

A Bottom-Up Dilemma: International Investment Law and Environmental Governance

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Global environmental governance reflects a bottom-up trend of polycentric, adaptive, and participatory decision-making processes. The legal regime for international investment, by contrast, has a top-down structure that requires consistent, stable, and predictable governance of foreign investment in host states. This difference in structure results in an emerging “bottom-up” dilemma where states face conflicting obligations regarding the distribution of governing authorities, the frequency of norm evolution, and the inclusiveness of decision-making. This paper analyzes three aspects of the bottom-up dilemma—governing actors, scales of governance, and modes of governance—as reflected in the investment arbitration case law. It then conducts an analysis of investment treaties to assess their effectiveness in solving the dilemma and makes proposals for future treaty reform and arbitration practice. In conclusion, the paper proposes to strike a balance between, on the one hand, the protection of foreign investors’ interests in a dynamic and complex governing process, and, on the other hand, the preservation of host states’ policy space to adopt a polycentric and bottom-up governance structure.

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I. INTRODUCTION

Global environmental governance is developing in a polycentric and bottom-up trend.¹ The failure to reach an effective international regime for some major environmental crises has led environmentalists to move from the pursuit of a top-down comprehensive international legal regime to consider a pluralist and decentralized governance structure. For example, the United Nations Framework Convention on Climate Change (UNFCCC) and the subsequent Paris Agreement have adopted a bottom-up structure for Contracting Parties to pledge and review their own Nationally Determined Contributions (NDCs).² The making of climate laws and policies mostly takes place on the domestic level rather than on the international level. As of 2022, the Climate Change Laws of the World database has recorded more than 2,000 climate laws and policies in around 200 countries.³ Climate lawsuits have been mostly initiated in domestic courts rather than in international tribunals.⁴ Climate norms are shaped by not only national authorities but also by political sub-units, such as provisional or local governments.⁵ Cities, for example, are crucial for enacting local laws and policies to respond to climate change.⁶ Other non-state actors, including local communities, nongovernmental organizations (NGOs), media, and expert groups, play indispensable and independent roles in climate governance. In sum, climate governance is exhibiting a polycentric governance structure with dynamic interaction among multiple state and non-state decision-makers from different levels and scales.⁷

1. Keith Carlisle & Rebecca Gruby, *Polycentric Systems of Governance: A Theoretical Model for the Commons*, 47 POL'Y STUD. J. 921, 923 (2019); Tanya Heikkila et al., *Bringing Polycentric Systems into Focus for Environmental Governance*, 28 ENV'T POL'Y & GOVERNANCE 207 (2018); Steve Rayner, *How to Eat an Elephant: A Bottom-Up Approach to Climate Policy*, 10 CLIMATE POL'Y 615 (2010).

2. Andrew Jordan et al., *Emergence of Polycentric Climate Governance and Its Future Prospects*, 5 NATURE CLIMATE CHANGE 977, 978 (2015).

3. *Climate Change Laws of the World*, GRANTHAM RSCH. INST. ON CLIMATE CHANGE & ENV'T, <https://climate-laws.org/> [<https://perma.cc/5XHD-ZFEU>] (last visited Nov. 22, 2022).

4. *Litigation Cases*, GRANTHAM RSCH. INST. ON CLIMATE CHANGE & ENV'T, https://climate-laws.org/litigation_cases [<https://perma.cc/3UYU-QYJX>] (last visited Nov. 22, 2022).

5. Gro Sandkjaer Hanssen et al., *Multi-Level Coordination of Climate Change Adaptation: By National Hierarchical Steering or by Regional Network Governance?*, 18 LOC. ENV'T 869, 887 (2013).

6. MICHELE BETSILL & HARRIET BULKELEY, *CITIES AND CLIMATE CHANGE: URBAN SUSTAINABILITY AND GLOBAL ENVIRONMENTAL GOVERNANCE 2* (Routledge, 1st ed. 2003).

7. Elinor Ostrom, *A Polycentric Approach for Coping with Climate Change* 16–22 (World Bank Pol'y Rsch., Working Paper No. 5095, 2009); Daniel Cole, *Advantages of a Polycentric Approach*

Today, environmental protection in many other issue areas, including deforestation,⁸ desertification,⁹ and coastal and marine protection¹⁰ operates in such polycentric rather than monocentric governance structures. Governance, as a broad concept, commonly refers to “the development of governing styles in which boundaries between and within public and private sectors have become blurred.”¹¹ Vincent Ostrom defines polycentric governance as a form of governance with multiple decision-making centers that are formally independent from each other but function as an interactive system.¹² This conception is opposed to a monocentric governance structure with a single unitary governing power.¹³ The advantages of polycentric environmental governance include greater adaptive capacity in circumstances of ecological and social change, production of institutions that better fit natural resources systems, and mitigation of the risk of institutional failure through redundancy of governing agencies.¹⁴ The environmental governance literature in the past few decades has developed several inter-linked theories—including polycentric governance, network governance, multi-level governance, interactive governance, adaptive governance, and evolutionary governance—to describe this multilayered and dynamic structure of environmental regime.¹⁵

Compared with environmental governance, foreign investment governance operates through a more effective international legal regime. There are thousands of binding investment treaties that are

to Climate Change Policy, 5 NATURE CLIMATE CHANGE 114, 114 (2015); Robert Keohane & David Victor, *The Regime Complex for Climate Change*, 9 PERSP. POL. 7, 7 (2011).

8. R. Patrick Bixler, *From Community Forest Management to Polycentric Governance: Assessing Evidence from the Bottom Up*, 27 SOC’Y & NAT. RES. 155, 155–56 (2014); Harini Nagendra & Elinor Ostrom, *Polycentric Governance of Multifunctional Forested Landscapes*, 6 INT’L J. COMMONS 104, 104–105 (2012).

9. Kyle Danish, *International Environmental Law and the “Bottom-Up” Approach: A Review of The Desertification Convention*, 3 IND. J. GLOB. LEGAL STUD. 133, 158 (1995).

10. Stefan Partelow et al., *Environmental Governance Theories: A Review and Application to Coastal Systems*, 25 ECOLOGY & SOC’Y 19, 23 (2020); Victor Galaz et al., *Polycentric Systems and Interacting Planetary Boundaries—Emerging Governance of Climate Change—Ocean Acidification—Marine Biodiversity*, 81 ECOLOGICAL ECON. 21, 24 (2012).

11. Gerry Stoker, *Governance as Theory: Five Propositions*, 50 INT’L SOC. SCI. J. 17, 17 (1998).

12. Vincent Ostrom et al., *The Organization of Government in Metropolitan Areas: A Theoretical Inquiry* 55 AM. POL. SCI. REV. 831, 831 (1961).

13. Andrew Jordan et al., *Governing Climate Change Polycentrically: Setting the Scene*, in GOVERNING CLIMATE CHANGE 3, 4 (Andrew Jordan et al. eds., 1st ed. 2018).

14. Keith Carlisle & Rebecca Gruby, *Polycentric Systems of Governance: A Theoretical Model for the Commons*, 47 POL’Y STUD. J. 921, 935–45 (2019).

15. For a comprehensive review of environmental governance theories, see JAMES EVANS, ENVIRONMENTAL GOVERNANCE 1–20 (Routledge eds., 1 ed. 2012).

implemented through international dispute settlement forums. Though mostly made bilaterally, investment treaties have very similar structures and provisions, providing standards of protection to foreign investors against discrimination, unfair or inequitable treatment, and expropriation without due compensation. Investment treaties are implemented in states in an integrated manner from federal, state, to local levels, and the national government will be held accountable for any breach of treaty obligations by its political sub-units. In most investment treaties, a foreign investor is entitled to directly bring arbitration claims against the host state, as a unitary disputing party, in front of international tribunals. To date, the number of cases under such investor-state dispute settlement (ISDS) mechanism has passed the 1,000 mark.¹⁶ In many cases, states' regulatory measures on public interests, including the environment, have been claimed by foreign investors as a breach of investment treaty obligations. This has caused fierce criticism and backlash against international investment law in the past two decades.¹⁷

Within the rich scholarship on the tension between international investment law and environmental protection,¹⁸ few have attributed the problem to the different governance structures of the two regimes. This paper attempts to fill the gap. Through the lens of governance theories, this paper argues that decentralized, adaptive, and participatory environmental governance conflicts with current international investment law, which regards the state as an integrated governing actor that should provide stable and consistent governance in an independent way from public interference. There is a

16. UNCTAD, INTERNATIONAL INVESTMENT AGREEMENTS ISSUES NOTE, INVESTOR-STATE DISPUTE SETTLEMENT CASES PASS THE 1,000 MARK: CASES AND OUTCOMES IN 2019 (July 8, 2020), <https://unctad.org/system/files/official-document/diaepcbinf2020d6.pdf> [<https://perma.cc/9MF4-X39Z>].

17. See, e.g., Michael Waibel et al., *The Backlash Against Investment Arbitration: Perceptions and Reality*, KLUWER L. INT'L (2010); Susan Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521 (2005); Charles Brower & Stephen Schill, *Is Arbitration a Threat or a Boom to the Legitimacy of International Investment Law*, 9 CHI. J. INT'L L. 471 (2008).

18. See, e.g., RESEARCH HANDBOOK ON ENVIRONMENT AND INVESTMENT LAW (Kate Miles ed., Edward Elgar publishing ed., 2019); Howard Mann, *Reconceptualizing International Investment Law: Its Role in Sustainable Development*, 17 LEWIS & CLARK L. REV. 521 (2013); SAVERIO DI BENEDETTO, INTERNATIONAL INVESTMENT LAW AND THE ENVIRONMENT (Elgar Int'l Inv. L. Series 2013); HARNESING FOREIGN INVESTMENT TO PROMOTE ENVIRONMENTAL PROTECTION: INCENTIVES AND SAFEGUARDS (Pierre-Marie Dupuy & Jorge Viñuales eds., 2013); JORGE VIÑUALES, GRADUATE INT. GENEVA, FOREIGN INVESTMENT AND THE ENVIRONMENT IN INTERNATIONAL LAW (Cambridge Stud. in Int'l and Compar. L. eds., 2012); Andreas Kulick, *International Investment Law and the Environment*, in GLOBAL PUBLIC INTEREST IN INTERNATIONAL INVESTMENT LAW 225-268 (Cambridge Stud. in Int'l & Compar. L. eds., 2012).

“bottom-up” dilemma between the polycentric environmental governance and the hierarchical top-down investment governance. An examination of case law illustrates three aspects of this dilemma: (1) *governing actors*, referring to the tension between participatory environmental governance and investment law prohibiting politically-motivated state actions; (2) *scales of governance*, referring to the tension between multi-leveled environmental governance and investment law requiring consistent decision-making; and (3) *modes of governance*, referring to the tension between adaptive environmental governance and investment law protecting foreign investors’ expectations.

The remainder of this paper proceeds as follows: Part II illustrates the fragmentation between international investment and environmental regimes. Part III explores the different governing structures of investment and environmental regimes that result in a bottom-up dilemma. Part IV analyzes three aspects of the bottom-up dilemma in investment arbitration case law. Part V conducts an empirical analysis of two major patterns of reforming investment treaties, and compares their effectiveness in solving the bottom-up dilemma. Part VI concludes with an overview.

II. THE FRAGMENTATION OF INTERNATIONAL INVESTMENT AND ENVIRONMENTAL REGIMES

The world order lacks centralized legislative, administrative, and enforcement organs comparable to those at the domestic level. To address common concerns, actors in international affairs cooperate with each other to build international regimes that are defined as “principles, norms, rules, and decision-making procedures around which actor expectations converge in a given issue-area.”¹⁹ Nowadays, there are a large number of international regimes with specific objectives, norms, and institutions, which contributes to a fragmentation problem.²⁰

The theme “fragmentation of international law” has emerged to address the anxiety resulting from conflicting and overlapping international legal rules and institutions.²¹ The literature tends to

19. Stephen Krasner, *Structural Causes and Regime Consequences: Regimes as Intervening Variables*, 36 INT’L ORG. 185, 185 (1982).

20. See generally REGIME INTERACTION IN INTERNATIONAL LAW: FACING FRAGMENTATION (Margaret Young ed., 2012).

21. Martti Koskenniemi & Päivi Leino, *Fragmentation of International Law? Postmodern Anxieties*, 15 LEIDEN J. INT’L L. 553, 556 (2002).

frame the root of the fragmentation of international law as a conflict of goals²² or rationalities²³ underlying different international regimes. Besides the “normative parallelism” through international law-making such as treaties and customary international law,²⁴ the increasing number of international courts and tribunals has exaggerated the fragmentation of international law through diverse interpretations of legal norms.²⁵ In 2006, the United Nations (UN) International Law Commission (ILC) released its study report on “Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law,”²⁶ advocating a tool-box for resolving normative conflicts within international law.²⁷ Different legal theories, including constitutionalism²⁸ and pluralism,²⁹ have been applied to explain and solve the fragmentation.

The fragmentation of international investment and environmental regimes is part of this big picture. In contrast to environmental treaties whose soft treaty language and weak enforcement mechanisms are often criticized as “toothless,” the past five decades have witnessed the rapid development of international investment law, which now consists of more than 3,000 international investment

22. Dirk Pulkowski, *The Law and Politics of International Regime Conflict* 21–22 (2014).

23. Andreas Fischer-Lescano & Gunther Teubner, *Regime-Collisions: The Vain Search for Legal Unity in the Fragmentation of Global Law*, 25 MICH. J. INT'L L. 999, 1004 (2003).

24. MULTI-SOURCED EQUIVALENT NORMS IN INTERNATIONAL LAW (Tomer Broude & Yuval Shany eds., 2011).

25. For discussions on the impacts of the proliferation of international courts and tribunals, see Rosalyn Higgins, *A Babel of Judicial Voices? Ruminations from the Bench*, 55 Int'l Compar. L. Q. 791 (2006); Jonathan Charney, *The Impact on the International Legal System of the Growth of International Courts and Tribunals*, 31 N.Y.U. J. Int'l L. Pol. 697 (1998).

26. Int'l L. Comm. Study Grp. on the Fragmentation of Int'l L., *Conclusions of the Work of the Study Group on the Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law at its Fifty-Eighth Session*, U.N. Doc. A/61/10, ¶ 251 (2006).

27. The tool-box includes (1) *lex specialis*, for solving conflicts between special and general law; (2) *lex posterior*, for solving conflicts between successive norms; (3) *jus cogens*, for solving conflicts of norms with different levels of importance; and (4) treaty integration and systematic interpretation. *Id.*

28. Erika De Wet, *The International Constitutional Order*, 55 INT'L COMPAR. L. Q. 51 (2006); Deborah Cass, *THE CONSTITUTIONALIZATION OF THE WORLD TRADE ORGANIZATION: LEGITIMACY, DEMOCRACY, AND COMMUNITY IN THE INTERNATIONAL TRADING SYSTEM* (2005); Jan Klabbers et al., *THE CONSTITUTIONALIZATION OF INTERNATIONAL LAW* (2011); Mattias Kumm, *The Legitimacy of International Law: A Constitutionalist Framework of Analysis*, 15 EUR. J. INT'L L. 907 (2004).

29. Andreas Fischer-Lescano & Gunther Teubner, *Regime-Collisions: The Vain Search for Legal Unity in The Fragmentation of Global Law*, 25 MICH. J. INT'L L. 999 (2004); *NORMATIVE PLURALISM AND INTERNATIONAL LAW: EXPLORING GLOBAL GOVERNANCE*, ASIL Studies in International Legal Theories (Jan Klabbers & Touko Piiparinen eds., 2013); NICO KRISCH, *BEYOND CONSTITUTIONALISM: THE PLURALIST STRUCTURE OF POSTNATIONAL LAW* (2010); PAUL SCHIFF BERMAN, *GLOBAL LEGAL PLURALISM: A JURISPRUDENCE OF LAW BEYOND BORDERS* (2012).

agreements (IIAs).³⁰ The IIAs accord substantive protection to foreign investors and commonly allow foreign investors to directly bring claims against host states under the investor-state dispute settlement (ISDS) mechanism.³¹ The rationale underlying the proliferation of the investment regime is the belief that the interests of foreign investors and states are mutually compatible and reinforcing.³² For capital-exporting countries, investment treaties provide substantive and procedural protection to their overseas investors and investments.³³ For capital-importing countries, investment treaties send a signal to hesitating foreign investors that the country is committed to international obligations, aiming at attracting foreign investments so as to boost the domestic economy and development.³⁴ This quest of mutual benefits promotes states to sign investment treaties that deliberately and reciprocally renounce a part of their sovereignty in exchange for competitiveness in attracting foreign investments.³⁵

However, with the increase of ISDS cases since the 1990s,³⁶ a number of states' environmental regulatory conduct through legislation, administration, and adjudication has been claimed by foreign investors as a violation of investment treaty obligations in ISDS cases.³⁷ The broad and vague standards of protection in

30. *Investment Policy Hub*, UNCTAD, <https://investmentpolicy.unctad.org/> [<https://perma.cc/XXX4-HHS8>] (last visited Nov. 19, 2022).

31. José Alvarez, *Pocketbooks of the Hague Acad. of Int'l L., The Public International Law Regime Governing International Investment* 30–31 (2011).

32. RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 21 (2d ed. 2012).

33. JESWALD SALACUSE, *THE LAW OF INVESTMENT TREATIES* 48–49 (2d ed. 2015).

34. The empirical literature has inconsistent views on whether investment treaties have positive impacts on the promotion of foreign investments. *See, e.g.*, Jason Webb Yackee, *Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints From Alternative Evidence* 51 VA. J. INT'L L. 397 (2011); Matthias Busse et al., *FDI Promotion Through Bilateral Investment Treaties: More Than a Bit?*, 146 REV. WORLD ECON. 147 (2010); Julien Chaisse & Christian Bellak, *Do Bilateral Investment Treaties Promote Foreign Direct Investment? Preliminary Reflections on A New Methodology*, 3 TRANSNAT'L CORP. REV. 3 (Dec. 2011).

35. DOLZER & SCHREUER, *supra* note 32, at 20; SALACUSE, *supra* note 33, at 46. But the IIA regime may have negative impacts on developing countries. *See* Andrew Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639 (1998); M. Sornarajah, *State Responsibility and Bilateral Investment Treaties*, 20 J. WORLD TRADE L. 79 (1986).

36. UNCTAD, *supra* note 16.

37. *See, e.g.*, *Metalclad Corporation v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award (Aug. 30, 2000) (*Metalclad*); *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award (May 29, 2003) (*Tecmed*); *Methanex Corporation v. United States of America*, UNCITRAL, Final Award of the Tribunal on Jurisdiction and Merits (Aug. 3, 2005) (*Methanex*); *Glamis Gold, Ltd. v. United States of America*, UNCITRAL, Award (June

investment treaties accord wide discretion to international tribunals to judge the policy-making by the host state, including environmental decision-making.³⁸ This generates the criticism that international investment law may chill the host state's right to regulate.³⁹ As a response, the recent efforts of reforming international investment law tend to preserve states' regulatory rights from investment obligations. In the treaty-making, there has been a clear trend of reforming investment treaties to accord more deference to states' regulatory rights.⁴⁰ In the adjudication, recent international investment arbitrators have used the host states' police powers as a justifiable ground for what would otherwise constitute a violation of investment treaty clauses.⁴¹ However, inadequate attention has been paid to how the bottom-up structure of environmental governance contributes to the investment-environment tension in the ISDS cases, which creates difficulties for tribunals when harmonizing investment and environmental interests.

III. THE INVESTMENT-ENVIRONMENT TENSION FROM A GOVERNANCE PERSPECTIVE

The nature of environmental problems and the difficulties of international cooperation on global commons contribute to a bottom-

8, 2009) (*Glamis Gold*); *Merrill & Ring Forestry L.P. v. Canada*, ICSID Case No. UNCT/07/1, Award (Mar. 31, 2010) (*Merrill & Ring*); *Marion Unglaube v. Republic of Costa Rica*, ICSID Case No. ARB/08/1, Award (May 16, 2012) (*Unglaube*); *William Ralph Clayton et al. v. Government of Canada*, UNCITRAL, PCA Case No. 2009-04, Award on Jurisdiction and Liability (March 17, 2015) (*Bilcon*); *Adel A Hamadi Al Tamimi v. Sultanate of Oman*, ICSID Case No. ARB/11/33, Award (Nov. 3, 2015) (*Al Tamimi*). In addition, recent years have seen a large number of cases concerning climate policies (particularly on renewable energy); for an overview of relevant cases, see UNCTAD, *supra* note 16, at 4.

38. Stephan Schill, *System-Building in Investment Treaty Arbitration and Lawmaking* 12 GER. L. J. 1083, 1085 (2011); Caroline Henckels, *Protecting Regulatory Autonomy Through Greater Precision in Investment Treaties: The TPP, CETA, And TTIP*, 19 J. INT'L ECON. L. 27, 28 (2016).

39. The term "right to regulate" has been widely used in the international investment law scholarship to describe the host state's policy space that should be carved out from investment protection obligations. For discussions on the definition and scope of states' right to regulate in international investment law, see, e.g., AIKATERINI TITI, *THE RIGHT TO REGULATE IN INTERNATIONAL INVESTMENT LAW* (Marc Bungenberg et al. eds., 2014); LONE WANDAHL MOUYAL, *INTERNATIONAL INVESTMENT LAW AND THE RIGHT TO REGULATE: A HUMAN RIGHTS PERSPECTIVE* (2016).

40. UNCTAD, *INTERNATIONAL INVESTMENT AGREEMENTS REFORM ACCELERATOR 2* (2020).

41. For discussions on the application of the police powers doctrine in the investment arbitration jurisprudence, see Catharine Titi, *Police Powers Doctrine and International Investment Law*, in GEN. PRINCIPLES L. INT'L INV. ARB., 323 (Andrea Gattini & Attila Tanzi eds., 2018); Noam Zamir, *The Police Powers Doctrine in International Investment Law*, 14 MANCHESTER J. INT'L ECON. L. 318 (2017); Crina Baltag, *Investment Arbitration and Police Powers: Emerging Issues*, 5 EUR. INV. L. AND ARB. REV. ONLINE 392 (2020).

up trend of environmental governance with polycentric, participatory, and adaptive features. However, foreign investment governance in the past half-century has developed a strong treaty system that is implemented in sovereign states in an integrated way. This leads to tension in governance between foreign investment and environmental protection.

A. The Governance Structure of Environmental Protection

The structure of a regime is designed to fit the nature and scale of the issue area it addresses. Natural resource systems and environmental problems often transcend territorial and administrative jurisdictions, which makes environmental governance unlikely to be confined within a single regulatory level or jurisdiction.⁴² Moreover, the complexities and uncertainties of environmental problems inherently need a diversified and flexible governance structure that is resilient to abrupt change and suitable for facilitating a learning process. As noted by Peter Haas:

The best institutional structure for dealing with complex and uncertain policy environments is loose, decentralized, dense networks of institutions and actors that are able to quickly relay information, and provide sufficient redundancies in the performance of functions so that the elimination or inactivity by one institution does not jeopardize the entire network. Decentralized information-rich systems are the best design for addressing highly complex and tightly-coupled problems. In short, strong centralized institutions are fundamentally unecological. They run counter to the ecological principle of requisite diversity or flexibility; inhibit random mutation, or policy innovation; and are easily captured by single powerful parties.⁴³

The nature of environmental problems contributes to a polycentric governance structure with multiple organizational scales. The multi-level environmental governance (MLEG) theory, focusing on vertical allocation of powers, refers to different levels of environmental authorities from local, regional, national to international levels.⁴⁴ The development of environmental governance in polycentric and multi-

42. Tanya Heikkila et al., *Bringing Polycentric Systems into Focus for Environmental Governance*, 28 ENV'T POL'Y GOV. 207, 207 (2018).

43. Peter Haas, *Addressing the Global Governance Deficit*, 4 GLOB. ENV'T POL. 1, 7 (2004). See also Jans Newig, *Synapses in the Network: Learning in Governance Networks in the Context of Environmental Management* 15 ECOLOGY & SOC. 24, 27 (2010).

44. For an introduction to the multi-level governance theory and its application to environmental governance, see Jenny Fairbrass & Andrew Jordan, *Multi-level Governance and Environmental Policy*, in MULTI-LEVEL GOVERNANCE 147 (Ian Bache & Matthew Flinders eds., 2004).

leveled scales has triggered the understanding of environmental governance as a “network” in which state and non-state actors interact in a decentralized and pluralistic way.⁴⁵ Despite the challenges of vertical integration across organizational levels, multi-level environmental governance has its economic rationales, including facilitating collective action through smaller-scale cooperation, reducing governance costs by enforcing an environmental measure within its optimal scale of implementation, and matching the multi-functional nature of natural resources that generate ecosystem services in different spatial scales.⁴⁶ For example, regional- or local-level governance might be more effective than national- or international-level initiatives for addressing some environmental problems.⁴⁷

Compared to a conventional top-down governance structure, a bottom-up environmental governance structure stresses the role of diverse state and non-state actors from different levels of jurisdictions in decision-making. Environmental governance literature has well recognized that the democratic and reflexive form of governance has positive impacts on environmental protection.⁴⁸ The rich scholarship on collaborative conservation,⁴⁹ civic environmentalism,⁵⁰ community-based initiatives,⁵¹ and interactive

45. Stefan Partelow et al., *supra* note 10, at 19; Jeremy Pittman & Derek Armitage, *Network Governance of Land-Sea Social-Ecological Systems in the Lesser Antilles*, 157 *ECOLOGICAL ECON.* 61, 62 (2019).

46. Jouni Paavola, *Multi-Level Environmental Governance: Exploring the Economic Explanations*, 26 *ENV. POL'Y GOV.* 143, 146–50 (2016).

47. Jörg Balsiger & Stacy VanDeveer, *Introduction: Navigating Regional Environmental Governance*, in 12 *GLOB. ENV'T POL'Y (SPECIAL ISSUE)* 1 (2012); MICHELE M. BETSILL & HARRIET BULKELEY, *CITIES AND CLIMATE CHANGE: URBAN SUSTAINABILITY AND GLOBAL ENVIRONMENTAL GOVERNANCE* 2–3 (2003).

48. Mark S. Reed, *Stakeholder Participation for Environmental Management: A Literature Review*, 141 *BIOLOGICAL CONSERVATION* 2417, 2418 (2008); Jordi Peris et al., *Scrutinizing the Link Between Participatory Governance and Urban Environmental Management: The Experience in Arequipa during 2003–2006*, 35 *HABITAT INT'L.* 84, 90 (2011).

49. BARB CESTERO, *BEYOND THE HUNDREDTH MEETING: A FIELD GUIDE TO COLLABORATIVE CONSERVATION ON THE WEST'S PUBLIC LANDS* (1999); JULIA M. WONDOLLECK & STEVEN L. YAFFEE, *MAKING COLLABORATION WORK: LESSONS FROM INNOVATION IN NATURAL RESOURCE MANAGEMENT* (2000).

50. JOHN DEWITT, *CIVIC ENVIRONMENTALISM: ALTERNATIVES TO REGULATION IN STATES AND COMMUNITIES* (1994); WILLIAM A. SHUTKIN, *THE LAND THAT COULD BE: ENVIRONMENTALISM AND DEMOCRACY IN THE TWENTY-FIRST CENTURY* (2000).

51. RONALD D. BRUNNER ET AL., *FINDING COMMON GROUND: GOVERNANCE AND NATURAL RESOURCES IN THE AMERICAN WEST* (2002); PETER J. BROSIUS ET AL., *COMMUNITIES AND CONSERVATION: HISTORIES AND POLITICS OF COMMUNITY-BASED NATURAL RESOURCE MANAGEMENT* (2005).

governance⁵² has illustrated the importance of participatory modes of governance in environmental protection.

A polycentric form of environmental governance facilitates learning and adaptation. The complex and uncertain social-ecological systems necessitate an evolutionary and resilient governing mode. Under the resilience theory⁵³ and the adaptive governance theory,⁵⁴ good environmental management is a learning process that occurs through experimentation and transformation. In recent years, the evolutionary governance theory (EGT) has emerged as a response to the constant change and radical transition of social-ecological systems.⁵⁵ EGT understands governance as a continuous “restructuring process” that allows for new understandings of the broader social change and regulatory space.⁵⁶ Environmental law scholarship also recognizes this adaptive and resilient feature of environmental management, taking a cautious view of the rigid application of the rule of law.⁵⁷ Some environmental lawyers have criticized the focus on maximizing the quality of each individual agency decision and argue for a more dynamic mode where “regulation is viewed as an ongoing cycle of experimentation and evaluation.”⁵⁸

B. The Governance Structure of Foreign Investment Protection

Compared with environmental governance, foreign investment governance has a stronger international legal regime in terms of law-making and implementation. Today, there are more than 3,000 investment treaties with binding substantive and procedural

52. Jan Kooiman et al., *Interactive Governance and Governability: An Introduction*, 7 J. TRANSDISCIPLINARY ENV'T STUD. 1 (2008).

53. Ahjond S. Garmestani et al., *Introduction to SOCIAL-ECOLOGICAL RESILIENCE AND LAW* 1, 5–6 (Ahjond S. Garmestani & Craig R. Allen eds., 2014).

54. Brian C. Chaffin et al., *A Decade of Adaptive Governance Scholarship: Synthesis and Future Directions*, 19 ECOLOGY SOC'Y 56, 56 (2014).

55. Achim Schlüter et al., *Land-Sea Interactions and Coastal Development: An Evolutionary Governance Perspective*, 112 MARINE POL'Y 1, 1–2 (2020).

56. Raoul Beunen et al., *The Search for Evolutionary Approaches to Governance*, in EVOLUTIONARY GOVERNANCE THEORY: THEORY AND APPLICATIONS 3, 4 (Raoul Beunen, et al. eds., 2015).

57. Richard J. Lazarus, *Environmental Law at the Crossroads: Looking Back 25, Looking Forward 25*, 2 MICH. J. ENV'T. ADMIN. L. 267, 267 (2012) (as praised by Richard Lazarus, “the only constant in environmental law was change.”).

58. Daniel A. Farber, *Environmental Protection as a Learning Experience*, 27 LOY. L.A. L. REV. 791, 802 (1994).

provisions.⁵⁹ If host states violate substantive obligations of investment protection, the foreign investors may seek a remedy under the dispute settlement clauses in investment treaties. Foreign investors often prefer neutral international forums to national courts.⁶⁰ Thus, investment disputes are usually settled in international arbitral tribunals, which not only largely replace national courts in adjudicating foreign investment disputes, but also reduce the national courts' chances to review arbitral awards.⁶¹ As a result, in contrast to environmental governance, foreign investment protection is guaranteed by a top-down legal regime. Sovereign countries sign binding treaties to commit to protecting foreign investors in each other's territories and enforce treaty obligations in an integrated manner where the national government bears the responsibility for the wrongdoings of subnational governments. This regime leads to three features of foreign investment governance.

First, in terms of governing actors, investment treaties govern the regulatory relationship between a host state, as the governor, and a foreign investor, as the governed.⁶² The host state as an integrated body commits to investment treaty obligations and bears the responsibility of any non-compliance. The role of civil society in investment treaties is limited.⁶³ A popular argument is that foreign investors, unlike nationals of the host state, cannot be presented within the country's political processes, so foreign investors deserve a higher level of protection from state's policy decisions that negatively affect their interests.⁶⁴ Therefore, investment treaties

59. See UNCTAD, *supra* note 30.

60. WILLIAM MICHAEL REISMAN, *SYSTEMS OF CONTROL IN INTERNATIONAL ADJUDICATION AND ARBITRATION: BREAKDOWN AND REPAIR* 46 (1992).

61. The investment tribunals are organized under the UNCITRAL Rules, or under institutional auspices such as the International Convention on the Settlement of Investment Disputes (ICSID), the Permanent Court of Arbitration (PCA), the International Chamber of Commerce (ICC), etc.

62. Anthea Roberts, *Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System* 107 *AM. J. INT'L L.* 45, 64 (2013).

63. The ongoing reform of the ISDS regime is attempting to remedy this defect by enhancing the participation of non-state actors in investment dispute settlement through various channels, including *amicus curiae*. See Eugenia Levine, *Amicus Curiae in International Investment Arbitration: The Implications of an Increase in Third-Party Participation*, 29 *BERKELEY J. INT'L L.* 200 (2011); Katia Fach Gómez, *Rethinking the Role of Amicus Curiae in International Investment Arbitration: How to Draw the Line Favorably for the Public Interest*, 35 *FORDHAM INT'L L. J.* 510 (2011). But the protection of civil society's interests under substantive clauses in investment treaties is still a long way to go. Only a few investment treaties include local community concerns in the treaty language.

64. Lorenzo Cotula, *Democracy and International Investment Law*, 30 *LEIDEN J. INT'L L.* 351, 358-59 (2017).

provide legal safeguards to protect foreign investment from governmental intervention, even if such intervention is a response to democratic decision-making.⁶⁵ In some investment arbitration cases, the tribunals refused to consider public opposition as a justifiable ground for the host state's adverse treatment of foreign investments.⁶⁶

Second, foreign investment governance prefers consistency. International investment law requires consistent and predictable decision-making between national, provincial, and local levels. On the one hand, investment treaty obligations are enforced from federal to state to local levels in an integrated manner, though this may create difficulties in countries with federalist structures.⁶⁷ On the other hand, investment tribunals have held that contradictory conduct between different levels of government violates investment treaty standards.⁶⁸ Some tribunals even required states to act "free from ambiguity and totally transparently" so that foreign investors "may know beforehand any and all rules and regulations that will govern its investments."⁶⁹

Third, foreign investment governance favors stability over change. A primary focus of investment treaties is to create a stable and predictable legal and political environment for foreign investors.⁷⁰ Almost all investment treaties include the fair and equitable treatment (FET) clause that has been interpreted by investment tribunals to protect the foreign investors' "legitimate expectations" at the time of making the investment. Some tribunals have interpreted the vague and broad term "legitimate expectations" as encompassing a stable and predictable legal framework, which may be an obstacle to the change of environmental laws or the innovation of new environmental standards.

65. *Id.*

66. Jonathan Bonnitcha & Zoe Williams, *Politically Motivated Conduct in Investment Treaty Arbitration*, INV. TREATY NEWS (Apr. 23, 2019), <https://www.iisd.org/itn/en/2019/04/23/politically-motivated-conduct-in-investment-treaty-arbitration-jonathan-bonnitcha-zoe-williams/> [https://perma.cc/9DR6-S6WG]; Jonathan Bonnitcha & Zoe Williams, *State Liability for 'Politically' Motivated Conduct in the Investment Treaty Regime*, 33 LEIDEN J. INT'L L. 77, 88-91 (2020).

67. Mark A. Luz & C. Marc Miller, *Globalization and Canadian Federalism: Implications of the NAFTA's Investment Rules*, 47 MCGILL L. J. 951 (2001); Matthew C. Porterfield, *International Expropriation Rules and Federalism*, 23 STAN. ENV'T. L. J. 3 (2004).

68. *See, e.g., Metalclad*, *supra* note 37, ¶ 100.

69. *Tecmed*, *supra* note 37, ¶ 154; *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award ¶ 114-5 (May 25, 2004).

70. DOLZER & SCHREUER, *supra* note 32, at 220.

In conclusion, foreign investment governance features binding investment treaties and strong international enforcement mechanisms. International investment norms regard a sovereign state as an integrated party where the national government will be held accountable for the violations of treaty obligations by its political sub-units. Although this is in line with the well-recognized international law of state responsibility, which also applies to environmental treaties, the unbalanced international legal regimes between investment and environmental issues make it often the case that investment treaties preempt domestic environmental regulation at provincial or local levels. When this top-down foreign investment governance interacts with bottom-up environmental governance, a bottom-up dilemma appears.

IV. THE BOTTOM-UP DILEMMA BETWEEN INTERNATIONAL INVESTMENT LAW AND ENVIRONMENTAL GOVERNANCE

The different governance structures between investment and environmental regimes lead to a “bottom-up” dilemma, where decentralized, adaptive, and participatory environmental governance is vulnerable to violating international investment law, which regards the state as an integrated governing actor that should provide stable and consistent governance in a way independent from public interference. This Part examines three facets of the dilemma—governing actors, scales of governance, and modes of governance—as reflected in case law.

A. Governing Actors: Participatory Environmental Governance and Investment Law

Polycentric environmental governance involves not only state actors but also non-state actors including local communities, NGOs, and experts that influence the host state’s treatment of foreign investment. This interactive decision-making process creates challenges for investment tribunals: What is the standard of review in deciding the legitimacy of this dynamic governing process under investment treaties, as compared to the traditional regulatory conduct of governments? Can a host state justify its negative treatment of foreign investors based on its concerns of public pressure or local communities’ opposition? How can a legitimate participatory and interactive mode of governance be distinguished

from a “politically” motivated government action targeting foreign investments?

The *Bilcon v. Canada* case, for example, concerns the environmental governance network among multiple levels of governments, local communities, environmental scientists and experts, and investors.⁷¹ In *Bilcon*, U.S. investors, Clayton and Bilcon, invested in a quarry and marine terminal project in Nova Scotia, Canada.⁷² The Canadian federal government and the provincial government of Nova Scotia jointly conducted an environmental assessment of the project.⁷³ As the governments jointly found that the project engaged widespread public concern and the possibility of significant adverse environmental effects, the project was subject to an environmental assessment by a Joint Review Panel (JRP) comprised of three professors from Dalhousie University.⁷⁴ The JRP held public hearings and submitted a report to the government recommending the rejection of the project for the reason that the project was likely to have a significant adverse environmental effect on the “community core values” of local people.⁷⁵ Based on the JRP report, the Canadian provincial and federal governments rejected the project.⁷⁶

The majority of the tribunal found that the denial of the project violated the Minimum Standard of Treatment (MST) clause in the North America Free Trade Agreement (NAFTA), which protects the foreign investor’s legitimate expectations at the time of investment. The clause provides: “Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.”⁷⁷ The tribunal held that the novel concept of “community core values” adopted by the JRP violated the MST clause because the JRP “effectively created, without legal authority or fair notice to Bilcon, a new standard of assessment rather than fully carrying out the mandate defined by the applicable law.”⁷⁸

In his dissenting opinion, Professor Donald McRae, as an arbitrator of the tribunal appointed by Canada, argued that the majority opinion

71. See *Bilcon*, *supra* note 37.

72. *Id.* ¶ 5.

73. *Id.*

74. *Id.* ¶¶ 162–3, 184, 406.

75. *Id.* ¶ 188 and 503.

76. *Id.* ¶ 220.

77. North American Free Trade Agreement, Can.-Mex.-U.S., Art. 1105(1), Dec. 17, 1992, 32 I.L.M. 289 (1993).

78. *Bilcon*, *supra* note 37, ¶ 591.

would cause “a significant intrusion into domestic jurisdiction and will create a chill on the operation of environmental review panels.”⁷⁹ What is more troubling, as McRae notes, is that the majority opinion found that “a review panel that put great weight on the effect of a project on the human environment and took account of the community’s own expression of its interests and values results in the state being liable in damages to an investor,” which is “an intrusion into the environmental public policy of the state.”⁸⁰ In particular, McRae justified the use of the novel language of “community core values” by professionals in the JRP:

A joint review panel is generally made up of scientists and environmental experts and not necessarily lawyers. It may use language that best expresses the views and conclusions it has reached, which may not be language familiar to lawyers and may not be the same as the language used by another joint review panel, expressing similar ideas. The real question is not what language has been used, but whether the Panel has done, in substance, what it has been asked to do.⁸¹

The *Bilcon* case illustrates how the interactive and participatory network of environmental governance that takes into account the local community’s subjective values may violate investment treaties due to frustration of foreign investors’ expectations. In the case, the challenged decision-making was not made by legislators or government officials, as is usually the case in conventional investment disputes, but by environmental professionals composed of scientists and experts. The novel environmental concept was not adopted in formal legislation or regulation in a top-down way, but in an environmental assessment report of a particular case by a review panel. The tribunal was not against the rationality of the new standard per se, but took issue with the manner of the innovation and adaption of environmental standards. If the new concept of “community core values” had been adopted in legislation rather than in an environmental review, it might not have been considered as an innovation “without legal authority or fair notice to *Bilcon*” or a failure of “fully carrying out the mandate defined by the applicable law.”⁸² Thus, a bottom-up way of norm innovation risks frustrating the

79. William Ralph Clayton, William Richard Clayton, Douglas Clayton, Daniel Clayton and *Bilcon of Delaware, Inc. v. Government of Canada*, UNCITRAL, PCA Case No. 2009-04, Dissenting Opinion of Professor Donald McRae (Mar. 10, 2015).

80. *Id.* ¶ 49.

81. *Id.* ¶ 46 (citation omitted).

82. *Bilcon*, *supra* note 37, ¶ 591.

foreign investor's legitimate expectations protected under investment treaties.

But how should the scope of legitimate expectations be defined? Considering the bottom-up trend of environmental governance, should a foreign investor have taken account of the participatory mode of environmental governance at the time of making its investment? Compared to *Bilcon*, the tribunal in *Methanex v. United States* took a more contextual review in deciding whether a California ban amounted to an expropriation of foreign investment.⁸³ This case concerned a Canadian investor, Methanex, that supplies methanol, a feedstock for methyl tertiary-butyl ether (MTBE).⁸⁴ The investor claimed that the Californian ban on MTBE from gasoline breached the investment protection obligations under NAFTA.⁸⁵ The tribunal considered public participation as part of the political economy of the investment environment that can shape the investors' expectations.⁸⁶ The tribunal noted that Methanex should have been aware of this political economy of the market it entered.⁸⁷ The tribunal stated:

Methanex entered a political economy in which it was widely known, if not notorious, that governmental environmental and health protection institutions at the federal and state level, *operating under the vigilant eyes of the media, interested corporations, non-governmental organizations and a politically active electorate*, continuously monitored the use and impact of chemical compounds and commonly prohibited or restricted the use of some of those compounds for environmental and/or health reasons. Indeed, the very market for MTBE in the United States was the result of precisely this regulatory process. *Methanex appreciated that the process of regulation in the United States involved wide participation of industry groups, non-governmental organizations, academics and other individuals, many of these actors deploying lobbyists.*⁸⁸

Therefore, the tribunal concluded that “the California ban was made for a public purpose, was non-discriminatory and was accomplished with due process,” and thus, “the California ban was a lawful regulation and not an expropriation.”⁸⁹ Unlike *Bilcon*, the *Methanex* tribunal assessed the investor's legitimate expectations in a

83. *Methanex*, *supra* note 37.

84. *Methanex*, *supra* note 37, Part I, ¶ 1.

85. *Id.*

86. *Methanex*, *supra* note 37, Part IV(D), ¶ 9.

87. *Id.*

88. *Id.* (emphasis added).

89. *Id.* ¶ 15.

contextual manner, taking into account the various non-state actors involved in the continuous governance process.

B. Scales of Governance: The Multi-Leveled Environmental Governance and Investment Law

A polycentric mode of environmental management includes multiple scales of governing processes from local, regional, national to international levels. Inconsistent regulation between different scales is not uncommon and even encouraged to meet the different needs of various scales upon a certain degree of coordination. Investment law, by contrast, prefers a consistent and predictable legal and administrative structure. For instance, the FET standard in international investment law, commonly requiring the host state to treat foreign investors in a fair and equitable manner, requires the consistency and transparency of regulation by different government agencies. In investment arbitration, a rigid application of the FET standard is in tension with the inconsistent conduct between multiple governmental authorities in environmental governance.

The *Metalclad v. Mexico* case explains how the different environmental decision-making between federal, state and municipal governments violate the FET standard in investment law.⁹⁰ In this case, the U.S. investor Metalclad invested in a hazardous waste landfill in Mexico.⁹¹ Metalclad received both federal and state permits to construct and operate the landfill and was assured by federal officials that it had all authority necessary to undertake the project.⁹² Metalclad subsequently started its construction.⁹³ However, the project was later prohibited by the municipal government due to the lack of a municipal construction permit.⁹⁴ The tribunal found that the decision made by the municipal government had frustrated Metalclad's expectations based on the representations of the federal officials.⁹⁵ The tribunal held that "Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in

90. *Metalclad*, *supra* note 37.

91. *Id.* ¶ 1.

92. *Id.* ¶ 28-36, 78.

93. *Id.* ¶ 38-39.

94. *Id.* ¶ 50.

95. *Id.* ¶ 87-89.

relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA.”⁹⁶

Multi-leveled environmental governance may also conflict with the non-discrimination standard in investment treaties. In investment treaties, the national treatment (NT) clause requires a host state to treat the foreign investor in a way no less favorably than another *domestic* investor in like circumstances. Likewise, the most-favored nation treatment (MFN) clause requires a host state to treat the foreign investor in a way no less favorably than another *third-state* investor in like circumstances. Most investment treaties do not have an explicit definition of “like circumstances.”⁹⁷ The question is: Are investors subject to different scales of governance (such as federal, state, and local levels) in like circumstances so that they are comparable? The foreign investor and the host state usually have different positions: On the one hand, foreign investors, aiming to prove discrimination, tend to argue for a broad scope of comparators crossing different governing scales so as to find a more-favorably-treated investor. On the other hand, host states tend to reduce the number of potential comparators by denying cross-jurisdictional comparison.

In some cases, foreign investors have claimed that environmental standards that differ between federal and state levels result in discrimination. For example, in *Merrill & Ring v. Canada*, a U.S. forestry company claimed that its investment in British Columbia, a province of Canada, was discriminated against by the Canadian government, because its investment was subject to the federal timber export rules, while most other log producers in the same province are regulated by provisional rules which are less strict than federal rules.⁹⁸ The question was whether foreign investors under federal and provincial authorities were comparable.⁹⁹ The tribunal rejected the federal-provincial comparison, holding that “the proper comparison is between investors which are subject to the same regulatory measures under the same jurisdictional authority.”¹⁰⁰ Following this rationale a comparison between scales of governance

96. *Id.* ¶ 99.

97. Investment Policy Hub, UNCTAD, <https://investmentpolicy.unctad.org/international-investment-agreements/iia-mapping> (last visited Nov. 28, 2022). The database maps the contents of 2584 investment treaties, among which only 344 explicitly refers to “like circumstances” or similar expressions in the national treatment clauses.

98. *Merrill & Ring*, *supra* note 37, ¶ 34.

99. *Id.* ¶ 81.

100. *Id.* ¶ 89.

is prohibited if investors are subject to different jurisdictional authorities.

However, a rigid application of the “comparison within the same jurisdiction” standard is not appropriate in a polycentric structure of governance consisting of various overlapping scales. Otherwise, it may provide opportunities for host states to shrink the scope of comparison to an extent most favorable to the host state. For instance, in the *Bilcon* case, as mentioned above, Bilcon’s project was denied by a joint federal-provincial review panel for environmental concerns.¹⁰¹ Bilcon argued that it was discriminated against compared to other similar projects.¹⁰² Canada defended that the proper comparators should only be those that have been reviewed by the joint federal-provincial panels. However, the tribunal rejected “such a narrow range of possible comparators.”¹⁰³

C. Modes of Governance: The Adaptive Environmental Governance and Investment Law

The polycentric structure of environmental governance with multiple governing actors contributes to a dynamic decision-making process. A bottom-up governance encourages norm innovation and adaptation in different scales and forums, not only in the formal legislative process, but also in the regulatory and adjudicative processes to fit constantly changing circumstances. The adaptive nature of polycentric environmental governance may cause a violation of investment treaties.

The *Glamis Gold v. United States* case concerned environmental norm innovation and adaptation in an interactive governance process that involves federal government, state government, professionals, local tribes, NGOs, and foreign investors.¹⁰⁴ Glamis Gold, a Canadian corporation, operated an open pit leach pad mining project near designated Native American lands in California.¹⁰⁵ The U.S. Bureau of Land Management retained a company, KEA Environmental, Inc., to conduct a cultural impact assessment to determine whether there existed any traditional cultural properties in the vicinity of the mining project.¹⁰⁶ However, the local tribe pressured the government to

101. *Bilcon*, *supra* note 37, ¶ 5.

102. *Id.* ¶ 11.

103. *Id.* ¶ 691.

104. *Glamis Gold*, *supra* note 37.

105. *Id.*

106. *Id.* ¶ 104.

conduct an impact assessment of a wider area than the “project vicinity.”¹⁰⁷ The U.S. Bureau of Land Management then adopted a novel concept of “Area of Traditional Cultural Concern” (ATCC) that enlarged the evaluation area. Glamis Gold argued that this novel concept of ATCC had not been used in previous cultural reviews and thus constituted discrimination under the MST clause in NAFTA.¹⁰⁸

The tribunal in *Glamis Gold* upheld the novel standard that was adopted based on advice of professionals. The tribunal noted that “[i]t is professionals such as these, with their technical background and expertise, not this Tribunal, who are the proper parties to determine whether, as Respondent argues, the use of the ATCC ‘accorded with standard archeological practice, which calls for a reduction in [the] survey interval when a number of archeological features in a given area are identified.’”¹⁰⁹

Glamis Gold also challenged another novel standard used in the environmental review: the “undue impairment” standard.¹¹⁰ Glamis Gold argued that the adoption of the new standard had frustrated its legitimate expectations relying on the settled practice based on the “unnecessary or undue degradation” standard, which is less strict.¹¹¹ The tribunal agreed that the shift in standard was surprising, but noted that no precedents compared to this case since the Glamis project had “a significant, unavoidable adverse impact to cultural resources and Native American sacred sites.”¹¹² The tribunal held that, despite the “arguably dramatic change” of a previous law or legal interpretation relied upon by a foreign investor, the novel standard does not amount to a violation of the MST clause in the treaty.¹¹³

The *Unglaube v. Costa Rica* case¹¹⁴ provides an example of adaptive environmental governance in the adjudication process. Costa Rica enacted the National Park Law in 1995, which established a national

107. *Id.*

108. *Id.*

109. *Id.* ¶ 783.

110. *Id.* ¶ 156.

111. The claimant asserted that, under the old standard, its Plan of Operations (POO) would have been approved as long as it employs economically foreseeable mitigation, even if such approval will result in the damage of Native American sacred sites. *Glamis Gold, supra* note 37, ¶ 758. The tribunal also agreed that “it appears indisputable that, under the decades-long rule of the ‘unnecessary or undue degradation’ standard, mining operators developed expectations that the discovery of Native American artifacts at a mining site could necessitate mitigation, but would not lead to denial of the project’s POO.” *Id.*

112. *Id.* ¶ 760.

113. *Id.* ¶ 761–71.

114. *Unglaube, supra* note 37.

marine park for the protection of leatherback turtles.¹¹⁵ The law authorizes the government to expropriate properties within the park.¹¹⁶ Later, an environmental NGO brought a petition that argued for stronger protection of turtles.¹¹⁷ As a response, the Costa Rican Supreme Court decided that properties in the park's "buffer zone" (within 500 meters from the boundaries of the park) should be suspended for further environmental impact assessment.¹¹⁸

The foreign investor in the case challenged the novel concept of a "buffer zone," which did not appear in the 1995 National Park Law, arguing that it violated the FET clause under the BIT.¹¹⁹ The tribunal noted that the new concept of buffer zone adopted by the Supreme Court decision had no foundation in domestic law, had not been previously adopted by administrative agencies, and lacked scientific or technical foundations.¹²⁰ Nonetheless, the tribunal found that the Supreme Court's decision adopting the novel concept of buffer zone did not violate the FET standard since the investor's interests were not significantly affected by such decision.¹²¹

With the development of the bottom-up trend of environmental governance, future tribunals may face more cases like *Glamis Gold* and *Unglaube*, where the emergence of new environmental standards in the regulatory or adjudicative processes (other than in national legislations) is claimed by foreign investors as a frustration of their expectations based on previous practice. To balance an increasingly dynamic environmental governance and the pursuit of a stable and predictable investment environment by foreign investors, the tribunals need to take a contextual and flexible approach to recognizing the adaptive mode of environmental governance, on the one hand, and protecting foreign investor's interest in a dynamic governance process, on the other.

In conclusion, the polycentric structure of environmental governance creates new challenges to investment protection because of the diverse governing actors, multiple and sometimes overlapping governing scales, and the evolving governance processes. In many cases, it is this dynamic governance process, rather than a particular

115. *Id.* ¶ 37 and 56.

116. *Id.* ¶ 57.

117. *Id.* ¶ 78.

118. *Id.* ¶ 79.

119. *Id.* ¶ 251.

120. *Id.* ¶ 255.

121. *Id.*

environmental measure challenged by the foreign investor, that is in tension with international investment obligations.

V. THE BOTTOM-UP DILEMMA AND INVESTMENT TREATY REFORM

In recent years, a key theme of international investment law has been to reform the current investment treaty regime to strike a balance between foreign investment protection and the preservation of public interests. Many recently concluded or renegotiated IIAs have mentioned public interest in treaties' preambles, clarified the previously broad standards of protection, carved out states' regulatory rights in general exceptions provisions, and restricted the use of the ISDS mechanism.¹²²

What does the bottom-up dilemma imply for the ongoing reform of the international investment treaty regime? How can investment treaties be reformed to reconcile the bottom-up dilemma? The paper takes an empirical study of the United Nations Conference on Trade and Development (UNCTAD) database that collected 3,219 investment treaties (including BITs and treaties with investment provisions),¹²³ and analyzes two main reform approaches: the general exceptions clause and the clarified standards of protection.¹²⁴ It argues that the general exceptions clause has its limitations in reconciling the bottom-up dilemma, since the conditions of general exceptions, including the unarbitrary and indiscriminate application of the challenged measure, are subject to the wide discretion of arbitral tribunals. Compared with the general exceptions clause, a better approach to solving the bottom-up dilemma could be to clarify the standards of protection in a way that takes into account the context and character of environmental governance. The following

122. UNCTAD, INTERNATIONAL INVESTMENT AGREEMENTS REFORM ACCELERATOR (2020). The efforts of reforming the ISDS system have also been conducted in the United Nations Commission on International Trade Law (UNCITL), the International Centre for Settlement of Investment Disputes (ICSID) and other institutions. See UNCITL, *Possible Reform of Investor-State Dispute Settlement (ISDS): Multilateral Instrument on ISDS Reform*, A/CN.9/WG.III/WP.194 (Jan. 16, 2020).

123. Investment Policy Hub, UNCTAD, <https://investmentpolicy.unctad.org/international-investment-agreements> (last visited Nov. 28, 2022).

124. The reform of investment treaties includes both substantive and procedural aspects. The survey only covers its substantive aspect since the bottom-up dilemma mainly concerns the tension between substantive protection standards of investment treaties and environmental governance. The procedural reform of the ISDS system may indirectly contribute to the resolution of the dilemma by ensuring a fair and participatory dispute resolution procedure. For the approaches of ISDS reform, see Anthea Roberts, *Incremental, Systemic, and Paradigmatic Reform of Investor-State Arbitration*, 112 AM. J. INT'L L. 410 (2018).

paragraphs will introduce both approaches and analyze their pros and cons in reconciling the bottom-up dilemma.

A. The General Exceptions Clause

A major approach to reforming investment treaties is incorporating the general exceptions clause borrowed from World Trade Organization law, such as GATT Article XX and GATS Article XIV. General exceptions clauses permit a state to take actions that would otherwise be inconsistent with treaty provisions to protect certain public interests, such as public morals, exhaustible resources, and human or animal health. However, the general exceptions clause has limitations in solving the bottom-up dilemma because of its conditions for justification.

General exceptions clauses in IIAs mostly provide conditions for justification, including that the measure should not be applied in an arbitrary or unjustifiable manner, and should not constitute a disguised restriction on international trade or investment. For example, Article XVII (3) of the 1994 Canada-Ukraine BIT provides that:

Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Contracting Party from adopting or maintaining measures, including environmental measures: (a) necessary to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement; (b) necessary to protect human, animal or plant life or health; or (c) relating to the conservation of living or non-living exhaustible natural resources.¹²⁵

Similar general exceptions clauses have been adopted in a number of Canadian BITs in the 1990s and 2000s,¹²⁶ in two Latvian BITs in

125. Bilateral Investment Treaty, Can.-Ukr., art. XVII(3), Oct. 24, 1994.

126. *Id.* art. XVII; Bilateral Investment Treaty, Can.-Trin. & Tobago, art. XVII, Sept. 11, 1995; Bilateral Investment Treaty, Can.-Phil., art. XVII, Nov. 10, 1995; Bilateral Investment Treaty, Can.-S. Afr., art. XVII, Nov. 27, 1995; Bilateral Investment Treaty, Can.-Rom., art. XVII, Apr. 17, 1996; Bilateral Investment Treaty, Can.-Ecuador, art. XVII, Apr. 29, 1996; Bilateral Investment Treaty, Barb.-Can., art. XVII, May 29, 1996; Bilateral Investment Treaty, Can.-Venez., art. XVII, July 1, 1996; Bilateral Investment Treaty, Can.-Pan., art. XVII, Sept. 12, 1996; Bilateral Investment Treaty, Can.-Egypt, art. XVII, Nov. 13, 1996; Bilateral Investment Treaty, Can.-Thai, art. XVII, Jan. 17, 1997; Bilateral Investment Treaty, Arm.-Can., art. XVII, May 8, 1997; Bilateral Investment Treaty, Can.-Croat, art. III, Feb. 3, 1997; Bilateral Investment Treaty, Can.-Leb., art. III, Apr. 11, 1997; Bilateral Investment Treaty, Can.-Uru., art. III, Oct. 29, 1997; Bilateral Investment Treaty, Can.-Costa Rica, art. III, Mar. 18, 1998.

2005,¹²⁷ and in three Hong Kong (China SAR) investment agreements in the 2010s.¹²⁸

After the 2000s, the most common type of general exceptions clause requires the non-discriminatory manner of state measure. The earliest example of this model is Article 8(3) of the 1995 Hong Kong, China SAR-New Zealand BIT, which provides that:

“The provisions of this Agreement shall not in any way limit the right of either Contracting Party to take measures directed to the protection of its essential interests, or to the protection of public health, or to the prevention of diseases and pests in animals and plants, *provided that such measures are not applied in a manner which would constitute a means of arbitrary or unjustified discrimination.*”¹²⁹

Following this approach, Canada¹³⁰ and Japan¹³¹ incorporated explicit non-discrimination requirements into their general exceptions clauses in BITs concluded after 2000. Other countries

127. Bilateral Investment Treaty, Geor.-Lat., art. 13, Oct. 5, 2005; Bilateral Investment Treaty, Arm.-Lat., art. 13, Oct. 7, 2005.

128. Bilateral Investment Treaty, Can.-H.K., art. 17, Feb. 10, 2016; Bilateral Investment Treaty, Chile-H.K., art. 18, Nov. 18, 2016; Closer Economic Partnership Arrangement Agreement, China-H.K., art. 22, June 28, 2017.

129. Bilateral Investment Treaty, H.K.-N.Z., art. 8(3), July 6, 1995 (emphasis added).

130. *See, e.g.*, Bilateral Investment Treaty, Can.-Peru, art. 10, Nov. 14, 2006; Bilateral Investment Treaty, Can.-Lat., art. XVII, May 5, 2009; Bilateral Investment Treaty, Can.-Czech, art. IX, May 6, 2009; Bilateral Investment Treaty, Can.-Jordan, art. 10, June 28, 2009; Bilateral Investment Treaty, Can.-Mali, art. 17, Nov. 28, 2014; Bilateral Investment Treaty, Can.-Côte d’Ivoire, art. 17, Nov. 30, 2014; Bilateral Investment Treaty, Burk. Faso-Can., art. 18, Apr. 20, 2015; Bilateral Investment Treaty, Can.-Guinea, art. 18, May 27, 2015; Bilateral Investment Treaty, Can.-Mong., art. 17, Sept. 8, 2016.

131. *See, e.g.*, Bilateral Investment Treaty, Japan-Uzb., art. 17, Aug. 15, 2008; Bilateral Investment Treaty, Japan-Peru, art. 19, Nov. 21, 2008; Bilateral Investment Treaty, Colom.-Japan, art. 15, Sept. 12, 2011; Bilateral Investment Treaty, Japan-Kuwait, art. 17, Mar. 22, 2012; Bilateral Investment Treaty, Japan-Mozam., art. 18, June 1, 2013; Bilateral Investment Treaty, Japan-Myan., art. 19, Dec. 15, 2013.

adopting the same approach include India,¹³² Finland,¹³³ Turkey,¹³⁴ Australia,¹³⁵ Singapore,¹³⁶ China,¹³⁷ Iran,¹³⁸ and the EU.¹³⁹

However, none of these treaties clarify what constitutes the “discriminatory” or “arbitrary” application of environmental measures. Wide discretion is accorded to investment tribunals to decide whether the challenged measure is discriminatory or arbitrary. This succinct approach is insufficient to reconcile the bottom-up dilemma. As mentioned above, the tribunals have faced difficult questions, including whether the inconsistent environmental decisions made by multi-level governments were discriminatory and whether the government’s denial of an environmental permit due to public opposition is arbitrary. The general exceptions clause does not provide explicit answers to these questions. Future tribunals still need to clarify the thresholds of arbitrariness and discrimination in

132. For example, Article 13 (titled “General and Security Exceptions”) of the 2008 India-Senegal BIT provides: “No provisions of this Agreement shall be interpreted as preventing the host Contracting Party from taking any measure necessary for the protection of its essential interests as regards security or for public health reasons or to prevent diseases affecting animals and plants or in circumstances of extreme emergency in accordance with its laws normally and reasonably applied on a non-discriminatory basis.” *Bilateral Investment Treaty, India-Sen.*, art. 13, Oct. 17, 2008. Such general exceptions provisions can be found in other Indian investment treaties. *See*, *Closer Economic Partnership Arrangement Agreement, India-S. Kor.*, art. 10.18, Aug. 7, 2009; *Bilateral Investment Treaty, Colom.-India*, art. 13, Nov. 10, 2009; *Agreement on Investment Under the Framework Agreement on Comprehensive Economic Cooperation, A.S.E.A.N.-India*, Nov. 12, 2015.

133. *Bilateral Investment Treaty, El Sal.-Fin.*, art. 14, May 20, 2002; *Bilateral Investment Treaty, Fin.-Namib.*, art. 16, Oct. 31, 2002; *Bilateral Investment Treaty, Fin.-Zam.*, art. 14(2), Sept. 7, 2005; *Bilateral Investment Treaty, Fin.-Pan.*, art. 14, Feb. 19, 2009.

134. *Bilateral Investment Treaty, Colom.-Tur.*, art. 6(1), July 28, 2014; *Bilateral Investment Treaty, Rwanda-Turk.*, art. 5, Nov. 3, 2016; *Bilateral Investment Treaty, Nigeria-Turk.*, art. 6, Feb. 2, 2011; *Bilateral Investment Treaty, Tanz.-Turk.*, art. 6, Mar. 11, 2011; *Bilateral Investment Treaty, Montenegro-Turk.*, art. 4, Mar. 14, 2012; *Bilateral Investment Treaty, Bangl.-Turk.*, art. 5, Apr. 12, 2012; *Bilateral Investment Treaty, Cameroon-Turk.*, art. 5, Apr. 24, 2012; *Bilateral Investment Treaty, Pak.-Turk.*, art. 5, May 22, 2012; *Bilateral Investment Treaty, Gabon-Turk.*, art. 5, July 18, 2012; *Bilateral Investment Treaty, Gam.-Turk.*, art. 5, Mar. 12, 2013.

135. *Free Trade Agreement, Austl.-Malay.*, art. 12.18, May 22, 2012; *Economic Partnership Agreement, Austl.-Japan EPA*, art. 14.15, July 8, 2014; *Free Trade Agreement, Austl.-China*, art. 9.8, June 17, 2015.

136. *Bilateral Investment Treaty, Jordan-Sing.*, art. 18, May 16, 2004; *Bilateral Investment Treaty, Nigeria-Sing.*, art. 28, Nov. 4, 2016.

137. *Free Trade Agreement, Austl.-China*, art. 9.8, June 17, 2015.

138. *Bilateral Investment Agreement, Iran-Slovk.*, art. 11, Jan. 19, 2016; *Bilateral Investment Agreement, Iran-Japan*, art. 13, Feb. 5, 2016.

139. *Partnership and Cooperation Agreement, E.U.-Iraq*, art. 29, U.N.T.S. Reg. No. 56655, Mar. 2, 2011; *Association Agreement, E.U.-Ukr.*, art. 141, Mar. 21, 2014; *Association Agreement, E.U.-Geor.*, art. 134(2)(b), June 27, 2014; *Association Agreement, E.U.-Mold.*, art. 261(2)(b), June 27, 2014; *Enhanced Partnership and Cooperation Agreement, E.U.-Kaz. EPCA*, art. 55, Dec. 21, 2015.

the arbitration process, and whether the features of environmental governance will be taken into account is uncertain.

B. Clarified Standards of Protection

Another approach to investment treaty reform that benefits the resolution of the bottom-up dilemma is clarifying the vague and broad standards of protection in investment treaties to accord more deference to the character of environmental governance. Typical examples include: clarification of the non-discrimination clauses by specifying what amounts to “like circumstances”; clarification of the FET clause by linking the standard to customary international law or by specifying a list of violation activities; clarification of the indirect expropriation clause by specifying the circumstances to be considered in the assessment of indirect expropriation.

1. Clarification of the Non-Discrimination Clauses

The non-discrimination clauses in investment treaties, including the national treatment clause and the most-favored nation treatment clause, require the host state to accord the foreign investor no less favorable treatment than a “comparable” domestic investor or an investor in a third state. As noted above, the comparability is assessed based on whether the two investors are in like circumstances.¹⁴⁰ The polycentric structure of environmental governance increases the possibility that investors are subject to different treatments in different decision-making centers, including administrative levels (such as between federal, state, and local levels), jurisdictions (such as between different states or provinces) or other decision-making bodies (such as different kinds of environmental review panels). The tribunals have to decide whether investors subject to different decision-making centers are in “like circumstances.”

Some recent investment treaties have adopted a clarified non-discrimination clause that specifies the meaning of “like circumstances.” For example, the 2016 BIT between Chile and Hong Kong, China Special Administrative Region (SAR) clarifies “like circumstances” in a footnote to the national treatment clause, stating that “[f]or greater certainty, whether treatment is accorded in ‘like circumstances’ . . . depends on the totality of the circumstances, including whether the relevant treatment distinguishes between

140. See Merrill & Ring, *supra* note 98.

investors or investments on the basis of legitimate public welfare objectives.”¹⁴¹ This clause requires tribunals to make a contextual analysis of “like circumstances,” but it is still uncertain whether the polycentric governance structure generates different circumstances. A foreign investor subject to a strict provincial environmental measure may claim that it suffers discriminatory treatment compared with similar investors in other provinces or those subject to federal governance. It seems hard to justify that the discrepancy between environmental standards in different jurisdictions is by itself designed “on the basis of” legitimate public welfare objectives. Moreover, the legitimacy standard is also blurred. In the *Bilcon* case, as mentioned above, the tribunal held that a “community core value” is not a rational public policy that can justify the different treatment of Bilcon compared to similar investments located in other communities.¹⁴² Thus, it is doubtful whether the local community’s concerns over the environmental impact of the foreign investment can constitute “legitimate” public welfare objectives, though local community constitutes an important decision-making scale in a polycentric governance structure.

One way to remedy this defect is by explicitly illustrating the examples of “circumstances.” For instance, the 2007 Investment Agreement for the Common Market for Eastern and Southern Africa (COMESA) Common Investment Area provides that “references to ‘like circumstances’ . . . requires an overall examination on a case-by-case basis of all the circumstances of an investment. . . .”¹⁴³ It then specifies six circumstances of an investment that should be considered in the likeness assessment:

(a) its effects on third persons and the local community; (b) its effects on the local, regional or national environment, including the cumulative effects of all investments within a jurisdiction on the environment; (c) the sector the investor is in; (d) the aim of the measure concerned; (e) the regulatory process generally applied in relation to the measure concerned; and (f) other factors directly relating to the investment or investor in relation to the measure concerned.¹⁴⁴

The treaty also noted that the examination of likeness “shall not be limited to or be biased towards any one factor.”¹⁴⁵ The COMESA

141. Bilateral Investment Treaty, Chile-H.K., art. 4, Nov. 18, 2016.

142. *Bilcon*, *supra* note 37, ¶ 724.

143. Investment Agreement for the COMESA Common Investment Area, Common Market for Eastern and Southern Africa, art. 17(2), May 23, 2007.

144. *Id.*

145. *Id.*

Agreement specifies the circumstances that should be considered in the interpretation of “like circumstances,” providing more detailed instruction for tribunals assessing discrimination. The explicit consideration of “local community” and “regulatory process,” and a miscellaneous provision including “other factors,” provide useful justifiable grounds for environmental governance. For example, if the foreign investor claims that it is subject to a stricter provisional environmental standard than another investor located in a province with a lower standard, the host state may respond with the defense that the two investors in different jurisdictions are subject to a different “regulatory process” so that they are incomparable. For another example, if the foreign investor claims that the denial of an environmental permit because of a local community’s opposition amounts to discrimination as compared with another investment sitting in a less environmentally friendly community, the host state can defend that the two investments are not in like circumstances because of their different “effects on third persons and the local community.” Similar clauses can be seen in the 2014 Investment Agreement between the Association of Southeast Asian Nations and India,¹⁴⁶ the 2016 BIT between Iran and Slovakia,¹⁴⁷ the 2016 BIT between Morocco and Nigeria,¹⁴⁸ and the 2016 Southern African Development Community Finance and Investment Protocol.¹⁴⁹

2. Clarification of the FET Clause

The FET clause in investment treaties requires fair and equitable treatment of foreign investors, including the predictability, consistency, and transparency of the regulatory framework in the host states. However, multi-level and cross-sector environmental governance frequently leads to inconsistency between levels and organs of governments, which creates vulnerability to violating the

146. Agreement on Investment Under the Framework Agreement on Comprehensive Economic Cooperation, A.S.E.A.N.-India, art. III, Nov. 12, 2014. The agreement provides:

A determination of whether investments or investors are in “like circumstances” should be made, based upon an objective assessment of all circumstances on a case-by-case basis, including, *inter alia*: (a) the sector the investor is in; (b) the location of the investment; (c) the aim of the measure concerned; and (d) the regulatory process generally applied in relation to the measure concerned. The examination shall not be limited to or biased towards any one factor. *Id.*

147. Bilateral Investment Treaty, Slov.-Iran, art. IV, Jan. 19, 2016.

148. Bilateral Investment Treaty, Morocco-Nigeria, art. VI, Dec. 3, 2016.

149. Agreement Amending Annex 1 (Co-Operation on Investment) of the Protocol on Finance and Investment, Southern African Development Community, art. 6(2), Aug. 31, 2016.

FET clause. This problem can be reconciled by clarifying the FET clause to allow a certain extent of inconsistencies in the governance process. In investment treaty reform, the clarification of the FET clause is mainly through two approaches. First is linking FET with customary international law. Second is specification of FET elements through an exhaustive or indicative list. The latter is more effective than the former in reconciling the bottom-up dilemma, as illustrated below.

The first approach has been taken by the NAFTA parties in the binding interpretation issued through the NAFTA Free Trade Commission, and was later included in the U.S. Model BIT,¹⁵⁰ the Canadian Model BIT,¹⁵¹ and many recent investment treaties.¹⁵² However, it is questionable whether the approach of linking FET with the minimum standard of treatment (MST) is effective in protecting environmental governance. It might not be able to “anchor the floating canoe” since the meaning of the MST is unclear.¹⁵³ Some investment tribunals refer MST to the standard in the *Neer v. Mexico* case¹⁵⁴ in 1926, in which the U.S.-Mexico General Claims Commission decided that “the treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.”¹⁵⁵ However, other tribunals have held that the MST has evolved to a higher standard than *Neer* as a result of the development of thousands of IIAs and hundreds of ISDS cases.¹⁵⁶ Therefore, even if the treaty refers FET to customary international law, the latter’s threshold on investment

150. Model BIT Agreement for the Encouragement and Reciprocal Protection of Investment, U.S., art. 5, 2012.

151. Model BIT Agreement for the Promotion and Protection of Investments, Can., art. 5, 2004.

152. See Bilateral Investment Treaty, Morocco-Viet., art. 2.2(c), June 15, 2012; Bilateral Investment Treaty, Can.-China, art. 4, Sept. 9, 2012; Bilateral Investment Treaty, Japan-Peru, art. 5, Nov. 21, 2008.

153. W. Michael Reisman, *Canute Confronts the Tide: States versus Tribunals and the Evolution of the Minimum Standard in Customary International Law*, 30 ICSID REV. 616, 625 (2015).

154. *Neer (U.S.) v. United Mexican States*, 4 R.I.A.A. 60 (1926).

155. *Glamis Gold*, *supra* note 37, ¶ 616; *Al Tamimi*, *supra* note 37, ¶ 390.

156. *Merrill & Ring*, *supra* note 37, ¶ 213. *ADF Grp. Inc. v. United States*, ICSID Case No. ARB(AF)/00/1, Award, ¶ 179 (Jan. 9, 2003); *Mondev Int’l Ltd. v. United States*, ICSID Case No. ARB(AF)/99/2, Award, ¶ 115-7 (Oct. 11, 2002); *Pope & Talbot Inc. v. The Government of Canada*, UNCITRAL, Award on the Merits of Phase 2, ¶ 118 (Apr. 10, 2001).

protection is far from clear or uncertain, which gives investment tribunals wide interpretative discretion.

The second approach, which is more recent, is to specify in the treaty an indicative or exhaustive list of FET elements. For example, the 2016 Morocco-Nigeria BIT provides: “‘fair and equitable treatment’ includes the obligation not to deny justice in criminal, civil or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of a Party.”¹⁵⁷ The 2017 Colombia-U.A.E. BIT provides a longer exhaustive list: “The concept of ‘fair and equitable treatment’ means protection against measures or series of measures that constitute: (a) denial of justice in criminal, civil or administrative proceedings; (b) fundamental breach of due process, in judicial and administrative proceedings; or (c) manifest arbitrariness.”¹⁵⁸ Similarly, the Comprehensive Economic and Trade Agreement (CETA) between Canada and EU provides:

A Party breaches the obligation of fair and equitable treatment referenced in paragraph 1 if a measure or series of measures constitutes: (a) denial of justice in criminal, civil or administrative proceedings; (b) fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings; (c) manifest arbitrariness; (d) targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief; (e) abusive treatment of investors, such as coercion, duress and harassment; or (f) a breach of any further elements of the fair and equitable treatment obligation adopted by the Parties in accordance with paragraph 3 of this Article.¹⁵⁹

Such an indicative or exhaustive list of violations of the FET clause is useful for exempting merely inconsistent actions between state organs or inconsistent representations by government officials, which may be typical of a polycentric form of environmental governance. The host state will only be held accountable under the FET clause when the environmental governance is so poorly coordinated to amount to a “fundamental” or “manifest” breach of due process or transparency.

3. Clarification of the Indirect Expropriation Clause

Some recent treaties clarify the indirect expropriation clauses by requiring the tribunals to take a “case-by-case, fact-based inquiry” of

157. Bilateral Investment Treaty, Morocco-Nigeria, art. 7, Dec. 3, 2016.

158. Bilateral Investment Treaty, Colom.-U.A.E., art. 5(2), Nov. 12, 2017.

159. Comprehensive Economic and Trade Agreement, Can.- E.U., art 8.10, Oct. 30, 2016.

whether the measure constitutes indirect expropriation and to exempt certain public welfare measures from the scope of indirect expropriation.¹⁶⁰ For instance, the 2021 U.K.-Australia FTA in its investment chapter provides:

The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:

- (i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
- (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
- (iii) the character of the government action.¹⁶¹

The three clarified factors of economic impact, investor's expectations and character of government action originate from the U.S. Supreme Court's decision in *Penn Central v. New York*.¹⁶² After such clarification, the Article then provides: "Non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations, except in rare circumstances."¹⁶³

The clarified indirect expropriation provision obliges investment tribunals to consider more than the economic effects of the challenged measure, but also the character of the governmental action and the foreign investor's reasonable expectations. However, further clarification of what amounts to "reasonable investment-backed expectations" will benefit the resolution of the bottom-up dilemma. As illustrated in case law, in a polycentric and dynamic environmental governance, new environmental standards or concepts might be first adopted not in formal legislations or regulations, but in court decisions (as in the *Un glaube* case) or environmental assessment reports (as in the *Bilcon* case). Should the foreign investor expect a rigid mode of regulation so that innovation from bottom up frustrates

160. For a more thorough analysis of the reform of the indirect expropriation clauses in investment treaties, see Ying Zhu, *Do Clarified Indirect Expropriation Clauses in International Investment Treaties Preserve Environmental Regulatory Space?*, 60 HARV. INT'L L. J. 377 (2019).

161. Free Trade Agreement, Austl.-U.K., Annex 14-B, Dec. 17, 2021.

162. Kenneth Vandeveld, *A Comparison of the 2004 and 1994 US Model BITs: Rebalancing Investor and Host Country Interests*, 2008-2009 YEARBOOK ON INT'L INV. L. & POL'Y, 283, 285 (2009).

163. *Id.*

its “reasonable investment-backed expectations”? Or should the foreign investor expect a progressively adapting environmental regulatory process which incorporates useful innovations? How should the system differentiate between different sectors of public interest (for example, environment and national security) that adopt different modes of governance that may affect the foreign investors’ expectations?

One approach to solving these questions is assessing the foreign investor’s expectations based on the regulatory context. Some recent treaties have adopted this approach.¹⁶⁴ For example, the 2019 Korea-Uzbekistan BIT adds a footnote to explain the phrase “distinct, reasonable investment-backed expectations” in the indirect expropriation clause: “[f]or greater certainty, whether an investor’s investment-backed expectations are reasonable depends in part on the nature and extent of governmental regulation in the relevant sector. For example, an investor’s expectations that regulations will not change are less likely to be reasonable in a heavily regulated sector than in a less heavily regulated sector.”¹⁶⁵ This provision is useful for exempting the dynamic nature of environmental governance from a breach of investors’ expectations.

Other investment treaties confine the scope of “investment-backed expectations” to binding written commitments made by host states to foreign investors. For example, the Regional Comprehensive Economic Partnership Agreement (RCEP) replaces the term “investor’s investment-backed expectations” with “whether the government action breaches the government’s prior binding written commitment to the investor, whether by contract, licence, or other legal document.”¹⁶⁶ Such a provision limits the protection of foreign investors’ expectations to the extent that the host state has made a specific promise in a written and binding form.

Some other treaties combine the two approaches. For example, the USMCA provides that an “investor’s investment-backed expectations” is an element to consider in the assessment of indirect expropriation, but it clarifies in a footnote that “[f]or greater certainty, whether an investor’s investment-backed expectations are reasonable depends,

164. Free Trade Agreement, Can.-S. Kor., Annex 8-B, Ch. 8, n. 13, Sept. 22, 2014; Agreement on Investment Under the Framework Agreement Establishing a Free Trade Area, S. Kor-Turk., Annex B, n. 18, Feb. 2, 2015; Bilateral Investment Treaty, Arm.-S. Kor., Annex I, n. 9, Oct. 19, 2018; Bilateral Investment Treaty, S. Kor.-Uzb., Annex I, n. 8, Oct. 4, 2019.

165. *Id.*

166. Regional Comprehensive Economic Partnership, A.S.E.A.N., Annex 10-B 3(b), Nov. 15, 2020.

to the extent relevant, on factors such as whether the government provided the investor with binding written assurances and the nature and extent of governmental regulation or the potential for government regulation in the relevant sector.”¹⁶⁷ The 2021 UK-Australia FTA adopts a similar clause.¹⁶⁸

In conclusion, recent investment treaty reform has taken two main approaches toward modernizing substantive provisions of investment protection. One is by incorporating general exceptions clauses in investment treaties; the other is by clarifying certain standards of protection clauses in investment treaties. The general exceptions clause has its limitations in reconciling the bottom-up dilemma. Most general expectations clauses require challenged measures be applied in a non-discriminatory and non-arbitrary way, without further clarification of how to assess discrimination and arbitrariness. However, in case law, even if an environmental measure is justifiable, the foreign investor usually claims that it is how the measure is adopted or applied (i.e., the mode of environmental governance rather than rationality of the measure) that violates investment obligations. A study of the case law shows that the decentralized, dynamic and participatory character of environmental governance has been found as discriminatory or unequitable under investment treaties. This may constitute an obstacle to justifying environmental governance under general exceptions clauses. As a comparison, the clarified standards of protection are more effective in the resolution of the bottom-up dilemma by deferring to the character of governance in treaty language.

VI. CONCLUSION

The polycentric trend of environmental governance creates new challenges to international investment law. The case law reveals that the dynamic environmental governing process involving multiple decision-makers in various scales of government makes it vulnerable to violating investment obligations. Future tribunals need to strike a balance between, on the one hand, the protection of foreign investors’ interests in this dynamic and complex governing process, and, on the other hand, the preservation of host states’ policy space to adopt a polycentric and bottom-up governance structure. To achieve such goals, this Article proposes: in arbitral practice, the tribunals should

167. United States-Mexico-Canada Agreement, Annex 14-B, n. 19, Dec. 10, 2019.

168. *See, e.g.*, Free Trade Agreement, Austl.-U.K., Annex 13-B, n. 24, Dec. 7, 2021.

take into account the participatory, polycentric, and dynamic features of environmental governance in deciding whether a particular environmental measure is justifiable; and in treaty-making, the contracting parties should clarify the standards of protection in investment treaties to defer to the character of environmental governance.