International investment law, renewable energy, and national policy-making: on ‘green’ discrimination, double regulatory squeeze, and the law of exceptions

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CHAPTER 8

International Investment Law, Renewable Energy, and National Policy-making:

On “Green” Discrimination, Double Regulatory Squeeze, and the Law of Exceptions

Mavluda Sattorova

The interaction between international investment law and national policies on green energy has already received some attention as part of a broader debate about investment treaty instruments and sustainable development. However, unlike the related theme of World Trade Organization (WTO) law and its role in facilitating or constraining greener energy solutions and policies, some of the more specific aspects of the relationship between international investment agreements (IIAs) and the promotion of renewable energy on a national level remain less explored. This chapter will draw upon existing scholarship on international investment law and sustainable development as a background for a fresh inquiry into barriers and opportunities the emerging global investment protection regime creates in the way of renewable energy initiatives. Potential clashes between international investment law and national policy-making in the renewable energy sector will be analyzed through the prism of concrete regulatory solutions that have been deployed by national governments, including biofuel certification programs, green subsidies, and carbon tax schemes. Drawing upon a comparative analysis of international trade and EU law, this chapter will also explore the role of and problems with carve-out provisions and exceptions clauses in providing national governments with policy space for promoting renewable energy. This chapter will also examine the concept of energy security as a catalyst behind the move toward renewable energy and a ground on which national measures can be insulated from investment treaty...
disciplines. Driven by discrete but often interrelated and competing objectives – such as climate change mitigation, sustainable development, environment protection, and energy security – national renewable energy initiatives and the matter of their consistency with international investment law offer a unique analytical angle from which some of the fundamental and systemic issues stemming from the evolution of a global investment protection regime will be explored.

Introduction

The need to address the problems of climate change, energy security, and sustainable economic growth has pushed governments across the globe to launch economic and regulatory initiatives promoting greener technologies and embracing renewable sources of energy. As far as the promotion of renewable energy is concerned, such initiatives include subsidies, certification schemes and pricing and taxation mechanisms, usually designed to help green energy survive competition in a global market that remains dominated by conventional energy products.¹ However, the compatibility of such national policies with international investment protection norms raises a number of complex issues. Can governments continue to promote green energy without at the same time facing challenges that affected parties may bring under international investment and trade instruments? Renewable energy projects need private investment, but how can the promotion and protection of foreign investment in existing treaties be reconciled with national policies promoting a greener future?

The clash between international investment law and renewable energy initiatives is a relatively recent phenomenon. Although the early years of investment arbitration amply

illustrated the capacity of international investment agreements to intrude upon national regulatory space in matters involving the creation of conservation areas, the prohibition on the movement of hazardous waste, and the replacement of methanol-based fuel additives by a cleaner ethanol-based alternative, the fate of renewable energy policies for some time had been solely a subject of prospective and speculative analyses until the recent wave of disputes pushed the topic to the forefront of legal discourse. Some of the noteworthy developments include a notice of arbitration filed by a group of foreign investors against the Spanish Government disputing the latter’s substantive cuts in its feed-in tariffs scheme and contending that such cuts breached Spain’s investment protection commitments under the Energy Charter Treaty. The disputed legislation capped photovoltaic solar energy production


and limited entitlement to incentive feed-in tariffs. The changes in Spanish law have resulted in a negative impact on the revenues for the Spanish solar energy projects in which the foreign investors had invested. Solar panels have also become the subject of a recent contention between the European Union and China, with the former launching an investigation into allegations of subsidization of Chinese manufacturers and dumping of solar panels into the European market. Although the Chinese solar panels issue has been framed as a matter of multilateral trade law that falls within a purview of WTO disciplines on antidumping and subsidies, the underlying conflict can become a subject of investor-state arbitration, particularly given a growing tendency for the simultaneous use of trade and investment rules by business actors whose economic interests have been detrimentally affected by national green policies.

This overlap between investment and trade disciplines is illustrated in a WTO panel report in *Canada–Feed-In Tariff Program*. The case concerned domestic content requirements to which the electricity-generation facilities utilizing solar photovoltaic and wind power technology were subject under the Feed-In Tariff Program adopted by the Government of the Province of Ontario. Along with giving rise to a trade dispute between compensation for Spanish solar cuts,” *Financial Times*, November 17, 2011, available at: [http://www.ft.com/cms/s/0/19088742-1117-11e1-ad22-00144feabdc0.html](http://www.ft.com/cms/s/0/19088742-1117-11e1-ad22-00144feabdc0.html) (last visited February 19, 2013).


the European Union and Canada, the same measures are being challenged in investor-state arbitration between Mesa Power Group, a U.S. investor, and the Government of Canada. In its notice of intent to arbitrate under Chapter 11 of the North American Free Trade Agreement (NAFTA), Mesa Power Group has claimed that its four wind farm projects which participated in Ontario’s renewable energy scheme suffered economic loss due to the imposition of domestic content requirements and unfair administration of the scheme by the provincial government.⁶

The potentially constraining effect of international investment protection rules on national policies in general have received attention in a number of scholarly works, including studies that alert to the possibility of regulatory chill whereby international investment law and the remedies it offers to business actors discourage states from adopting socially desirable regulation.⁷ On the other end of the spectrum are the studies that deny that


investment protection rules have a chilling effect on national regulatory activities. The impact of international investment agreements on renewable energy promotion specifically has been touched upon in a number of recent works. There is also a growing body of literature analyzing whether tax relief measures for green energy, subsidies for renewables, and certification schemes for biofuels are consistent with nondiscrimination provisions in the General Agreement on Tariffs and Trade (GATT) and the WTO Agreement on Subsidies and Countervailing Measures.

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However, the question of how governments can reconcile their investment protection commitments with renewable energy initiatives has so far received relatively little attention. Recent studies of the interplay between international investment law and renewable energy, for example, tend to focus predominantly on the role of bilateral and multilateral investment agreements in promoting and protecting foreign investment in renewables.\textsuperscript{11} Likewise, the interplay between renewable energy policies and investment protection has been partly addressed in the literature that focuses on investor rights in challenging emission reduction instruments under the Kyoto Protocol.\textsuperscript{12} An important aspect missing from existing analyses is an evaluation of how national green energy policies may be affected by the ongoing trade rules: Is this a case of unlawful discrimination?\textsuperscript{37}” 37 Journal of World Trade 359 (2003); Simonetta Zarrilli, “Biotechnology in the energy sector: some implications for developing countries,” in Daniel Wüger and Thomas Cottier, eds., Genetic Engineering and the World Trade System (Cambridge: Cambridge University Press, 2008), p. 151; Stephanie Switzer and Joe McMahon, “EU biofuels policy – raising the question of WTO compatibility,” International and Comparative Law Quarterly 713 (2011).


transformations within investment treaty law, its evolving relationship with multilateral trade rules, and its function in the broader framework of international economic law. This contribution will use the interplay between investment protection and renewable energy policies as a springboard for the analysis of some of the hitherto unexplored systemic issues relating to the evolution of international investment law and its impact on the pursuit of competing policy objectives by host states.

A. Differentiating Renewables: National Policy Options and National Treatment Disciplines

1. Sustainability as a Basis of Differentiation: From “Foreign vs. Domestic” to “Green vs. Not Green”

The promotion of renewable energy often presupposes differentiation. It is commonly acknowledged that although traditional fossil fuels will remain the dominant source of energy for at least the next three decades, the gradual transition to renewable energy sources may contribute to alleviating climate change, environment protection, and security of supply concerns. In order to promote and embed greener energy solutions as an alternative to carbon-rich fuels, states will frequently need to use differentiation and afford more favorable treatment to renewable energy. The classic example of differentiation between conventional and renewable energy products is a carbon tax.\(^\text{13}\) Carbon taxes are seen as a form of

environmental taxation, providing they are designed and implemented with the intention of changing environmentally damaging behavior.\textsuperscript{14} Introducing carbon taxes is one of the principal ways in which the reduction of greenhouse gas emissions can be achieved: the tax raises the price of the environment-damaging fossil fuels, thus encouraging the use of greener alternatives. Just like any differentiation mechanism, a carbon tax may be regarded as a form of legitimate discrimination inasmuch as it is consistently implemented to achieve the relevant environmental policy objectives. However, the higher tax burden on carbon fuels and the correspondingly lower rate enjoyed by low-emission renewable energy products may give rise to claims of discrimination by disadvantaged economic parties (i.e., those involved in the production, marketing, and distribution of the carbon-rich fossil fuels). By way of example, it was reported that some European states have introduced carbon taxes, but such taxes were not pure environmental taxes: the rate of the tax only partially reflected the carbon content of the relevant fuel.\textsuperscript{15} Besides, various rebates and exemptions were applied, reflecting nonenvironmental policy objectives, such as the preservation of sectoral competitiveness.\textsuperscript{16} The internal incoherence of the carbon tax measure may indicate the existence of underlying protectionist intent, which may render the measure challengeable under the nondiscrimination

\textit{Mitigation of Climate Change} (Cambridge: Cambridge University Press, 2009), p. 60;


\textsuperscript{14} Zarrilli, “Domestic taxation of energy products and multilateral trade rules: Is this a case of unlawful discrimination?” 2003, \textit{op. cit.}, p. 364.

\textsuperscript{15} Zarrilli, “Domestic taxation of energy products and multilateral trade rules: Is this a case of unlawful discrimination?” 2003, \textit{op. cit.}, p. 366.

\textsuperscript{16} Zarrilli, “Domestic taxation of energy products and multilateral trade rules: Is this a case of unlawful discrimination?” 2003, \textit{op. cit.}, p. 366.
obligations in international trade and investment agreements. This is a classic example of
differentiation disguised by environmental policy objectives but driven, totally or partially,
by protectionist considerations.

Differentiation, however, can be made not just among conventional and renewable
energy, but also between various renewable energy projects. As far as the latter category is
concerned, differentiation can be made on the basis of criteria reflecting the ability of various
renewables to facilitate the achievement of policy objectives relating to climate change,
environment protection, and energy security. For instance, along with wind, wave, and solar
power, biofuels – including ethanol and biodiesel – are increasingly considered as an
alternative source of energy, in particular in countries where land capacity and climate
conditions are conducive to the production of sufficient quantities of raw biomass. From the
economic standpoint, biofuels offer opportunities to foster development in rural areas,
through diversification of agricultural production, offering local employment and opening
new streams of income. On the one hand, the production and use of bioenergy call for
governmental support such as subsidies, tax relief and regulatory instruments. On the other
hand, there are concerns that bioenergy crops could entail harmful implications for land and
workers, in particular in developing countries. Biofuel production may result in a situation
where land is increasingly allocated to fuel crops, thus compromising food and feedstock

17 George R. Pring, Alexandra Suzann Haas and Benton Tyler Drinkwine, “The impact of
energy on health, environment and sustainable development: the TANSTAAFL problem,” in
Don Zilman, Catherine Redgwell, Yinka Omorogbe, and Lila K. Barrera-Hernández, eds.,
Beyond Carbon Economy: Energy Law in Transition (New York: Oxford University Press,
2008), p. 27.
production, forestry, animal grazing, and conservation. Potential threats include deforestation, desertification, and negative environmental impacts associated with the use of genetically modified organisms in large-scale corporate farming practices. Unwelcome social consequences of rapidly growing biofuel production may also involve poor labor standards, including the use of vulnerable workers and dangerous working conditions. In the early years of launching a biofuel program in Brazil, for instance, the extensive use of land and the need to protect sensitive environmental areas were largely ignored. It is clear that despite being regarded as a means of mitigating environmental degradation, biofuels – and other renewable energy sources – can raise sustainability concerns and call for national and international legal and policy solutions.

Certification of biofuels is one of the ways in which sustainability concerns can be addressed, usually through laying down a set of criteria that need to be satisfied for biofuels to count toward renewable energy targets and/or qualify for financial benefits. Certification schemes and other sustainability assurance programs have been launched in a number of countries, including Belgium, the Netherlands, Canada, France, Germany, the United

Kingdom, and Brazil.\textsuperscript{22} In the European Union, sustainability criteria now form part of the regulatory framework embodied in the recent EU Renewable Energy Directive.\textsuperscript{23} Importantly, the Directive makes sustainability a precondition for biofuels not only to be counted toward national targets and renewable energy obligations but also to be eligible for financial support.\textsuperscript{24} The criteria of sustainability are twofold. First, the Directive prescribes the minimum level of emissions savings that needs to be met for biofuels to be considered sustainable. Second, it prohibits biofuels made from raw materials obtained from (1) land with high biodiversity value, (2) land with high carbon stock, and (3) in the case of raw material produced in the EU, biofuels obtained in violation of EU environmental requirements for agriculture.\textsuperscript{25} Besides, the Directive also endeavors to embrace social sustainability criteria by highlighting the importance of international labor and worker protection standards.\textsuperscript{26}

The EU Directive and its national prototypes are examples of a regulatory policy that strives to encourage transition to renewable energy while at the same time foreclosing

\begin{itemize}
\item \textsuperscript{22} Zarrilli and Burnett, “Certifying biofuels: benefits for the environment, development and trade?,” 2009, \textit{op. cit.}, pp. 201–203.
\item \textsuperscript{24} \textit{Directive 2009/28/EC, op. cit.}, art. 17 (1).
\item \textsuperscript{25} \textit{Directive 2009/28/EC, op. cit.}, art. 17 (2)–(6).
\item \textsuperscript{26} The EU Directive has been criticized for failing to include the impact on labor, land use and the price of food crops in the binding sustainability criteria. See Switzer and McMahon, “EU biofuels policy—raising the question of WTO compatibility,” 2011, \textit{op. cit.}, p. 718.
\end{itemize}
business practices that are unsustainable due to their detrimental environmental and social effects. Yet it also epitomizes a national policy instrument where a range of competing economic and noneconomic interests clash with one another, exposing the policy to legal challenges and endangering the achievement of the relevant policy objectives. Consider, for example, the minimum emissions saving target that a biofuel must meet in order to satisfy the sustainability criteria under the EU Directive. The setting of a minimum emissions saving level appears to be justified by the overarching environmental protection and climate change considerations: although biofuels are “carbon-neutral” for the purposes of reducing greenhouse gases, they are not “carbon-free” as the biomass industry does produce emissions over the total fuel cycle.  

Thus, the carbon neutrality of biofuels ultimately hinges on their net positive energy balance, which in turn is based on the capacity of biomass to not only release carbon dioxide but also to recapture it from the atmosphere. The requirement to attain a certain level of emissions saving as a precondition to sustainability could thus be seen as a legitimate and positive contribution toward achieving the Directive’s key objective of climate change mitigation. Yet the very same requirement may fall afoul of nondiscrimination standards in bilateral and multilateral investment treaty instruments. Presently, the Directive sets the minimum level of emissions savings at 35%, with a further rise to 50% in 2017. The Directive also lays down the typical and default values for


29 Switzer and McMahon have suggested that this sustainability criterion could potentially give rise to a challenge under GATT Article III:4. See Switzer and McMahon, “EU biofuels policy—raising the question of WTO compatibility,” 2011, op. cit., p. 729.
calculating the greenhouse gas impact of various biofuels: biodiesel produced from rapeseed oil, for example, has the default emissions savings of 38%, whereas the default savings value for biodiesel produced from palm oil is set at a comparatively modest 19%. These figures suggest that biofuel production from domestically produced rapeseed oil might be treated more favorably compared to imported biodiesel derived from palm oil. It has been observed that, although origin-neutral on its face, the relevant provision in the Directive may give rise to claims of de facto discrimination under GATT Article III:4. Informal complaints have been made by U.S. soy biodiesel producers in regard to default emission values which disqualify soy as a feedstock for biodiesel due to the latter’s greenhouse gas emission falling just below the EU cap of 35%.

While the possible clash between sustainability schemes, including that of the EU Renewable Energy Directive, and nondiscrimination provisions under international trade

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agreements has already been discussed in academic literature, the possibility of similar disputes under investment treaty instruments remains less explored. To use the language of investment tribunals, the differentiation on the basis of sustainability criteria may confer advantages onto domestic investors and thus result in the loss of a market share for foreign investors. At a time when business actors are increasingly aware that trade disputes can go hand-in-hand with investment disputes, an analysis of investment treaty disciplines and their impact on renewable energy initiatives should be situated within a broader picture of international economic law, which is increasingly characterized by the overlap between trade and investment regimes.

Indeed, in addition to being potentially inconsistent with multilateral trade norms, sustainability criteria in the renewable energy policies can be disputed as protectionist under investment treaty instruments that invariably contain at least some form of nondiscrimination standard, such as the national treatment clause, the clause prohibiting arbitrary and


35 See Nicholas DiMascio and Joost Pauwelyn, “Non-discrimination in trade and investment treaties: World apart or two sides of the same coin?” 102 American Journal of International Law 48 (2008), p. 49. Examples of an overlap in the material scope of the two regimes can also be found in Anne van Aaken and Jürgen Kurtz, “Prudence or discrimination? Emergency measures, the global financial crisis and international economic law,” 12 Journal of International Economic Law 859 (2009); and Arwel Davies, “Scoping the boundary between the trade law and investment law regimes: When does a measure relate to investment?” 15 Journal of International Economic Law 793 (2012).
discriminatory conduct, or even a combination of the two. When implemented in national legal orders, the EU Directive may give rise to investment treaty claims, not least because it makes sustainability a precondition for receiving financial benefits. Such renewable energy initiatives may also violate national treatment and other nondiscrimination standards of international investment agreements in attempting to protect small producers. One of the attractions of a greater transition to biofuel production in regions with the requisite agricultural capacity has been the ensuing possibilities of creating employment opportunities in local communities and of the facilitation of rural development in general, including through supporting small producers. However, certification of biofuels is a costly process, and smaller producers in developing countries may not afford to comply with the

36 See, e.g., Article 3(1) of the Netherlands-Bolivia bilateral investment treaty, which requires that “[e]ach Contracting Party shall ensure fair and equitable treatment to the investments of nationals of the other Contracting Party and shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those nationals.” This provision is followed by a national treatment clause in Article 3(2). Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Bolivia, art. III, available at: http://unctad.org/sections/dite/iaa/docs/bits/netherlands_bolivia.pdf (last visited February 19, 2013).

37 Arbitral practice contains examples of disputes where different treatment of similar products for taxation and state aid purposes was challenged as incompatible with nondiscrimination and fair and equitable treatment provisions. See Corn Products International Inc. v. Mexico, ICSID Case No. ARB(AF)/04/1, decision on responsibility (January 15, 2008) [herein Corn Products v. Mexico] and Saluka Investments BV v. Czech Republic, PCA—UNCITRAL Arbitration Rules, partial award (March 17, 2006).
requirements for certification and thus lose their market share.\textsuperscript{38} To address these concerns, it has been suggested that a condition can be imposed that a certain part of the biomass should originate from small producers for the final product to satisfy the relevant certification standards. Brazil and the Netherlands have followed this approach.\textsuperscript{39} The Brazilian social program for biodiesel, for instance, rendered it mandatory for a certain part of biomass to originate from small producers.\textsuperscript{40} Although aimed at achieving legitimate social and economic policy objectives – and despite the fact that it does not expressly favor local producers – this requirement can be seen as conferring greater advantage on the local biofuels industry and thus be potentially open to a challenge under national treatment provisions and the prohibition of arbitrary or discriminatory conduct in international investment agreements.

The potential inconsistency between both the sustainability standards and the carbon taxes discussed earlier with nondiscrimination disciplines illustrates a complex and multifaceted interaction between green policies and investment treaty law. While existing literature tends to consider this incompatibility primarily through a lens of the conflict


between economic and noneconomic concerns, such as investment protection and green
development, a cursory look at what is a fraction of the entire gamut of renewable energy
initiatives reveals a broader and more diverse range of competing interests that such schemes
affect. Again, the EU Renewable Energy Directive is a good case in point: actual and
potential conflicts to which it may give rise do not fall exclusively within the familiar
conceptual framework of a clash between investment protection and noneconomic policy
objectives but rather represent a different kind of competition – the one that involves various
categories of foreign economic interests such as foreign investments in green and
conventional energy or renewable investments that pass the sustainability criteria and those
that do not. Although the state enacting a renewable policy measure remains at the center of
investment dispute, the underlying conflicts are foreign versus foreign, green versus not
green, sustainable versus unsustainable, rather than foreign versus domestic. The function of
the existing international investment regime thus seems to have shifted from imposing
constraints on state power to reallocating power between private economic actors, in
particular by enabling the latter to harness the conflict between investment treaty norms and
national regulations in an effort to optimize their economic strength vis-à-vis their
competitors in a market shaped by new pressing global policy concerns, changing consumer
perceptions, and technological innovation. The increasingly tripartite nature of investment
disputes41 and the resulting shift in the aims and scope of private ordering in international

41 The increasingly tripartite nature of investment disputes can be discerned in cases falling
under the rubrics “investment protection versus human rights” and “investment protection
versus environment” as evidenced, for example, in the ongoing conflict in the Chevron-Lago
Agrio saga where the local community, the government of Ecuador and a U.S. oil company
have been entangled in a number of cross-related litigation, arbitration, and enforcement
cases. Documents relating to various strands of the Chevron-Lago Agrio conflict are
investment law should inform a discussion of the interplay between investor rights and green policies, and in particular the analysis of how the investment protection regime could be redesigned in order to better enable effective policy-making.

2. The Interplay between Trade and Investment Regimes: A Double Regulatory Squeeze

In addition to being subject to the demanding nondiscrimination disciplines under international investment agreements, the capacity of national policy-makers to launch and implement green energy initiatives can also be restrained through a double squeeze generated by convergence and divergence between international investment law and multilateral trade rules. The most recent example of the inter-regime overlap can be found in the very topical Canada–Feed-in-Tariff Program case, where local content requirements linked to a feed-in tariff scheme were challenged as a violation of the Agreement on Trade-Related Investment (TRIMs), as prohibited subsidies under SCM Agreement, and as discriminatory measures.


Alongside the WTO proceedings, a notice of intent has been filed under NAFTA Chapter 11 disputing the same measures under investment protection rules.\textsuperscript{44} Although the mutually complementary nature of the investment and trade regimes has gained some attention in recent discourse,\textsuperscript{45} its effect on national policy-making remains unaddressed.

The overlap between international investment law and multilateral trade norms can be discerned in connection with different disciplines, of which nondiscrimination rules provide one example.\textsuperscript{46} Despite the arguments that consider nondiscrimination obligations under international trade and investment protection law as conceptually and functionally different, it is undeniable that there is a significant degree of overspill in the way the principle operates in the two fields. A principal economic objective of the nondiscrimination rule is to ensure the same competitive conditions for both foreign and domestic business actors and to prevent the host state from favoring domestic business by affording less favorable treatment to their foreign counterparts.\textsuperscript{47} Even though the national treatment obligation in international

\textsuperscript{44} Mesa Power Group LLC v. Canada, \textit{op. cit.}

\textsuperscript{45} See, e.g., DiMascio and Pauwelyn “Non-discrimination in trade and investment treaties: world apart or two sides of the same coin?,” 2008, \textit{op. cit.}; Davies, “Scoping the boundary between the trade law and investment law regimes: when does a measure relate to investment?,” 2012, \textit{op. cit.}

\textsuperscript{46} To mention a few examples, performance requirements are regulated by both investment and trade rules, and to a certain extent so are the subsidies.

investment agreements and GATT vary in terms of their foci on investments and goods\textsuperscript{48} respectively, it is undeniable that a national policy affecting foreign business interests can trigger both an international trade dispute and an individual challenge under international investment agreements. So far as the application of nondiscrimination norms to national green energy policies is concerned, the overlap between international trade and investment instruments offers business actors greater and more varied opportunities to challenge renewable energy initiatives. On the one hand, an increasingly divergent and self-contained development of norms in the two regimes prevents their coalescence, thereby generating an additional layer of protection for business actors and increasing the host country’s exposure to the risk of international review of its policies. On the other hand, there is a degree of convergence in the way nondiscrimination standards are construed and applied under international investment agreements and GATT/WTO agreements. This convergence may widen the scope of nondiscrimination standards of international investment agreements, which too may translate into a greater squeeze of national regulatory space by preventing states from using differentiation in the promotion of renewable energy.

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\textsuperscript{48}The General Agreement on Trade in Services (GATS) can also be brought into this equation as its scope and coverage is also characterized by the overlap with international investment agreements. See Rudolf Adlung and Martín Molinuevo, “Bilateralism in services trade: Is there fire behind the (BIT-)smoke?,” 11 \textit{Journal of International Economic Law} 365 (2008).

As regards the divergence in the formulation and interpretation of nondiscrimination provisions under trade and investment agreements, a comparative overview of national treatment obligations provides a useful backdrop against which a double-squeezing effect of international investment agreements on national renewable energy policies can be examined. National treatment in investment treaty law has a broader ambit than those in WTO law. For instance, a typical national treatment clause in an international investment agreement demands that states subject foreign investors and their investments to treatment no less favorable than that accorded to domestic investors and their investments.\(^49\) Thus, unlike in the international trade regime which focuses on goods (and to some extent on services), the finding of discrimination under investment treaty instruments will hinge on a broader range of circumstances underpinning various aspects of what may often involve a complex and multidimensional economic project.\(^50\) The fact that the typical treaty definition of investment refers to different facets and phases of an investment process as a business activity is suggestive of the breadth of factors which may be taken into account in determining the existence of discrimination in an investor-state dispute. Furthermore, in some treaties, the


\(^50\) Investment is a project, not a transaction or an asset: see Saipem S.p.A. v. People’s Republic of Bangladesh, ICSID Case No. ARB/05/7, decision on jurisdiction (March 21, 2007), para. 127; see also Romak S.A. (Switzerland) v. Republic of Uzbekistan, PCA Case No. AA280, decision (November 26, 2009), para. 211. For the argument in favor of a process-oriented understanding of investment, see Mavluda Sattorova, “Defining investment under the ICSID Convention and BITs: Of ordinary meaning, telos, and beyond,” 2 Asian Journal of International Law 267 (2012), pp. 275–277.
nondiscrimination requirements are blended into a potentially very broad and all-encompassing guarantee requiring state parties to accord investments fair and equitable treatment and to refrain from impairing, through discriminatory and unreasonable measures, the management, maintenance, use, enjoyment, and disposal of investments.\(^{51}\) By referring to various stages as well as organizational and temporal aspects of investment as a multifarious process, the latter formulation suggests that international investment agreement disciplines on nondiscrimination can go beyond their counterparts in GATT Article III, and thus enhance opportunities for disputing the legality of national renewable energy initiatives by affected business actors.

The lack of uniformity in the interpretation of the relevant provisions by investment tribunals, too, is conducive to creating a legal environment where the scope and meaning of nondiscrimination disciplines in international investment agreements can be significantly stretched, with the resulting expansion of their protective reach and the corresponding squeeze on a national regulatory space. International trade panels and investment tribunals differ in their assessment of “likeness,” which traditionally plays a key role in the multipronged analysis of discrimination claims. This stage of analysis is particularly important in assessing the legality of differentiation between renewable and conventional energy, or between sustainable renewables and other renewable products. The national treatment test under GATT Article III centers on competitive conditions between foreign and domestic goods, such conditions being crucial for establishing the likeness between the two.\(^{52}\)


By contrast, investment tribunals have attributed varying degrees of importance to the competitive conditions between foreign and national investments. Some tribunals, for instance, have gravitated toward endorsing the importance of competition in a comparison of the foreign-owned enterprises with domestic firms operating in the same business sector.\textsuperscript{53} Others have stressed that “it is possible for two investors or enterprises to be in the same sector or to be in competition and nonetheless be quite unlike in respect of some characteristic critical to a particular treatment.”\textsuperscript{54} Yet another category of decisions appears to be influenced by GATT/WTO jurisprudence and by some of the previously decided investment disputes in which the determination of likeness revolved around several factors, including a regulatory purpose behind a disputed governmental act as well as competition between a foreign investor and its domestic counterpart.\textsuperscript{55} This diversity in interpretation of nondiscrimination requirements sets investment arbitration apart from GATT/WTO fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III ‘is to ensure that internal measures “not be applied to imported or domestic products so as to afford protection to domestic production”.’ Towards this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products.”


\textsuperscript{54} United Parcel Service of America Inc. v. Canada, Ad hoc—UNCITRAL Arbitration Rules, \textit{award and separate opinion, separate opinion of Dean Ronald A. Cass} (May 24, 2007), para. 16.

\textsuperscript{55} \textit{Corn Products v. Mexico}, op. cit.
jurisprudence, subjecting national policies to what are two distinct areas of international scrutiny.

At the same time, the lack of uniformity within international investment law and the resulting elasticity of interpretive approaches may widen the protective reach of international investment agreements and add to their constraining effect. Consider, for example, the propensity of some arbitral tribunals for setting too broad a basis for comparing between two enterprises in the application of the like circumstances test under international investment agreements. The broader the range of comparators to choose from, the greater the possibility that a disputed measure might be found discriminatory thus amounting to an investment treaty breach (and compelling the host state to defend its measures and to indemnify disadvantaged business actors). For example, in *Occidental v. Ecuador (Occidental)*, an investor claimed that a refusal to grant value-added tax refunds to oil companies was in violation of the national treatment standard because companies engaged in the export of other goods, such as flowers and seafood products, had been entitled to the refunds. The tribunal held that the “like circumstances” test ought not to be confined to companies operating in the same sector but called for comparison between exporters generally. Selecting a domestic comparator from a broader range of exporters was a vehicle by which the tribunal arrived at its finding of discrimination. In practice, the broadness of such an interpretive stance expands the scope and coverage of nondiscrimination provisions, potentially making investment

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56 Occidental Exploration and Production Company v. Ecuador, LCIA Case No. UN 3467, *award* (July 1, 2004) [herein *Occidental v. Ecuador*].

57 *Occidental v. Ecuador*, *op. cit.*, para. 173 (“... like situations cannot be interpreted in the narrow sense advanced by Ecuador as the purpose of national treatment is to protect investors as compared to local producers, and this cannot be done by addressing exclusively the sector in which that particular activity is undertaken.”).
arbitration both an attractive venue for discontented business actors and a threat to an increasingly shrinking national policy space. In the case of a dispute concerning renewable energy, one cannot exclude the possibility of an investment tribunal following the footsteps of *Occidental* and selecting a comparator in a way that would justify the finding of a renewable energy project to be like other energy projects, or indeed, finding that sustainably produced biofuels are like biofuels that do not meet the sustainability requirements. Since any rational policy aimed at encouragement of alternative energy solutions by definition calls for differentiation between, for example, renewables and conventional energy products or sustainable biofuels and other biofuels, setting too broad a basis of comparison would render such differentiation impossible. This would in turn delimit the range of policy solutions that national regulators can adopt in facilitating greener and more sustainable energy.

Finally, the overlap between and mutual complementarity of international investment law and international trade law produces a double-squeezing effect on national green energy policies because the same policy measures can be simultaneously disputed in different fora. A prime example is the aforementioned Ontario renewable energy program, which has become the subject of a WTO dispute in *Canada–Feed-in-Tariff Program* while also triggering investor-state arbitration under NAFTA Chapter 11. Even prior to the *Canada–Feed-in-Tariff Program* controversy, national regulatory measures had been challenged under both

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58 See Susan D. Franck, “International Decisions,” 99 *American Journal of International Law* 676 (2005), para. 679 (criticizing the tribunal’s choice of comparator and observing that such interpretation makes it easy to establish a BIT violation).

international investment and trade agreements on a number of occasions. Of course, the existence of parallel routes in the trade and investment fora does not mean the identity of claimants and of the objects and causes of action remain the same in respective proceedings, especially given that unlike foreign investors under international investment agreements, individual claimants do not have standing in WTO dispute settlement. However, as far as the exposure of national policy measures to international scrutiny is concerned, the convergence between the trade and investment regimes translates into a double litigation burden and double squeeze of regulatory space for host states.

The squeezing effect of the converging and diverging investment and trade rules on national policy space could be mitigated through cross-fertilization and alignment in the interpretation of the respective obligations in the two regimes. However, the distinctiveness of dispute settlement mechanisms under trade and investment agreements militates against such inter-regime alignment and instead results in a situation where the otherwise similar obligations actually add to each other, thus increasing the exposure of national measures to international review in different fora. Add to this a lack of internal consistency within international investment law and it becomes clear how investment treaty law, in combination with international trade rules and alone, threatens to constrain the degree of national regulatory flexibility in such areas as green energy development. Indeed, it has been reported that the suggestions for a stronger articulation of environmental and sustainability requirements in the EU Renewable Energy Directive failed to make their way into the final version of the document since a compromise had to be made between the European Union’s 60 The Mexican sweeteners controversy and Canadian softwood lumber disputes exemplify the concurring protective scope of WTO and investment treaty agreements. For a detailed analysis, see Davies, “Scoping the boundary between the trade law and investment law regimes: When does a measure relate to investment?,” 2012, op. cit.
commitment to environment protection and sustainable development and its obligations under multilateral trade agreements.\textsuperscript{61} The European Commission has acknowledged that the desire to prevent claims under WTO law was a motivating factor for not adopting stronger criteria. This serves as evidence of a “chilling” effect multilateral trade rules have on national regulatory behavior.\textsuperscript{62} The possibility of individual challenges under international investment agreements – especially given their elasticity and protective reach that makes them an attractive option for disputing regulatory schemes by disgruntled business actors – may add to an anticipatory chilling effect of international norms on national policy-making in the green energy sector.

3. Differentiation and Regulatory Purpose under International Investment Agreements: Between the Promise of Flexibility and the Restrictive Effect

Paradoxically, the breadth and elasticity of arbitral interpretations of nondiscrimination provisions under international investment agreements may offer – at least theoretically – the possibility of accommodating renewable energy policies. In contrast with approaches that dominate GATT/WTO jurisprudence on GATT Article III, investment tribunals seem to be more willing (and indeed flexible) to endorse the regulatory purpose test and to take into account the aims and objectives of a disputed national policy in assessing its discriminatory impact. Whereas many an international trade panel has rejected the relevance of the purpose of a regulatory instrument in the determination of the likeness, the interpretation of “like


circumstances” by arbitral tribunals in investment treaty disputes has frequently involved an examination of policy objectives behind a disputed measure. NAFTA tribunals were among the first to set the trend, which was subsequently endorsed in other cases and in some of the recent treaties. In investor-state arbitration, the regulatory purpose may be relevant not only at the stage of determining the appropriate comparators but also as part of establishing legitimate, nonprotectionist justifications for the disputed treatment.

As stated by the tribunal in Pope & Talbot v. Canada, the like circumstances analysis must address “any difference in treatment, demanding that it be justified by showing that it bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign owned investments.” In contrast to international trade law, which remains largely dismissive of the


65 See Pope & Talbot Inc. v. Canada, Ad hoc—UNCITRAL Arbitration Rules, award on the merits of phase 2 (April 10, 2001), para. 79. See also GAMI Investments, Incorporated v. Mexico, Ad hoc—UNCITRAL Arbitration Rules, final award (November 15, 2004), para. 114 (the measure must be plausibly connected with a legitimate goal of policy); Saluka Investments BV v. Czech Republic, op. cit., para. 307 (any differential treatment of a foreign investor must not be based on unreasonable distinctions and demands, and must be justified by showing that it bears a reasonable relationship to rational policies not motivated by a preference for other investments over the foreign-owned investment). In a different way, a regulatory purpose behind the disputed national measure formed part of the tribunal’s
idea that the regulatory purpose should be considered in assessing discrimination claims, investment treaty law may seem almost regulation-friendly by allowing policy justifications to be taken into account when establishing the very existence of discrimination.

On a closer look, however, the degree of acceptance the regulatory purpose test received in international investment law is belied by the general tendency for inconsistency and the unpredictability of arbitral practice. Investment tribunals could certainly be encouraged to pay closer attention to a regulatory context and policy justifications in assessing claims of discrimination. Foreign investments usually have a larger imprint than foreign imports and penetrate deeper into a social and economic fabric of the host country, and this penetration dictates that a broader regulatory context and its socioeconomic underpinnings are taken into consideration when deciding whether an investor suffered discrimination. The COMESA CCIA Agreement endorses this approach as it provides an explicit textual support for the inclusion of policy objectives into a nondiscrimination analysis, particularly at the stage of establishing whether national and foreign investors are in analysis of alleged discrimination in *Corn Products v. Mexico* – the tribunal took into account the regulatory purpose in determining the existence of likeness and discrimination. Mexico admitted that the purpose of the disputed tax had been to act as a countermeasure targeting the United States for a failure to open its markets to Mexican sugar imports (*Corn Products v. Mexico, op. cit.*, paras. 32–48, 136).

Although regulatory purpose was considered as part of establishing discriminatory treatment in a number of cases, there is lack of uniformity and consistency in existing jurisprudence. The lack of uniformity in the formulation of nondiscrimination provisions is one of the factors that may continue to engender variance in arbitral approaches.

like circumstances.\textsuperscript{68} The COMESA CCIA Agreement is, however, somewhat exceptional; it differs from the traditionally sparse texts of the bulk of investment treaty instruments, including some of the new and revised models, which remain silent as to whether policy objectives should be considered in the assessment of discrimination claims. The lack of textual support in a great many investment treaties may thus forestall a more widespread and consistent embedding of the regulatory purpose test in investment arbitration. Likewise, inconsistency and unpredictability of investment arbitration jurisprudence make it difficult to foresee whether future tribunals will favor an interpretation that prioritizes investment protection over policy justifications that respondent-states may proffer.\textsuperscript{69}

\textsuperscript{68} Article 17 (2) [National Treatment] reads as follows: “For greater certainty, references to ‘like circumstances’ in paragraph 1 of this Article requires an overall examination on a case by case basis of all the circumstances of an investment including, inter alia: (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; and the examination shall not be limited to or be biased towards any one factor”;

\textsuperscript{69} For example, the tribunal in \textit{Eastern Sugar} was not inclined to consider policy justifications proffered by the respondent government (see Eastern Sugar BV v. Czech Republic, SCC Case No. 088/2004, \textit{partial award and partial dissenting opinion} (March 27,
4. Environmental Impact and Sustainability: Process and Production Distinctions in Investment Treaty Law

Along with its more fragmented and less predictable nature, the attractiveness of investment treaty law to prospective claimants – and the corresponding degree of threat it poses to the already confined policy space for green energy initiatives – also stems from the limitations pertaining to the design and institutional underpinnings of international investment law. The nondiscrimination standards in international investment agreements again offer a pertinent context. Consider, for instance, the question of whether sustainably produced biofuels are like other biofuels. As investment treaty jurisprudence remains characterized by inconsistency and “latitudinarian” interpretations, it is difficult to predict whether renewables produced in line with the sustainability criteria would be found to be “like” renewable products that do not.

A similar reluctance to consider a policy-related justification can be discerned in Saluka Investments BV v. Czech Republic, op. cit., paras. 325–337. See also Miles, “Sustainable development, national treatment and like circumstances in investment law,” 2011, op. cit., p. 271.

Even though the focus of investment treaty standards is on investments of investors, arbitral practice reveals that the likeness of goods can translate into the likeness of enterprises that are engaged in their production and marketing of the relevant products. See, for example, the analysis in Corn Products v. Mexico, op. cit.

not meet the sustainability requirements. When viewed against the general tendency among arbitral tribunals to favor a literal construction of treaty terms, the formulation of the national treatment standard in international investment agreements does not lend itself readily to an interpretation that would take into account the different characteristics of renewable energy products and the different processes and production methods they involve. Sustainability standards – and regulatory schemes designed to enforce them through certification and similar measures – frequently involve a differentiation that is not based on the physical qualities of these products but rather on processes and methods through which they have been produced.\(^\text{72}\) Whether national measures can afford different treatment to products because of their non-physical aspects has been the subject of an extensive debate in WTO scholarship.\(^\text{73}\)

Although a widely held belief is that multilateral trading rules prohibit national measures linked to aspects other than physical qualities of products, the evolution of WTO law is characterized by a progression from the early rejection of processes and production methods measures as per se illegal and indefensible to the subsequent recognition that such measures can in principle be justified.\(^\text{74}\) While some scholars go even further and question the

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\(^\text{72}\) For example, the requirement that biofuel producers ensure compliance with labor standards is a process requirement as it does not concern the physical properties of biofuels but rather regulates the manner in which they are produced.


\(^\text{74}\) A progressive shift in the perception of PPMs in GATT/WTO law can be tracked through seminal decisions in cases concerning restrictions on imports of tuna and import prohibitions of certain shrimp and shrimp products. For detailed analysis, see Robert Howse, “The
assumption that processes and production methods measures violate GATT/WTO rules in the first place, the prevailing view seems to be that, although justifiable under relevant exceptions, processes and production methods which do not leave any physical trace in the end-product would be in breach of the relevant norms, including the national treatment provisions.

To what extent would processes and production methods, including those that cannot be traced in physical qualities of an end product, be considered as a relevant factor in investment disputes? Would more sustainable and greener processes and production methods be accepted as a legitimate basis for differentiation between energy projects? As noted above, the focus of analysis in determining allegations of discrimination under international investment agreements is on the investments of investors. However, arbitral jurisprudence also suggests that, in cases involving an investment into the production and distribution of energy, characteristics of energy may be taken into account alongside other factors in deciding whether a disputed national policy measure is discriminatory.

Still, it is difficult to predict, for instance, whether a foreign company engaged in the production and marketing of biofuels obtained from land with high biodiversity value would be found to be in like circumstance to a domestically owned and more sustainable biofuel producer. Or, would an

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77 See, e.g., *Corn Products v. Mexico*, op. cit., and, to a certain extent, United Parcel Service of America Inc. v. Canada, op. cit.
investment project involving green electricity be regarded as like or dissimilar to a conventional (“dirty”) electricity project if processes and production methods employed in the two projects are different?

Some argue that, in light of how like circumstances were assessed by arbitral tribunals in the past, national measures that make legitimate distinctions – including processes and production methods distinctions – in promoting sustainable renewable energy might fall afoul of international investment agreements. Indeed, investment treaty case law discussed above suggests that the criteria for determining “likeness” have frequently been limited to commercial considerations. This could certainly lead one to conclude that considerations relating to the sustainable process and environmental impact are likely to be excluded from the likeness analysis under international investment agreements, and that differentiation on environmental and sustainability grounds might be condemned as discriminatory.

However, just as the existing focus on the physical incorporation and traceability of processes and production methods has been influenced by the textual analysis of the relevant GATT/WTO provisions and in particular by the centrality of “goods” in the formulation of nondiscrimination standards in GATT Article III, the outcome of an investment claim involving processes and production methods may be influenced by a similar adherence to the textual interpretation of investment treaty norms. Given the references to “like

78 See Miles, “Sustainable Development, National Treatment and Like Circumstances in Investment Law,” 2011, op. cit., p. 279. It is important to note that this argument was made in the context of the discussion of differentiation between renewable energy and conventional energy.

79 Miles, “Sustainable Development, National Treatment and Like Circumstances in Investment Law,” 2011, op. cit., p. 279. See also cases such as SD Myers Incorporated v. Canada, op. cit., and Occidental v. Ecuador, op. cit.
circumstances” and to an infinitely more flexible and stretchable notion of “like investments” (as opposed to “like goods”), the nondiscrimination provisions of international investment agreements could be seen as offering the requisite textual support for setting a relatively broader scope of comparison and enabling national policy-makers to make processes and production methods distinctions in promoting sustainable green energy solutions. It is true that nondiscrimination provisions under international investment agreements can be more expansive in their scope and reach than their GATT/WTO counterparts. Due to its temporal, organizational and economic dimensions, investment is regarded as a process which penetrates deeper into the fabric of the host country.80 The relationship between a foreign investment and a national regulator is thus more complex. Yet precisely owing to their expansive and more far-reaching scope, nondiscrimination provisions under international investment agreements could in fact be regarded as offering room for taking account of various noncommercial considerations (including more sustainable and environment-friendly processes and production methods) in comparing investments. The breadth of the notion of investment, the latter being a common denominator in the likeness analysis under international investment agreements, may also help to counter the narrow remit of analysis under GATT by allowing a wider range of factors to be considered as part of establishing whether a foreign investment is in like circumstances to a domestic investment. Since comparisons are not delimited to goods (and their physical and traceable characteristics) but are concerned with investments and circumstances surrounding them, international investment agreements arguably provide the necessary basis and support for taking processes and production methods into account in deciding on the legality of disputed differentiation. Although the less-defined scope of key protection standards might make investment treaty

law potentially more intrusive in its impact on national regulatory freedom, the comparative breadth of national treatment provisions in international investment agreements arguably means that processes and production methods distinctions could – at least in principle – be made without rendering the relevant policies per se incompatible with investment protection norms. While it is true that the determination of likeness in existing jurisprudence has in some cases been confined by commercial considerations, the wording of the threshold provisions on investment as well as the formulation of a national treatment clause offer ample opportunities to accommodate processes and production methods distinctions and to take account of environmental and sustainability factors under international investment agreements.

The environmental impact of renewable energy products, along with the relevant processes and production methods distinctions, can also be taken into account in determining their likeness with other products where a relevant treaty expressly highlights the importance of environmental regulation. Article 12(2) of the U.S.-Uruguay bilateral investment treaty (BIT), for instance, provides that “nothing in this Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.”81 Some arbitral tribunals have also endorsed the need to look beyond commercial considerations and to examine environmental factors in

81 Signed in 2005, this treaty between the United States of America and the Oriental Republic of Uruguay concerning the encouragement and reciprocal protection of investment (2005) [herein US-Uruguay BIT], embodies the features of a new generation of BITs. See the text available at:[http://unctad.org/sections/dite/iia/docs/bits/US_Uruguay.pdf]. The latest Model BITs of Canada and Norway also contain similar provisions as well as references to sustainable development in their preambles.
assessing the allegations of discrimination. For example, in *Parkerings v. Lithuania*, the tribunal held that environmental impact was a relevant consideration in determining the likeness and in justifying differential treatment.\(^{82}\) The influence of these unsystematic efforts on the evolution of investment treaty disciplines, however, may be fragmented and limited. It is the institutional underpinnings of international investment law and of its dispute settlement structures that will ultimately determine the outcome of a conflict between international investment agreements and renewable energy policies. While the wording and interpretation of investment treaty provisions can in principle be geared toward preventing the unnecessary intrusion into national regulatory space, the lack of a green agenda on an institutional level or the lack of institutional framework as such – international investment law remains by and large fragmented and ad hoc – may lead future tribunals to opt for more policy-constraining and less green-energy-friendly interpretation of investment treaty standards.

**B. Sustainability: A Performance Requirement or an Overarching Treaty Objective?**

One popular solution for reconciling the clash between international investment agreements and national green energy initiatives is the inclusion of an explicit textual reference to environmental goals and clarification that renewable energy is not like energy from carbon-rich sources.\(^{83}\) Likewise, it has been suggested that sustainable development should be

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expressly endorsed as one of the principal objectives of investment treaty instruments.\textsuperscript{84} By referring to sustainable development as a treaty objective, contracting state parties may influence arbitral interpretations and compel rather than merely encourage arbitral tribunals to balance investment protection with the pursuit of national green energy initiatives. The references to environmental protection and sustainable development in NAFTA and some of the recent international investment agreements\textsuperscript{85} – although still absent in the bulk of existing investment treaties – may indeed provide the much needed textual support for accommodating the relevant national policies. The interesting question that follows is whether such an explicit reference to sustainable development in treaty texts would suffice to make the treaties greener or whether a more radical reform of investment treaty law is called for in order to reconcile clashes between investment protection and national initiatives in green energy and related areas. Could sustainability requirements in national energy regulations be regarded as a species of performance requirement and thus clash with


\textsuperscript{85} The US-Uruguay BIT, 2005, \textit{op. cit.}, refers to the desirability of promoting and protecting investment in the manner consistent with the protection of environment. The Canadian Model FIPA goes a step further and includes a reference to sustainable development among treaty objectives in the preamble, while also adding a further provision whereby the parties “recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures.” Canadian Model Foreign Investment Promotion and Protection Agreement (2004), available at: \url{http://italaw.com/documents/Canadian2004-FIPA-model-en.pdf} (last visited September 1, 2013) [herein \textit{2004 Canadian Model FIPA}].
prohibitions contained in a range of international investment agreements?\textsuperscript{86} Some elements in
the existing biofuel sustainability and certification schemes are already open to challenge on
this ground. Conditioning certification upon the requirement that some part of the biomass is
sourced from small producers,\textsuperscript{87} for example, can be classified either as a requirement to
“achieve a certain level of domestic content” or as a requirement “to purchase, use, or accord
a preference to goods produced in its territory, or to purchase goods from persons in its
territory.” Both represent the type of performance requirements outlawed in a number of

\textsuperscript{86} By way of example, US-Uruguay BIT, \textit{op. cit.}, art. VIII, provides, “neither party may
impose or enforce performance requirements, including requirements . . . (b) to achieve a
given level or percentage of domestic content; (c) to purchase, use, or accord a preference to
goods produced in its territory, or to purchase goods from persons in its territory.” See also
the \textit{2004 Canadian Model FIPA, op. cit.}, which is remarkable as it covers the type of
regulatory solution adopted in the EU Renewable Energy Directive, in particular its
conditioning of financial benefits upon sustainability requirements. Article VII(3) of the
model states that “[n]either Party may condition the receipt or continued receipt of an
advantage, in connection with an investment in its territory of an investor of a Party or of a
non-Party, on compliance with any of the following requirements: (a) to achieve a given level
or percentage of domestic content; (b) to purchase, use or accord a preference to goods
produced in its territory, or to purchase goods from producers in its territory.” It appears that
the Brazilian biofuels program also could fall foul of this type of performance requirement
clause.

\textsuperscript{87} Zarrilli and Burnett, “Certifying Biofuels: Benefits for the Environment, Development and
Trade?,” 2009, \textit{op. cit.}, p. 210. In particular referring to Sustainable Production of Biomass,
“Testing framework for sustainable biomass: Final report of the project group ‘Sustainable
international investment agreements. In contrast with the traditionally banned local content
requirements – such as those imposed by the Province of Ontario and subsequently disputed
under WTO agreements and NAFTA Chapter 11 – the protection of small biofuel producers
could arguably be classified as a means of ensuring sustainable development, yet it is just as
likely to be condemned as a prohibited performance requirement.\textsuperscript{88} Even where sustainability
is acknowledged as an overarching principle and one of the key objectives of an international
investment agreement, the prohibition on performance requirements may limit regulatory
choices available to national policy-makers.

A reformulation of the performance requirements clauses in IIAs might help avoid
their otherwise inevitable clash with sustainability standards. For instance, an “except for
sustainability requirements” proviso may help discourage host states from resorting to
protectionist performance requirements while at the same time providing room for policies
that are conceived and designed to promote sustainable development, including in the green
energy sector. The drafters of the 2007 Norwegian Model BIT suggested that a requirement
concerning the use of a technology to meet generally applicable health, safety or
environmental requirements should not be regarded as a prohibited performance
requirement.\textsuperscript{89} The 2012 U.S. Model BIT and the 2004 Canadian FIPA have qualified the

\textsuperscript{88} See Canada–Measures Relating to the Feed-in Tariff Program (DS 426), 2013, \textit{op. cit.}, and
Mesa Power Group LLC v. Canada, \textit{notice of intent to arbitrate} (July 6, 2011), available at:
February 19, 2013).

\textsuperscript{89} \textit{Norwegian Model BIT}, \textit{op. cit.}, art. VIII(2). The model, however, failed to gained political
support in Norway. See Damon Vis-Dunbar, “Norway shelves its draft model bilateral
investment treaty,” available at: http://www.iisd.org/itn/2009/06/08/norway-shelves-its-
proposed-model-bilateral-investment-treaty/.
scope of the prohibition by making it possible for state parties to derogate on specified grounds.\textsuperscript{90} Nevertheless, until other international investment agreements containing the performance requirements clause are revised in a comprehensive manner,\textsuperscript{91} the standard may continue to restrain the range of policy options states could deploy in promoting greener and more sustainable energy solutions.


Traditionally, exceptions clauses or treaty derogations have been designed to enable national policy-makers to pursue various policy objectives uninhibited by the fear of challenge from affected parties. As far as the interplay between international investment protection and national renewable energy initiatives is concerned, the role exceptions clauses may play in reducing existing hurdles in the way of green energy policies has been significantly influenced by a number of distinct but somewhat interrelated developments within

\textsuperscript{90} See Article 7(2) of the 2004 Canadian Model FIPA, op. cit.

\textsuperscript{91} For example, although the performance requirements clause in the 2004 Canadian Model FIPA makes an exception for health, safety and environmental regulations, such exception does not extend to sustainability standards that a national regulation may impose, including in connection with the protection of small producers as well as the protection of worker rights. Even the more comprehensive GATT-like exception in the 2012 U.S. Model BIT might not cover certain sustainability measures. Besides, these exceptions are a relatively recent development, and the performance requirements clauses in the earlier instruments are framed in a more categorical manner. Some countries, such as Japan, provide for a long list of exceptions to the performance requirements clause but again those exceptions are usually framed as sectoral carve-outs and do not readily accommodate sustainability standards.
international investment law and within the broader framework of international economic law. This section will examine investment treaty exceptions, with particular focus on (1) a distinction between absolute and contingent standards of treatment and their interchangeable use in investment arbitration; and (2) a fragmented and two-speed evolution of treaties as regards their stance on environment protection, sustainable development, and regulatory flexibility. Along with exploring the problems with existing approaches to the drafting of exceptions clauses in international investment agreements, the section aims to critically evaluate how the fragmentation and asymmetries in investment treaty practice might affect both the shaping of an emerging global investment protection regime and its interplay with national policy-making, including in the promotion of renewable energy.

1. Carve-out Clauses and Regulatory Flexibility

One of the principal policy instruments governments deploy in promoting renewable energy is state aid in the form of subsidies, such as tax credits to promote the use of ethanol, feed-in tariffs, fuel-blending requirements, and renewable portfolio standards whereby renewable energy producers are supported through assurance that all or part of their production will be purchased.92 Since subsidies usually operate by conferring advantages on renewable energy producers to ensure their financial viability,93 they are open to challenges from disadvantaged parties. The existence of subsidization was one of the grounds on which the European Union disputed the renewable energy scheme in Canada–Feed-In-Tariffs Program.94 The WTO

92 On the status of the latter as a subsidy under WTO law, see Luca Rubini, “Ain’t wastin’ time no more: Subsidies for renewable energy, the SCM Agreement, policy space, and law reform,” 15 Journal of International Economic Law 525 (2012).


94 Canada–Measures Relating to the Feed-in Tariff Program (DS 426), 2013, op. cit.
panel was divided in its ruling, with one dissenting member concluding that the subsidization did take place as the pricing mechanism in question enabled certain power generators to enter the wholesale electricity market, when they would otherwise not have been able to in the absence of the disputed feed-in tariff program.\textsuperscript{95} Subsidies as an instrument promoting sustainable production of renewable energy also feature in the EU Renewable Energy Directive where compliance with the sustainability criteria operates as a prerequisite for receiving financial benefits. Generally, if a foreign investment is precluded from receiving a subsidy, tax concession or other form of state aid, international investment agreements can be harnessed as an instrument to challenge the validity of the relevant scheme and to obtain monetary compensation.\textsuperscript{96} Unlike WTO law, which offers a comprehensive legal framework to address negative trade externalities of subsidies in its Agreement on Subsidies and Countervailing Measures, the majority of existing international investment agreements do not

\textsuperscript{95} The panel report is available at:

\url{http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds412_e.htm} (last visited May 10, 2013).

\textsuperscript{96} See, for example Nycomb Synergetics Technology Holding AB v. Latvia, SCC Case No. 118/2001, \textit{award} (December 16, 2003), para. 4.3.2. (The case concerned a support scheme for low-carbon electricity installation whereby domestic investors enjoyed a double-tariff but the foreign investor was excluded from the scheme.) See also Anne van Aaken and Jurgen Kurtz, “Prudence or discrimination? Emergency measures, the global financial crisis and international economic law,” 12 \textit{Journal of International Economic Law} 859 (2009) (discussing how various support schemes, including those adopted in response to the economic crisis, can be challenged as discriminatory).
directly engage with subsidies. Nonetheless, due to its favorable *jus standi* provisions for individual claimants and the possibility of claiming directly against host state, investment arbitration may act to complement and in some cases substitute WTO dispute settlement in cases where the legality of a renewable energy subsidy is contested. As far as the substantive scope of international investment agreements is concerned, subsidies may fall within the ambit of core investment protection standards, such as national treatment, the prohibition of arbitrary and discriminatory measures, fair and equitable treatment, and even expropriation.

The less-regimented nature of investment protection guarantees – reflected in particular in the overlap between and interchangeability of core standards and a relatively


98 This could happen if arbitral tribunals favor a broad basis for comparison such as in *Occidental v. Ecuador*, *op. cit.*

99 Also known as the nonimpairment standard, this obligation has been considered separately from other standards of treatment in cases such as Saluka Investments BV v. Czech Republic, *op. cit.*, para. 457, and Nycomb Synergetics Technology Holding AB v. Latvia, *op. cit.* (Although both tribunals noted that the standard overlaps significantly with FET, they applied the standard in examining the allegations of discriminatory treatment which resulted from the exclusion of the foreign investors from support schemes).

100 For example, in Saluka Investments BV v. Czech Republic, *op. cit.*, paras. 249, 310, 457 (the exclusion of a company from state aid was disputed under the expropriation standard, FET, and nondiscriminatory measures provisions).
low threshold of illegality that needs to be established before the finding of an investment treaty breach is made\textsuperscript{101} – may render investment arbitration a particularly attractive option in cases where green subsidies adversely affect business actors.

The fact that renewable policy measures may fall squarely within the remit of both international trade and investment protection regimes has significant bearing on the extent of regulatory flexibility afforded to national policy-makers. As noted earlier in the context of the discussion of nondiscrimination standards, such complementarity between the two regimes can be problematic. Even though international investment law and international trade law continue to be regarded as previously cognate but increasingly divergent disciplines that pursue distinct objectives and are characterized by different political economies, the possibility of a green subsidy being disputed both as a trade measure and an investment treaty breach is just another piece of evidence of a significant overlap between the two regimes. For international business actors, this overlap maximizes the opportunities to reduce negative externalities of national policies by offering a broad, diverse, and flexible range of remedies. For national policy-makers, including those charged with the task of promoting and embedding green energy solutions, the overlap between the international trade and investment protection regimes signifies a double squeeze on the increasingly shrinking regulatory space and the ensuing risk of having to defend national policy choices before international tribunals.

For the purposes of this section, subsidies offer a useful introductory background for discussing treaty exceptions as a means of insulating renewable energy measures from stringent trade and investment disciplines. Subsidies – and other regulatory schemes

promoting renewable energy – can in principle be ring-fenced against investment treaty disciplines through the inclusion of tailor-made carve-out clauses in relevant treaty texts. Article 9 of the Canadian Model FIPA,\textsuperscript{102} for instance, expressly precludes the application of national treatment and most-favored nation (MFN) guarantees to subsidies and grants as well as to national measures with respect to certain sectors or activities as may be agreed between the two state parties.\textsuperscript{103} Yet the critical shortcoming of such carve-outs is that they often do not immunize states from claims brought under the fair and equitable treatment (FET) and expropriation provisions. In other words, even where treaties preclude the application of certain standards to subsidies, the latter can still be disputed as unfair and inequitable treatment or as measures tantamount to expropriation. At least one case in arbitral practice – \textit{Saluka v. Czech Republic}\textsuperscript{104} – suggests that investors may obtain monetary redress for being excluded from state aid by successfully claiming that the latter was allocated in a discriminatory or unfair and inequitable manner. The open-ended and potentially all-encompassing nature of FET and its capacity to serve as a substitute for most investment treaty guarantees – from national treatment to performance requirements – renders carve-out

\textsuperscript{102} 2004 Canadian Model FIPA, \textit{op. cit.}

\textsuperscript{103} The possibility of carving out whole sectors of economy suggests that the energy sector could, in principle, be insulated from investment treaty disciplines by virtue of express reservations to that effect. Existing treaty models, however, also suggest that it is unlikely that the energy sector would be completely carved out from the treaty. For example, the Article III of the German Model BIT (2008), which specifically refers to energy investments in its national treatment clause, stresses the importance it attaches to bringing energy-related economic interests within the protective scope of substantive protection norms; available at: \url{http://www.italaw.com/sites/default/files/archive/ita1025.pdf} (last visited May 10, 2013).

\textsuperscript{104} Saluka Investments BV v. Czech Republic, \textit{op. cit.}
clauses in existing treaties largely meaningless. Should state parties wish to exempt certain sectors of the economy or certain types of policy measures from the scope of investment protection guarantees, the pertinent carve-out clauses should be framed and formulated so as to take into account the breadth of FET as well as substitutability of investment protection guarantees generally. Likewise, account should be taken of the fact that the expropriation standard can also be used in challenging a variety of host state measures; just like FET, expropriation has been used as an alternative ground of recovery in cases where recourse to other standards, such as national treatment, was precluded by a restrictive dispute settlement mandate. 105

When analyzed from a broader policy perspective, the drafting of carve-out clauses in recent international investment agreements creates an impression of a haphazard exercise in balancing the importance of protecting foreign investment with the preservation of national regulatory freedom in selected areas of strategic economic, social and political importance. It is haphazard in the sense that, despite purporting to ensure a degree of regulatory flexibility through provision of at least some form of express derogations in relation to certain categories of national measures, such treaties continue to expose the same measures to potential challenges under open-ended, overlapping, and frequently interchangeable standards of treatment. The apparent contrast between the fairly vague formulations of investment protection guarantees and the contrastingly explicit and detailed yet narrow carve-out

105 For more detail, see Sattorova, “Investment treaty breach as internationally proscribed conduct: Shifting scope, evolving objectives, recalibrated remedies?,” 2012, op. cit. Some of the prominent cases where expropriation was invoked in lieu of other standards of treatment are Saipem v. Bangladesh, ICSID Case No. ARB/05/7, award (June 20, 2009), paras. 129–134, and Fireman’s Fund Insurance Company v. Mexico, ICSID Case No. ARB(AF)/02/01, award (July 17, 2006), para. 203.
provisions raises a number of questions. Does the retention of open-ended and overlapping investment protection guarantees in more recent treaties indicate the resilience of traditional drafting solutions or a deliberate policy choice? Should the fact that investment protection guarantees remain open to a flexible interpretation but are accompanied by narrowly worded and often ineffectual carve-outs be regarded as yet another piece of evidence of the traditional emphasis on strong investment protection as a key priority of treaty practice of developed states? Can investment treaty guarantees be redefined to match the specificity and precision that characterizes the wording of carve-out clauses in some of the new generation treaties?

The fact that carve-outs are often limited to contingent standards (such as national treatment and MFN treatment) but do not preclude the application of absolute standards (such as expropriation and FET) can be explained by reference to the difference in the role played by the respective standards in the overall framework of investment protection as well as the differences in types of governmental misconduct these standards are designed to remedy. However, a closer look at arbitral jurisprudence and investment treaty practice reveals the need to reevaluate the function of absolute standards and their relationship with other, contingent, investment treaty protections. The protection against uncompensated expropriation may have been duly regarded as an absolute and minimum guarantee at a time when internationally condemnable forms of state interference with foreign investment tended to be drastic in their scope and manner. However, with the recent changes in the scope of the standard, and in particular the increasingly expanding range of policies it captures and the relatively low threshold of illegality it requires, approaching the expropriation provisions as absolute and non-derogable guarantee seems to be outdated. Furthermore, expropriation is not the only provision which investors may rely upon in protecting their interests vis-à-vis host states: a defining characteristic of investment arbitration practice has been the possibility of simultaneous and interchangeable use of expropriation and nonexpropriatory standards of
treatment by claimant investors. In light of a steadily growing recourse to other standards of treatment in disputing host state action and the related change in the goals and protective reach of international investment agreements, it is imperative to reconsider the role of expropriation and the hallmark of unconditionality attached to it. The same considerations apply to the fair and equitable treatment standard, which most treaties consider as a non-derogable standard. If a subsidy and the differentiation it makes between foreign and domestic investments – unfair as it may be – cannot be disputed by virtue of express treaty derogations precluding the application of the national treatment standard, the question arises why the same subsidy should remain open to challenge as a matter of fair and equitable treatment or as an expropriation. The possibility of the same national measure being challenged under different headings defeats the purpose of reservations expressly agreed upon between contracting state parties. In light of the recent evolution in interpretation and application of investment protection standards and their interrelationship (characterized by significant opportunities for their substitutable use), the differentiation between absolute and contingent should be abandoned as conceptually flawed and practically problematic. This, in

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turn, would facilitate a more effective operation of carve-out clauses and open up regulatory space for national policy-making in such areas as renewable energy and sustainable development.

2. General Exceptions: The Promise of Derogations, Non-derogable Standards, and the Chilling Effect of Silent Treaties

Just like carve-outs, general exceptions clauses are traditionally regarded as a means of enabling states to achieve specific policy objectives without incurring liability for a violation of investment protection guarantees. In WTO law, for instance, national policies in the renewable energy sector may be justified under GATT Article XX, which allows states to derogate from their trade obligations in pursuing measures that “are necessary to protect human, animal or plant life or health” or relate “to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.” However, even the existence of such comprehensive general exceptions has not resolved the problem of the chilling effect trade disciplines may have on national regulatory activity, including policy-making in such areas as green energy development. The drafting history of the EU Renewable Energy Directive, in particular the eventual relaxation of some of the sustainability requirements due to concerns over their possible inconsistency with GATT/WTO disciplines, is a prime example of a regulatory chill.

It is all the more striking that, unlike international trade instruments, the majority of international investment agreements currently in force do not contain provisions that would

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expressly allow states to derogate from their investment commitments in pursuing certain policy objectives. The limited grounds for permissible derogation – coupled with broad and far-reaching investment protection guarantees – restrict national regulatory space and increase the risk of national measures being disputed by disadvantaged economic actors. Only a few treaties from a more recent generation of BITs and free trade agreements (FTAs) contain a GATT-like exceptions clause. The inclusion of general exceptions would arguably act to discourage the possible overreaching interpretations of treaty terms by arbitral tribunals. However, some believe that general exceptions do not enhance regulatory flexibility. The risk with the use of a closed list of legitimate policy objectives in general exceptions clauses is that they may have an unintended effect of further squeezing the policy


space available to states.\textsuperscript{112} It has been argued that the absence of a GATT-like general exceptions clause in international investment agreements could contain promise for a greater regulatory flexibility as tribunals, undeterred by textual formulations in international investment agreements, might be encouraged to adopt a more deferential approach by allowing states to derogate in connection with a potentially unlimited range of policy objectives.\textsuperscript{113} Some authors have observed that arbitral interpretation of policy justifications under international investment agreements has been less restrictive than that adopted by WTO panels.\textsuperscript{114}

While an in-depth analysis of the above arguments falls outside the scope of this chapter, suffice it to say that recent arbitral practice casts doubt on whether the absence of derogations in international investment agreements would encourage tribunals to adopt a more deferential stance in setting the boundaries of regulatory space within which states can operate without incurring monetary liability. For instance, in \textit{Continental Casualty v. Argentina} (\textit{Continental}), the availability of an express treaty derogation for measures aimed

\textsuperscript{112} Newcombe, “General Exceptions in International Investment Agreements,” 2011, \textit{op. cit.}, p. 358.

\textsuperscript{113} Newcombe, “General Exceptions in International Investment Agreements,” 2011, \textit{op. cit.}, p. 358.

\textsuperscript{114} For instance, while derogations from trade obligations are usually valid only if \textit{necessary} for the achievement of a certain policy goal, a prima facie breach of investment treaty norm can be justified if shown to be reasonably and rationally \textit{related to} the policy objective at issue. See \textit{Pope & Talbot, award, op. cit.}; \textit{GAMI, award, op. cit.} See also DiMascio and Pauwelyn, “Non-discrimination in trade and investment treaties: World apart or two sides of the same coin?,” \textit{op. cit.}, p. 77; Newcombe and Paradell, \textit{Law and Practice of Investment Treaties: Standards of Treatment}, 2009, \textit{op. cit.}, p. 367.
at the maintenance of public order and the protection of essential security interests enabled Argentina to defend its policy decisions adopted in response to the economic and political crisis in 2001–2002.\textsuperscript{115} In contrast, in \textit{Total v. Argentina (Total)} the applicable BIT did not contain such derogations, and the respondent government was limited in the range of defenses which it could invoke in justification of disputed policy measures.\textsuperscript{116} In matters as important as the exemption of host states from responsibility for economic consequences of national policy measures, the absence of express derogations in the text of the relevant IIA is unlikely to result in tribunals showing more deference to national policy-makers. Quite to the contrary, a comparative analysis of \textit{Continental Casualty} and \textit{Total} clearly suggests that tribunals are more likely to give weight to policy justifications where the applicable treaty expressly allows them to do so.

Where a treaty contains no express derogations, tribunals should at least be offered guidance in the form of a provision stating that investment protection commitments do not prevent states from pursuing other policy objectives – even if such a provision takes the form of the right-to-regulate clause such as that advocated in the draft of the 2007 Norwegian Model BIT. This would go some way toward enabling adjudicators to look beyond the immediate objective of investment protection.\textsuperscript{117} Lack of such guidance may result in arbitral

\begin{footnotesize}
\begin{enumerate}
\item Continential Casualty Company v. Argentina, ICSID Case No. ARB/03/9, \textit{award} (September 5, 2008), paras. 231–233.
\item Argentina’s plea of necessity under customary international law as well as its attempt to invoke Article 5 (3) of the Argentine-France BIT was unsuccessful. See \textit{Total S.A. v. Argentine Republic}, ICSID Case No. ARB/04/1, \textit{decision on liability} (December 27, 2010), paras. 224–230 [herein \textit{Total v. Argentina}].
\item In the absence of such provisions, tribunals have been tempted to consider investment protection as the sole and exclusive objective of an international investment agreement. This,
\end{enumerate}
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panels being tempted to construe certain investment treaty standards, including expropriation and FET, as non-derogable. Indeed, arguments have been made in scholarly writings that even if justified by legitimate policy objectives, certain national measures should always be accompanied by monetary indemnification\textsuperscript{118} and that investment protection ought not to be balanced with other public policy concerns.\textsuperscript{119} While it is true that a “blanket exception for in turn, was used as a basis of a pro-investor interpretation of treaty provisions. See, e.g., SGS Société Générale de Surveillance S.A. v. Philippines, ICSID Case No. ARB/02/6, \textit{decision on objections to jurisdiction and separate declaration} (January 29, 2004), para. 116 (the tribunal referred to the treaty preamble which referred to the contracting parties’ intention “to create and maintain favourable conditions for investments by investors of one Contracting Party in the territory of the other.” The tribunal then deduced that it was legitimate to resolve interpretive uncertainties so as to favor the protection of investments).\textsuperscript{118} See, e.g., Ursula Kriebaum, “Regulatory takings: balancing the interests of the investor and the state,” 8 \textit{Journal of World Investment and Trade} 717 (2007), pp. 726–727; see also Newcombe and Paradell, \textit{Law and Practice of Investment Treaties: Standards of Treatment}, 2009, \textit{op. cit.}, p. 369; Andrew Newcombe, “The boundaries of regulatory expropriation in international law,” 20 \textit{ICSID Review—Foreign Investment Law Journal} 1 (2005). These authors argue in support of treating the protection against expropriation as an unconditional and non-derogable standard, so that even when an expropriation is carried out in pursuit of a policy objective, compensation remains due. These arguments, however, overlook the fact that a breach of national treatment clause can be dressed as an indirect expropriation and vice versa. This interchangeability of standards of treatment makes a distinction between absolute and contingent guarantees both conceptually and practically problematic.\textsuperscript{119} Newcombe, “The boundaries of regulatory expropriation in international law,” 2005, \textit{op. cit.}
regulatory measures would create a gaping loophole\textsuperscript{120} in international investment protection, an express treaty clause providing for the possibility of justifying national measures on policy grounds\textsuperscript{121} would prevent the interpretation of certain investment treaty obligations as absolute, non-derogable standards that always entail a form of compensatory or restitutionary redress.

The silence of treaties as to policy objectives which may legitimately be invoked in justification of investment treaty breaches can also be a somewhat risky strategy after a number of international investment agreements moved to include some form of an exceptions clause. The fact that some of the more recent treaties continue to provide no exceptions clause – after a number of FTAs and model treaties have expressly embraced them – might be construed as implicit evidence of state parties wishing to treat some of their mutual commitments as non-derogable. Once comprehensive exception clauses have been included in a number of treaties, the absence of such provisions in later agreements can (and is likely) to be seen as a deliberate choice. A comparative semantic analysis of the difference in the wording of treaty provisions in various treaties has already been used by arbitral tribunals in

\textsuperscript{120} Pope and Talbot Inc. v. Canada, UNCITRAL (NAFTA), \textit{interim award} (June 26, 2000), para. 99.

\textsuperscript{121} It could be a right-to-regulate provision such as that contained in the 2007 Norwegian Model BIT, a provision clarifying the scope of the expropriation clause, such as that adopted in the recent generation of the U.S. and Canada BITs, or a GATT-like exception. Although the first two options have a comparatively limited scope and may not be as effective as a straightforward exception clause, they nevertheless would offer the often missing textual basis for a more balanced treatment of regulatory measures by investment tribunals.
clarifying the scope of the FET standard.\textsuperscript{122} If a similar approach is adopted in interpreting the absence of exceptions in some international investment agreements – and this possibility should not be overlooked – the “silent” treaties may in the end entail a greater squeezing effect on national policy-making. Viewed in this light, the inclusion in the recent model treaties of the United States and Canada of a comprehensive general exceptions clause modeled upon Article XX GATT is a welcome development. The least such clauses can do is to highlight the importance of noninvestment values, such as the protection of the environment, public health, and conservation of exhaustible resources. They establish a presumption that states can legitimately regulate in certain policy areas such as sustainable development of green energy, providing that such regulatory measures are “necessary to” or “related to” the relevant policy objectives.

From a broader perspective of a global investment protection policy and its evolution, the fact that some states have been reluctant to include comprehensive general exceptions in their recent model agreements can be seen as evidence of a long-standing asymmetry in the design of investment treaty instruments. Is it a mere coincidence that developed states which have had the experience of defending their policy measures in investment arbitration, including Canada and the United States, have incorporated comprehensive exception clauses

\textsuperscript{122} For instance, the \textit{Vivendi} tribunal declined to follow some of the previously decided cases and equate FET with the international minimum on the ground that the wording of the applicable treaty did not support such interpretation. See Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentina, ICSID Case No. ARB/97/3, \textit{award} (August 20, 2007), para. 7.4.7. See also Newcombe and Paradell, \textit{Law and Practice of Investment Treaties: Standards of Treatment}, 2009, \textit{op. cit.}, p. 264 (supporting the view that the interpretation of a specific FET provision depends on the actual text of the treaty in question under principles of treaty interpretation).
in their recent model treaties, while other developed states continue to adhere to the older drafting models that provide no exceptions for regulatory measures pursuing certain policy objectives? Consider a hypothetical example of a treaty between the Netherlands and the Isle of Growth (a fictitious capital-importing state) which follows traditional drafting patterns: sparsely worded, containing open-ended standards and providing no derogations which both contracting state parties might supposedly need to justify their policy measures, including those aimed at the promotion of green energy. Should the reluctance on the part of the Netherlands to include exceptions in the new and revised treaty texts be regarded as a sign of institutional and political inertia or adherence to the long-preserved patterns of treaty-making? Or could it rather be the case that the Netherlands is predominantly focused on making the treaty safeguard the interests of Dutch investors in the Isle of Growth and is fairly confident that the same treaty will hardly ever be deployed in challenging Dutch policies by investors from the Isle of Growth (thus rendering general exceptions unnecessary as far as the Netherlands is concerned)?

The absence of comprehensive exceptions clauses in the majority of international investment agreements, including some of the more recent models, also revives the debate over an increasingly fragmented evolution of the global investment protection regime. Not only can national measures affecting private economic interests be frequently open to dispute before both international trade panels and investment tribunals, but the applicability of core investment protection guarantees to such measures and in particular the extent to which such measures are insulated from investor claims will differ dramatically depending on the presence and wording of general exceptions clauses therein. While offering more diversified dispute settlement opportunities for economic actors, this variance in treaty practice opens

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123 For instance, the Netherlands, Switzerland, and Italy do not offer exceptions clauses in their model negotiating texts and recently concluded agreements.
doors to treaty shopping, thus exposing host governments to additional constraints and challenges and potentially undermining the achievement of policy objectives in such areas as green energy development.

The abiding loyalty of some investment treaty champions to the traditional sparsely worded treaty models – and the incapacity or deliberate failure of the recently concluded treaties and revised models to respond to the evolving nature of global economic relations – renders questionable the very fitness of existing treaties as instruments of global economic governance. The original models, to which some states continue to adhere, were founded upon a different role of state as regulator, and were launched at a time when an individual could hardly envisage the possibility of challenging a host state’s conduct on such grounds as transparency, stability, or regulatory fairness. Since tribunals increasingly favor the vision of investment treaty law as mandating the host state to be proactive and comply with good governance standards vis-à-vis foreign investors, the same standards should arguably guide

124 For instance, the tribunal in MTD Chile S.A. v. Chile construed FET as treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment and implying a host state’s obligation to act proactively as opposed to merely avoiding prejudicial conduct to the investors. See MTD Equity Sdn Bhd and MTD Chile S.A. v. Chile, ICSID Case No. ARB/01/7, award (May 25, 2004), para. 113. The Saluka tribunal held that FET ought to be construed as a guarantee protecting investors against state conduct that displays “a relatively lower degree of inappropriateness.” See Saluka Investments BV v. Czech Republic, op. cit., para. 292. Other awards that interpreted FET to include the requirements of transparency, stability, and predictability are Metalclad Corporation v. Mexico, op. cit., para. 76; Técnicas Medioambientales Tecmed S.A. v. Mexico, ISCID Case No. ARB(AF)/00/2, award (May 29, 2003), para. 154; Occidental exploration and Production Company v. Methanex, op. cit., para. 191. These awards have been criticized for construing
the assessment of the state’s behavior as a regulator in matters of significant importance, including climate change, environment protection, and energy security. In other words, if states are expected to comply with good governance standards in their treatment of foreign investments, they should be afforded the corresponding degree of regulatory flexibility to ensure good governance in pursuing other policy objectives. The new treaties ought to accommodate these changes.


Along with carve-out clauses and general exceptions, provisions relating specifically to national security may also serve as a means of providing states with some regulatory space and flexibility in the areas of policy-making which may otherwise give rise to claims under international investment agreements. While remaining reluctant, ambivalent, or principally opposed to the inclusion of comprehensive exceptions clauses, some states nevertheless have incorporated a reference to national security, public security, and public order in their recent models and new treaties. The UK treaty practice provides an interesting example of what can be seen as a gradual recognition of the need to insulate the government from liability for measures that contravene investment protection guarantees but are aimed at the protection of security interests. Prior to the adoption of a revised Model BIT in 2006, UK BITs offered a limited exceptions clause which precluded the invocation of national treatment and MFN FET as “a description of a perfect public regulation in a perfect public world, to which all states should aspire, but very few (if any) will ever attain.” Zachary Douglas, “Nothing if not critical for investment treaty arbitration: Occidental, Eureko, and Methanex,” 22 Arbitration International (2006), pp. 27, 28. However, many of the subsequent tribunals endorsed the interpretation of the standard and inclusion of transparency, consistency, stability, and predictability within its scope.
disciplines in the areas covered by customs union, taxation, and similar international agreements. The amended provision in the 2006 Model BIT expands the range of situations in which national treatment and MFN obligations would not apply; it now enables state parties to derogate from these standards in adopting or enforcing measures “which are necessary to protect national security, public security or public order.” Yet the extent to which the incorporation of this form of security exceptions in recent model treaties would create regulatory flexibility, in particular in promoting renewable energy, remains questionable for a number of reasons.

First, the scope of the security exception in the UK Model BIT is fairly narrow as it precludes the applicability of national treatment and MFN provisions only. Just as with the carve-out provisions discussed above, such wording of the exceptions clauses does not prevent security-driven national measures from being challenged under FET and expropriation standards and, in some cases, under the arbitrary and discriminatory measures clause. The possibility of a national treatment claim channeled under other investment treaty provisions renders the exception clause in its current form almost entirely inadequate, except perhaps for highlighting the states’ intention to retain a degree of policy space for security-related measures. Second, unlike a security exception in the 2012 U.S. Model BIT, the UK version is not self-judging as it refers to “measures which are necessary to . . .” This formulation leaves it to arbitral tribunals to decide whether disputed measures were indeed necessary for the protection of security interests. By contrast, the security exception in the

125 See Article VII; the text of this model is available in Zachary Douglas, The International Law of Investment Claims (Cambridge: Cambridge University Press, 2009), p. 562.

126 On the requirement of necessity and its interpretation in arbitral practice see, for example, William Burke-White and Andreas von Staden, “Investment protection in extraordinary

U.S. model offers a stronger means of protecting a state’s regulatory freedom as it refers to “measures that it [the state party] considers necessary for the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.” This wording of the clause enables the state parties to decide on the necessity of security measures as opposed to vesting the power to assess the validity of security-based justifications in arbitral tribunals – the eventuality which the UK model appears to favor. The security exceptions clause in the U.S. model is also arguably a more effective shield as it does not limit itself to precluding the application of national treatment and MFN disciplines but rather allows security-based considerations to be invoked in justifying a breach of any treaty obligations. Such formulation forestalls national treatment claims being dressed as FET and expropriation claims, and abandons a problematic distinction between absolute and contingent standards of treatment at least for purposes of security exceptions.

A crucial question concerning the effectiveness of security exceptions and their role in enabling national policy-making is whether, to what extent and in what circumstances renewable energy policies and their various components would fall under the rubric of “national security,” “public security” or “essential security interests.” The interplay between national policy-making in renewable energy and investment treaty exceptions for security-related measures is important because renewable energy policies are not driven exclusively by considerations relating to the protection of the environment and mitigation of climate change but also by concerns over the security of energy supplies. Even though it is acknowledged that fossil fuels will remain the dominant source of energy in the next two decades, the prognosis is that by 2035 the share of renewable energy may increase and times: The interpretation and application of non-precluded measures provisions in bilateral investment treaties,” 48 Virginia Journal of International Law (2008), p. 307.
account for up to 25% of the primary energy supply.\textsuperscript{127} Energy security is thus an important drive behind national measures aimed at the promotion of renewable energy products. An effective regulatory framework to promote sustainable production of biofuels, for instance, could serve as a mechanism to provide energy security in an environmentally positive way.\textsuperscript{128} To afford national policy-makers a sufficient degree of regulatory flexibility in this area, some renewable policy measures could arguably be insulated from investment treaty disciplines on the ground that they aim to achieve energy security objectives.

The problem with accommodating energy security measures within existing treaties lies in the restrictive wording as well as the vagueness of the relevant exception clauses. As noted above, treaties also differ when it comes to the scope of security exceptions and their self-judging or other character. Even in treaties where a security exception clause is framed as self-judging, the establishing of a precise meaning of “national security” may be and is frequently left to adjudicators. It is therefore difficult to envisage whether the security of energy supplies would be found to fall within the exception, in particular given the variable role renewable energy may play in contributing to the achievement of the given policy objective. Should there be an imminent threat to the security of supply in the short term for a disputed national measure to be categorized as falling under the rubric of essential security interests? Or, in the absence of an immediate threat, would the lasting, long-term importance


\textsuperscript{128} Stephanie Switzer, “International trade law and the environment: Designing a legal framework to curtail the import of unsustainably produced biofuels,” 7 University College Dublin Law Review (2007); see also Switzer and McMahon, “EU biofuels policy—raising the question of WTO compatibility,” 2011, op. cit., p. 713.
of renewable energy products alone suffice for the relevant policy measures to be immunized from investor claims? Of interest here is the related notion of food security which comes into play in connection with national policies on the sustainable production of biofuels – would it fall within the broader notion of national security or a state’s essential interests? Energy security is, arguably, fundamentally different in character from the security concerns the drafters of security exceptions had in mind. The wording of exception clauses in some treaties may support a narrow interpretation, especially where the clause refers to “measures necessary to protect” security interests as opposed to using a “measures relating to” phrase. Even where the necessity of a measure and its categorization as a security interest are treated as two different stages in the analysis, the phrase “measures relating to” arguably invites a broader interpretation of the notion of security and brings the concerns over the security of

Unsustainable production of biofuels may have a detrimental impact on farming and thus undermine food security. A state wishing to address these concerns may introduce new regulatory requirements changing the legal regime for the production and distribution of biofuels. These regulatory requirements, although aimed at alleviating concerns related to food security, can be challenged by affected business actors under international investment agreements. This, in turn, renders the notion of food security at least potentially important in the prospective insulation of host states from liability through the inclusion of security exceptions in their international investment agreements.

energy supply, both long-term and short-term, within the scope of the relevant exception clause.

A number of arguments can be made in favor of an interpretation that would enable national renewable energy policies to benefit from the security exception and thus enjoy a greater degree of regulatory flexibility. First, it has been rightly observed that the notion of national security or a state’s essential security interests may not remain constant over time.\textsuperscript{131} While the original function of the security exceptions in international trade and commerce instruments may have been confined to addressing “the immediate political-military conditions that a State deems important for its position in the world,”\textsuperscript{132} even a narrow concept of security may change in keeping with the evolutionary processes that have transformed the entire landscape of international investment law over the past few decades. Indeed, a fitting example of such evolution in the interpretation of core investment protection standards is the contemporary understanding of the meaning and scope of the FET standard. Many a panel agreed that the threshold of illegality that needs to be shown to establish a breach of the FET standard is presently lower than that which was set out in the \textit{Neer} case many decades ago.\textsuperscript{133} The notions of acceptable state behavior have changed to support more

\textsuperscript{133} LFH Neer & Pauline v. United Mexican States, \textit{American Journal of International Law} 555 (1926) is well known as an early customary international law authority for a high threshold that ought to be satisfied before a breach of the international minimum standard could be established. A number of tribunals, including Mondev International Ltd. v. United
good-governance compliant treatment by states of foreign investors. In light of this tendency to place states under a duty to be proactive and to ensure good governance, the concept of national security cannot remain static. National security should no longer be limited to political-military and even economic emergency concerns but should also include concerns relating to the mitigation of climate change, preservation of exhaustible natural resources, the protection of livelihoods in local communities, as well as the general need to ensure the security of energy supplies in the country or any part of it. A recent determination by the UN Security Council that climate change poses a threat to global security testifies to the changing perceptions of “security” and to the role of renewable energy in alleviating such threats.


Judicial precedents from other areas of international economic law also support the inclusion of energy security within the scope of exceptions clauses that refer to national security, essential security interests, or public security, even in situations where no immediate threat to the security of supply exists. In EU law, for instance, energy security has been regarded as a key component of public security and has justified national measures that contravened the otherwise far-reaching and stringent provisions on free movement of goods and capital. A prominent example is the judgment in Campus Oil, which concerned Irish rules mandating the purchase of oil at a fixed price from a local state-owned refinery. Although protectionist and discriminatory in its nature, the disputed measure was found to be aimed at ensuring the security of energy supplies and thus justified under the public security exception.\footnote{Case 72/83 Campus Oil, ECR 2727 (1984).} Likewise, in Commission v. Belgium, the court found energy security to fall within the exception under Article 36 of the Treaty on the Functioning of the European Union, thus justifying a measure which breached the guarantee of free movement of capital.\footnote{Case C-503/99 Commission v. Belgium, ECR I-4809 (2002).} Although none of these cases concerned renewable energy policies, they provide useful examples inasmuch as the importance of energy security was found to be such as to justify its inclusion under the rubric of public security, even in cases where no immediate threat to the security of supply existed.

It is also noteworthy that as early as in 1997, the ICJ considered the related notion of ecological damages to fall within the rubric of an essential interest of all states. See Case concerning the Gabčíkovo-Nagymaros Project (Hungary v. Slovakia), I.C.J. Reports 7 (1997), para. 53, available at: \url{http://www.icj-cij.org/docket/files/92/7375.pdf} (last visited June 23, 2013).
It should be conceded that recent trends in the development of international investment law render it somewhat unlikely that arbitral tribunals will readily embrace the approaches earlier endorsed in EU jurisprudence.\textsuperscript{138} A greater degree of deference afforded to national policy-makers in the above-mentioned cases has certainly been influenced by the distinct political underpinnings of EU law on free movement, and the distinct allocation of decision-making powers between national and supranational bodies in different policy areas. The unique architecture of investment treaty law, particularly its fairly narrow object and purposes and the nature of its dispute settlement mechanism, may militate against an

\textsuperscript{138} This conclusion is drawn from what Hirsch referred to as a sociocultural distance between investment law and other areas of law. See Moshe Hirsch, “The interaction between international investment law and human rights treaties: A sociological perspective,” in Tomer Broude & Yuval Shany, eds., \textit{Multi-Sourced Equivalent Norms in International Law} (Oxford, UK: Hart Publishing, 2011), p. 219, or to use Koskenniemi’s terms, the “pigeon-holing” of investment treaty law into a specialized field of international law that operates in isolation from other fields. See Study Group of the International Law Commission, “Fragmentation of international law: Difficulties arising from the diversification and expansion of international law,” A/ CN.4/L.682 (April 13, 2006), p. 18. This distancing and pigeon-holing can be traced in the relationship between investment treaty law and human rights law and international environmental law as well as between investment treaty law and EU law. The latter has been the subject of discussion in a string of arbitral cases, including Eureko B.V. v. The Slovak Republic, PCA Case No. 2008-13, \textit{award on jurisdiction} (November 26, 2010); AES Summit Generation Limited and AES-Tisza Erömü Kft v. Hungary, Award ICSID Case No. ARB/07/22, \textit{award} (September 17, 2010); Electrabel S.A. v. The Republic of Hungary, ICSID Case No. ARB/07/19, \textit{decision on jurisdiction, applicable law and liability} (November 30, 2012).
interpretation of security exceptions in favor of national policies that promote energy security. Unless security exceptions clauses are further revamped to expressly cover measures that may not be necessary but still *relate to* energy security, the current design of investment treaty law is likely to accommodate only a fairly narrow interpretation of security-related justifications.

Ultimately, a distinctive feature that sets investment treaty law apart from EU free movement disciplines and GATT/WTO jurisprudence – and is likely to inform the interpretation of security exceptions in international investment agreements – is a comparatively lesser role ascribed to environment protection and sustainable development among other primary objectives of the international investment regime. Despite the fact that references to sustainable development and environment protection have been incorporated in some of the new generation international investment agreements, the majority of existing treaties, including some of the recently revised models, continue to prioritize investment protection as a principal objective which in turn is likely to inform interpretation of relevant norms by arbitral tribunals. The recent developments in the drafting of investment treaty instruments can be seen as a “two-speed” or “variable geometry” evolution, where some treaties increasingly endorse (and enforce) noninvestment values such as environment protection and sustainable development while others continue prioritizing investment protection as a dominant objective. As far as its broader practical implications for regulatory flexibility are concerned, this two-speed regime may considerably undermine the recent efforts to embrace noninvestment policy objectives in new treaties. To mention one possibility, investors may invoke MFN clauses and resort to corporate structuring and treaty shopping so as to benefit from international investment agreements that are more investor-friendly and correspondingly less accommodating of environment protection and sustainable development objectives. Such forum-shopping and treaty-shopping tactics will greatly detract
from the usefulness of the treaties that have taken a more progressive stance on socially desirable policies. Since countries such as Germany, the Netherlands, and the United Kingdom continue to favor old models and refrain from making room for competing social policies, the role of the arguably more progressive Canadian BITs is effectively reduced to signaling a tentative and localized shift in investment treaty policy.

Conclusion

This chapter has sought to explore the interplay between international investment law and national policies promoting renewable energy. Driven by distinct but often interconnected concerns relating to climate change, environment protection, energy security, and sustainable economic growth, renewable energy policies offer a suitable platform to examine the complex and multilevel conflicts which lie beneath investor-state disputes. The rise of “green versus not green” conflicts, such as those which regulatory schemes on sustainability and certification of renewable energy may trigger, signals a shift from the traditional perception of investment treaty law as a means of restraining state powers to a mechanism of reallocating power between private economic actors and harnessing the conflict between investment treaty norms and national regulations in an effort to optimize their economic strength vis-à-vis their competitors in a market shaped by new pressing global policy concerns, changing consumer perceptions, and technological innovation. The changing patterns of private ordering in international investment law should inform a discussion of the interplay between investor rights and green policies, and in particular in the analysis of how the regime needs to be adapted and redesigned in order to better enable effective policy-making on a national level.

In examining a potential inconsistency of renewable energy policies with nondiscrimination standards under international investment agreements, the chapter has drawn attention to a combined effect that the distinct but frequently converging international
trade and investment protection rules may have on regulatory flexibility. How much policy space is left to states in an international legal environment where different regimes overlap but continue to coexist within divergent institutional frameworks? It is argued that although the wording and interpretation of investment treaty provisions can in principle be geared toward facilitating renewable energy initiatives, a fragmented and uncoordinated development of investment treaty norms as well as the lack of green agenda on an intra-regime level may result in future tribunals opting for more policy-constraining and less green-energy-friendly construction of investment treaty standards. Despite recent moves to incorporate sustainable development as an overarching principle and a treaty objective in some of the new generation international investment agreements, the efficacy of such references may be negated by the adherence to traditional drafting solutions, including the continued use of the prohibition of performance requirements and differentiation between absolute and contingent standards of treatment. The traditional treaty models were premised upon a different role of state in global economic relations, and were adopted at the time when a foreign investor could hardly foresee the possibility of challenging a host state’s conduct on such grounds as transparency, stability and regulatory fairness. As investment tribunals increasingly favor the vision of investment treaty law as mandating the host state to be proactive and comply with good governance standards vis-à-vis foreign investors, the same standards should arguably guide the assessment of the state’s behavior as a regulator in the matters of significant importance, including climate change, environment protection, and energy security. Likewise, the elastic and interchangeable use of investment protection guarantees in recent practice signals the need to revisit their respective functions and to rethink whether some of those guarantees – such as expropriation and FET – should continue to be considered absolute, non-derogable, and always accompanied by a right to compensatory or restitutionary redress.
While exceptions clauses, ranging from carve-outs to general exceptions to derogations on public security grounds, are increasingly regarded as a means of preserving regulatory flexibility, their effectiveness may be considerably undermined by the inconsistency, fragmentation, and asymmetry that presently characterize the evolution of investment treaty instruments. One fundamental problem with the existing drafting of international investment agreements and of exceptions clauses contained therein is a two-speed (or variable geometry) development of investment treaty rules, whereby some states progressively endorse the need to balance investment protection with competing economic and noneconomic values, whereas others continue to steadfastly prioritize investment protection as a primary goal of their international investment agreements and remain silent on the mitigation of climate change, environment protection and sustainable development. This variable geometry may compromise the efficacy of the new models that aspire to accommodate national policy-making through the inclusion of exceptions clauses.