their actions not only met the 'essential nexus' test, but also 'proportionate' to the pursued objective.[86]

These cases illustrate that the legitimate/proportionality test is regarded as one of the factors to be considered—though applied in different ways by different courts and judges—in determining whether a regulation has gone too far. They also establish the court's legitimate role in adopting a heightened scrutiny of regulators' actions which adversely affect private proprietary rights. That is not only aimed at striking a balance between the individual right and that of the public but also to prevent abuse of regulatory power to further some narrow political or economic interests. For as the European Court of Human Rights noted, many a times politicians in democratic societies take decisions based on what is politically expedient and rarely are their actions based on what is rationally related to legitimate State aim.[87] Many times, the offical decisions of politicians are influenced by the need to achieve some narrow short-term political objectives or satisfying/promoting the vested interests they represent[88]—be it that of the majority working class against the

85. In the court's opinion, 'it is difficult to see why recreational visitors trampling along petitioner's floodplan easement are sufficiently related to the city's legitimate interest in reducing flooding problems along Fanno Creek and the city has not attempted to make any individualised determination to support this part of its request', at p. 9 of 20.

86. In classic communitarian words, Stevens J argued that, 'in our changing world one thing is certain: uncertainty will characterise predictions about the impact of new urban developments on the risks of floods, earthquakes, traffic congestion, or environmental harms. When there is doubt concerning the magnitude of those impacts, the public interest in averting them must outweigh the private interest of the commercial entrepreneur. If the government can demonstrate that the condition it has imposed in a land-use permit are rational, a strong presumption of validity should attach to those conditions. The burden of demonstrating that those conditions have unreasonably impaired the economic value of the proposed improvement belongs squarely on the shoulders of the party challenging the state action's constitutionality.'

87. The *Late Duke of Westminster* case, above at 546.

88. Political scientists and economists have long recognised and relied on the public choice doctrine to explain the dynamics of political behaviour in which individuals use their voting power to secure from the collective decision-making process some personal advantages for either themselves or for the vested interest they represent rather than for the general public. See, A. Ogus, *Regulation Legal Form and Economic Theory*, (Oxford: Clarendon Press, 1994); E. Ilhange, 'Does Interest Group Theory Justify More Intrusive Judicial Review?, 101 Yale LJ (1991) 31; Laitos, (1996), supra, 281–83.; Taking Back Takings: A Coasean Approach to Regulation (1993) 106 Harv. L. Rev. 914, n. 104 and accompanying text; contrast with W. Treanor, 'The Original Understanding of the Takings Clause and the Political Process' (1995) 95

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minority property owners, or in our case, protection of domestic investors against foreign competitors by using the environment as an excuse. Hence, politicians are not to be always trusted to act in the public interest; as such their decisions should be judicially scrutinised to ensure that they are not disguised protectionism or covert means to take private proprietary rights. One way through which the courts have done that is by applying the principle of proportionality—that the measure adopted does not only pursue a legitimate objective, but it must also maintain a fair balance between the demands of the general community and the requirements of the protection of the private individual's fundamental rights.[89] In practice, the courts have given consideration to among other things: the degree of the protection from arbitrariness that is afforded by the domestic law, the availability of other reasonable options of achieving the stated objective, and whether the property owner has had to bear an individual and excessive burden.[90]

Thus in *Agrotexin & Others v Greece*, the applicants, who were shareholders in a brewery company, claimed compensation for de facto expropriation of the company's property by the Athens local council which placed signposts with the words 'Area to be Expropriated' on one of the company's properties and occupied others thereby restricting the ability of the company to sell the properties in order to solve its financial problems. The European Commission of Human Rights found that the duration of the interference (ten years), and the uncertainty created in the minds of the applicants, coupled with the fact that the local council had disregarded the orders of the prosecutor of the Athens Court of Appeal over the disputed properties, resulted in the company being made to bear an individual and excessive burden. This would have been legitimate had expropriation proceedings been initiated within a reasonable time thereby enabling the company to obtain either the withdrawal of the expropriation or a compensation. As such, the measures adopted by the local council were disproportionate to the aim sought to be achieved.[91] In other words, the local council might as well have achieved its aims by complying with the orders of the court. This would not have affected the council's discretion to refuse a planning

Col L Rev 782, 855–87 in which he argues that the court should only intervene in exceptional cases such as where the taking was discriminatory against a minority or politically weaker group otherwise it is up to the political process to decide.

89. *Pine Valley*, above, European Commission of Human Right's Opinion, at para. 79 where the commission held that 'the question of proportionality which is inherent in the convention, requires the commission to determine whether, whilst recognising the wide margin of appreciation afforded to States in the planning field, a fair balance was struck between the general interest of the community and the protection of the individual's rights.' For discussion of the principle under European Union laws as well as comparative Member States' laws see, J. Schwarze, *European Administrative Law* (London: Sweet & Maxwell, 1992) 677–866; R. Youngs, *English, French and German Comparative Law* (London: Cavendish Publishing Ltd, 1998) 100–2.

90. *Hentrich v France* (1994) 18 EHRR 440; Matos E Silva, *LDA & Ors. v Portugal* (1997) 24 EHRR 573; *Sporrong & Lonnroth v Sweden* (1983) 5 EHRR 35 at para. 73; *Agosi v UK* (1987) 9 EHRR, at para. 62. These cases reflect the German 'Sonderopfer' (special sacrifice) concept, above.

91. (1996) 21 EHRR 250, at para. 77–8; Matos Silva, above, at para. 92.

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permission to any potential purchaser of the disputed properties who might wish to develop them in a manner inconsistent with the council's planning regulation, rather than placing the expropriation signpost and occupation of the properties.

On the other hand, in the *Pine Valley case*, the applicant bought land in 1978 relying on an existing outline planning permission for industrial development. An initial refusal to grant planning permission by the planning authorities on the ground that the property was part of a planned greenbelt was overturned by the courts on appeal by the first applicant. But a year later, the original grant of outline planning permission was held by the Irish Supreme Court to have been ultra vires and a nullity as it was contrary to the relevant legislation. Subsequent to the Supreme Court decision, legislation was enacted which validated grants of earlier planning permission but excluded that of the applicants. The applicants' contention that the non-payment of compensation to them, or the validation of their planning permission, was disproportionate because it put an excessive burden on them, was rejected by both the European Commission and Court of Human Rights. The court held that the measure was proportionate as it was the only way in which the aim (ie preservation of greenbelt), could have been achieved.[92]

The jurisprudence of the European Court of Justice on the free movement of goods and persons within the European Union, and that of the US Supreme Court on the inter-state commerce clause as well as the WTO panels decisions provide further detail.[93] They define the border between legitimate regulation of and excessive intervention into privately organised commercial activities—without, in this context, judging State activities under the category of expropriation. The judicial organs assume the competence to decide whether or not the State measure pursues legitimate State interest and whether it is 'necessary' and 'proportionate' to the claimed objective. The general test laid down by the courts and WTO panels is this: measures must not restrict trade between Member States any more than is absolutely necessary for the attainment of their legitimate purpose and they must be the least restrictive method of attaining that purpose.[94] In determining whether a measure is 'necessary' to the objective pursued, the courts take into account the extent of the burden which the measure imposes on trade between Member Sstates. Thus, in interpreting Article XX of the GATT in one of its latest decisions involving the American embargo on shrimps from India, Malaysia, Pakistan and Thailand, the WTO Appellate Body held that the measure constituted unjustified discrimination in that, under the terms of the law, the United States had an alternative method

92. *Pine Valley Developments Ltd & Ors. v Ireland* (1992) 14 EHRR 319, para. 59; *Mellacher v Austria* (1990) 12 EHRR 391, para. 57; *Fredin v Sweden* (1991) 13 EHRR 784, para. 51.

93. See D. Geradin, 'Free Trade and Environmental Protection in an Integrated Market: A Survey of the Case Law of the United States Supreme Court and the European Court of Justice', (1993) 2 J. Trans'l. L. & Pol. 141.

94. Ibid. 181; T. Weiler, 'Regulatory Reform Obligations under International Law', 24 JWT 71 (2000).

of attaining its goals through the negotiation of bilateral or multilateral treaties for the conservation of sea turtles (as it had with other countries in the Americas) rather than simply resorting to an import ban.[95] In other words, though legitimate, the American law was not the least trade restrictive of all the options reasonably available.[96] These GATT cases illustrate the difficulty in distinguishing between legitimate measures to protect the environment on one hand, and protectionist ones on the other. Nevertheless they also give us a clue on how the proportionality/necessity test may be applied in other contexts, and as such, they do provide us with some useful analogies.

Article 30 (ex-36) of the European Community Treaty allows Member States to impose trade measures 'justified on grounds of . . . the protection of health and life of humans, animals or plants'. In interpreting this provision, the European Court of Justice has adopted the same reasoning as the WTO panel jurisprudence. It applied the so-called 'rule of reason' enunciated in the *Cassis de Dijon case*, in which exceptions to trade based on, among other reasons, the protection of public health were held to be permitted.[97] The decisions of the court endorse the requirement of proportionality/necessity test in order to distinguish measures aimed at legitimate environmental objectives from disguised trade restrictions.[98]

Similarly, the US Supreme Court has used the legitimate reason/proportionality test to decide whether or not state environmental measures violate the inter-state commerce clause of the American constitution. It investigated not only whether the regulation was rationally related to legitimate state ends, but also determined that the burden imposed on commerce must not be excessive in relation to the putative local benefits.[99] While recognising as legitimate

95 <www.wto.org/wto/dispute/58abr.doc.>; *see also*, *The Economist* (17 Oct 1998), 124; Asif Qureshi, 'WTO: Extraterritorial Shrimps, NGOs and the WTO Appellate Body' (1999) 48 ICLQ 199; eg P. Mavroides (2000) 34 JWT 73–88 discussing the shrimp-turtle cases; on proportionality as a general principle in EU law: J. Usher, *General Principles of EC Law* (London, 1998, 37).

96. *See also*, *US-restrictions on imports of Tuna from EEC & Netherlands (Tuna-Dolphin II)* DS29/R at para. 5.35; *US-restrictions on imports of Tuna from Mexico*, BISD 39th Supp. 155 (1993) (*Tuna-Dolphin I*) at para. 5.28; *Thailand Cigarettes* case (1991) 30 ILM 1122; also *Gasoline Standards Appeal* case, 35 ILM (1996) 603.

97. Case 120/78, *Rewe-Zentral AG v Bundesmonopolverwaltung fur Branntwein*, 1979 ECR 649, at 662 ('*Cassis de Dijon*'), where the court stated: 'Obstacles to movement within the Community resulting from disparities between national laws relating to the marketing of the products in question must be accepted in so far as those provisions may be recognised as being necessary in order to satisfy mandatory requirements relating in particular to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defense of the consumer.' J. Weiler, *The EU, the WTO and the NAFTA*, OUP 2000, 201.

98. See in particular, Case 302/86, *Commission v Kingdom of Denmark*, 1988 ECR 4607 ('*Danish Bottles Cas*e'); Case 2/90, *Commission v Kingdom of Belgium* (1993) 1 CMLR 365; *Geradin*, (1993), above, 181–90.

99. *Dean Milk Co. v City of Madison*, 340 US 349 (1951). The extent of the burden that will be tolerated depends 'on the nature of the local interest involved, and whether it could be promoted as well as with a lesser impact on interstate activities'. *Pike v Bruce Church, Inc*. 397 US 137, 142 (1970); *Minnesota v Clover Leaf Creamery Co.*, 449 US 456 (1981); *Geradin*, (1993), above, 152–4.

state measures aimed at conservation of land resource, protection of health, safety and welfare of the citizen, it held that measures limiting access to local markets by foreign competitors were not.[100] For instance, in *C&A Carbone, Inc. v Clarkstown*—a case that parallels the *Myers v Canada case* in the US context, a local waste flow Ordinance required all solid waste to be processed at a designated transfer station before leaving the municipality (so as to retain the processing fees charged at the transfer station, as well as to help offset the cost of the facility). The court held that such an Ordinance violated the inter-state commerce clause. It deprived out-of-state businesses from access to the local market by preventing everyone except the favoured local operator from performing the initial processing step. It also held that the Ordinance's revenue generating purpose by itself was not a local interest that can justify discrimination against inter-state commerce. The court was of the opinion that there were alternatives open to the town (such as a uniform safety regulations) for addressing the health and environmental problems which it sought to address through the ordinance without discriminating against any company.[101]

To apply such analysis to, for example, the *Ethyl* case,[102] it could be asked whether the Canadian ban on the importation and interprovincial transportation of the chemical substance MMT which was challenged by Ethyl company, could be said to be proportionate to the desired objective—public health and environmental protection? On one hand, Canada would have argued that although it had no conclusive scientific evidence on the extent of health and environmental hazard posed by MMT, the ban was a reasonably necessary step to take under the 'precautionary principle'. It could also have argued that the ban was aimed at allaying a legitimate public concern over the safety of the product and that it was timely as any delay in the ban until the effects became manifest might have fatal consequences in both human and material terms. This is the more so as the US EPA (Environmental Protection Agency) had banned MMT for use in formulated gasoline and the state of California has placed a total ban on the product. The burden would then have shifted on to Ethyl to adduce scientific evidence to show that the product was harmless. On the other hand, Ethyl might have contended that lack of scientific evidence to support the ban demonstrated that the ban was based on mere speculation and hence an over-reaction, possibly succumbing to political pressure mounted by critics of free trade; more so as the ban did not apply to the local manufacture of the product. If the Canadian government was really serious about the public health and environmental effects of the product, why did it not legislate for a total ban on manufacture, transportation, sale or use of the chemical substance throughout the country. The discriminatory nature of the legislation could have suggested a hidden protectionist agenda behind the government measure.

100. *Dean Milk* case, above.

101. US Supreme Court decision of 16 May, 1994, <htt://laws.findlaw.com/us/000/ u10400.html>.

102. See n. 68 above.

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To sum up, these cases suggest that in determining proportionality, the discriminatory character of the regulation may be taken to indicate that proportionality was absent.[103] These cases in fact indicate an emerging presumption against legitimacy of a domestic regulation if it favours a domestic operator against foreign competitors; such presumption would need particular hard and weighty evidence as input into the required balancing process before it can be rebutted. While the precautionary principle should allow risks which are as yet not fully confirmed to be taken into account, it cannot mean that any risk, however small and insubstantial, justifies regulation. There must rather be a reasonable relationship between the magnitude, the likelihood and the solidity of scientific evidence of a risk with the intensity of the regulatory measure taken.

B. National Treatment (Non-discrimination)

Environmental regulation which affects in particular foreign investors tends to frequently involve elements of discrimination, ie the regulation does not affect national competitors in the same way, either formally or by the way such regulations are implemented or some times compensated by State aid or similar measures.[104] Since the modern BITs and MITs all include a national treatment (ie non-discrimination) rule, a breach of the rule will establish the prospect of damages awarded by the competent arbitral tribunal. Discrimination will therefore, as an independent cause of action or as a significant criterion in the balancing process to identify expropriation, result in compensation. Such compensation is presumably smaller if the discrimination per se does not amount to expropriation, and larger if it contributes towards the assessment of a regulatory action as expropriatory.[105]

In modern understanding, the key function of property is less the tangibility of 'things', but rather the capability of a combination of rights in a commercial and corporate setting and under a regulatory regime to earn a commercial rate of return.[106]

For a business to run properly, it must be able to compete on a level playing field. If the regulatory framework, consisting of utilities, tax, licensing,

103. This was also the argument in the WTO *Reformulated Gasoline* case, above. Here, the Appellate Body observed that a finding of 'arbitrary or unjustifiable discrimination' may be 'taken into account in determining the presence of a "disguised restriction" on international trade'.

104. Muchlinski, (1995), above, 505. E. Graham (1998) 31 Cornell Int'l LJ 599 (1998) above. The *Myers v Canada NAFTA case*, above, relies mainly on discrimination as a separate cause of action as distinct from expropriation.

105. The question of damages—and differences between compensation for expropriation and damages for breach of duties such as discrimination or fair and equitable treatment—is not treated here, see: separate opinion of B. Schwartz in *Myers v Canada*.

106. The jurisprudence of the Iran–US Claims Tribunal suggests a recognition of this modern conception of property as 'rights' rather than 'things' under international law. See, *Amoco International Finance Corpn. v Iran*, 15 Iran-USCTR 189, 220; *Phillips Petroleum Co. v. Iran*, 21 Iran-USCTR 79, 106; *Starrett Housing Corp. v Iran*, 4 Iran—USCTR 122, 156–7. Brower and Brueschke, (1998),

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corporate, commercial, competition law and other significant operating conditions, is distorted so as to favour some, mainly domestic or politically better connected competitors, then the 'bundle of property rights' of the foreign investor cannot function effectively.[107] So discrimination is not only, as perhaps in the older sense of the term used in international law, an action repugnant to common morality of international intercourse,[108] but it affects the core function of modern business property.[109] Investment/business property which is subject to discrimination cannot function properly in a competitive environment and thus is losing its value—up to zero; this is quite independent from the exposure of individual property components to a formal governmental 'taking'.

The concept of discrimination is difficult to apply in practice.[110] The jurisprudence of the European Court of Human Rights, the European Court of Justice and the US Supreme court decisions on the inter-State commerce clause[111] suggest that the term refers to dissimilar treatment of like situations or similar treatment of unlike situations.[112] Thus, any distinct treatment of a foreign investor based simply on its 'foreign' status may be unjustifiable except where there exist legitimate reasons for different treatment.[113]

above, 372–5. Modern BITs and MITs also define property in its broader sense to include not just tangible property, but also contractual rights, such as concessions and licence to exploit natural resources. R. Dolzer and M. Stevens, *Bilateral Investment Treaties* (1995) 25–6; Zedalis, (1996), above, 123–4. A similar position is said to be obtainable under the ICSID Convention, see *Fedex NV v Venezuela*, 37 ILM (1998) in which the arbitral tribunal held that the scope of Art. 25 of the ICSID Convention is broad enough to cover the promissory notes in dispute as they are evidence of a loan and therefore qualify as an 'investment' under the Convention. C. Schreuer, 'Commentary on the ICSID Convention' (1996) 11 ICSID Rev./FILJ (1996) 318. In the *NAFTA* case *Pope-Talbot v Canada*, the arbitral tribunal, in an interim award, considered access to the US market as a protected property right: <www.naftaclaims.com.> Interim award of 26 June 2000.

107. In the *Myers v Canada* case (above), the tribunal found manifest discrimination and protectionist purpose. The government had, against advice from its own environmental experts, imposed an export ban on the export of PCB-waste by Myers Canada to its—geographically very conveniently located and efficient—disposal facilities in order to favour an environmentally less advantageous Canadian competitor.

108. For instance, as reflected in *BP v Libya*, 53 ILR 329. See O. Schachter, 'General courses in Public International Law', 179 RDC-Collected Courses (1982-V) 21.

109. Walde and Wouters (1996), above, 148–9.

110. McKean, *Equality and Discrimination Under International Law* (1983); E. W. Vierdag, *The Concept of Discrimination in International Law* (1973); J. Dine and B. Watt (eds), *Discrimination Law* (London, 1996); Schwarze (1992), above, ch. 4.

111. It should however be noted that while discrimination in trade law mostly relates to the question of access to domestic markets, the concept is much more important in investment law because of the hostage status of the foreign investor. Zedalis, (1996), above, 129–31. 'A foreign trader may have trouble in penetrating a market, but is not exposed to any significant risk. A foreign investor, on the other hand, is heavily exposed for the long-term to significant political and now regulatory risk, both in developing and developed countries. Discrimination is therefore a much more serious issue for an investor as compared to a trader.'

112. In *Van Raalte v The Netherlands* (1997) 24 EHRR 503, at para. 139, the court restated its long-established test of discrimination as 'a difference in treatment . . . [that] has no objective and reasonable justification . . .' See also, *Pine Valley* case, above, para. 10; *Fredin v Sweden*, above, 60.

113. The combined effect of Articles 1, 3 and 11 of the GATT also suggests that the discrim-

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The jurisprudence of the courts seems to suggest a two-pronged approach which analyses the law to see whether on the surface it discriminates explicitly against the foreign investor, mainly in a context of competition, or does so in fact and with regard to its effect. Thus, in the *Dean Milk* case the disputed law was found to be discriminatory in effect, though formally and on appearance, it looked neutral.[114] In several recent Canadian NAFTA cases,[115] there was both a clearly identified intention to discriminate and a discriminatory effect. The impact is probably the key criterion. Discriminatory intention without discriminatory impact is of no relevance, though discriminatory intention (if clearly identifiable) may help to indicate a discriminatory impact. The relevant cases decided by the European Court of Human Rights establish the relevance of discrimination in determining a legitimate non-compensable regulation. In the *Pine Valley* case, the Commission of Human Rights held that the government did not provide good reasons for the difference in treatment of the second and third applicants with others in the same situation as the applicants who had their permissions retrospectively validated.[116] But in many other cases, the court found no proof of discrimination despite repeated claims by the applicants.[117]

To sum up: discrimination needs to be included in the balancing process between legitimate regulation and expropriatory action; it will weigh on the side of expropriation. Further more, a finding of discrimination may also influence the quantum of compensation payable to the investor.[118] Discrimination alone, and expropriation constituted out of several factors (including discrimination) are still separate causes of action under MITs. But it is increasingly difficult to separate the two, as economic regulation targets and affects commercial activities and thus both breach the duty of non-discrimination and undermine the economic function of the underlying bundle of property rights.

C. Measure Renders the Investment Economically Unviable

Of all the factors discussed, this is the most contentious. The question is: what degree of impact must the regulation have on the investor's proprietary rights to amount to expropriation? This question is more important in environmental

ination prohibited is between like products (domestic and imported) as illustrated by the *US-Taxes on Petroleum and Certain Imported Substances (Superfund)* case, GATT, BISD 345/236. The reported facts of the *Ethyl case* suggest that the Canadian ban of imports of the MMT additive did not affect domestic manufacturers of the substance. If that was the case, then the law would probably have contravened the non-discrimination requirement under NAFTA in form and effect. Zedalis (1996), above 131.

114. 340 US 349 (1951); *Carbone, Inc. v Clarkstown* (1994), above, at 4–5 of 24.

115. *Myers v Canada; Ethyl*; above. On the relationship between discriminatory intent and impact see in particular the separate opinion by B. Schwartz in the *Myers* case.

116. 14 EHRR 319, para. 97; *Van Raalte* case, above, para. 139; *Matos E Silva, et al. v Portugal*, above (the court did not deem it necessary to address the question).

117. eg *Fredin v Sweden*, above, para. 61.

118. *Papamichalopoulos & Others v Greece* (1996) 21 EHRR 439, para. 36.

regulation where such action rarely destroys all economic value of the investment,[119] but usually reduces significantly the commercial value of the property. This is apparent from the facts of the recent litigation under chapter XI of the NAFTA.

The first case involved Ethyl, a US company with business interests in Canada, which claimed that a law banning importation and interprovincial trade in MMT, a chemical substance which formed part of the company's business operations in Canada, amounted to expropriation of its investment. No ban on local manufacture of the product was however imposed. The parties were able to reach a settlement with the company accepting $13 million in compensation from the Canadian government for lost trading opportunities, a lift on the ban and a public statement regretting the ban which the government conceded was based on unsubstantiated scientific facts.[120] In the second case, *Metalclad v. Mexico*, the tribunal awarded damages to Metalclad, a US company.[121] According to the tribunal, the state and municipal authorities had undermined the federally authorised investment by unexpectedly requiring and refusing an hitherto unknown municipal permit and by placing the area into a newly created ecological protection zone for cactus. The tribunal awarded damages for breaches of the required duty of 'fair and equitable treatment' through lack of transparency, lack of consultation and unreasonable use of ex-post permitting to undermine a properly approved investment by the state authorities; it also found an action tantamount to expropriation through the ecological reserve law.

In the third case, *Myers v Canada*[122] the government imposed an export ban on Myers Canada seeking to export PCB wastes to its—in comparison to its Canadian competitors—conveniently located US processing facility. There was clear evidence that the Minister of Environment intended to reserve this business, against advice from the Canadian environmental experts, to Canadian competitors who had lobbied her strenuously. The ban was lifted after fifteen months. The company demanded compensation for loss of business during the ban.[123] The arbitral tribunal based its award on discrimination; it did not consider it necessary to decide on the expropriation issue. The *MTBE* case concerns a restriction by the government of California on trade and usage

119. R. Lazarus, 'Putting the Correct "Spin" on Lucas' (1993) 45 Stan. L. Rev. 1411, n. 94 at 1427 ('environmental laws often bar the most profitable use, but they only rarely eliminate all economic uses of property').

120. Todd Weiler, 'The Ethyl Arbitration', above. The case has been withdrawn following the Canadian government's lifting of the ban, but after the ICSID tribunal accepted jurisdiction (1999) 38 ILM 700. The main reason for Canada's actions (both the imposition and the lifting of the ban) seems to have been the case that there was political pressure for a trade restriction by NGOs, but not enough and credible scientific evidence for justifying the ban.

121. Decision of 25 Aug 2000, <www.worldbank.org/icsid>.

122. <www.naftaclaims.com>; forthcoming: Comment by T. Weiler in JW Investment 2002.

123. See R. Palmer, 'Canada Revoked PCB Ban to Avoid NAFTA Challemg', <www.islandnet.com/~ncfs/maisite/fta-myer.htm>.

of methyl tertiary-butyl ether (*MTBE*).[124] The Canadian company Methanex is suing the US government for US$ 970m claiming that the ban violates investor rights under NAFTA Chapter XI by limiting the company's ability to sell MTBE. In the *Pope-Talbot v Canada case*,[125] the issue is export restrictions on Canadian softwood. The tribunal confirmed in an interim award that access to the US market is a property right subject to NAFTA Chapter XI's investment protection regime. There are, naturally, further instances where NAFTA Chapter XI was raised in the context of regulatory company-government negotiations which take place in the shadow of prospective NAFTA/MIT procedures, for example in the context of a British Columbian/Canada restriction on bulk water exports.[126]

To require compensation for every diminution in the value of property caused by regulation will render public governance almost impossible as governments will be economically crippled by claims for compensation.[127] This is particularly so to the extent regulation responds to changes in evolving technology and public expectations. A doctrine of compensation for expropriation cannot impose on the community the normal commercial risk which is associated with every business.[128] On the other hand, to allow the State very extensive regulatory powers without any attention to compensation would result in over-regulation uninhibited by the economic costs of the State's actions. Hence the need to strike a balance between the two competing rights. The Iran–US claims tribunals have taken the position that in commercial undertakings, a regulation or interference becomes a compensable taking when it denies the owner of the property 'fundamental rights of ownership, use, enjoyment or management of the business' (eg the right to take part in management decisions or to derive profits from the investment) even though title might still remain with the investor.[129] While the jurisprudence of the Iran–US claims tribunal is of general precedential value,

124. See Executive Order D-5–99 by the Governor of California (available through <www.harmonisationalert.org>).

125. <www.naftaclaims.com; www.appletonlaw.com>.

126. See for a survey of this—*Sun Belt Water*—plus the *Metalclad*, *Ethyl and Myers* cases by Juli Abouchar, 'Environmental Laws as Expropriation under NAFTA' (1999) 8 RECIEL 209–215, a Canadian pharmaceutical regulation affecting a Mexican company or a company which lost out in a tender for construction at the Toronto airport (claiming expropriation/regulatory taking of the right to a fair tender complying with the tender rules). We are grateful to references by Gary Horlick, Esq. Of the Washington DC Bar in June 1999 to these situations (rather than cases). Much of the NGO discussion of such cases confuses often excessive legal claims raised by a party in negotiations with a government or advocated when instituting a legal procedure with a definite award by an arbitration tribunal. An ICSID tribunal dismissed the *Azinian* claim against Mexico—<www.worldbank.org/icsid>—the company had claimed expropriation of a waste management contract and denial of justice in Mexico. The tribunal disagreed and considered the issue one of a normal commercial dispute between a Mexican municipality and a not very reputable US company.

127. *Pennsylvania Coal Co. v Mahon*, above, at 413. For an elaboration of this argument from an economic analysis perspective: Rose-Ackerman/Rossi, op. cit., (2000).

128. Rossi (1998), at 307–9.

129. *ITT Industries, Inc. v Iran, et al.* 2 Iran–USCTR 348; *Tippets, Abbett, McCarthy, Stratton v TAMS-AFFA Consulting Engineers of Iran, et al*. 6 Iran-USCTR 219; see generally,

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it is of less use to our specific discussion of environmental regulation. Hence, guidance should be sought from the jurisprudence of national courts and the European Court of Human Rights.

A look at the relevant cases suggests that most courts have been reluctant to award compensation where the regulation did not render the property totally valueless and where the regulated property still had some economic value even though it might not be the kind of value preferred by the owner.[130] But they have found a 'regulatory taking' when the economic value was reduced to zero: in the *Pennsylvania Coal* case, the US Supreme Court held a state law which prohibited the mining of coal in a manner that could cause subsidence of residence on the surface, amounted to a taking because it rendered the underlying mineral rights economically valueless.[131] That position was reiterated by the court in the leading case of *Lucas v South Carolina Coastal Council*, in which the majority held that a regulation which deprived the owner of 'all economically beneficial uses' of the property amounted to a taking except if the activity constituted a noxious or nuisance-like use of the property under the state's common law rules.[132] In this case, Lucas sought to challenge the constitutionality of legislation which had the effect of barring him from constructing houses on his lots close to a beach, and which he acquired prior to the legislation coming into force. One should note that in the *Lucas* case there had been a legitimate expectation that housing would be permitted and this expectation had led to substantial prior investment.

Although the court in *Lucas* avoided drawing the 'bright-line' test of 'where the extent of diminution ceases being "mere" diminution (a value reduction not requiring compensation) and where it crosses over to unacceptable compensable loss of all viable economic use', yet it did acknowledge the possibility of finding a taking even where the property was not deprived of 'all

Brower and Brueschke (1998), above, 376–441; Aldrich, (1996), above, 171–218; Kolo, (1994), above, Chaps. 3 and 4. This concept—of regulatory expropriation—is in fact very similar to standard language in modern MITs concerning the general treatment duty of states, viz. Art. 10 (1) ECT: 'no Contracting party shall in any way impair by unreasonable or discriminatory measures their (ie investments') management, maintenance, use, enjoyment or disposal.' Almost identical Part IV 1.1 of the draft MAI (April 1998 version).

130. *Agins v Tiburon*, 447 US 255, 260. On the American position, see generally, Lisker, (1996), above.

131. 260 US 393 (1922); *Whitney Benefits, Inc. v US*, 926 F.2d 1169 (Fed. Cir.), cert. denied, 112 S Ct (1991); contrast with *Keystone Bituminous* cases, above, where the mining companies were required to leave about 2 per cent of all the coal they had title to unmined so as to be used to prevent subsidence. It was held this did not amount to a taking of the companies' mining rights. Justice Stevens tried to distinguish this case from *Pennsylvania Coal* by evaluating the purposes of each statute. He concluded that whereas the Kohler Act in Pennsylvania involved 'a balance of the private economic interests of coal companies against the private interest of the surface owners', the Subsidence Act in *Keystone* serves 'important public interest'. 107 S Ct at 1242; D. Kmiec, 'The Original Understanding of the Takings Clause is Neither Weak nor Obtuse' (1988) 88 Col. L. Rev. 1630.

132. 112 S. Ct. 2886 (1992; see also, *Keystone Bituminous* case, above, at 1243–6; *Miller v Schoene*, 276 US 272 (1928).

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economically feasible use'. But the courts found a compensable taking where there was a physical invasion or occupation of part of the property; based on the theory that the occupation denies the owner the right to exclude others—being 'one of the most essential sticks in the bundle of rights that are commonly characterised as property'.[133]

The possibility of finding a taking in a case of diminution in value of the property did find support in two decisions of the Federal Circuit Court of Appeals in 1994. In *Florida Rock Industries v United States*,[134] a denial of permit to the plaintiff to mine limestone in a wetlands area was held to amount to a partial compensable taking of property notwithstanding the fact that the land retained substantial value even after denial of the permit. In reaching that decision, the court relied on the analogy of physical occupation and wondered why physical occupation of, say, five acres of 100 acres of land for public use should attract compensation, but a wetland regulation diminishing value by a similar amount should be treated differently? In the court's opinion: 'the fact that the source of any particular taking is a regulation rather than a physical entry should make no difference.' The court then sought to draw the line between compensable diminution from a non-compensable one by stating that where a regulation ceases to produce a 'reciprocity of advantages' or 'direct compensating benefits' to the landowner, compensation becomes payable. Similarly, in *Loveladies Harbor, Inc. v US*, the court set the threshold denominator value by only considering the segment of the property affected by the regulation, and excluded all those which had either been sold or otherwise conveyed by the owner.[135] It then concluded that the segment affected by the regulation had been deprived of all economic value and hence found a compensable taking to have occurred under the total deprivation test stated in *Lucas*.

These two decisions have been criticised by environmentally sympathetic commentators as contrary to established precedent and of potentially destabilising effect.[136] To the best of our knowledge, no similar decisions have been issued either by the US Supreme Court or the European Court of Human Rights. Hence, apart from the decisions not emanating from the highest court (which invariably reduces their precedential value), the decisions are unlikely to be enthusiastically followed by other courts or tribunals bearing in mind present day concern over the environment and public opinion. Indeed neither

133. *Kaiser Aetna v US*, 444 US 164 (1979); *Loretto v TelePrompTer Manhattan CATV Corp.*, 458 S. 419 (1982); *Nollan v California Coastal Commission*, 483 US 825 (1987); *Dolan v City of Tigard*, 512 US 374 (1994).

134. 18 F.3d 1560, 1572 (Fed Cir 1994).

135. 28 F.3d 1171 (Fed Cir 1994).

136. Professor Blumm, in his article, 'The End of Environmental Law? Libertarian Property, Natural Law, and the Just Compensation Clause in the Federal Circuit' (1995) 25 Envt'l. Law 171, views the *Florida Rock* decision as 'exposing all wetlands regulation, [and possibly] all environmental and land use regulation to compensation claims', at 180. He also sees *Loveladies Harbor's* 'ratification of property owner's ability to segment property into small parcels' as likely to encourage landowners to 'act strategically to create segments capable of taking advantage of *Lucas*' categorical rule.', id at 189.

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the jurisprudence of the European Court of Human Rights nor that of other national courts[137] seem to share the Federal Circuit Court's opinion. Instead, they seem to adopt the same course and standard as in the *Lucas* decision.

The position of the European Court of Human Rights on the question seems to have been well articulated in *Kate v Italy*,[138] in which the applicant challenged the Rome District Council's decision to rescind an earlier approval to develop land granted to the applicant. The land in question formed part of the Ciborna park. The applicant claimed that the ban on development rendered his property devoid of any substance and therefore amounted to expropriation. In rejecting the applicant's claim, the European Court of Human rights stated the legal position under Italian law (which presumably does not conflict with the Convention) as follows: 'Where, following an administrative decision concerning specific property, the owner retains the ownership subject to restrictions which reduce to virtually nothing the economic value of the use or exchange of the property, this is known as "value expropriation" and it gives rise to an entitlement to compensation. This situation arises where the restriction is very severe—absolute prohibition—and where it is imposed for an indefinite period of time or remains in force for longer than is reasonable. On the other hand, there is no entitlement to compensation for damage resulting from a restriction which although imposed for an indefinite period does not have such a profound effect on the right, or a restriction which is due to cease within a reasonable time even though it is a very severe one.'

Using these judicial findings as an analogy and relying on the environmental spirit of NAFTA, Canada could have argued in the *Ethyl* case (above) that the legislation banning the importation and interprovincal transportation of MMT did not amount to expropriation of Ethyl's investment as the ban did not deny the company all economic uses of its investment nor would it have a profound effect on the company. It would only reduce the company's sales revenue or profitability but not render it totally valueless as the company could still engage in other businesses including the importation of other less dangerous products. This argument is strengthened by the fact that the company was not engaged in domestic manufacture of the product. Such an argument might be upheld by a tribunal because it is not clear whether a regulatory measure which adversely affects the profitability of an investment but falls short of rendering it economically useless would amount to expropriation under international law. Perhaps one needs to distinguish more clearly between a cause of action for damages based on discrimination—and a higher level of compensation in the case of a regulation which conforms to the more demanding test of full regulatory taking.

137. See, *Murphyores v Commonwealth of Australia* (1976), in Pritchard (ed), *Economic Development: Foreign Investment and the Law* (London: Kluwer/IBA, 1996), 105–6; *Manitoba Fisheries Ltd v R* (1978) 6 WW R 498; *British Columbia v Tener* (1985) 1 SC 533 based on; B. Barton, *Canadian Law of Mining* (Calgary: Canadian Institute of Resources Law, 1993) 169–91.

138. (1995) 19 EHRR 368;. See also, *Matos E. Silva case*, (1997) 24 EHRR 573.

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D. Environmental Measure Imposed in Breach of a Prior Commitment

Another relevant factor to be taken into account in determining whether a regulation went 'too far' is a breach of prior contractual commitment—sanctionable under, for example, Article 10(1) of the ECT by investment arbitration presumably leading to an award of damages.[139] The breach of a contractual commitment should be a factor in the balancing process to identify expropriatory action. Again, a breach of commitment could be a separate cause of action entitling the award of damages, but also fulfil the conditions of the more demanding requirements for expropriation if additional conditions were met.

Modern property consists of a bundle of relevant rights for a business project, and contractual rights, in particular with a government, are an important part of it.[140] Most MITs and modern BITs now include 'permits', 'licenses' and 'contracts' in their list of investment protected—presumably thus establishing the modern MIT definition of investor property. While a 'normal' contractual breach—such as defective or delayed performance—is not an indication of 'expropriation' of a contractual right,[141] a breach by a government of a typical governmental, public service and administrative contract should in many cases, be considered as tantamount to its confiscatory revocation.

Contractual commitment can be entered into by government in various ways—in the form of the natural resources licence agreement (production sharing, concession contract), of licences issued with contractual form and character [142] and even by formal governmental promise (in treaties, laws and even investment brochures) which are then acted upon and thereby accepted by investors,[143] as illustrated by in particular the ICSID '*Pyramids*' cases.[144]

139. E. Paasivirta, 'The Energy Charter Treaty and Investment Contracts: Towards Security of Contracts', in Walde (ed.), (1996), above, 349; Walde, in ibid. 294–7; Verhoosel, (1998), above.

140. As one commentator has noted, 'Unlike our ancestors, we no longer count our wealth by looking first to our social property of land, farm, buildings. Instead our principal means of support consist of legal property: stocks, bonds, pensions, an assortment of rights granted by the activist welfare state.' B. Ackerman, *Private Property and the Constitution* (1977), 166 quoted by Treanor, (1995), above, at 812; see also ibid. 798–803. In a similar vein, Professor Grey has observed that: 'Under the classical conception, actual dispossession was required before ownership rights were violated and property was taken. By contrast, modern lawyers—and multilateral treaties—are nominalists about "ownership"; they see property in resources as consisting of the infinitely divisible claims to possession, use, disposition, and profit that the people might have with respect to those things.' T. Grey, 'The Malthusian Constitution' (1986) 41 U Miami L Rev. 21 at 30, cited by Treanor, above, 812. On a similar position under international law, see Brower and Brueschke (1998), above, 372–5.

141. This was the decision of the recent ICSID-tribunal in the NAFTA *'Azinian'* case against Mexico, above.

142. T. Daintith, (ed); *The Legal Character of Petroleum Licences: A Comparative Study* (CPMLS, University of Dundee & IBA, 1981).

143. A. Fatouros, *Government Guarantees to Foreign Investors* (New York, 1962), 69; Waelde and Ndi, (1996), above; Sornarajah (1994), above, 86–7.

144. *Pyramids* case, decision (in Excerpt) published in 16 YB Comm. Arb (1991) 16, 32, comments by Delaume and Craig, 8 ICSID-Rev/FILJ (1993) 231, 264; also: *SPP v Arab Republic of Egypt*, 8 ICSID Rev./FILJ (1993) 328.

If a government confirms that it is no longer bound by a 'typically governmental' contractual commitment and if its breach has no 'commercial', but a typically governmental character, then both the rules on breach of agreement and expropriation under modern MITs become applicable.

Contractual commitment by a government formalises a legitimate expectation with the foreign investor.[145] The investor, in reliance on such commitment, takes the commercial risk by investing his capital, technology and managerial skills into a project. A breach of the commitment by the government undermines that legitimate expectation. Such breach needs to be taken into account in determining whether the breach is confiscatory.[146] The existence of a commitment by the government may not extinguish the government's legislative authority to change or enact new environmental laws.[147] But where such regulation severely impacts on the investment (eg by rendering it no longer profitable to operate, or adding exorbitant costs on the investor—which were not contemplated at the time of the investment), then that breach of commitment weighs in on the side of the factors indicating expropriation.[148] This principle applies more so, if the commitment was made recently by the host State when it had a fair idea about the environmental implications of the investment project, and when no substantial change has occurred in scientific knowledge and environmental standards regarding the project in question.[149]

145. Waelde and Ndi, (1996), above.

146. In *Opel v EU Council* (1997) All ER 97, the ECJ held that the principle of protection of legitimate expectation formed part of the Community legal order and which could be relied on by an economic operator to whom an institution had given justified hopes.

147. In *Kate v Italy* (1995) 19 EHRR 368, the court held that the conclusion of an agreement between the applicant and the Rome District Council, giving effect to approval of the claimant's land development proposal, cannot prevent the authorities from acting in the planning sphere. Perhaps what influenced that decision was the earlier finding by the Commission of Human Rights that the housing development agreement concluded with the applicant contained an exemption clause which explicitly reserved the authoritie' prerogatives with regard to regulating urban development. However, in *Fredin v Sweden*, there was an implicit suggestion by the court to the effect that, had the authorities given some assurances to the applicants that they would continue to mine the gravel pit for a longer period than provided by the regulation in question, that would have been taken into account in deciding the case. In fact it is widely accepted that the principle of legitimate expectation is a general principle of law under the European Union laws and Member States laws. See generally, Schwarze (1992), above ch. 6 esp. at 1114–53; Usher (1998) op. cit. 52 ff.

148. eg see, *US v Winstar Corp. et al*. 116 S. Ct. 2432 (1996) in which the US Supreme Court held that the government cannot escape from its contractual obligations by relying on changes in the regulatory regime; further discussion of the *Winstar* decision in Rose-Ackerman and Rossi (2000) above. Although the case is a domestic one nonetheless the reasoning is equally applicable to an international setting. The discussion of a divided court is reflective of the positions usually taken by international lawyers in the assessment of the legal validity of stabilisation provisions in investor-government agreements.

149. This seems to be the position taken by the ICJ in *Gabčikovo-Nagymaros (Hungary v Slovakia)*, 37 ILM (1998) 162, in which the Court held that there had not beeen a substantial change in scientific knowledge from the time the Treaty was signed in 1977 and 1989, when Hungary decided to suspend the project. Furthermore, the Court observed that even if there had been any change in scientific knowledge, Hungary was estopped from relying on it because of its

In determining whether a regulatory taking had occurred, the US Supreme Court did consider, in a number of cases, the concept of 'interference with distinct investment-backed expectations' as a relevant factor.[150] What that means is that the court considers the effects of the new regulation on property owners who relied on the then existing regulation and altered their economic position. The principle is also used to judge against retroactive application of new laws if they will severely undermine the investment expectations of property owners or economic operators.[151] The basis of the principle is fairness and the need for relative certainty in the regulatory regime which governs economic activities.

E. 'Special Sacrifice' Imposed on Investor to the Benefit of the Community at Large

A last criterion that emerges in particular from comparative constitutional law[152] is the concept of the 'Sonderopfer'—ie that special sacrifices imposed by regulation on individuals for the benefit of the community at large need to be compensated. The concept constitutes the core of German expropriation law; but it is also reflected in pertinent US Supreme Court practice: the relevant Fifth Amendment is designed to prevent 'the *public from loading upon one individual more than his just share of the burdens of government, and says that when he surrenders to the public something more and different from that which is exacted from other members of the public, a full and just equivalent shall be returned to him*'.[153] While there are undertones of the discrimination principle in the 'special sacrifice' test, it goes beyond this concept. There may well be criteria for the regulatory confiscation which cover indiscriminately all in the same situation—ie mineral titleholders in a newly established national park. But the 'Sonderopfer' test would still be met since this particular group, having obtained mineral title in good faith and carried out subsequent investment in it, is now asked to give up its legitimate commercial interest for the benefit of the community as such.[154] The regulatory taking/compensation determination simulates a bargain negotiated on behalf of the community by the State with the property owners: They are asked to give up their legitimate

conduct towards the project which indicated that it was still interested in seeing the project completed. This decision suggests that an investment agreement that was entered into 20 or 30 years ago might be viewed differently (from the environmental perspective) from a relatively more recent one.

150. *Penn Central Transport Co. v New York City*, 438 US 104, 124 (1979).

151. *Laitos* (1996), above, 288–90.

152. Van der Walt, *The Constitutional Property Clause*, *Kenwyn South Africa* (1997); Van der Walt, (1999) op. cit.; Rose-Ackerman and Rossi (2000) at n. 46; European Court of Justice (First Instance) in the *Dorsch* case (1998), as cited above).

153. *Mononghahela Navigation v US*, 148 US 312 (1893); also *Armstrong v US*, 364 US 40 (1960).

154. See, the Australian cases quoted in Pritchard, 1996 (above) ; also *Columbia v Tender*, a Canadian case: 1985 ISCR 533 as discussed in Dearden, op. cit. at 118, 199.

expectation of using their investment-backed property in exchange for the compensation to be paid. The duty to pay compensation because of a finding of 'regulatory taking' is here part of the normal function of a constitutional guarantee: to protect a minority's rights against the majority, to make the majority pause and consider the cost of its action—rather than shift the cost to the minority. This applies particularly so where there is often no well-reflected and supported action by a true majority, but rather the capturing of the government machinery by well-organised special interest groups. The constitutional (or treaty-based) duty to pay compensation means that the cost of such capture of the machinery of government should be made transparent.

IV. CONCLUSION

This study has revealed the subtleties involved in applying the new concept of 'regulatory taking' (governmental action 'tantamount' to expropriation) as evolving in modern multilateral and bilateral economic treaties, in judicial and arbitral practice. Contrary to the claims made recently with respect to the aborted MAI and with respect to NAFTA by environmentalist NGOs, it is unlikely that courts or arbitrators will find a compensable expropriation in cases where governments issue environmental regulation for legitimate purposes, in accordance with the state of scientific knowledge and accepted international guidelines. It is only when the environment becomes a pretext for domestic protectionism and when elements of discrimination, of breach of governmental commitments or of use of regulation to extract benefits unrelated to the legitimate purpose of the regulation can be detected that a regulatory taking would, and should, be found. In the extreme case of complete and indefinite destruction of the economic value of property by otherwise fully legitimate regulation, and if individuals are required by regulation to make a special sacrifice in terms of their proprietary rights for the benefit of the society at large, compensation is also owed. This is a fair outcome since the community should pay the individual if it compels the individual to bear a special and exorbitant sacrifice for the community's preferences.

The codification of customary international law on investor protection in modern MITs is no unreasonable fetter on governmental policies. It places international law controls over the tendency of governments to discriminate against and squeeze foreign investors to the benefit of domestic competitors or special interest groups which are able to capture the regulatory power of national governments—often to the detriment of the people at large. Such controls can be seen as a desirable constraint over the domestic political process to maintain the benefits that a country and its people gain from their integration with the wealth-generating global economy. It is also wrong to infer from the recent cases of direct investor-State litigation (primarily under NAFTA) that foreign investors can keep governments from pursuing legitimate policies. In these cases, as in all litigation, one need not to look at exaggerated claims made

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in adversarial proceedings or investor-State bargaining, but at the ultimate award. What the litigation rights now available to foreign investors against host States do is to erect a warning sign to governments that uncontrolled submission to domestic competitor and special interest group pressure can lead to undesirable international sanctions—thus in fact support governments to stand firm against domestic pressure for discrimination and protectionism. These modern treaty-rules support the national forces of 'good governance' in their conflict and bargaining with special interest groups. The direct investor-State litigation rights are a step towards good governance in international economic relations. Modern multinational economic treaties provide proto-constitutional elements of governance for the global economy. It is hard to see how the trend towards international regulation of the global economy should not be conducive to a global environmental agenda: creating a well functioning global economy will create the resources for environmental protection which are not available in closed economies.

In this analysis we have relied to a substantial extent on the rich comparative experience, primarily from US jurisprudence and debate on 'regulatory taking' and the somewhat more conservative judicial decisions by the European Court of Justice and European Court of Human Rights. In our view, the constitutional law character of these cases makes them particularly apposite to serve as a laboratory—but also as a relative precedent—for the interpretative challenges in multilateral treaties now arising. Similar to national (or in the EU or ECHR, European) constitutional law, multilateral treaties now serve to establish superior law controls on domestic regulation of economic activities. But such national experience cannot be automatically transposed into the process of treaty interpretation. One needs to bear in mind the specific policies and conditions of the treaties and their application.

Specific rules need also to be fine-tuned in response to the situation of a country—where the powers of weak governments to carry out necessary regulation should not be frozen forever through deals with much stronger multinational companies. Similarly, one will have to look at the nature of the industry and investment at issue: investment of a long-term nature exposing the foreign investor to a comparatively higher political and regulatory risk (eg natural resources development; utilities and infrastructure with high vulnerability to domestic regulation) will require and justify a much higher standard of regulatory stability than investments with rapid pay-back and high environmental sensitivity.[155] The design of more specific rules (by additional rule-making in treaty-format or by interpretative action) must also assess how such rules will

155. Activities with particular environmental sensitivites thus justify a greater intervention by environmental regulation as such regulation specifies the inherent and implied obligations on property not to be injurious to the community—see the US Supreme Court, *Mugler v Kansas* 123 US 623, 665 (1887); *Keystone Bituminous Coal v De Benedictis*, 480 US 470 (488, 489 (1987). But then such regulation must conform with the essential standards of non-discrimination and fairness (both substantive and procedural).

work, not just in litigation but in investor-State bargaining in the shadow of relevant rules. A rule which would open up the 'floodgates' of easy harassment of weak governments by litigious investors is not right—but equally nor is a rule which makes it virtually impossible for an aggrieved investor to seek justice from an independent tribunal.

This study has focused on the concept of 'regulatory taking' as reflected in the references to actions 'tantamount to expropriation' in modern treaties. There are other disciplines—discrimination, compliance with contractual commitments and 'fair and equitable treatment' which can both influence a finding of regulatory expropriation and constitute independent, often overlapping, causes of action. Perhaps we are moving towards a single, comprehensive international tort of regulatory misconduct.[156]

156. T. Waelde, JWT April 2000 op. cit; and BusLaw International (1999) op. cit. above and the writings of Todd Weiler, op. cit.

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