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# CLUB GOODS AND REGULATORY OPPORTUNISM: TRANS-PACIFIC PARTNERSHIP AND RULES OF ORIGIN FOR AUTOS

*CAROL M. BAST

## INTRODUCTION

The twelve Trans-Pacific Partnership (TPP)[1] parties vary widely in geographical location, level of economic development, political institutions, and interconnectedness. The parties to the TPP include the three North American Free Trade Agreement (NAFTA)[2] parties, the United States, Canada, and Mexico; three additional developed countries, Australia, Japan, and New Zealand; an advanced economy, Singapore; two rapidly-growing economies, Vietnam and Peru; a well-to-do economy dependent on gas and oil, Brunei Darussalam (Brunei); and middle income countries, Malaysia and Chile.[3] The United States, Canada, and Mexico have developed many integrated supply manufacturing chains as a result of NAFTA.[4] For Japan and the United States, TPP is the countries' first bilateral trade agreement of this depth and breadth.[5]

The twelve countries became signatories to TPP to take advantage of the benefits that a regional trade agreement offers.[6] In a way, being a party to TPP is similar to joining an exclusive club and receiving the benefits of "club goods."[7] The detriment of not being a TPP member is being discriminated against in not receiving the benefits of the club goods.[8] Non-members may be tempted to use opportunistic behavior to take advantage of the spillover benefit of the TPP regulatory system even though they were not the intended recipients of TPP. TPP members might assume that non-TPP parties will use regulatory opportunism to

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1. Trans-Pacific Partnership Agreement, UNCTAD/WEB/DITC/2016/3, http://unctad.org/en/PublicationsLibrary/webditc2016d3_en.pdf.

2. North American Free Trade Agreement, Dec. 17, 1992, art. 1708(14), H.R. Doc. 103-159, 32 I.L.M. 289, 673 (entered into force Jan. 1, 1994).

3. INT'L TRADE COMM'N, TRANS-PACIFIC PARTNERSHIP AGREEMENT: LIKELY IMPACT ON THE U.S. ECONOMY AND ON SPECIFIC INDUSTRY SECTORS 52-54, 56-59, 695-740 USITC Pub. 4607 (May 2016), https://www.usitc.gov/publications/332/pub4607.pdf [hereinafter INT'L TRADE COMM'N].

4. *Id.* at 56.

5. *Id.*

6. *See generally Regional Trade Agreements*, THE ORGANISATION FOR ECONOMIC CO-OPERATION & DEVELOPMENT (OECD), http://www.oecd.org/tad/benefitlib/regionaltradeagreements.htm (last visited Nov. 19, 2016).

7. *See* Trans-Pacific Partnership Agreement, art. 8.

8. *See infra* footnotes 244–57 and accompanying text.

benefit.[9] The hypothesis of this article is that TPP will have an overall positive effect on the auto and auto parts industry of the TPP parties and that TPP will have a slightly negative effect on China, a non-member.

Part I of this article reviews the economic, political, and institutional dimensions of a regional trade agreement. Part II describes the auto industry, paying special attention to the auto industry in the United States. Part III provides information on rules of origin in general and TPP rules of origin for autos in particular. Part IV analyzes the effect of TPP on the auto industry.

## I. THE ECONOMIC, POLITICAL, AND INSTITUTIONAL DIMENSIONS OF A REGIONAL TRADE AGREEMENT

Fiat Chrysler Automobiles, Ford Motor Company, and General Motors, sometimes referred to as the Detroit Three, still have a strong presence in the United States.[10] They have been joined by other car makers who import vehicles into the United States and who manufacture foreign cars in the United States.[11] In addition, the Detroit Three manufacture vehicles outside the United States, either in their own plants or in partnership with foreign car makers, some of which are imported into the United States.[12] The global value chain is central to the automotive sector in that auto components and the parts that make up each component often originate from far-flung locations all over the world.[13]

A regional trade agreement has economic, political, and institutional dimensions. TPP is an exercise in balancing domestic needs, which might demand protectionist provisions, in the face of an increasingly global economy whose foundation is trade liberalism.[14] The United States representatives to TPP negotiations kept interest groups in the United States in mind because of the potential opposition interest groups could cause in Congress if they did not see benefits for them under TPP.[15] This part considers each of the three dimensions in turn.

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9. *See infra* footnotes 258–66 and accompanying text.

10. *See generally* Thomas H. Klier, *From Tail Fins to Hybrids: How Detroit Lost Its Dominance*, 33 ECON. PERSP. 2 (2Q/2009), https://www.chicagofed.org/publications/economic-perspectives/2009/2qtr-klier.

11. *Id.* at 14.

12. Timothy J. Sturgeon & Johannes Van Biesebroeck, *Crisis and Protection in the Automotive Industry: A Global Value Chain Perspective* 8 (World Bank Pol'y Res. Working Paper No. 5060, 2009), http://documents.worldbank.org/curated/en/357861468315545086/pdf/WPS5060.pdf [hereinafter Sturgeon & Van Biesebroeck].

13. *Id.* at 3.

14. World Bank Group, *Trade Liberalization: Why So Much Controversy? In* ECONOMIC GROWTH IN THE 1990S: LEARNING FROM A DECADE OF REFORM 135-36, http://www1.worldbank.org/prem/lessons1990s/chaps/05-Ch05_kl.pdf

15. Eric Bradner, *How secretive is the Trans-Pacific Partnership?*, CNN (June 12, 2015), http://www.cnn.com/2015/06/11/politics/trade-deal-secrecy-tpp/.

*A. The economic dimension*

The economic dimension of an international trade agreement ranks just above the political dimension in criticality.[16] Valuing the effects of TPP is extremely difficult, even for economists. Much depends on how TPP is interpreted and applied into the future. Economists and attorneys may spend many months working up a regulatory impact assessment of a trade agreement *ex ante*;[17] however, an *ex post* regulatory impact assessment may differ significantly.[18]

The auto industry is a multi-national enterprise that is extremely competitive.[19] As a significant stakeholder, the auto industry will be performing its own regulatory impact assessment of the strengths, weaknesses, opportunities, and threats.[20] The effect of the TPP on the auto industry has much to do with the rules of origin.

The United States has both strengths and weaknesses in the automotive industry; these strengths and weaknesses must be considered when evaluating the effects that TPP might have on those industries. The United States strengths lie in research and development, technology innovations, and a workforce with the advanced skills used in certain phases and sectors of manufacturing.[21] Portions of the auto industry that are high-skilled and high-paying depend on the integration of the United States auto industry into the global value chain.[22]

The United States vulnerability lies in lower-skill level manufacturing.[23] One of the sensitive sectors for the United States is the automotive sector because of the potential job loss in lower-skill level auto and auto component manufacturing.[24] The fear is that lower-skill level production of autos and auto components will move to other countries that have lower labor costs.[25] However, well-meaning but protectionist policies, if instituted by the United States, would likely result in retaliatory action from international trading partners and loss of foreign direct

16. SHIHOKO GOTO, THE TPP REMAINS KEY TO U.S. ENGAGEMENT IN THE ASIA-PACIFIC REGION (2015), *available at* https://www.wilsoncenter.org/article/the-tpp-remains-key-to-us-engagement-the-asia-pacific-region.

17. *See* DIEGO A. CERDEIRO, ESTIMATING THE EFFECTS OF THE TRANS-PACIFIC PARTNERSHIP (TPP) ON LATIN AMERICA AND THE CARIBBEAN (LAC) 4, 17–19 (2016), https://www.imf.org/external/pubs/ft/wp/2016/wp16101.pdf.

18. *Id.* at 19.

19. Wagner Cezar Lucato et al., *Measure the Degree of Competitiveness for Auto Parts Manufacturing Companies*, 50 INT'L J. PRODUCTION RES. 5508, 5519-20 (2012).

20. Keith Head, *How Will* the TPP Affect the Auto Industry?, WORLD ECO. FORUM (Nov. 15, 2015), https://www.weforum.org/agenda/2015/11/how-will-the-tpp-affect-the-auto-industry/.

21. Theodore H. Moran & Lindsay Oldenski, *How Offshoring and Global Supply Chains Enhance the US Economy*, PETERSON INST. FOR INT'L ECONOMICS 5 (2016).

22. *Id.*

23. *Id.*

24. *TPP Auto ROO Most Likely To Hurt Makers Of Less Complex Parts: Experts*, INSIDE U.S. TRADE (Jan. 21, 2016), https://insidetrade.com/inside-us-trade/tpp-auto-roo-most-likely-hurt-makers-less-complex-parts-experts (last visited Jan. 21, 2017).

25. *Id.*

investment in the United States.[26] As a result of the United States auto industry's integration into the global value chain, protectionist moves by the United States would be counter-productive by resulting in the loss of foreign investment and high-skilled and high-paying auto industry jobs in the United States.[27]

China, a TPP non-party, Japan, and the United States, as TPP parties, all have significant ties to the automotive industry.[28] A key question is what effect TPP will have on the automotive industry of the three countries. The table below shows the importance of total worldwide exports of cars and car parts for China, Japan, and the United States as far as the top thirty export industries for those countries.[29] For Japan and the United States, the car and car parts industries were among the top thirty exporting industries, while only the car parts industry was among the top thirty exporting industries for China.[30] When comparing exports to imports, one sees that the exports and imports of car parts for China was nearly equal;[31] for Japan, car exports were approximately nine times imports, and exports of car parts were approximately five times imports;[32] for the United States, car exports were a little more than one-third the amount of imports and car part exports were approximately four-fifth of imports.[33]

26. *Id.*

27. *Id.* at 1–2.

28. ROBERT E. SCOTT, THE CONSEQUENCES OF NEGLECTING MANUFACTURING; COMPARED WITH OTHER NATIONS, U.S. HAS MORE IMPORT COMPETITION IN LEADING EXPORT INDUSTRIES 8, 10, 14 (2015), http://www.epi.org/files/pdf/83495.pdf.

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.*

33. *Id.*

Trade in cars and motor vehicle parts ranked by value of exports, 2013 (billions of dollars)[34]

| Country | Rank of export | HS code | Description | exports | imports | trade balance | Import ratio |
|---|---|---|---|---|---|---|---|
| China | 8 of 30 | 8708 | Parts and accessories for motor vehicles | $25.5 | $24.2 | $1.4 | 94.7% |
| Japan | 1 of 30 | 8703 | cars | $91.7 | $10.6 | $81.1 | 11.6% |
| Japan | 3 of 30 | 8708 | Parts and accessories for motor vehicles | $35.3 | $7.1 | $28.8 | 20.2% |
| United States | 3 of 30 | 8703 | cars | $57.1 | $155.7 | -$98.6 | 272.5% |
| United States | 4 of 30 | 8708 | Parts and accessories for motor vehicles | $42.9 | $58.9 | -$15.9 | 137.1% |

The TPP *Rules of Origin* for autos recognize[35] that the automotive industry is critical for the economies of a number of the parties to the TPP as well as being critical for non-members. One indication of the criticality of the trade in cars and car parts is the convoluted nature of the extremely lengthy rules of origin for autos with all their bewildering cross-references that were heavily debated;[36] another indication of the critical nature of the auto industry to the economies of several TPP countries is that the TPP provisions concerning autos were reportedly some of

34. SCOTT, *supra* note 28, at 8–15.

35. *See* Trans-Pacific Partnership Agreement, art. 8.

36. *See* MARK WU, TRANS-PACIFIC PARTNERSHIP ROUNDTABLE ON AUTO MANUFACTURING SUPPLY CHAIN, PREPARED REMARKS BEFORE U.S. HOUSE OF REPRESENTATIVE – COMMITTEE ON WAYS AND MEANS, CONVENED BY DEMOCRATIC MEMBERS (January 11, 2016), *available at* http://democrats.waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/Wu%20-%20TPP%20Roundtable%20on%20Autos%20-%20Jan%202016.pdf; U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON WAYS & MEANS MINORITY STAFF REPORT 114TH CONGRESS, TPP ISSUE ANALYSIS: TRADE IN THE AUTOMOTIVE MANUFACTURING SUPPLY CHAIN (Jan. 8, 2016), *available at* http://democrats.waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/TPP%20Issue%20Analysis%20-%20Autos.pdf [hereinafter TPP ISSUE ANALYSIS: TRADE]; Reid Whitten, *The Trans Pacific Partnership and the Auto Industry: Will Six Thousand Pages Pave the Way for Increased Exports?*, GLOBAL TRADE LAW BLOG (Nov. 12, 2015), http://www.globaltradelawblog.com/2015/11/12/the-trans-pacific-partnership-and-the-auto-industry-will-six-thousand-pages-pave-the-way-for-increased-exports/.

the latest agreed upon in the negotiations.[37]

The reason to implement TPP is in part due to its projected economic benefits. Economists have long thought that integration of the markets of countries with differences in labor costs, productivity, capital, and natural resources will result in greater efficiency and growth;[38] global value chains account for eighty percent of international trade.[39] United States multi-national enterprises, such as automakers and auto part suppliers use global supply chains to reduce labor costs, increase productivity, and expand their shares of the global market.[40] TPP should produce aggregate economic gains because of the wide variances in labor, capital, and natural resources among the parties to TPP.[41] Another benefit of a regional trade agreement may be in reducing non-tariff barriers.[42] The reality is that the welfare of sensitive sectors of the United States economy, such as the auto industry, must be balanced against an economically-sound trade system favored by most economists.[43]

### *B. The Political Dimension*

The political dimension is critical because it involves spending political capital. A trade agreement involves giving up some sovereignty and the question is to what extent. Each country must provide bargaining chips that can be used to entice a needed concession from another signatory. A trade agreement can lock-in domestic reforms; because it operates over the long term, it can provide stability over many changes in government administration.[44] A trade agreement can provide shelter to a new government administration against pressure to change a domestic reform made by a prior government administration; at the same time, a foreign direct investor expects predictability based on the trade agreement.[45]

After the United States becomes a signatory to a trade agreement, it must be ratified by Congress to make it become part of the country's domestic law.[46] The United States is typically a standard-setter because of its large market share and the recognition by other signatories that the trade agreement cannot become effective

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37. *TPP Rule of Origin is 45% for Vehicles, With Caveats; 35-45% for Auto Parts,* INSIDE U.S. TRADE (Oct. 7, 2015), http://www.bilaterals.org/?tpp-rule-of-origin-is-45-for [hereinafter TPP RULE OF ORIGIN IS 45%].

38. David H. Autor, et al., *The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade* (Nat'l Bureau of Econ. Res., Working Paper No. 21906, 2016), http://www.ddorn.net/papers/Autor-Dorn-Hanson-ChinaShock.pdf.

39. Moran & Oldenski, *supra* note 21.

40. *Id.*

41. CERDEIRO, *supra* note 17, at 8–10.

42. *Id.* at 10.

43. *Id.* at 12.

44. John Whalley, *Why Do Countries Seek Regional Trade Agreements?*, in THE REGIONALIZATION OF THE WORLD ECONOMY 63, 71 (Jeffrey A. Frankel, ed. 1998), *available at* http://www.nber.org/chapters/c7820.pdf.

45. *Id.*

46. Meredith Kolsky Lewis, *The Trans-Pacific Partnership: New Paradigm or Wolf in Sheep's Clothing?*, 34 B.C. INT'L & COMP. L. REV. 27, 44 (2011).

without Congressional ratification.[47] A trade agreement is an opportunity with advantages and disadvantages, but not ratifying can have advantages and disadvantages as well. For ratification, the overall benefits of the trade agreement must outweigh the constraints that the trade agreement imposes.

Entering into a trade agreement can involve a political cost. Ratification of a trade agreement may involve a dominant industry championing the trade agreement; a dominant industry being convinced not to oppose the trade agreement; a government leader willing to place political capital at risk; or a combination. For United States elections, the candidate typically uses rhetoric that appeals to the ordinary citizen rather than to big business.[48] However, once elected, government officials must keep businesses in mind when implementing policy to keep the economy thriving; in other words, trade policy usually follows the money trail.[49] Each member of Congress constantly monitors the member's voter base to gauge whether the member's constituents are favorably or unfavorably inclined toward a trade agreement scheduled to come up for a vote in Congress.[50] Politicians are extremely susceptible to pressure from constituents and interest groups.[51]

A trade agreement like the TPP stirs up politics in the United States because of the domestic consequences it can have in restructuring the distribution chain in the various manufacturing sectors, not the least being the auto industry.[52] An interesting factor that plays into this is the openness of a country's economy. Generally, a country has a more closed economy if its exports significantly exceed its imports.[53] China is considered a closed economy, as is Japan, although not to the degree of China.[54] In contrast, the United States has an open economy, with its imports exceeding exports in its top thirty export industries, thus leading to a trade deficit.[55] The trade deficit of the United States becomes a matter for political discussion when the voter feels that domestic production is receiving "unfair" competition from foreign imports and the United States is not exporting more because of trade barriers erected by the same countries from which the United

47. *Id.* at 39.

48. *New Survey Shows Majority Of Clinton Supporters Favor TPP*, INSIDER TRADE (2016), http://insidetrade.com/trade/new-survey-shows-majority-clinton-supporters-favor-tpp. For example, at one campaign stop Hillary Clinton declared: "My message to every worker in Michigan and across America is this. I will stop any trade deal that kills jobs or holds down wages, including the Trans-Pacific Partnership." *Id.*

49. *The Benefits of International Trade*, THE U.S. CHAMBER OF COMMERCE, https://www.uschamber.com/international/international-policy/benefits-international-trade-0 (last visit Dec. 5, 2016).

50. *BRT: Anti-Trade Campaign Rhetoric Impacts Congressional Support For TPP*, INSIDER TRADE (2016), http://insidetrade.com/daily-news/brt-anti-trade-campaign-rhetoric-impacts-congressional-support-tpp.

51. *See generally* INTN'L TRADE COMM'N, *supra* note 3

52. Robert Scott, *Trading Away the Manufacturing Advantage*, ECONOMIC POLICY INSTITUTE (Sep. 30, 2013) http://www.epi.org/publication/trading-manufacturing-advantage-china-trade/.

53. SCOTT, *supra* note 28.

54. *Id.*

55. *Id.* at 3.

States is receiving a high volume of imports.[56] One economist opines that the trade deficit in the United States "is a consequence of its toleration of massive currency manipulation over many years by China, Japan, and about 20 other countries, the failure to eliminate widespread tariff and nontariff barriers to U.S. exports, and the failure to develop effective strategies for rebuilding U.S. manufacturing."[57]

United States national politics is always woven through the fabric of a trade agreement in that a politician is conscious of how constituents in the politician's district will react to the trade provisions that have an impact on the district. A danger in the United States is that the average voter is not particularly well-informed about international trade agreements and most of the information that the average voter does have is from the sound-bytes captured by the news media.[58] These sound-bytes tend to oversimplify the potential effects of an international trade agreement and characterize the agreement in positive or negative terms. One simplification derived from the media is that, for the United States, domestic production and export of United States-manufactured goods provides a benefit to the country;[59] another simplification from the media is that it is detrimental to the United States' economy to import goods that compete with domestically-produced goods, and United States multi-national enterprises that base a portion of their production outside the United States are depriving the United States of needed employment opportunities.[60]

A voter's task in understanding an international trade agreement is an onerous one. TPP is no exception to this generalization. TPP is a massive document of more than 600 pages, not including annexes, appendixes, and side letters, and its effect is wide in its coverage of various subject matters.[61] While trade liberalism should result in gains, one might be a little cautious when analyzing the potential effects of the new rules of origin for autos; the *ex post* effects are dependent on the varying economic strengths of the various TPP signatories and the ability of auto and auto component producers to utilize the extremely complicated rules of origin.[62]

Members of Congress have available to them research services and can hear from experts so that they can be advised on the effect of an international trade agreement.[63] Given that members of Congress are politicians, it is not unheard of

56. Douglas Irwin, *International Trade Agreements,* THE LIBRARY OF ECONOMICS & LIBERTY, http://www.econlib.org/library/Enc/InternationalTradeAgreements.html (last visited Dec. 5, 2016).

57. *Id.*

58. Michael Tomz, DEMOCRATIC DEFAULT: DOMESTIC AUDIENCES AND COMPLIANCE WITH INTERNATIONAL AGREEMENTS, Annual Meeting of the American Political Science Assoc. (Aug. 29–Sept. 1 2002),

4–5 (unpublished), available at https://web.stanford.edu/~tomz/working/apsa02.pdf.

59. *The Benefits of International Trade*, U.S. CHAMBER OF COMMERCE, https://www.uschamber.com/international/international-policy/benefits-international-trade-0 (last visited Nov. 16, 2016).

60. Moran & Oldenski, *supra* note 21.

61. *See generally* Trans-Pacific Partnership Agreement.

62. *See generally* TPP ISSUE ANALYSIS: TRADE *supra* note 36.

63. *See, e.g.*, WU, *supra* note 36; TPP ISSUE ANALYSIS: TRADE *supra* note 36.

them to place their own interpretations on the potential effects of a trade agreement.[64] Thus, what the voters hear may be an extremely partisan assessment of a trade agreement, perhaps distorted in certain respects.

The United States has long reflected a protectionist stance towards the auto industry.[65] The United States' auto industry is a powerful political force in the country for a number of reasons. The auto industry employs a great number of people and makes a significant contribution to the economy,[66] the auto unions have been active in politics,[67] and the car produced by a Detroit carmaker has an iconic place in the culture of the country.[68] However, there is a risk in listening too closely to those pressing protectionism in light of the participation of the auto industry in the global value chain.[69]

### *C. The Institutional Dimension*

The third dimension is institutional. The institutional dimension has to do with the ability of institutions to interpret and apply the provisions of the trade agreement.[70] Customs authorities may have almost as much difficulty in interpreting the rules of origin as the businesses wishing to utilize the rules because customs and business are on a par in receiving sparse legislative guidance.[71] Given that, the customs authorities may often have to make country of origin determinations on a case-by-case basis. This interpretation may or may not coincide with the nation's trade policies or objectives, as political motivations for trade may vary over time. The businesses affected may claim the country of origin determinations are subjective and conflict with other determinations, thus offering scant guidance or predictability. Product processing and assembly methods may differ from country to country and that may lead customs authorities to assume that a product was produced by the methods employed by the domestic industry rather than the methods under which the product was in reality produced.[72]

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64. *Open argument: The case for free trade is overwhelming. But the losers need more help*, ECONOMIST (Apr. 2, 2016), http://www.economist.com/news/leaders/21695879-case-free-trade-overwhelming-losers-need-more-help-open-argument?cid1=cust/ednew/n/bl/n/20160331n/owned/n/n/nwl/n/n/AP/n; *Trade, at what price?: America's economy benefits hugely from trade. But its costs have been amplified by policy failures*, ECONOMIST (Apr. 2, 2016), http://www.economist.com/news/united-states/21695855-americas-economy-benefits-hugely-trade-its-costs-have-been-amplified-policy; Pedro Nicolaci da Costa, *The Questionable Rationale behind Washington's Antitrade Rhetoric*, PETERSON INST. FOR INT'L ECONOMICS

65. Nat'l Bureau of Econ. Res., Working Paper No. 5349 (1995).

66. SCOTT, *supra* note 28.

67. The Political Economy of American Trade Policy 163-66 (Anne O. Krueger, ed., 1996), http://www.nber.org/chapters/c8705.pdf.

68. Klier, *supra* note 10, at 2.

69. *See* Whalley, *supra* note 44, at 71.

70. ANNE VAN DE HEETKAMP & RUUD TUSVELD, ORIGIN MANAGEMENT: RULES OF ORIGIN IN FREE TRADE AGREEMENTS v-vi (2011).

71. *Id.* at 122–24.

72. Importing authorities may visit an exporter's factory to ascertain the production method. *Id.* at 118.

Tariffs can be a barrier to international trade.[73] One of the reasons that a TPP party enters into the trade agreement is the hope that a manufacturer in the country may be able to take advantage of a lower tariff on the manufacturer's product that is imported into the country of another TPP member.[74] In other words, trade among the TPP partners is liberalized by lowering tariffs.[75] The regional and global supply chains are the backbone of today's auto industry.[76] East Asia is notable in its development of regional supply chains, a number of which are important to the auto industry.[77]

An auto is an extremely complex machine often comprised of components sourced from around the world and firms within the auto industry are located internationally.[78] The international auto industry involves both market-seeking investment and efficiency-seeking investment.[79] Promotion of efficiency-seeking investment is one of the motivations for entering into a mega-regional trade agreement.[80] The auto, once assembled, is heavy and delicate.[81] For that reason, assembly plants are typically located in proximity to large markets with purchasing power.[82] Auto components are lighter and more easily transported than the cars they comprise.[83] Auto components suppliers have to keep in mind sequencing of auto production and be located where they can smoothly fit into the sequence. At the same time, lower cost inputs may contribute to profitability. Many suppliers located where they can be more efficient by taking advantage of lower labor and manufacturing costs.[84]

International sourcing of auto components necessarily means cross-border trade.[85] The risks associated with trade time delay are often more crucial than trade costs.[86] Trade patterns may influence countries entering into international trade

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73. John Manzella, *The Impact of Trade Barriers*, THE MANZELLA REPORT (Jul. 1, 2016) http://www.manzellareport.com/index.php/trade-finance/378-the-impact-of-trade-barriers (last visited Jan. 21, 2016).

74. INT'L TRADE COMM'N, *supra* note 3.

75. *Id.*

76. Timothy Sturgeon et al., *Value Chains, Networks and Clusters: Reframing the Global Automotive Industry*, 8 J. ECON. GEOGRAPHY 297, 302-04 (2008).

77. *Id.* at 303.

78. *Id.* at 302–03.

79. An investor's motivation may be characterized as "market-seeking" where the geographical location has a sales potential. The "efficiency-seeking" investment is motivated by being able to take advantage of lower costs in a particular geographical location. Cecile Fruman, *Why Does Efficiency-Seeking FDI Matter?*, WORLD BANK: PRIVATE SECTOR DEV. (Feb. 5, 2016), http://blogs.worldbank.org/psd/why-does-efficiency-seeking-fdi-matter.

80. Sturgeon et al., *supra* note 76.

81. *Id.* at 303–04.

82. *Id.* at 302–03.

83. *Id.* at 304.

84. *Id.*

85. *Id.*

86. *Id.* at 299, 304, 311; Thomas H. Klier, *Determinants of Supplier Plant Location: Evidence from the Auto Industry*, 29 ECON. PERSP. 2 (3Q/2005), https://www.chicagofed.org/publications/economic-perspectives/2005/3qtr2005-part1-klier.

agreements to safeguard existing supply chains. With lean manufacturing,[87] certainty of receiving auto components in a timely fashion is extremely important to an auto manufacturer's profitability.[88] In addition, international trade agreements may cause the auto manufacturer to organize its supply chain across the countries of the trade agreement. Price elasticity means that a small change in price can have a big effect on demand and may influence a shift in the composition of the supply chain.[89]

A trade agreement may influence an auto manufacturer to shift part of its supply chain from countries outside the trade agreement to countries that are parties to the trade agreement.[90] A trade agreement can be viewed as a bargaining device that gives smaller economies the potential of greater participation in global value chains. Thus, a trade agreement may directly effect a movement in production and investment.[91] Factors important to the auto industry include predictability and certainty of market access to countries in which a portion of the value chain is located.[92] Rules of origin for autos and auto components is an important factor in an auto manufacturer developing supply chains as it permits export and import of autos and auto components at low or zero tariff.[93]

Utilization of a rule of origin is a multi-step process that tends to be inefficient.[94] A high percentage of preferences go unused because either business people are unaware that they could benefit or the costs of compliance are too high in comparison with the potential savings.[95] The first step is determining whether a product qualifies under a trade agreement by assigning a country of origin.[96] The next step is sustaining the importer's claim that the product meets the rule of origin.[97] This step involves the supplier to the manufacturing exporter, the manufacturing exporter, the importer, and the exporting and importing authorities.[98] There is usually involvement of customs brokers, vendors of trade documentation software, industry associations, and attorneys.[99] The potential final step is the one in which an importing authority may perform an audit of the claim

87. Japan pioneered the lean manufacturing production system. The basic elements of this system are "production quality, speedy response to market conditions, low levels of inventory, and frequent deliveries of parts." Klier, *supra* note 86.

88. *Id.*

89. MCKINSEY & COMPANY, THE FUTURE OF THE NORTH AMERICAN AUTOMOTIVE SUPPLIER INDUSTRY: EVOLUTION OF COMPONENT COSTS, PENETRATION, AND VALUE CREATION POTENTIAL THROUGH 2020 10–13 (2012).

90. John Manzella, *The Impact of Trade Agreements,* THE MANZELLA REPORT (Jan. 1, 1999) http://manzellareport.com/index.php/trade-finance/401-the-impact-of-trade-agreements.

91. Whalley, *supra* note 44, at 71.

92. *Id.* at 12.

93. Jonathan M. Cooper, Comment, *NAFTA's Rule of Origin and its Effect on the North American Automotive Industry*, 14 NW. J. INT'L L. & BUS. 442, 442-43, 451, 469–70 (1994).

94. VAN DE HEETKAMP & TUSVELD, *supra* note 70, at 46.

95. *Id.* at 177.

96. *Id.* at 111.

97. *Id.*

98. *Id.*

99. *Id.*

that a particular product meets the applicable rule of origin.[100] The company's documentation trail must be sufficient to withstand the audit.[101]

The company may feel the consequence of failing an audit, including delay and added scrutiny of its imports. The most minor consequence is being forced to pay the difference between the disallowed preferential tariff and the non-preferential tariff.[102] Civil penalties may be assessed by customs for non-compliance[103] and may be retroactive, possibly covering a number of years of non-compliance.[104] For a large automobile company, the penalty can be millions of dollars.[105]

## II. THE AUTO INDUSTRY

Currently, multi-national carmakers world-wide compete in the automotive market. The auto and auto parts industries are integrating themselves into a global value chain and are some of the industries with the most participation in international production.[106] What has become an international production network began in the early years with a carmaker, perhaps with a headquarters located in a "home country," positioning a fragment of the production process in a country with low labor costs or close proximity and ability to complete certain auto parts.[107] For example, a close relationship between the Detroit, Michigan and Ontario, Canada car industries was a natural development given the much shorter distance between southeastern Michigan and Canada than between Detroit and southern states engaged in the car industry, such as Kentucky and Tennessee.[108] The finished component was shipped back to the home country for further incorporation into the auto or auto component.[109] Gradually, the cross-border flow

100. *Id.* at 114.

101. *Id.* at 122.

102. *Id.* at 124.

103. *See generally* 19 U.S.C.A. § 1592 (2016).

104. VAN DE HEETKAMP & TUSVELD, *supra* note 70, at 124.

105. *See* Joel K. Simon & Hillel M. Tuchman, *Decisions of the Court of International Trade Under 28 U.S.C. § 1582: The Year in Review*, 40 GEO. J. INT'L L. 243, 244–46 (2008) (assessing Ford the maximum penalty). Later, U.S. Customs and Ford entered into a stipulation that the case be dismissed and Ford escaped paying the $42 million that had previously been assessed. Beata Spuhler, *CBP and Ford Motor Company settle NAFTA recordkeeping case; recordkeeping policy under potential review* (2007), DRINKERBIDDLEGARDNERCARTON, http://www.drinkerbiddle.com/-/media/files/insights/publications/2007/12/cbp-and-ford-motor-company-settle-nafta-recordke__/cbp-and-ford-motor-company-settle-nafta-recordkeeping-case-recordkeeping-policy-under-potential-review.pdf.

106. Leticia Blázquez & Belén González-Díaz, *International Automotive Production Networks: HtWeb Comes Together*, 11 J. ECON. INTERACTION COORDINATION 119, 120 (2016).

107. Debdeep De, *Regional Trade and International Production Networks: The Context of Automobile Industry*, 10 ASIA INT'L J. TECH. MGMT. & SUSTAINABLE DEV. 77, 80 (2011).

108. Thomas H. Klier & James M. Rubenstein, *Auto Production Footprints: Comparing Europe and North America*, 39 ECON. PERSP. 101, 102 Figure 1 (2015), https://www.chicagofed.org/publications/economic-perspectives/2015/4q-klier-rubenstein [hereinafter Klier & Rubenstein].

109. Klier, *supra* note 86, at 2–3.

increased until the production process for the finished vehicle entailed multiple border crossing.[110] Another gradual change was that the auto components produced abroad became more sophisticated.[111]

The global value chain seems to have benefits for all concerned. Countries with skilled but lower-cost labor benefit from increased employment prospects for the country.[112] Countries with higher labor costs, often where carmaker headquarters are located, can outsource auto components to the lower-cost country, can produce the finished vehicle at a lower cost and can realize higher profit.[113] Consumers benefit by being able to purchase the finished vehicle at a lower price than possible were the production network limited to a single country.[114]

### *A. Modern History of the United States Auto Industry*

During the first half of the twentieth century, United States automakers dominated the United States auto industry.[115] From the mid-1950s to 2008, the tables turned and the United States automakers lost more than forty percent of the United States market.[116] In the middle of the twentieth century, foreign carmakers began to introduce smaller cars into the United States.[117] United States carmakers could not compete in price because the cost for a United States carmaker of producing a small car was not lower than that of producing a large car; this similarity in production cost would have resulted in a smaller profit on the sale of a small car versus a large car.[118] United States drivers could indulge their taste for large cars for a while longer because of wider roads, longer driving distances, less expensive gasoline, and more disposable income.[119] Those drivers who preferred smaller cars, such as the Volkswagen Beetle, could buy imports. In the 1970s, small cars became much more popular because of the two oil crises that the nation weathered.[120] Congress mandated corporate average fuel economy standards in 1976, with fuel economy standards distorting the car market.[121] Foreign small cars sold well because of their greater fuel efficiency, competitive pricing, and perceived quality advantage.[122] It took until the late 1970s for United States carmakers to build smaller cars in the United States.[123]

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110. *Id.*
111. De, *supra* note 107, at 78.
112. Sturgeon et al., *supra* note 76, at 304.
113. *Id.* at 312.
114. *Id.*
115. Klier, *supra* note 86, at 2.
116. *Id.*
117. *Id.* at 4.
118. *Id.*
119. *Id.*
120. *Id.* at 6–7.
121. *Id.* at 8.
122. TAEKO HOSHINO, BOUNDARIES OF FIRMS AND CATCHING UP BY LATECOMERS IN GLOBAL PRODUCTION NETWORKS: THE CASE OF A MEXICAN AUTO-PARTS MANUFACTURER 20 (IDE Discussion Paper NO. 492 2015), http://www.ide.go.jp/English/Publish/Download/Dp/pdf/492.pdf.
123. NAT'L RES. COUNCIL, THE COMPETITIVE STATUS OF THE U.S. AUTO INDUSTRY: A STUDY OF

The United States auto industry wields considerable political power because the auto industry is a major contributor to the United States economy. With the two gas crises of the 1970s, Japan secured a foothold in the United States market.[124] The substitution of imported cars for domestic cars was met with a political backlash in the United States to rein in car imports.[125] As a result of political pressure and at the request of the United States, Japan implemented a voluntary export restraint on Japanese cars imported into the United States in May of 1981.[126] Japan's voluntary export restraint did not lessen the demand from the United States consumer for Japanese cars. To meet this demand, Japanese car companies established assembly plants in the United States.[127] Within four years after the voluntary export restraint, Honda had established itself in Marysville, Ohio and Nissan had begun operations in Tennessee.[128] Other Japanese carmakers, including Toyota, Mazda, and Mitsubishi, followed suit.[129]

Japanese carmakers producing cars in the United States had to find suppliers of auto parts used in car manufacture.[130] Traditionally, Japanese carmakers developed long-term and cooperative relationships with their parts suppliers and were loath to discontinue that relationship and switch to an alternative parts supplier.[131] For that reason, Japanese carmakers with assembly plants located in the United States did not immediately begin sourcing parts from United States companies.[132] Besides establishing assembly plants, Japanese carmakers began to use foreign direct investment to develop parts suppliers within the United States.[133] Japanese carmakers had developed 280 parts suppliers in the United States by 1993, with half solely owned by Japanese carmakers and half joint ventures.[134]

Until the 1990's, the United States auto industry was heavily vertically integrated.[135] The industry produced many auto parts in-house; parts manufacturers in the United States and abroad produced parts not manufactured in-house.[136] The United States automakers developed detailed specifications on parts and put parts

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THE INFLUENCES OF TECHNOLOGY IN DETERMINING INTERNATIONAL INDUSTRIAL COMPETITIVE ADVANTAGE 3 (1982), http://www.nap.edu/catalog/291/the-competitive-status-of-the-us-auto-industry-a-study.

124. Klier, *supra* note 86.

125. Sturgeon & Van Biesebroeck, *supra* note 12.

126. *See generally* JAMES LEVINSOHN, CARWARS: TRYING TO MAKE SENSE OF U.S.-JAPAN TRADE FRICTIONS IN THE AUTOMOBILE AND AUTOMOBILE PARTS MARKETS (1997), *available at* http://www.nber.org/chapters/c0307.pdf [hereinafter LEVINSOHN].

127. *Id.* at 11.

128. *Id.* at 16.

129. *Id.*

130. *Id.* at 17.

131. *Id.* at 13–14.

132. Factors that encouraged Japanese carmakers to make the switch included a favorable exchange rate for United States produced parts, political pressure from the United States and the threat of domestic content legislation. *Id.* at 17.

133. *Id.* at 17.

134. *Id.*

135. *Id.* at 13.

136. *Id.*.

out for bid, hoping to obtain the lowest possible price.[137] The problems with this procedure were multifold: the relationship between the part supplier and the automaker was not a close and cooperative one; the bidding process often did not result in parts known for their quality; and the bidding process did not encourage much research and development or capital investment by the part supplier.[138] For those parts supplied from abroad, an automaker would purchase sufficient quantities so that production was not impaired by a shipping delay.[139]

In the mid-1980s, the automakers began to source out more parts, rather than produce them in house.[140] That trend continued until, in the late 1990's, GM and Ford spun off the parts divisions of their firms to create Delphi and Visteon.[141] Because the two automakers had a global presence, the two new part supplier companies also already had a global presence.[142]

*B. The North American Auto Industry Today*

A consumer restricting certain purchases to those products made in America may do so because of a sense of patriotism, a desire to preserve jobs in the United States, or a belief in the quality of the product.[143] Whether a car is "made in America" is not as easy to discern as it once was when the car components were produced and the car was assembled in the United States by a carmaker headquartered in the United States.[144] A United States auto consumer may obtain some information on the origin of a new car being purchased by reviewing the sticker that United States law requires be attached to the outside of the car.[145] Another indication of the origin of imported new cars and parts is the importer's use of a rule of origin to obtain a lower preferential tariff.[146] Rules of origin for autos are introduced and reviewed in the following part of this article.

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137. *Id.*

138. *Id.*

139. *Id.*.

140. Sturgeon, et al., *supra* note 76, at 305.

141. *Id.*

142. *Id.* at 305.

143. Benjamin Levin, *Made in the U.S.A.: Corporate Responsibility and Collective Identity in the American Automotive Industry*, 53 B.C. L. REV. 821, 829–36 (2012).

144. Thomas H. Klier & James M. Rubenstein, *Whose part is it?—Measuring domestic content of vehicles*, CHICAGO FED LETTER 1, 3 (Oct. 2007), https://www.chicagofed.org/publications/chicago-fed-letter/2007/october-243.

145. The American Automobile Labeling Act of 1992 (AALA) requires automakers to provide certain information to consumers on the window sticker of the new car. 49 U.S.C.A. § 32304 (1998). Pursuant to the AALA, a car is domestic if at least eighty-five percent of its content is from the United States or Canada. *Id.* § 32304(b)(1). A part is counted as domestic if at least seventy percent is from the United States or Canada. *Id.* § 32304(a)(9). A car with less than that eighty-five percent must state the two countries that contributed the highest value content and the applicable percentages. *Id.* § 32304(b)(1). The sticker must contain the city, state, and the country of assembly and the country of origin of the engine and transmission (with the United States and Canada stated separately) and, with respect to the engine or transmission, the percentage attributable to the country of origin based on direct costs, labor and assembly. *Id.* § 32304(a)(3), (a)(5), (b)(1).

146. VAN DE HEETKAMP & TUSVELD, *supra* note 70, at 82.

North America hosts seventy assembly plants, with the plants concentrated in a north-south swath, nicknamed "auto alley," primarily from Michigan through Alabama.[147] From the north end of auto alley, the auto production concentration extends from Michigan into Ontario, Canada and there is a concentration of production in central Mexico.[148] Besides vehicle assembly plants, there are several thousand plants worldwide that produce the approximately 15,000 parts that become part of a vehicle.[149]

Investment in the auto industry is capital and skills intensive.[150] The automotive industry is facing a number of pressures, including increasingly stringent fuel standards, price increases on materials such as steel, rubber, and plastic, increased labor costs, and the possibility of newly-mandated safety features.[151] Price elasticity is the responsiveness of the amount of a product demanded to the change in the price of the product. In other words, a small change in price may make a large difference in demand for a product, with a lower price significantly increasing demand and a higher price decreasing demand.[152] Price elasticity often is a factor in a manufacturer sourcing components for a product because the manufacturer is often seeking the least expensive cost for a component, yet not at the sacrifice of quality.[153] The auto industry has price elasticity such that a change in car price can have an impact on sales.[154] A carmaker has a potential bump in sales if the carmaker finds a new lower-cost supplier and passes the cost saving along to the consumer.[155] Price elasticity may lead to a manufacturer reshuffling its auto component suppliers.[156]

Lower labor costs, which are dependent on lower wages or benefits or less rigid work rules, have influenced investment to shift towards the southern United States, historically not an auto union stronghold, and towards Mexico.[157] Auto alley, together with its Canada extension, host approximately seventy-three percent of North America's auto assembly and sixty-two percent of its parts supplier plants.[158] Mexico, the other area with a concentration of auto manufacturing, hosts

147. Klier & Rubenstein, *supra* note 108, at 101–02.

148. *Id.* at 102, Figure 1.

149. *Id.*

150. Thomas H. Klier & James M. Rubenstein, *The Growing Importance of Mexico in North America's Auto Production*, CHICAGO FED LETTER 1, 2–3 (May 2013), https://www.chicagofed.org/publications/chicago-fed-letter/2013/may-310 [hereinafter *The Growing Importance of Mexico in North America's Auto Production*].

151. ARENT FOX LLP, TPP Automotive Origin Rules: The New "Rules of the Road" (Nov. 2, 2015), http://www.arentfox.com/newsroom/alerts/tpp-automotive-origin-rules-new-rules-road#.Vp2vXU1ljIU.

152. MCKINSEY & COMPANY, *supra* note 89, at 14.

153. *Id.*

154. *Id.* at 6.

155. *Id.* at 4.

156. *Id.*

157. Marcel P. Timmer, Erik Dietzenbacher, Bart Los, Robert Stehrer, & Gaaitzen J. de Vries, *An Illustrated User Guide to the World Input–Output Database: the Case of Global Automotive Production*, 23 REV. INT'L ECON. 575, 584 (2015).

158. Klier & Rubenstein, *supra* note 108, at 103.

nineteen percent of vehicle assembly plants and twenty percent of parts supplier plants.[159]

Because of the weight, size, and fragility of a finished vehicle as well as the capital tied up in it, automakers tend to locate assembly plants close to end markets.[160] The location of auto alley facilitates a finished car reaching a dealer showroom in a timely fashion. Within a one-day drive in the United States, a truck can transport a finished vehicle from an assembly plant in auto alley as far as to New York, in the far northeast extreme, or to Texas, in the far southwest extreme.[161]

The auto parts industry is stratified into vertically arranged tiers.[162] This vertical structure places automakers at the top, first-tier suppliers below the automakers, second-tier suppliers below first-tier suppliers, and third-tier suppliers below second-tier suppliers.[163] First-tier part suppliers supply the automakers, second-tier parts suppliers supply first-tier parts suppliers, and third-tier parts suppliers supply second-tier parts suppliers.[164] The parts industry is extremely dynamic and constantly subject to quick change because of competition among the parts suppliers and the innovation knowledge that diffuses among the automaker and parts suppliers.[165]

First-tier part suppliers produce specialized units.[166] Specialized units include transmissions, engines, cockpit assemblies, and rolling chassis, which are also heavy and bulky.[167] To cut transportation costs and ensure timely delivery, suppliers of specialized parts typically are clustered near auto assembly plants.[168] As high as three-quarters of the specialized parts suppliers are located within a one-day drive of an auto assembly plant.[169] Some specialized parts suppliers, including those who contribute seats, stamping, and trim, are located within an hour drive.[170]

Second-tier and third-tier part suppliers produce sub-units and parts.[171] More

159. *Id.*

160. *Id.* at 105.

161. *Id.* at 106.

162. Thomas H. Klier, *The impact of Lean Manufacturing on Sourcing Relationships*, CHICAGO FED LETTER 8, 12 (June 1993), https://www.chicagofed.org/~/media/. . ./1994/ep-jul-aug1994-part2-klier-pdf.

163. *Id.*

164. Park Tae-Hoon, *Hierarchical Structures and Competitive Strategies in Car Development: Inter-Organizational Relationships with Toyota's First-, Second- and Third-Tier Suppliers*, 6 ASIAN BUS. & MGMT. 179, 194 fig.4 (2007) [hereinafter Hoon].

165. HOSHINO, *supra* note 122, at 4.

166. Hoon, *supra* note 164.

167. Sturgeon & Van Biesebroeck, *supra* note 12, at 3–4.

168. *Id.*

169. Thomas H. Klier & James M. Rubenstein, *Who really made your car?*, CHICAGO FED LETTER (Oct. 2008), at 2, https://www.chicagofed.org/publications/chicago-fed-letter/2008/october-255a.

170. *Id.*

171. Hoon, *supra* note 164.

generic parts, such as tires, batteries, and harnesses, are lighter.[172] A supplier of this type of part can provide product to multiple automakers because a single standardized part may function in vehicles of a number of different automakers.[173] Suppliers of those more standardized parts can be located at more distant locations to take advantage of lower labor costs and economies of scale.[174]

The relationship between the automakers and first tier suppliers, on one hand, and down-stream suppliers of more standardized parts, on the other hand, is distinct. Automakers have an ongoing relationship with their first-tier suppliers that produce specialized parts and have to coordinate their activities closely with the automakers.[175] Specialized parts suppliers may be larger firms with more of a global presence in that they have subsidiaries located around the world.[176] Lower-tier suppliers of more generic parts generally do not have as close a relationship with the automakers; in addition, they may be smaller firms, and their presence may be more local or regional than global.[177] Because of these factors, lower-tier suppliers may be more vulnerable to being switched out for suppliers who can supply the generic parts at a lower cost.[178]

The Detroit Three carmakers continue to be important in politics, with politicians paying much more attention to the automakers than to their suppliers.[179] This bargaining power of the automakers means that they can force domestic parts suppliers to compete against foreign parts suppliers.[180] A lower-tier parts supplier is especially fearful of being switched out for a foreign parts supplier that can offer the same quality parts at a lower price.[181]

### *C. The Relationship of Canada and Mexico to the United States Auto Industry*

NAFTA has encouraged Canada and Mexico to play a significant role in the North American auto industry.[182] Canada produced 12.6 percent of North American light vehicle manufacturing (including light trucks) in the first three quarters of 2015, reduced from seventeen percent in 2007, and in the first three quarters of 2015, Mexico produced 19.5 percent of North American light vehicle manufacturing.[183] Canada[184] and Mexico are similar in that their participation in

172. Sturgeon & Van Biesebroeck, *supra* note 12, at 3–4.

173. *Id.*

174. *Id.*

175. HOSHINO, *supra* note 122, at 22.

176. *Id.*

177. Sturgeon et al., *supra* note 76, at 307.

178. Sturgeon & Van Biesebroeck, *supra* note 12, at 7.

179. *Id.* at 21–22.

180. *Id.*

181. *Id.*

182. M. ANGELES VILLARREAL & IAN F. FERGUSSON, CONG. RESEARCH SERV., RL31340, NAFTA AT 20: OVERVIEW AND TRADE EFFECTS 15–16 (2014).

183. Susan Noakes, *Trans-Pacific Partnership divides auto parts industry: Canadian tariffs on autos and parts lowered over 5 years, but over 25 years in U.S.*, CBC NEWS (Oct. 29, 2015), http://www.cbc.ca/news/business/tpp-auto-parts-sector-1.3292456.

184. CHARLOTTE YATES, HOW CAN PUBLIC POLICY SUSTAIN A COMPETITIVE CANADIAN AUTO

the auto manufacturing process has been dependent on foreign firms locating operations in Canada and Mexico.[185]

The United States and Canada have run an integrated auto production operation since the 1960s.[186] The operation was centered in the Great Lakes region and included Indiana, Illinois, Michigan, Ohio, Ontario, and Wisconsin.[187] Auto production coordination began in 1965 when the United States and Canada signed the Automotive Products Trade Agreement, commonly referred to as the "Auto Pact."[188] Since then, Canada has run a negative trade balance with the United States on auto parts and a positive trade balance with the United States on finished vehicle.[189] Those trade balances are an indication that many auto parts were imported into Canada from the United States, primarily and, from those imported parts, Canada produced many cars of a limited number of models, a substantial portion of which were exported to the United States.[190]

The health of the Canadian auto industry has been variable from 1990 to the present. The 1990s was a good decade for the Canadian auto industry, with the peak in 1999.[191] From 2000 to 2007, there was a decline in Canada in new vehicle production, which hit bottom in 2009 with the economic crisis.[192] Canadian new vehicle production started to pick up after the crisis but then began to decline again because of loss of production facilities to the United States and Mexico and the loss of a Canadian vehicle assembly plant.[193] The year 2008 was significant for the Canadian auto industry because Canadian auto production fell back to the level of 1987 at fourteen percent of North American production.[194] In that same year, the percentage of Mexican auto production in North America, at twenty percent, first exceeded that of Canada.[195]

Statisticians monitoring Canadian auto and auto parts industries keep close watch on Canada's balance of trade with its trading partners. Since 2009, the Canadian positive automotive balance of trade within North America has declined, mostly due to Mexican autos and auto parts being imported into Canada.[196] Canada's largest trading partners in autos and auto parts other than in North America are the European Union, China, Japan, and South Korea.[197] As far as both

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INDUSTRY? 3 (2015).

185. Klier & Rubenstein, *supra* note 108, at 1.

186. JOHN HOLMES, WHATEVER HAPPENED TO CANADA'S AUTOMOTIVE TRADE SURPLUS?: A PRELIMINARY NOTE 3 (2015), https://aprc.mcmaster.ca/sites/default/files/pubs/aprc-canada-trade-deficit-holmes-report.pdf.

187. *Id.*

188. *Id.*

189. *Id.*

190. *Id.*

191. *Id.*

192. *Id.* at 4.

193. *Id.*

194. *Id.*

195. *Id.*

196. *Id.*

197. *Id.* at 6.

autos and auto parts are concerned, Canada runs a negative trade balance with each of these four trading partners.[198] Between 1998 and 2008, Canada's negative trade balance in finished vehicles was impacted heavily by Japanese imports and later by imported finished vehicles from the European Union and South Korea.[199] Since 2004, Canada's negative trade balance in auto parts has been negatively impacted by an increase in auto parts imports from Korea and a sharp increase in auto parts imports from China.[200] Significantly, Canada's negative automotive trade balance with countries outside of NAFTA was greater in 2013 and 2014 than Canada's positive trade balance with the United States.[201]

Early on, the Mexican auto industry was an import substitution industry.[202] In 1962, Mexico adopted a protectionist auto policy that had a significant impact on the country.[203] The 1962 policy:

> 1) banned imports of auto engines and certain other auto parts;
>
> 2) banned imports of completed autos;
>
> 3) mandated that sixty percent of the auto parts used in autos manufactured in Mexico be of domestic origin; and
>
> 4) mandated that auto parts suppliers have at least sixty percent Mexican ownership.[204]

The objective of the 1962 policy was to attract the auto industry to Mexico to sell vehicles to the growing Mexican market.[205] By the mid-1960s, VW and Nissan had established a presence in Aguascalientes and Puebla, both located in proximity to Mexico City.[206]

The Mexican auto industry saw further changes in the 1980's and 1990's. In the 1980's, GM and Ford located plants in northern Mexico to produce autos destined for the United States.[207] NAFTA made a substantial change in the Mexican auto industry because Mexico loosened its prior restrictions.[208] With NAFTA, the twenty percent import duty that Mexico charged on light vehicles was reduced to zero over ten years for Canadian and United States imports.[209] The minimum content of Mexican content for Mexican-produced cars was reduced from between thirty-four and thirty-six percent to zero over ten years.[210] After 2004, 62.5% of the content had to be from a NAFTA country for duty-free export

198. *Id.* at 6.
199. *Id*
200. *Id.*
201. *Id.* at 7.
202. HOSHINO, *supra* note 122, at 5.
203. Klier & Rubenstein, *supra* note 108, at 1.
204. *Id.* at 1–2.
205. *Id.* at 2.
206. *Id.*
207. *Id.*
208. *Id.*
209. *Id.*
210. *Id.*

from Mexico to another NAFTA country.[211]

Prior to NAFTA, the Mexican auto industry had begun to transition from an import substitution industry to an export industry.[212] Five automakers, Chrysler, Ford, GM, Nissan, and VW, had already established a presence in Mexico.[213] Those five automakers had a head start when NAFTA took effect and encountered lower barriers to taking advantages to the NAFTA provisions concerning autos.[214] Subsequently, Honda and Toyota established a production presence in Mexico. Mazda and Audi have either established a presence in Mexico or announced plans to do so.[215] Lower labor cost encourages certain auto industry production in Mexico.[216] For example, Mexico can still make a profit, albeit slim, on sub-compact cars and compact cars, and is attractive to manufacture that is labor intensive.[217]

Mexico's auto industry is primarily an export market.[218] In 2012, Mexico ranked fourth in the world in auto exports behind Germany, Japan, and South Korea.[219] There are several factors in Mexico's favor.[220] Lower labor costs make Mexico an attractive location;[221] fairly low shipping costs make exports of cars from plants located in northern Mexico to the United States feasible;[222] location of auto plants near the Pacific Ocean facilitates export of Mexican-manufactured cars to Asia;[223] and Mexico has signed free trade agreements with over forty countries, including those with the European Union and Japan.[224]

## III. RULES OF ORIGIN FOR AUTOS

Application of the TPP rules of origin determines the derivation country of a product, such as an auto or an auto component, and the TPP rules of origin are designed to confine the benefit of the reduced preferential tariff under TPP to those autos and auto components manufactured and whose input is from the TPP parties.[225] Under TPP, the tariff is generally reduced for autos and auto components exported into one of the TPP countries so long as the exporter meets the requirements of TPP rules of origin and the importer has the appropriate supportive documentation.[226] The purpose of the rules of origin is to limit the

211. *Id.*
212. HOSHINO, *supra* note 122, at 5.
213. Klier & Rubenstein, *supra* note 108, at 2.
214. *Id.*
215. *Id.* at 2–3.
216. *Id.* at 3.
217. HOLMES, *supra* note 186, at 4.
218. *Id.* at 3; Klier & Rubenstein, *supra* note 108, at 3.
219. Klier & Rubenstein, *supra* note 108, at 3.
220. *Id.*
221. *Id.*
222. *Id.*
223. *Id.*
224. HOLMES, *supra* note 186, at 4; Klier & Rubenstein, *supra* note 108, at 3.
225. INT'L TRADE COMM'N, *supra* note 3, at 225.
226. *Id.*

benefits of a preferential trade agreement, like TPP, to the parties to the trade agreement.

*A. Tariff Reduction Schedules*

Tariff reduction schedules are important in that they specify the time period over which tariffs on autos and auto parts will be reduced and in what amounts.[227] Neither tariff reduction schedules nor the present tariff rates are uniform among the various TPP parties.[228] For the countries that already have a free trade agreement with the United States, there would be a zero tariff on imports of United States cars into those countries.[229] With certain countries, the tariff reductions extend over a period of time and can be back loaded. For example, the tariff reduction period on cars imported from Japan into the United States spans twenty five years and the reduction begins in year fifteen.[230] Brunei and New Zealand will reduce tariffs on imports of United States cars over ten years, as will Malaysia and Vietnam for certain tariff classifications.[231] For Malaysia and Vietnam, the tariff on certain tariff classifications will not be reduced until TPP has been in force for thirteen years.[232]

The tariff reduction schedule for some countries has received discussion.[233] The tariff reduction schedule for chapter 87 of the harmonized system,[234] which is the automotive chapter, is viewed in an overall positive light.[235] The lengthy and back-loaded nature of the tariff reduction schedule was welcomed by some because of Japan's past unwillingness to open its auto industry to competition.[236] Some are disappointed that the full tariff reduction for Malaysia and Vietnam for some of the most important tariff classifications extends over thirteen years.[237] The United States automotive industry may see a decrease in exports to Canada when Canada eliminates tariffs on Japanese cars in year six.[238]

Rules of origin are meant to rectify the "free-rider" problem[239] and blatantly

227. *Id.* at 238–39, tbl.4.11.

228. Each TPP party's commitment to eliminate tariffs is specified on its Schedule to Annex 2-D.

229. INT'L TRADE COMM'N, *supra* note 3, at 238.

230. *Id.* at 238–39, 239 tbl.4.11.

231. *Id.* at 238–39, 239 tbl.4.11.

232. *Id.* at 238–40, tbl.4.11, tbl.4.12.

233. INDUST. TRADE ADVISORY COMM. ON AUTO. EQUIP. & CAPITAL GOODS, THE TRANS-PACIFIC PARTNERSHIP TRADE AGREEMENT 5 (2015), https://ustr.gov/sites/default/files/ITAC-2-Automobile-Equipment-and-Capital-Goods.pdf [hereinafter INDUST. TRADE ADVISORY COMM.].

234. Trans-Pacific Partnership Annex 3-D, at 15765.

235. INDUST. TRADE ADVISORY COMM., *supra* note 233, at 5.

236. *Id.*

237. *Id.*

238. INT'L TRADE COMM'N, *supra* note 3, at 232.

239. One reason for a country to become a party to TPP is to have autos and auto components produced in the TPP-member country benefit from preferential tariff rates. An auto component supplier located in a non-TPP country might still indirectly benefit, in other words become a free-rider, if the component was incorporated into an auto that received a preferential tariff. *See* Chris Brummer, *Regional Integration and Incomplete Club Goods: A Trade Perspective*, 8 CHI. J. INT'L L. 535, 536, 548–49 (2008).

discriminate against other, non-TPP, countries benefitting from the lower tariffs under TPP.[240] For example, without the rules of origin, a non-TPP country could try to free-ride on the lower TPP tariff and circumvent TPP by shipping a product to a TPP country and, from there, shipping the same product to another TPP country. For that reason, the rules of origin are extremely politically protectionist and are reflective of the nationalist tendencies of the parties to the trade agreement.[241]

One might take Australia as an example. Australia receives a significant volume of imported finished cars and complex parts from the United States and Japan.[242] To take advantage of the reduced preferential tariff offered by Australia under TPP, the United States and Japan will have to be cognizant of and meet the limits on non-originating components under TPP for those cars and car components imported into Australia.[243]

*B. Club Goods*

In considering the rules of origin for autos under TPP, benefits of a regional trade agreement could be considered club goods.[244] The idea of club goods is an economic theory[245] that views the members of the trade agreement like members of a private club. Part of the attraction of the private club is that it is exclusive in that members are admitted to the club based on certain preconditions and non-members are discriminated against in not receiving the advantages available to club members.[246] Joining the club is enticing with the prospect of participating in new opportunities. There is also fear of being excluded from the popular group if one does not join.[247]

Central to the TPP are reciprocal trade concessions from the twelve TPP parties in which each party lowers certain tariff or non-tariff barriers to trade in exchange for concessions from other parties so as to open market access among the parties.[248] The hope is that all parties will benefit, but the benefit varies from party to party and from sector to sector. There are several club goods effects of TPP. One club goods effect is that TPP parties obtain access to new markets at a lower tariff rate than previously.[249] For example, Malaysia and Vietnam presently have tariffs on auto components that can reach the high of seventy percent.[250] To tariff "jump" or "hop" the high tariff, some multi-national companies in the automotive

240. INT'L TRADE COMM'N, *supra* note 3, at 238–39.

241. INDUST. TRADE ADVISORY COMM., *supra* note 233, at 3–4, 6–7.

242. WU, *supra* note 36, at 1. In the past, Australia was an auto manufacturer. However, Ford, Holden, and Toyota will be ceasing auto manufacturing in Australia. ECONOMICS REFERENCES COMMITTEE, FUTURE OF AUSTRALIA'S AUTOMOTIVE INDUSTRY: INTERIM REPORT 57 (2015).

243. WU, *supra* note 36, at 2–3.

244. Brummer, *supra* note 239, at 536–37.

245. *Id.*

246. *Id.* at 540–41.

247. *Id.*

248. Whalley, *supra* note 44, at 69–70.

249. ARENT FOX LLP, *supra* note 151.

250. *Id.*

industry located production in those countries.[251] With a lower tariff under TPP, those companies that are in the mode of consolidating their interests may rethink whether they want to keep production there.[252] Another club goods effect is that TPP parties can use cheaper auto parts from some TPP countries in the auto manufacturing process.[253] For example, a number of Japanese part suppliers rely on cheaper inputs from Malaysia and Vietnam.[254]

Sometimes the club members are unsuccessful in keeping club goods to themselves and non-club members reap an indirect benefit when the benefits of the club spillover to the benefit of non-members. A spillover effect in the auto industry is where automakers or auto parts suppliers are able to incorporate parts from non-TPP countries, yet still comply with the rules of origin.[255] A firm would do this if use of parts from non-TPP countries result in a cost savings for the firm.[256] Whether a spillover effect is advantageous or not is dependent on a firm's geographical location and the tier at which the firm is situated in the auto industry.[257]

*C. Regulatory Opportunism*

A country that is not a member of a trade agreement may attempt to take advantage of club goods that spillover from the closed circle of parties to the trade agreement. The action of a non-member taking what members of the trade agreement likely view as an unfair advantage may be seen as opportunistic because the trade agreement was established to restrict the benefit of club goods to the member of the club.[258] Parties to the trade agreement may view outsiders as untrustworthy and trade agreement parties may fear that outsiders are acting out of ulterior motives.[259] One of the goals of the regulations within a trade agreement is to reduce opportunistic behavior.[260] The spillover effect may mean that a non-TPP member is engaging in regulatory opportunism. However, regulatory restrictions, such as rules of origin, are not fool-proof and regulatory opportunism may be a product. The distrust held by TPP members may raise a perception that a non-member is thus gaining an advantage that was not negotiated by the non-member.[261]

The countries most worrisome at this point in receiving spillover benefits from TPP appear to be China and Thailand, but other countries in Asia could be of

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251. *Id.*
252. *Id.*
253. *Id.*
254. *Id.*
255. *Id.*
256. *Id.*
257. WU, *supra* note 36, at 2–3.
258. Daron Acemoglu & Alexander Wolitzky, *Cycles of Distrust: An Economic Model* 2 (Nat'l Bureau of Econ. Research No. 18227, 2012).
259. Nat'l Bureau of Econ. Research, Working Paper No. 18257; *Id.*
260. Beth V. Yarbrough & Robert M. Yarbrough, *Economic Integration and Governance: The Role of Preferential Trade Agreements*, 5 J. INT'L ECON. INTEGRATION No. 2, 1, 1 (1990).
261. Acemoglu & Wolitzky, *supra* note 258, at 1.

concern in the future. China and Thailand are worrisome because they can produce auto parts at a cost savings over other countries.[262] An example of the potential spillover effect of the rules of origin is that Japan could use parts from non-TPP countries, such as China and Thailand, in its manufacture of autos and auto parts, yet still comply with the TPP rules of origin. Currently, China supplies the most auto body parts, airbags, and miscellaneous auto parts to Japan as well as supplying the most brakes and wheels to Japan and the United States.[263]

Of course, use of Chinese and Thai parts is not limited to Japan and the United States is not the only country concerned whether the lower mandated percentages under the TPP rules of origin will result in a spillover effect.[264] Canadian auto parts producers located in Ontario, Canada that currently sell to the Canadian or United States auto industries may be replaced by suppliers of lower-cost imports from China and Thailand.[265] On the other hand, Canadian automakers could benefit by switching from higher cost Canadian parts to lower-cost Chinese and Thai parts.[266]

### *D. Substantial Transformation*

Historically, the concept of "substantial transformation"[267] was the key in the United States for determining whether a product originally from a foreign jurisdiction has undergone a process domestically such that it could be considered as originating domestically.[268] An understanding of the term helps one understand some of the methods commonly used in various rule of origin schemes, including TPP.[269] When considering application of a preferential tariff under a preferential trade agreement, one step in the process is to distinguish between an originating and non-originating product by examining if the manufacturing process has substantially transformed the non-originating input to the product.[270]

The genesis of the transformation concept was dependent on two United States Supreme Court cases. The first case, *Hartranft v. Wiegmann*,[271] was decided in 1887 and the second case, *Anheuser-Busch Brewing Association v. United States*, [272] was decided in 1908. In *Hartranft*, the issue was whether a

262. TPP ISSUE ANALYSIS: TRADE, *supra* note 36, at 18.

263. Matthew Schewel, *TPP Auto ROO Most Likely To Hurt Makers Of Less Complex Parts: Experts (2016)*, INSIDE TRADE, http://insidetrade.com/share/152178 (last visited Feb. 6, 2017).

264. Noakes, *supra* note 183.

265. *Id.*

266. *Id.*

267. The test to determine whether substantial transformation has taken place "is whether the good has emerged from a given process with a 'distinctive name, character or use' in a particular state." Joseph A. LaNasa III, *Rules of Origin under the North American Free Trade Agreement: A Substantial Transformation into Objectively Transparent Protectionism*, 34 HARV. INT'L L.J. No. 2, 381, 384 (1993) (quoting *Anheuser-Busch Brewing Ass'n v. United States*, 207 U.S. 556, 562 (1908)).

268. *Id.* at 384–85.

269. VAN DE HEETKAMP & TUSVELD, *supra* note 70, at 74–75.

270. *Id.*

271. *Hartranft v. Wiegmann*, 121 U.S. 609, 609–611 (1887).

272. *Anheuser-Busch Brewing Ass'n v. U.S.*, 207 U.S. 556, 562 (1908).

manufacturing operation had been performed on a product such that customs authorities would impose a higher duty on the product.[273] The Court formulated the idea that the product must be changed in character for customs to conclude that the product had been manufactured.[274] In this case, the Philadelphia customs district had charged J. H. Wiegmann & Son a thirty-five percent ad valorem duty when the firm imported shells into the United States from London on the basis that they fell into the category of manufactured shells.[275] The firm's position was that no duty was owed because the shells were not manufactured.[276] The firm stated: "These shells have [simply] had the outer layer ground off so as to exhibit the beautiful inner layer. That has been done by the application of a wheel, and afterwards by polishing."[277] The United States Supreme Court sided with Wiegmann, the importer, and found that the shells did not fall into the category of manufactured shells.[278] The Court stated: "They were still shells. They had not been manufactured into a new and different article, having a distinctive name, character, or use from that of a shell."[279]

The United States Supreme Court relied on the reasoning of *Hartranft* when the Court used the word "transformation" in 1908 in *Anheuser-Busch Brewing Association v. United States*.[280] In that case, Anheuser-Busch had paid a duty when it imported cork from Spain to use in bottling beer.[281] The beer bottled using the corks originating from Spain was later exported and the case arose after the beer was exported.[282] The brewer wanted to use a "drawback" provision of customs regulation that would have permitted the brewer to obtain a refund of the customs duty paid when the cork was originally imported from Spain.[283] The brewer's argument was that the refund was due because the brewer had performed a manufacturing operation on the cork to prepare it for use in the bottling process and the cork was subsequently re-exported.[284] For the time period, the potential refund was the quite sizable amount of $10,995 USD paid on 73,299.78 pounds of imported cork.[285] The Court disagreed with the brewer and found that the brewer was not due the refund because the cork had not undergone a manufacturing operation as required under the customs regulation: "There must be transformation; a new and different article must emerge, 'having a distinctive name, character, or use.' This cannot be said of the corks in question."[286]

273. *See Hartranft*, 121 U.S. at 613–14.
274. *Id.* at 615.
275. *Id.* at 610, 613.
276. *Id.* at 610, 615.
277. *Id.* at 611.
278. *Id.* at 615.
279. *See Hartranft*, 121 U.S. at 615.
280. *Anheuser-Busch*, 207 U.S. at 562.
281. *Id.* at 559, finding 3.
282. *Id.* at 558.
283. *Id.*
284. *Id.* at 562–63.
285. *Anheuser-Busch*, 207 U.S. at 564.
286. *Id.* at 562.

The substantial transformation rule has not necessarily been applied over the years in a consistent, predictable, or coherent fashion, perhaps because of the subjectivity necessarily inherent in the test.[287] One reason for including detailed rules of origin in a preferential trade agreement is to make determination of whether a product is originating or non-originating more consistent and to avoid problems encountered in administering the rules of origin in prior trade agreements.[288] Although detailed rules of origin may lead to more consistent application, the rules of origin in recent preferential trade agreements have become so complicated that their utilization may require teams of attorneys and professionals trained in customs matters to interpret them.[289] Some of the complication may come from the fact that individual provisions of the rules of origin are the result of lobbying by some industry of a particular country to draw intricate lines carving out benefits for itself. There are some common principles running through the rules of origin in the various preferential trade agreements;[290] however, there is not a match between the differing rules of origin schemes of the many trade agreements.

### *E. Basic Principles on Rules of Origin for Autos*

Prior to delving into the complicated specifics of the TPP rules of origin, it might be helpful to provide some principles common to rules of origin. Rules of origin are designed to handle multi-country transactions in which various components of a manufactured item and its assembly take place in different locations around the globe.[291] A preferential trade agreement, like TPP, distinguishes between "originating" goods, which come from a country within the preferential trade agreement, and "non-originating" goods, which come from a country outside the preferential trade agreement.[292] Even if material or a part is non-originating because it was imported into a TPP country from a non-TPP country, it could be deemed originating if it were substantially transformed in a country within the preferential trade agreement.[293]

Rules of origin for autos are extremely complicated and the complication is meant to draw fine lines to distinguish between originating and non-originating goods so that TPP countries achieve the bargained-for protection for sensitive industries.[294] Complying with the rules of origin is a huge expense for a company and the company may have a whole staff to deal with the documentation from the

287. *See Generally,* DONALDSON COMPANY, INC., RULES OF ORIGIN, https://www.donaldson.com/en/supplier/compliance/origin.pdf.

288. William J. Kovatch, Jr., *The NAFTA's Rules of Origin, Certificate of Origin, and Record-keeping Requirements: The Disadvantage to Small Businesses*, 12 TRANSNAT'L LAW. 403, 409 (1999).

289. *Id.* at 417–19.

290. VAN DE HEETKAMP & TUSVELD, *supra* note 70, at 98–104.

291. DONALDSON COMPANY, INC., *supra* note 287.

292. WU, *supra* note 36, at 1.

293. *Id.* at 2–3.

294. TPP RULE OF ORIGIN IS 45%, *supra* note 37.

product components.[295] TPP Articles 3.20 through 3.26 concern the certificate of origin requirements,[296] Article 3.27 concerns verification of the certificate of origin by the country into which the good is imported,[297] Articles 3.28 through 3.29 concern claims,[298] Article 3.30 concerns penalties,[299] and Article 3.31 concerns confidentiality.[300] The advantage of using the rules of origin can be sizable for a big company such as an automaker.[301] A big company cumulating a very low drop in cost for each of a high number of products can still find using the rules of origin profitable because the cost saving in tariff exceeds the cost spent in utilizing the rules of origin.[302] For a big car company, the company can make good use of the rules of origin for cost saving.

Some producers fail to use rules of origin even though their use would decrease the amount of tariff paid to have a product clear customs.[303] As more fully described below, implementing the rules of origin of a trade agreement can be quite complicated and require keeping detailed records.[304] The utilization of rules of origin is based on gains from complying with the rules of origin being higher than the total of: a) costs of complying with the rules of origin; and b) the reduction in tariffs.[305]

Three principles provide the foundation for the multi-country rules of origin. The three principles are:

1) tariff shift;

2) value percentage criteria; and

3) specified process.[306]

These three principles are tools used to determine whether substantial transformation has occurred.[307]

A good within a particular tariff classification may shift to fall into a different tariff classification after undergoing processing or manufacture. The tariff shift principle permits a good originating outside any TPP country to be considered originating in a TPP country if the non-originating good was substantially transformed in the TPP country.[308] The value percentage criteria is based on a

295. Kovatch, *supra* note 288, at 417–19.

296. Trans-Pacific Partnership Agreement, ch. 3, arts. 3.20–3.27, Nov. 12, 2011, https://ustr.gov/sites/default/files/TPP-Final-Text-Rules-of-Origin-and-Origin-Procedures.pdf.

297. *Id.* ch. 3, art. 3.27.

298. *Id.* ch. 3, arts. 3.28–3.29.

299. *Id.* ch. 3, art. 3.30.

300. *Id.* ch. 3, art. 3.31.

301. Kovatch, *supra* note 288, at 419.

302. *Id.*

303. *Id.*

304. *Id.* at 417–18.

305. *Id.* at 417–19.

306. INT'L TRADE COMM'N, *supra* note 3, at 236–37.

307. David Palmeter, THE WTO AS A LEGAL SYSTEM ESSAYS ON INTERNATIONAL TRADE LAW AND POLICY, 154–55 (2003).

308. INT'L TRADE COMM'N, *supra* note 3, at 226.

comparison between the domestic and foreign content of a good.[309] It requires that the imported good either contain a minimum percentage of originating content or that the imported good not exceed a maximum non-originating content.[310] The specified process principle permits a good that was originally non-originating to be considered originating if the non-originating good underwent a process in a TPP country that substantially transformed it.[311]

Although use of one of the three principles would seem to provide clarity not inherent in the determination of whether a substantial transformation has occurred, none of the three principles is entirely foolproof in producing coherent results.[312] In addition, a particular rule of origin for a particular industry may combine the use of two or more of the three principles described in this section.[313]

The use of a tariff shift is dependent on the intersection between the Harmonized Commodity Description and Coding System, often referred to as the Harmonized System, and the rules of origin of a particular trade agreement.[314] The elaborate nature of the Harmonized System, more fully described in the following section, might make one think that use of tariff shift provisions leads to consistent and predictable results.[315] The purpose of the Harmonized System was to be able to classify a wide range of imported products and generate import statistics; however, the purpose of the Harmonized System was not to enable determination of when a preferential tariff should be applied.[316] One problem is that different customs authorities may classify different goods differently and thus assign different tariff codes to the same good.[317] The tariff codes may not be sufficiently detailed for some products in that substantial processing of a particular product may not result in a tariff shift. This happens when a processed product continues to be classified under the same tariff code as the inputs for the product.

There is another problem with the tariff shift principle. The rules of origin in a trade agreement are typically negotiated with the purpose of protecting certain sensitive industries.[318] To do so may considerably lengthen the rules of origin because the negotiators must include tariff shift schedules comprised of tables of various tariff codes, often with reference to detailed exceptions.[319] Deciphering the effect of tariff shift schedules requires knowledge of the Harmonized System and some experience working with it.

The value percentage criteria is not without its problems. Determining value percentage requires an intensive accounting exercise, yet accounting methods are

309. David Palmeter, *supra* note 307.
310. *Id.* at 236–37.
311. *Id.*
312. VAN DE HEETKAMP & TUSVELD, *supra* note 70, at 122–24.
313. *See, e.g.,* INT'L TRADE COMM'N, *supra* note 3, at 236–37.
314. LaNasa, *supra* note 267, at 388.
315. *Id.* at 390.
316. *Id.* at 391.
317. VAN DE HEETKAMP & TUSVELD, *supra* note 70, at 122–24.
318. WU, *supra* note 36, at 2, 3.
319. Whitten, *supra* note 36.

not consistent throughout the world.[320] The elaborate accounting exercise must be backed up with documents to protect the importer should the customs administration decide to audit the cost of materials and production on which the customs declaration was based.[321] The results of the calculation are not necessarily consistent, given that the currency exchange rates and prices of inputs likely vary over time and labor and other production costs vary from country to country.[322]

The specified process principle seems to be more straightforward at first glance. It is designed to distinguish a process that substantially transforms a good from a process that is minimal or that can be done easily with minimal equipment, such as a screwdriver.[323] One drawback is that the principle lengthens the rules of origin because the covered processes must be stated in sufficient detail so that there can be an understanding of what a particular process means.[324] There still may be a disagreement between the customs authorities and the firm claiming the preferential treatment as to whether the operation performed falls within a particular process category specified in the rule of origin.[325] Another drawback is that future technology may not be adequately covered in the rules of origin because the technology was non-existent when the trade agreement was negotiated.

### *F. The Harmonized System Description and Coding System*

The tariff shift principle requires an understanding of tariff schedules. The World Customs Organization[326] developed the Harmonized System,[327] which classifies roughly 5,000 commodity groups and identifies each group by a six-digit code.[328] More than 200 countries use the system for its original purpose of tracking trade passing across international boundaries;[329] however, the system was not originally developed as a tool for duty classification nor determination of country of origin.[330] TPP requires use of the Harmonized System to determine rules of origin and tariffs imposed on an auto or auto component imported into a TPP country when the importer relies on a tariff shift provision of TPP.[331]

The Harmonized System is comprised of six-digit codes.[332] The first two digits are referred to as the *chapter*, the first four digits are referred to as the

320. Raj Gnanarajah, *U.S. Capital Markets and International Accounting Standards*, *in* ACCOUNTING METHODS & STANDARDS & BONUS DEPRECIATION: SELECTED ANALYSES (Suzanne Thomas ed., 2016) 1–2.

321. VAN DE HEETKAMP & TUSVELD, *supra* note 70, at 115–17.

322. *Id.*

323. *Id.*

324. *Id.*

325. *Id.*

326. *Id.*

327. *Id.*

328. Peggy Chaplin, *An Introduction to the Harmonized System*, 12 N.C. J. INT'L L. & COM. REG. 417, 426 (1987).

329. *Id.*

330. LaNasa, *supra* note 267, at 391.

331. INT'L TRADE COMM'N, *supra* note 3, at 226.

332. Chaplin, *supra* note 328, at 426.

*heading*, and the entire six digits are referred to as the *subheading*.[333] Countries that want more detail are at liberty to add additional digits, but any digits above six are country-specific.[334]

Certain portions of the Harmonized System are critical to the auto industry.[335] Subheadings 8407.33 and 8407.34 corresponds to vehicle engines;[336] subheading 8544.30 corresponds to wire harnesses.[337] Heading 8703 corresponds to passenger vehicles.[338] A number of subheadings within heading 8708 are important to the automotive industry; these include 8708.29 (vehicle body parts);[339] 8708.30 (brakes and parts);[340] 8708.40 (transmissions);[341] 8708.70 (road wheels and parts);[342] 8708.94 (steering wheels);[343] airbags (8708.95);[344] 8708.99 (miscellaneous motor vehicle parts).[345] An example of product-specific rules of origin that is provided later in this Part references some of these tariff lines.

### *G. Basic TPP Provisions Impacting Rules on Origin*

Rules of origin are obscure and technical in nature. Determining if an auto or auto component meets the TPP rules of origin is an exercise of patience. Under TPP,[346] one must consider: 1) Chapter 3; 2) Annex 3-D (to Chapter 3); and 3) Appendix 1 (to Annex 3-D).[347]

Chapter 3 of TPP encompasses rules of origin basic provisions.[348] Section A of Chapter 3 (Articles 3.1 through 3.18) comprises substantive provisions;[349] and Section B of Chapter 3 (Articles 3.19 through 3.32) comprises procedures.[350] Annex 3-D to Chapter 3, which is 212 pages in length, contains the product-specific rules of origin.[351] The product-specific rules of origin of Annex 3-D are based on the principles of tariff shift and regional value content.[352] An example of portions of this Annex is included later in this part.[353] Appendix 1 to Annex 3-D

333. *Id.*
334. *Id.*
335. *See* Trans-Pacific Partnership Agreement, Annex 3-D, at 96–97, 154, 157–65.
336. *Compare* Annex 3-D, at 96–97, *with* Annex 3-D app. 1, at 2–3.
337. *See* Trans-Pacific Partnership Agreement, Annex 3-D, at 154.
338. *Id.* at Annex 3-D, at 157.
339. *Compare* Annex 3-D, at 158, *with* Annex 3-D app. 1, at 2.
340. *Compare* Annex 3-D, at 159, *with* Annex 3-D app. 1, at 3.
341. *Id.*
342. *See* Trans-Pacific Partnership Agreement, Annex 3-D, at 159.
343. *Compare* Annex 3-D, at 160, *with* Annex 3-D app. 1, at 3.
344. *Compare* Annex 3-D, at 161, *with* Annex 3-D app. 1, at 3.
345. *Id.*
346. Trans-Pacific Partnership Agreement, https://ustr.gov/tpp/.
347. Trans-Pacific Partnership Agreement, ch. 3, Annex 3-D, Annex 3-D app. 1.
348. Trans-Pacific Partnership Agreement, ch. 3 Exec. Summary.
349. *Id.* at 3.1–3.18.
350. *Id.* at 3.19–3.31.
351. *Id.* Annex 3-D.
352. INT'L TRADE COMM'N, *supra* note 3, at 226.
353. *Infra* note 392 and accompanying text.

has provisions that directly relate to autos and auto parts.[354] Appendix 1 is only three pages long, but it contains three tables, designated as tables A, B, and C.[355] Table B is based on specific processes, the third principle of rules of origin.[356]

Autos and auto components meet the TPP rules of origin if they fall into one of three categories (TPP Article 3.2) and otherwise comply with chapter 3.[357] TPP Article 3.6 permits a material originating from a non-TPP country to be considered originating when it undergoes a substantial transformation.[358] TPP Article 3.10, the accumulation provision, permits an originating product from any TPP country to count toward the threshold.[359]

When reviewing the three categories of TPP Article 3.2, the first and the second categories seem to be the easiest to understand and comply with.[360] In simple terms, the first category is comprised of raw materials, including minerals, mined from a TPP party; the second category is comprised of products manufactured within a TPP party from materials originating within a TPP party, but the materials may contain materials sourced from a non-TPP country.[361] For example, a TPP country could import pig iron that the country processes into cast iron, which is used to make the auto engine.[362] The cast iron portion of the auto engine would be originating.[363] For the finished auto engine to fall within the second category, every other part in the engine besides that cast iron portion must be originating.[364] The third category is satisfied if the product meets the product-specific rules of origin.[365] Because of the multi-country nature and complexity of the manufacturing involved in the automobile industry, chances are that producers in the industry will have little occasion to use either of the first two categories of the rules of origin with the exception, perhaps, of second-tier or third-tier suppliers of very basic auto components.[366]

The third category of rules of origin will be crucial to the automotive industry in claiming preferential tariff treatment and is the category most often used by the auto industry.[367] The two basic divisions within the third category are tariff shift, meaning that the tariff classification for a good has changed, and regional value content.[368] To use regional value content, a producer must have at least a minimum

354. Trans-Pacific Partnership Agreement, Annex 3-D app. 1.
355. *Id.* at 1–3.
356. *Id.* at 2.
357. Trans-Pacific Partnership Agreement, ch. 3, art. 3.2.
358. *Id.* art. 3.6.
359. *Id.* art. 3.10.
360. *Id.* art. 3.2(a), (b).
361. INT'L TRADE COMM'N, *supra* note 3, at 225–26.
362. *Id.* at 226.
363. *Id.*
364. *Id.*
365. *Id.*
366. *Id.* at 225–26.
367. *Id.* at 236.
368. *Id.*

regional value content by performing a quantitative analysis.[369] This means that at least a certain portion of the product must come from TPP countries (TPP originating materials) and limits the amount of materials coming from countries outside TPP (non-originating materials).[370]

The quantitative analysis required to determine regional value content is an accounting exercise. In this exercise, elements such as the value of goods used in production, labor, overheads, and other costs are examined to determine if they meet a particular threshold percentage.[371] TPP regional value content comprises four separate methods, any one of which may be used in calculating a product's regional value content as long as it is one of the methods specified for a good of a particular tariff classification.[372] TPP article 3.5 contains the formulas for calculating the focused value method, the build-down method, the build-up method, and the net cost method.[373]

Someone who wants to use regional value content to qualify a product under the TPP rules of origin would determine which method of the methods allowable would be most beneficial.[374] A further description of each of the four formulas is useful here. The focused value method is a new method for calculating regional value content beyond the methods included in NAFTA.[375] The method is "focused" in that the calculation is based only on the value of the non-originating materials specified in the product specific rules of Annex 3-D.[376] The build-down method requires the regional value content to be calculated based on the value of all non-originating materials.[377] The build-down method is the one that Japan reportedly prefers.[378] One notices that both the focused value method and the build-down method require a calculation of the value of non-originating materials.[379] This calculation may be simpler than other calculations if the customs valuation of the imported materials is available; however, other costs associated with the imported materials, such as transportation, might also figure into the calculation.[380] The build-up method requires the regional value content to be calculated based on the value of originating materials.[381] The net cost method compares the net cost of the good, less the value of non-originating materials, as

369. *Id.*

370. TPP art. 3.11 does permit a *de minimis* inclusion of non-originating goods if not more than 10%. *See* Trans-Pacific Partnership Agreement, ch.3, art. 3.11.

371. *See U.S.-Korea Free Trade Agreement, Rules of Origin, A Regional Value Content Rule*, EXPORT.GOV, http://2016.export.gov/FTA/korea/eg_main_048793.asp (last visited Dec. 5, 2016) [hereinafter *U.S.-Korea Free Trade Agreement*].

372. Trans-Pacific Partnership Agreement, ch. 3, art. 3.5.

373. *Id.*

374. INT'L TRADE COMM'N, *supra* note 3, at 236–37.

375. Trans-Pacific Partnership Agreement, ch. 3, art. 3.5(a).

376. *Id.*

377. *Id.* art. 3.5(b).

378. TPP RULE OF ORIGIN IS 45%, *supra* note 37.

379. Trans-Pacific Partnership Agreement, ch. 3, art. 3.5(a), (b).

380. *See U.S.-Korea Free Trade Agreement*, *supra* note 371.

381. Trans-Pacific Partnership Agreement, ch. 3, art. 3.5(c).

compared to the net cost of the good.[382]

Appendix 1 to Annex 3-D adds another layer of complexity to the already complicated rules of origin for autos.[383] Appendix 1 is referenced in a footnote to the table included in the following section of this part.[384] Appendix 1 contains Tables A, B, and C.[385] Table A lists seven auto parts: two types of safety glass, two types of vehicle bodies, bumpers, door assemblies, and drive-axles.[386] Table B lists eleven processing operations: complex assembly, complex welding, die or other casting, extrusion, forging, heat treatment, laminating, machining, metal forming, molding, and stamping.[387] Table C lists certain key auto components.[388] The material and parts used in producing those key components are considered originating if they meet their own regional value content or are produced using at least one of the processes listed on Table B.[389] However, if a processing method from Table B is used in production, Table C specifies a maximum on the value of the materials and parts that can be deemed originating content under the value (build-up / build-down) or net cost methods of calculating regional value content.[390] Some of the auto parts and the applicable percentages shown on Table C include: engines (8407.33 and 8407.34)(10%); bumpers, brakes, and transmissions (10%); airbags and other vehicle parts (8707.99)(5%).[391]

### *H. An Example of Product-Specific Rules of Origin*

The third category of rules of origin encompasses more and is much more detailed than one might initially anticipate. One way to gain some understanding of the complexity of product-specific rules of origin is to review portions of TPP that are closely connected to the auto and auto parts industries. A glance at selected portions of TPP Annex 3-D shows the following information:[392]

382. *Id.* art. 3.5(d).
383. INDUST. TRADE ADVISORY COMM., *supra* note 233, at 7.
384. *Infra* note 397 and accompanying text.
385. Trans-Pacific Partnership Agreement, Annex 3-D app. 1.
386. *Id.* at 2.
387. *Id.*
388. *Id.* at 2–3.
389. *Id.* at 1, ¶ 1.
390. *Id.* at 1, ¶¶ 2–3.
391. *See* Whitten, *supra* note 36 (discussing the application of this appendix to the manufacture of a car body from steel imported from China).
392. Trans-Pacific Partnership Annex 3-D, at 96-97, 154, 157–61.

| **HS Classification** | **Classified product** | **Product-Specific Rule of Origin** |
|---|---|---|
| 8407.33†[393] | Spark-ignition reciprocating piston engines of a kind used for the propulsion of vehicles of Chapter 87 : Of a cylinder capacity exceeding 250 cc but not exceeding 1,000 cc | No change in tariff classification required for a good of subheading 8407.33 through 8407.34, provided there is a regional value content of not less than:<br>(a) 45 per cent under the build-up method;<br>or<br>(b) 45 per cent under the net cost method; or<br>(c) 55 per cent under the build-down method. |
| 8407.34†[394] | Spark-ignition reciprocating piston engines of a kind used for the propulsion of vehicles of Chapter 87 : Of a cylinder capacity exceeding 1,000 cc | See above |
| 8544.30 | Wire harnesses | A change to a good of subheading 8544.30 from any other subheading, except from heading 74.08, 74.13, 76.05, 76.14 or subheading 8544.11 through 8544.20 or 8544.42 through 8544.60; or<br>No change in tariff classification required for a good of subheading 8544.30, provided there is a regional value content of not less than:<br>(a) 35 per cent under the build-up method;<br>or<br>(b) 45 per cent under the build-down method; or<br>(c) 60 per cent under the focused value method taking into account only the nonoriginating materials of heading 74.08, 74.13, 76.05, 76.14 and subheading 8544.11 through 8544.60. |
| 870.02-87.95† | Cars | No change in tariff classification required for a good of heading 87.02 through 87.05, provided there is a regional value content of not less than:<br>(a) 45 per cent under the net cost method; or<br>(b) 55 per cent under the build-down method. |

393. *Id.*
394. *Id.*

| | | |
|---|---|---|
| 8707.10†[395] | Bodies for the motor vehicles of heading 8703 | A change to a good of subheading 8708.10 through 8708.21 from any other subheading; or<br>No change in tariff classification required for a good of subheading 8708.10 through 8708.21, provided there is a regional value content of not less than:<br>(a) 45 per cent under the build-up method;<br>or<br>(b) 45 per cent under the net cost method; or<br>(c) 55 per cent under the build-down method. |
| 8708.70[396] [397] | Road wheels and parts | A change to a good of subheading 8708.70 from any other subheading; or<br>No change in tariff classification required for a good of subheading 8708.70, provided there is a regional value content of not less than:<br>(a) 35 per cent under the build-up method;<br>or<br>(b) 35 per cent under the net cost method; or<br>(c) 45 per cent under the build-down method. |

Review of the above information indicates that a finished car imported into Australia need only satisfy regional value content to receive a preferential tariff under TPP.[398] In contrast, all of the car components, except for piston engines, require either a tariff shift or regional value content.[399] The regional value content percentages also vary.[400] For vehicles, the minimum percentage is forty-five percent under the net cost method and fifty-five percent under the build-down method; for auto parts, there is a general range of minimum percentages from thirty-five percent to fifty-five percent and the regional value content calculation method that can be applied.[401]

From review of the above table, one notices that the product-specific rule of origin for wire harnesses is particularly lengthy.[402] If tariff shift is used, certain

395. *Id.*

396. *Id.*

397. *See* also Appendix 1 (Provisions Related to the Product-Specific Rules of Origin for Certain Vehicles and Parts of Vehicles).

398. The portion of the table above containing information on Harmonized System heading 87.02-87.05 (passenger vehicles).

399. The portion of the table above containing information on Harmonized System subheading 8544.30 (wire harnesses); heading 8703; subheadings 8708.29 (vehicle body parts); 8708.30 (brakes and parts); 8708.40 (transmissions); 8708.70 (road wheels and parts); 8708.94 (steering wheels); airbags (8708.95); 8708.99 (miscellaneous motor vehicle parts).

400. Portions of the table above.

401. *Id.*

402. The portion of the table above containing information on Harmonized System subheading 8544.30 (wire harnesses).

tariff code headings and subheadings are excluded from the calculation;[403] those same tariff code headings and subheadings are required to be taken into account when using the regional value content focused value method.[404] The specifically-referenced tariff code headings and sub-headings include insulated and non-insulated wire.[405] For the product-specific rules of origin for wire harnesses in the above table, three regional value content methods are used, but the net cost method is not one of them.[406] In the above table, wire harnesses are the only parts that include the focused value method in the product-specific rule of origin and the sixty percent content requirement is higher than the content for any other good included in the table.[407] The high originating content requirement under the focused value method probably is a result of some concern that wire harnesses may be an auto component likely to be assembled in a non-TPP country.[408] The sixty percent requirement would permit assembly in a non-TPP country but using a high content of materials produced in TPP countries.[409]

The wire harness is a critical car component that requires some portion of the assembly to be done by hand.[410] An automotive car harness is a collection of wires bundled together that provide electricity and signals to various areas of the car.[411] The bundling of the wires using some type of sleeve, tape, or other restraint into a one-piece component has the advantages of being more compact, increasing the ability to safeguard the electrical system from damage due to vibration, moisture, or abrasion, decreasing the possibility of a short, decreasing the possibility of fire through the use of a flame-retardant sleeve, and decreasing the time needed to wire the car.[412] After production, the wire harness must be tested to ascertain that it is functioning correctly.[413] Although part of the wire harness manufacturing process can be automated, such as cutting the wires, other portions of the process must be done by hand.[414] A wire harness supplier may have the component manufactured in

403. *Id.*

404. *Id.*

405. Trans-Pacific Partnership Annex 3-D, at 81–82, 84, 152–55.

406. The portion of the table above containing information on Harmonized System subheading 8544.30 (wire harnesses).

407. *Id.*

408. *See* CARLOS AYALA, AUTOMOTIVE WIRING HARNESS: MANUFACTURING PROCESS (1999), http://www.personal.engin.umd.umich.edu/~jwvm/ece539/W99Presentations/Wiring_Harn/AutoHarness.PDF.

409. The portion of the table above containing information on Harmonized System subheading 8544.30 (wire harnesses).

410. AYALA, *supra* note 408, at 1, 8.

411. *Id.* at 1.

412. Masakazu Kobayashi, Yoshiya Hirano & Masatake Higashi, *Optimization of Assembly Processes of an Automobile Wire Harness*, 11 COMPUTER-AIDED DESIGN & APPLICATIONS 305, 305 (2013); Robert Kraus & David Ryan, Advances in Heat-Shrink Technology, 4 IEEE ELECTRICAL INSULATION MAG. 31, 33 (1988); Austin Weber, *A Little Covering Goes a Long Way*, WIRE PROCESSING 12 (Oct. 2016).

413. AYALA, *supra* note 408, at 11–12.

414. *Id.* at 8, 11–12.

a location with low labor cost to cut down on its cost of manufacture.[415]

*I. Differences Between NAFTA and TPP Rules of Origin*

Those familiar with NAFTA rules of origin would note the major differences between NAFTA and TPP rules of origin when determining regional value content. One difference is that TPP no longer requires tracing of certain non-originating components.[416] Pursuant to the tracing rule, the non-originating status of certain goods was determined at the time a NAFTA party took title.[417] From then on, those goods had to be traced and they maintained their status as non-originating goods throughout the balance of the production process.[418] The reason for the tracing rule was to combat the "roll-up" problem. Roll-up occurs when an auto part contains some non-originating content but the part is deemed to be originating under the rules of origin.[419] This status of being 100% an originating good continues when the auto part is incorporated into the finished car.[420] Thus the roll-up may give an inaccurate picture of the percentage of the car that was produced with materials originating in countries within the trade agreement.[421] The auto industry had lobbied for the tracing rule but no longer supports the rule because of the administrative burden.[422]

Another difference between NAFTA and TPP is between applicable percentages when using regional value content.[423] For example, NAFTA requires 62.5% originating materials for cars and many parts under the net cost method to qualify for preferential tariffs.[424] Under TPP, the percentage drops to 45% under the net cost method for cars.[425] For some auto parts, TPP lowers the threshold percentage to 35% under the net cost method. TPP includes the use of a build-down method that is unavailable under NAFTA.[426] The threshold minimum of originating material is 55% for cars under the build-down method.[427] The build-down method can be used for auto parts, including motor vehicle bodies, road wheels, radiators, mufflers, exhaust pipes, and clutches, and the threshold minimum of originating material for those auto parts is 45%.[428] The build-up method can also be used for those same parts, with a threshold minimum of

415. *Id.*
416. INTERN'L TRADE COMM'N, *supra* note 3, at 236–37.
417. North American Free Trade Agreement, Dec. 17, 1992, art. 403.1.16, H.R. Doc. 103-159, 32 I.L.M. 289, 673 (entered into force Jan. 1, 1994).
418. North American Free Trade Agreement, Dec. 17, 1992, Annex 403.1, 403.2, H.R. Doc. 103-159, 32 I.L.M. 289, 673 (entered into force Jan. 1, 1994).
419. SCHEWEL, *supra* note 263.
420. *Id.*
421. *Id.*
422. *Id.*
423. INTERN'L TRADE COMM'N, *supra* note 3, at 237.
424. WU, *supra* note 36, at 2.
425. *Id.*
426. *Id.*
427. *Id.*
428. *Id.* at 2 n.3.

originating material of 35%.[429]

The lower percentages lead most analysts to the conclusion that the threshold percentages are lower under TPP than under NAFTA.[430] Japan negotiated for low threshold minimum percentages for originating materials to accommodate the country's present practice of outsourcing parts from non-TPP countries, including China.[431] The percentage figures contained in TPP for auto goods were a compromise between Japan and other TPP parties,[432] as some representing Canadian and Mexican interests had advocated for a minimum fifty percent originating materials percentage on all auto parts.[433]

The beneficiaries of the lower minimum percentages of originating materials included in TPP depend on several factors. As far as a United States auto company is concerned, the lower percentages may give an automaker the ability to outsource auto components from a non-TPP country to save on costs yet still take advantage of the TPP preferential tariffs.[434] This may mean that a United States third-tier producer of auto components may face more competition in cost, especially if the product is a simple one like tires or steel.[435] Producers of complex auto components or those for which the auto component producer needs to be geographically close to a higher tier part supplier or automaker likely will be unaffected.[436] A company with a global footprint may decide to shift some of its operations to less costly geographical locations; however, a company with a more local focus may not have that option.[437]

## IV. ANALYSIS OF THE EFFECT OF TPP

### *A. Geopolitics*

Some political scientists employ game theory in analyzing the strategy of what a country will do in relationship with what the country thinks other countries will do.[438] One theory is that the signing of one free trade agreement may have a contagion effect leading non-parties to the agreement to sign their own trade agreement for fear of being left out of the gains the parties to the first trade agreement, or losing existing markets,[439] with "the degree of contagion . . . related to the importance of the partners' markets."[440] Another motivation may be for a

429. *Id.*
430. *Id.* at 2.
431. *Id.*
432. *Id.*
433. TPP RULE OF ORIGIN IS 45%, *supra* note 38.
434. WU, *supra* note 36, at 2.
435. SCHEWEL, *supra* note 263.
436. WU, *supra* note 64, at 2–3.
437. TPP RULE OF ORIGIN IS 45%, *supra* note 37.
438. Emilie M. Hafner-Burton, Brad L. LeVeck, David G. Victor, & James H. Fowler, *Decision Maker Preferences for International Legal Cooperation*, 68 INT'L ORG. 845, 852 (2014).
439. Richard Baldwin & Dany Jaimovich, *Are Free Trade Agreements contagious?*, 88 J. INT'L ECON. 1, 1 (2012).
440. *Id.* at 21.

country to be in the position to better compete for future foreign direct investment anticipated to be made in support of the global supply chain for the auto and auto parts industries.[441] Although many think that the choice of partners is dependent on trade, the choice is dependent more on power and politics.[442] Economic interdependence seems to have a positive effect in deterring conflict and promoting peace and security.[443]

TPP is the lead mega-regional[444] in a region that has spawned a number of concepts in the past for Asian regional integration.[445] The primary Asian regional association has been the Association of Southeast Asian Nations ("ASEAN"), with its original five members, Indonesia, Malaysia, the Philippines, Singapore and Thailand, and the addition of Brunei, plus the later addition of four more countries, Cambodia, Laos, Myanmar and Vietnam, bringing the total countries in ASEAN to ten.[446] In turn, China has been pressing forward with the Regional Comprehensive Economic Partnership, comprised of ASEAN+6 (the ASEAN countries plus Australia, China, India, Japan, Korea, and New Zealand).[447]

The TPP itself was an outgrowth of the P4 (Brunei, Chile, New Zealand and Singapore).[448] When the United States expressed its interest in joining, Australia, Malaysia, Peru, and Vietnam followed shortly thereafter.[449] Vietnam has high tariffs; as a developing country it saw that it could benefit from joining the others[450] and Malaysia did not want to be left out.[451] Canada and Mexico had to join to be covered on the new measures under TPP that are not covered under NAFTA.[452] Japan had to join; it could not afford to have the United States get a better deal with the other TPP parties than Japan.[453]

Game theory should trigger an examination of the existing trade agreements between TPP parties and what TPP parties stand to lose if TPP does not go into

441. *Id.* at 11.

442. Emilie M. Hafner-Burton, David G. Victor & Yonatan Lupu, *Political Science Research on International Law: The State of the Field*, 106 AM. J. INT'L L. 47, 51-52 (2012).

443. Emilie M. Hafner-Burton & Alexander H. Montgomery, *War, Trade, and Distrust: Why Trade Agreements Don't Always Keep the Peace*, 29 CONFLICT MGMT. & PEACE SCI. 257, 258 (2012).

444. For background on the TPP, *see* Chunding Li & John Whalley, *China and the Trans-Pacific Partnership: A Numerical Simulation Assessment of the Effects Involved*, 37 WORLD ECON. 169, 170–73 (2014).

445. Meredith Kolsky Lewis, *The TPP and the RCEP (ASEAN+6) as Potential Paths toward Deeper Asian Economic Integration*, 8 ASIAN J. OF WTO & INT'L HEALTH L. & POL'Y 359, 361 (2013).

446. *Id.* at n.1, 3.

447. *Id.* at 361–62.

448. *Id.* at 364; Meredith Kolsky Lewis, *Expanding the P-4 Trade Agreement into a Broader Trans-Pacific Partnership: Implications, Risks and Opportunities*, 4 ASIAN J. OF WTO & INT'L HEALTH L. & POL'Y 401, 403 (2009).

449. Lewis, *supra* note 448, at 403.

450. Raj Bhala, *Trans-Pacific Partnership or Trampling Poor Partners? A Tentative Critical Review*, 1 MANCHESTER J. INT'L ECON. L. 2, 19 (2014).

451. CERDEIRO, *supra* note 17, at 13, 17, 23.

452. *Id.* at 7.

453. *Id.* at 8–9.

effect. Three trade agreements overlap in the Pacific Ocean area of the globe. The three are TPP, NAFTA, and the ASEAN Trade in Goods Agreement.[454] The three NAFTA countries, the United States, Canada, and Mexico, are also parties to TPP.[455] Of the ten members of ASEAN, only four, Brunei, Malaysia, Singapore, and Vietnam, are parties to TPP.[456] The six ASEAN members who are not parties to TPP are Cambodia, Indonesia, Laos, Myanmar, the Philippines, and Thailand.[457] As far as ASEAN countries with auto industries, only two, Malaysia and Vietnam, are parties to TPP; three other ASEAN members with auto industries, Indonesia, the Philippines, and Thailand, are not parties to TPP.[458] The auto industries of Malaysia and Vietnam may receive a boost above the auto industries of Indonesia, the Philippines, and Thailand because the latter three countries will not receive the benefits that TPP has to offer. With TPP, the huge United States consumer base would become more attractive to Brunei, Japan, Malaysia, Singapore, and Vietnam.[459] Chances are that those five countries will export more products to satisfy the demands of consumers in the United States, as these are the only countries with which the United States does not currently have a preferential trade agreement in effect.[460]

As far as Latin America is concerned, the United States already has trade agreements with Chile, Mexico, and Peru.[461] TPP will strengthen the ties between the United States and those countries and will update NAFTA.[462] One study considered the effect of non-TPP Latin American countries joining TPP.[463] The conclusion of the study was that the countries that could see positive results by becoming TPP members are Brazil, Guatemala, Nicaragua and Colombia because of their current restrictiveness in trade in goods; Argentina and El Salvador are the countries that would show little effect.[464]

### *B. Economics and TPP*

The United States International Trade Commission (ITC) released its analysis of TPP in May of 2016 and projected positive effects over baseline projections, although representing a small percentage in comparison with the large size of the United States economy.[465] The analysis showed that by 2032, the United States

454. INTERN'L TRADE COMM'N, *supra* note 3, at 695–740.

455. *Id.* at 703.

456. *Id.* at 410 n.28.

457. *Id.* at 19; Lewis, *supra* note 448, at 410 n.28.

458. HIDEO KOBAYASHI, CURRENT STATE AND ISSUES OF THE AUTOMOBILE AND AUTO PARTS INDUSTRIES IN ASEAN 1 (2015), http://www.eria.org/ERIA-DP-2015-22.pdf.

459. GOTO, *supra* note 16.

460. *Id.*

461. CHRISTOPHER WILSON, THE IMPACT OF TPP ON LATIN AMERICA AND U.S. RELATIONS WITH THE REGION (2015), https://www.wilsoncenter.org/article/the-impact-tpp-latin-america-and-us-relations-the-region.

462. *Id.*

463. *See* CERDEIRO, *supra* note 17.

464. *Id.* at 21.

465. INTERN'L TRADE COMM'N, *supra* note 3, at 21.

will show a $57.3 billion USD increase in annual income (0.23 percent), a $42.7 billion USD increase in gross domestic product (0.15), and an increase in employment (0.07 percent).[466] United States exports and imports would rise ($27.2 billion USD or 1.0 percent for exports and $48.9 billion USD or 1.1 percent for imports).[467] The analysis considered the effect on United States exports to and imports from TPP countries that are new partners to free trade agreements with the United States.[468] The estimates were that United States exports would show an increase of $34.6 billion USD, or 18.7 percent, and United States imports would show an increase of $23.4 billion USD, or 10.4 percent.[469]

The ITC May 2016 report contained an economic assessment of the United States auto industry.[470] The overview of the auto industry was positive with growth in imports and exports of United States finished vehicles and vehicle parts.[471] For 2032, the report showed a growth of $1.6 billion USD, or 0.3 percent, in finished cars but a decrease in auto parts of $1.4 billion USD, or 0.3 percent.[472] The increase in exports is primarily based on exports to Japan and Vietnam. Japan would contribute to the increase in car imports due to the reduction in United States tariffs.[473] Imports of vehicles and parts from Canada and Mexico are also projected to increase.[474] The TPP rules of origin for autos are expected to impact the United States auto and auto parts industries.[475] The study concludes that the lowering of the regional value content under TPP as compared to NAFTA will contribute to a rise in the exports of United States autos but a decline in exports of United States auto parts to Canada and Mexico.[476] Auto industry experts see the regional value content percentages as sufficiently differentiating between carmakers in TPP and non-TPP countries to lower the likelihood of carmakers in non-TPP countries from taking advantage of the treaty.[477] However, there is a perception that the rules of origin that impact auto parts may not be sufficiently strong to protect auto parts suppliers in TPP countries.[478]

Another recent economic analysis conducted in Spring of 2016 from the Peterson Institute for International Economics (Peterson) projects that TPP will result in benefits, although more significant than those projected by the International Trade Commission.[479] This second analysis predicts that by 2030, the

466. *Id.*
467. *Id.*
468. *Id.*
469. *Id.*
470. *Id.* at 31–32, 232–54.
471. *Id.* at 31, 232.
472. *Id.* at 31.
473. *Id.*
474. *Id.* at 31, 232–36.
475. *Id.* at 31.
476. *Id.* at 31, 236–38.
477. INDUST. TRADE ADVISORY COMM., *supra* note 233, at 6.
478. *Id.* at 6–7.
479. PETER A. PETRI & MICHAEL G. PLUMMER, ECONOMICS OF THE TRANS-PACIFIC PARTNERSHIP: DISTRIBUTIONAL IMPACT (2016), https://piie.com/commentary/op-eds/economics-trans-

incomes of TPP countries will show a $465 billion USD annual increase (1.1 percent) and the exports of TPP countries will show a $1,025 billion USD annual increase (11.5 percent).[480] The United States economy is projected to have a $131 billion USD boost, in part based on a 9.1 percent increase in exports.[481] Although the United States is ahead of all TPP countries in the dollar figure gain, Vietnam is projected to have the largest percentage increase in real income, at 9.1 percent.[482] Other substantial beneficiaries are Japan, Malaysia, and Canada. Trade diversion is projected to have a slightly negative effect on China.[483]

The projected economic benefits may be different for different economic groups in the United States. For example, two economists analyzed the effects of trade on the United States economy for the twenty-year period from 1988 to 2008.[484] They found that there was a $720 billion USD benefit due to increased trade but that competition from imports suppressed wages by $140 billion USD.[485] Although the overall effect was positive, the top twenty percent of United States households received three-quarters of this gain.[486] Two other economists analyzed who are the winners and losers from the effects of trade.[487] They found a "pro-poor bias of trade."[488] What that means is that the poorest would lose sixty-three percent of their purchasing power if the country was closed off from international trade but, in contrast, the high-income individuals would lose twenty-eight percent.[489] The reason for this is that the poorest spend more on goods that are more traded and the wealthy spend a larger portion of disposable income on services, which are not so heavily traded.[490] The Peterson Spring 2016 report supports the pro-poor bias of trade.[491] Although a common belief is that TPP will benefit the wealthy, the recent analysis projected that TPP will slightly benefit the middle and lower classes more than the upper class and will have a substantial beneficial effect on the poorer developing countries.[492]

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pacific-partnership-distributional-impact.

480. *Id.*; *see also* Peter A. Petri & Michael G. Plummer, *The Economic Effects of the Trans-Pacific Partnership: New Estimates*, *in* PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS, ASSESSING THE TRANS-PACIFIC PARTNERSHIP; VOLUME 1: MARKET ACCESS AND SECTORAL ISSUES (Cathleen Cimino-Isaacs & Jeffrey J. Schott eds., 2016), https://piie.com/system/files/documents/piieb16-1.pdf.

481. PETRI & PLUMMER, *supra* note 479.

482. *Id.*

483. *Id.*

484. Gary Clyde Hufbauer & Tyler Moran, *Does Foreign Trade and Investment Reduce Average US Wages and Increase Inequality? (Part 2)*, TRADE & INV. POL'Y WATCH (Nov. 10, 2015), https://piie.com/blogs/trade-investment-policy-watch/does-foreign-trade-and-investment-reduce-average-us-wages-and.

485. *Id.*

486. *Id.*

487. *Id.*

488. Pablo D. Fajgelbaum & Amit K. Khandelwal, MEASURING THE UNEQUAL GAINS FROM TRADE 3 (2014), http://www.nber.org/papers/w20331.

489. *Id.*

490. *Id.*

491. PETRI & PLUMMER , *supra* note 479.

492. *Id.*

Vietnam's inclusion in TPP may have an interesting effect on the United States and on China. Vietnam's labor costs are twenty percent lower than labor costs in China and the Vietnamese population is becoming increasingly well-educated.[493] Vietnam is reportedly encouraging domestic firms to develop by protecting them from competition from China.[494] Vietnam may be able to improve economic efficiency by permitting presently state-owned enterprises to pass into private hands. The dynamism of the Vietnamese economy may be enhanced if it receives foreign direct investment.[495] In 2014, the United States collected $5.53 billion USD in tariff duties.[496] Because Vietnam had no free trade agreement with the United States, Vietnam paid 42.9 percent of that amount.[497] TPP will benefit Vietnam by significantly reducing the tariffs that Vietnam pays to the United States. One estimate is that the reduction in tariffs results in an 8.1 percent increase in the gross domestic product of Vietnam by the year 2030.[498] Vietnam's inclusion in TPP may result in Vietnam taking over some trade with the United States that would otherwise go to China.[499] For China, this may result in a zero to 0.1 percent decline in China's gross domestic product.[500]

Economists have been very interested in studying the potential effects of the various regional trade agreements.[501] China has become a big player in world trade with exports fueling its economy.[502] The volume of China's exports has made some countries leery of China because of China's imports competing strongly with domestic production.[503] Some have talked about China either joining TPP at some point or becoming an associate member of TPP.[504] One econometric study examined the effects of China being or not being a participant in TPP.[505] The study estimates that China not being a participant in TPP would raise outside demand, resulting in a growth of the exports and total production of the country, but that China would decrease imports.[506] In econometric terms, this would be a "welfare loss,"[507] but a relatively small one, for China because of the combination of the

493. Andrew Collier, *China Eyes Vietnam and the TPP Warily: Vietnam's economic growth, coupled with TPP, could spell trouble for Chinese companies*, DIPLOMAT (May 14, 2016), http://thediplomat.com/2016/05/china-eyes-vietnam-and-the-tpp-warily/.

494. *Id.*

495. *Id.*

496. *Id.*

497. *Id.*

498. *Id.*

499. *Id.*

500. *Id. See also* Rahel Aichele & Gabriel Felbermayr, *The Trans-Pacific Partnership Deal (TPP): What Are the Economic Consequences for In- and Outsiders?*, 16 CESIFO F. 53, 59 (2016), http://www.cesifo-group.de/portal/page/portal/DocB . . . pacific-december.pdf.

501. Chunding Li & John Whalley, *China's potential future growth and gains from trade policy bargaining: Some numerical simulation results*, 37 ECON. MODELLING 65, 65–66 (2014).

502. *Id.* at 65.

503. *Id.*

504. Li & Whalley, *supra* note 444, at 169.

505. *Id.*

506. *Id.* at 170.

507. *Id.*

growth in China's exports and the decline in China's imports. The situation would change if China were to be a participant in TPP. The effect for China as a participant would be significantly positive.[508]

## V. CONCLUSION

The TPP is a trade agreement with important geopolitical, strategic dimensions.[509] The United States continues as the market hegemon in trade.[510] The TPP is attractive to the United States because it promotes the United States integration into the Asian region, which holds a large portion of the world's population and has shown itself to be a region of dynamic economic growth.[511] The United States can better protect the investment interests of multi-national enterprises headquartered in the United States by having a stronger presence in Asia. If Congress were not to ratify the TPP, that action could very well signal a protectionist trend and isolate the United States from being a full participant in global trade.[512]

The United States needs to show its continuance as a world power in the region and might provide needed stability in Asia during a time that Asia is encountering substantial political, economic, and institutional changes.[513] With the United States solidifying the Asian American block, the world could be dominated by two blocks – Asian America on one side of the globe and Europe on the other.[514] The United States needs to become a party to a regional club that includes Asia during the time that other trade agreements are being negotiated.[515] The downside of TPP not being successful is that the United States may be foreclosing itself from participation in other clubs that might come into being in Asia.[516]

When considering the auto industry, TPP may have an overall beneficial effect on the consumer by lowering prices or keeping prices fairly constant even with rising prices of raw materials and increased safety and gas conservation requirements; TPP may have a negative effect in certain areas of the country that lose business because an automaker moves a portion of the manufacturing chain to another TPP country from the United States. Yet, a multinational enterprise, like a major automaker, may benefit from lower costs of auto components and the opening of new markets from the decrease in tariffs. A politician knows that a small number of people a trade measure affects to a greater extent, such as those in the auto component portion of the industry losing business, are more politically effective than a large number of people, such as auto consumers, all affected by a

508. *Id.*

509. Lewis, *supra* note 46, at 37; Bhala, *supra* note 450, at 2.

510. Emilie M. Hafner-Burton & Alexander H. Montgomery, *The Hegemon's Purse: No Economic Peace Between Democracies*, 45 J. PEACE RES. 111, 112 (2008).

511. Lewis, *supra* note 46, at 38–39.

512. GOTO, *supra* note 16.

513. Lewis, *supra* note 448, at 371; Bhala, *supra* note 450, at 20.

514. Lewis, *supra* note 448, at 412.

515. Lewis, *supra* note 46, at 51.

516. GOTO, *supra* note 16.

smaller amount. The political effectiveness of the smaller group is based on the fact that those who will lose from the TPP rules of origin for autos will be more vocal in their objections and are likely to lobby their representatives in Congress. Another factor is that the vast, but individually small, gains to consumers are transparent in that consumers typically do not realize that they are benefiting from a trade agreement in being able to take advantage of lower prices.

An econometric study published in 2014 analyzed the club goods effect of TPP. The study found that the TPP mostly has a positive effect on the members of the TPP club, although global free trade has a positive effect on nearly all countries, with the global free trade benefits considerably exceeding the benefits of the free trade effects of TPP.[517] TPP will increase the production, exports, and imports of all club members, with the largest gains received by the smaller countries.[518] For most of the non-club members, exports are estimated to increase and imports to decrease, with a decrease in welfare.[519] The 2014 study is consistent with the ITC and Peterson econometric analyses from the spring of 2016 as far as overall benefits are concerned and with the effect on non-club members. A word of caution is advisable concerning the effect on the suppliers of less complex auto parts. Those suppliers run the risk of stiff competition from other TPP members with lower labor costs.

Therefore, the conclusion is that the TPP will have an overall positive effect on the auto and suppliers of more sophisticated auto parts of the TPP parties. However, TPP may not have such a positive effect on the suppliers of the less complex auto parts. The effect of TPP will likely be slightly negative as far as China's auto and auto parts industries are concerned.

517. Li & Whalley, *supra* note 444, at 170.
518. *Id.* at 182.
519. *Id.* at 182.

# THE TRANS-PACIFIC PARTNERSHIP AGREEMENT AND STATES' RIGHT TO REGULATE UNDER INTERNATIONAL INVESTMENT LAW

*NOAM ZAMIR & PAUL BARKER

## I. INTRODUCTION

The Trans-Pacific Partnership Agreement (TPP),[1] which was signed in November 2015 by Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam, is said to establish new terms for trade and investment deals.[2] The TPP was intended to establish a free trade area in the Asia-Pacific covering nearly 40 percent of global GDP and a third of global trade.[3] The agreement also forms an integral part of broader geopolitical calculations in the region.[4] However, the TPP as currently drafted can only come into force if ratified by six or more of the States Parties representing at least 85% of the GDP of the twelve original signatories.[5] This prospect is now

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1. Trans-Pacific Partnership Agreement, UNCTAD/WEB/DITC/2016/3, http://unctad.org/en/PublicationsLibrary/webditc2016d3_en.pdf.

2. *See* Kevin Granville, *The Trans-Pacific Partnership, Explained*, THE NEW YORK TIMES (Aug. 20, 2016), http://www.nytimes.com/interactive/2016/business/tpp-explained-what-is-trans-pacific-partnership.html ('The Trans-Pacific Partnership, the largest regional trade accord in history, would set new terms for trade and business investment among the United States and 11 other Pacific Rim nations'); Mehreen Khan, *Why TPP is the most important acronym you've never heard of*', THE TELEGRAPH (Oct. 6, 2015), http://www.telegraph.co.uk/finance/economics/11913939/What-is-Trans-Pacific-Partnership-TPP-Obama-Japan.html; *see also* Office of the U.S. Trade Representative, *The Trans-Pacific Partnership*, https://ustr.gov/tpp/.

3. *See* Office of the U.S. Trade Representative, Overview of the Trans Pacific Partnership, https://ustr.gov/tpp/overview-of-the-TPP ("Through this agreement, the Obama Administration seeks to boost U.S. economic growth and support the creation and retention of high-quality American jobs by increasing exports in a region that includes some of the world's most robust economies and that represents nearly 40 percent of global GDP."); *see also* Granville, *supra* note 2 (stating "the United States and 11 other Pacific Rim nations — a far-flung group with an annual gross domestic product of nearly $28 trillion that represents roughly 40 percent of global G.D.P. and one-third of world trade.").

4. President Obama, *The TPP Would Let America, not China, lead the way on global trade*, THE WASHINGTON POST (May 2, 2016), https://www.washingtonpost.com/opinions/president-obama-the-tpp-would-let-america-not-china-lead-the-way-on-global-trade/2016/05/02/680540e4-0fd0-11e6-93ae-50921721165d_story.html ("The world has changed. The rules are changing with it. The United States, not countries like China, should write them. Let's seize this opportunity, pass the Trans-Pacific Partnership and make sure America isn't holding the bag, but holding the pen.").

5. Trans-Pacific Partnership Agreement, art. 30.5, UNCTAD/WEB/DITC/2016/3, http://unctad.org/en/PublicationsLibrary/webditc2016d3_en.pdf.

unlikely following the new U.S. administration's announcement in January 2017 that it will not ratify the treaty,[6] amidst a rising tide of anti-free trade sentiment around the world.[7] Nevertheless, other States Parties to the TPP continue to strive for ratification in one form or another,[8] and the TPP will arguably remain a benchmark for future trade deal negotiations.

The political response to, and widespread scepticism towards the TPP and other international investment agreements (IIAs) is complex and widely debated. This article will focus on one issue that has played an important role in framing the debate on the TPP: the potential impact of the TPP (and similar deals) on States' right to regulate public welfare under international investment law.

In response to a growing number of investment treaty arbitrations arising out of regulatory measures taken by host States, the recent trend in IIA practice[9] has been to include express language in the treaty preamble reaffirming the right to regulate, to provide greater guidance on the standards of investment protection as they apply to regulatory measures, and to carve out general exceptions, for example, measures taken for the protection of the environment, public health or financial stability.[10]

As the tribunal in *Lemire v. Ukraine*[11] stated, the host States enjoys an "inherent right to regulate (. . .) in order to protect the common good of its people."[12] Indeed, it is said that IIAs "may not be read as preventing States from *bona fide* regulation in the public interest"[13] and that it is necessary "to balance investment protection with competing policy objectives of the host State, and in particular, with its right to regulate in the public interest."[14] In a recent high profile award rejecting Philip Morris' claims against Uruguay relating to tobacco control measures, an eminent tribunal held that there is a "consistent trend" in awards and treaty practice differentiating an indirect expropriation from a non-compensable

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6. Peter Baker, *Trump Abandons Trans-Pacific Partnership, Obama's Signature Trade Deal*, NEW YORK TIMES (Jan. 23, 2017), https://www.nytimes.com/2017/01/23/us/politics/tpp-trump-trade-nafta.html?_r=0.

7. Martin Wolf, *The Tide of Gloablisation is Turning*, FINANCIAL TIMES (Sept. 6, 2016), https://www.ft.com/content/87bb0eda-7364-11e6-bf48-b372cdb1043a.

8. Jason Scott, Australia Strives for 'TPP Minus 1' After Trump Withdraws, REUTERS (Feb. 7, 2017), https://www.bloomberg.com/news/articles/2017-02-07/australia-striving-for-tpp-minus-1-after-trump-s-withdrawal.

9. *Recent Trends in IIAs and ISDS* - IIA Issues Note No.1, UNCTAD (Feb. 2015), http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d1_en.pdf.

10. *Id.* at 3.

11. Joseph Charles Lemire v. Ukraine, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability (Jan. 14, 2010).

12. *Id.* ¶ 505.

13. *Expropriation – A Sequel - UNCTAD Series on Issues in International Investment Agreements II*, UNCTAD (2012), 85, http://unctad.org/en/Docs/unctaddiaeia2011d7_en.pdf [hereinafter Expropriation – A Sequel].

14. *Fair and Equitable Treatment - UNCTAD Series on Issues in International Investment Agreements II*, UNCTAD (2012), xiii, http://unctad.org/en/Docs/unctaddiaeia2011d5_en.pdf.

regulatory measure.[15] However, the circumstances in which a host State may still be obliged to compensate a foreign investor for a regulatory measure having an economic impact on a protected investment remain contested. In *Daimler v. Argentina*[16], for example, the Tribunal agreed that host States have the right to regulate the economy as they see fit, but held that:

> [W]here Argentina elects to exercise its powers in a manner that contravenes one of Argentina's voluntarily assumed international obligations to German investors under the German-Argentine BIT, and where such contravention specifically harms the Claimant's investment, Argentina must compensate the Claimant for the violation.[17]

Against this background, critics of investment treaty arbitration assert that tribunals illegitimately interfere with States' core public policy prerogatives and that an award of damages against host States can have a "chilling effect on future governmental conduct by preventing governments from adopting certain courses of action for fear of future liability."[18] These concerns have translated into heightened public scrutiny of investment treaty arbitration awards and of IIA negotiations, including the TPP.[19]

Accordingly, this paper seeks to establish the extent to which the States Parties to the TPP have negotiated the treaty's language to address concerns regarding their right to regulate, and how consistent this has been with the efforts of non-TPP parties, such as the European Union, in their treaty negotiations. As the current uncertainty surrounding the TPP's ratification partly demonstrates, it remains an open question whether the contents of the TPP's investment protection chapter will be sufficient to secure the confidence of all stakeholders.

It has been suggested elsewhere that the TPP's Investment Chapter sets a new worldwide standard.[20] We suggest that the Investment Chapter is nevertheless

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15. Philip Morris Brands Sàrl, Philip Morris Products SA, Abal Hermanos SA v. Uruguay, ICSID Case No. ARB/10/7, Award ¶ 295 (July 8, 2016).

16. Daimler Financial Services AG v. Argentina, ICSID Case No ARB/05/1, Award (Aug. 22, 2012).

17. *Id.* ¶ 100.

18. Anthea Roberts, *The Present – Investment Arbitration as a Governance Tool for Economic International Relations? The Next Battleground: Standards of Review in Investment Treaty Arbitration, in* ALBERT JAN VAN DEN BERG (ED.), ARBITRATION: THE NEXT FIFTY YEARS, ICCA CONGRESS SERIES 16, 170 (2011).

19. *See, e.g.*, Cecilia Olivet and Alberto Villareal, *Who really won the legal battle between Philip Morris and Uruguay?*, THE GUARDIAN (Jul. 28, 2016), https://www.theguardian.com/global-development/2016/jul/28/who-really-won-legal-battle-philip-morris-uruguay-cigarette-adverts; Mark Weisbrot, *Trans-Pacific Partnership Agreements Run Into Serious Resistance Due to Public Scrutiny*, HUFFINGTON POST (Nov. 19, 2013), http://www.huffingtonpost.com/mark-weisbrot/trans-pacific-partnership_b_4303066.html.

20. Melida Hodgson, *The Trans-Pacific Partnership inestment chapter sets out a new worldwide standard*, COLUMBIA FDI PERSPECTIVES ON TOPICAL FOREIGN DIRECT INVESTMENT ISSUES BY COLUMBIA CENTER ON SUSTAINABLE DEVELOPMENT, No. 160 (Nov. 9, 2015), http://ccsi.columbia.edu/files/2013/10/No-160-Hodgson-FINAL.pdf.

broadly consistent (and in parts entirely derivative of) the approach taken by the U.S. for over ten years. Although States Parties to the TPP appear to have reacted to particular investment treaty arbitration claims or awards – as well as perhaps to general legitimacy concerns regarding how investment agreements constrain host State regulatory space – the TPP represents an evolution rather than revolution in the drafting of IIAs.[21] Indeed, as set out below, the TPP is largely consistent with the 2012 U.S. Model BIT[22] and recent U.S. IIAs, and notably seeks to preserve the status quo by retaining ad hoc arbitration as the mechanism for resolving investor-State disputes.[23] By contrast, new EU investment treaties, including the EU-Canada Comprehensive Economic and Trade Agreement (CETA), have replaced investment treaty arbitration with a standing international investment court.[24]

This paper is structured as follows: Section II briefly explains the main features of international investment law and the debates regarding the legitimacy of this legal regime in light of its effect on States' regulatory power; Section III examines the main provisions of Chapter 9, the Investment Chapter of the TPP, which address States Parties' regulatory power, and highlights how some of these provisions were drafted in direct response to certain controversial treaty claims and awards. This reaction is manifest in three main respects: (1) express language asserting the inherent rights of States to regulate in the public interest; (2) denial of benefits clauses excluding specific types of claim, such as tobacco regulations; and (3) more detailed guidance in order to limit tribunal discretion in the interpretation of the standards of protection in the treaty. Section IV concludes this paper.

## II. THE MAIN FEATURES OF INTERNATIONAL INVESTMENT LAW AND THE LEGITIMACY DEBATES REGARDING THIS REGIME

International investment law is a branch of public international law that governs the protection of foreign investments in host States.[25] IIAs are the primary source of international investment law and establish certain substantive standards of investment protection, including fair and equitable treatment ("FET") and compensation for acts of expropriation.[26] The majority of the more-than-3,200 IIAs

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21. *Id.*

22. 2012 U.S. Model BIT, *Annex B (Expropriation)*, https://ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf.

23. TPP, *supra* note 1, ch. 9, sec. B (Investor-State Dispute Settlement).

24. European Comm'n Press Release IP/16/399, CETA: EU and Canada agree on new approach on investment in trade agreement (Feb. 29, 2016), http://trade.ec.europa.eu/doclib/press/index.cfm?id=1468.

25. International Investment Law and Arbitration, ROSTRUMLEGAL, http://rostrumlegal.com/course/international-investment-law-arbitration/ (stating "International investment law is a branch of public international law which governs foreign direct investment and the resolution of disputes between foreign investors and sovereign states").

26. Andrew Newcombe & Lluís Paradell, LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT 1, 70–71, (2009), http://www.italaw.com/documents/NewcombeandParadellLawandPracticeofInvestmentTreaties-Chapter1.pdf.

worldwide are bilateral investment treaties (BITs), which as the name suggests are concluded between two States.[27] There are also a growing number of free trade agreements ("FTAs") that contain foreign investment protection provisions in addition to establishing free trade areas. These may be bilateral or multilateral, such as the North American Free Trade Agreement ("NAFTA"),[28] the Energy Charter Treaty[29] and the TPP itself.

Investor-State disputes are typically heard by an international arbitration tribunal.[30] The creation of a neutral forum for the settlement of disputes between investors and States is a key feature of the modern system of international investment protection. Whereas the jurisdiction of international commercial arbitration tribunals is based on an arbitration clause in a contract between the parties,[31] the claimant investor in an investment treaty arbitration is not a party to the IIA. Rather, the arbitration clause in the IIA contains an offer by the host State to arbitrate investment disputes; the investor accepts this offer by filing a request for arbitration.[32] This procedure for investor-State dispute settlement has famously been described as "arbitration without privity."[33] As discussed below, the use of arbitration for investor-State dispute settlement is not without its critics.[34] Indeed, the recently signed but not yet effective EU-Vietnam FTA,[35] and the EU-Canada CETA, both replace investor-State arbitration with a standing international investment court.[36]

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27. *See* International Investment Agreements Navigator, INVESTMENT POLICY, http://investmentpolicyhub.unctad.org/IIA (stating there are 2958 BITS in total, 2324 of them are in force).

28. North American Free Trade Agreement, 32 I.L.M. 289 (1992), ch. 11 (Dec. 17).

29. Energy Charter Treaty, Dec. 17, 1994, 2080 U.N.T.S. 95, part III.

30. *Investor-State" Disputes in Trade Pacts Threaten Fundamental Principles of National Judicial Systems*, CITIZEN.ORG, https://www.citizen.org/documents/isds-domestic-legal-process-background-brief.pdf.

31. *Standard ICC Arbitration Clauses*, INT'L CHAMBER OF COMMERCE, http://www.iccwbo.org/products-and-services/arbitration-and-adr/arbitration/standard-icc-arbitration-clauses/.

32. *How to file a Request for Arbitration* – ICSID Convention Arbitration, ICSID, https://icsid.worldbank.org/apps/ICSIDWEB/process/Pages/How-to-File-a-Request-for-Arbitration-Convention.aspx.

33. *See* Jan Paulsson, *Arbitration without Privity*, 10 ICSID REV. 232 (1995).

34. *See, e.g.*, Matthew Rimmer, *A Supplementary Submission to the Joint Standing Committee on Treaties the Korea-Australia Free Trade Agreement* 5, https://works.bepress.com/matthew_rimmer/202/ (stating that "investor-state arbitration raises some profoundly troublesome political issues regardless of arbitrator discretion"); Danny Vinik, *Why Obama Is Spurning Liberals With a Massive Trade Deal*, NEW REPUBLIC (April 7, 2015), https://newrepublic.com/article/121476/trans-pacific-partnership-foundation-all-future-trade-deals (stating that international investment arbitration "gives extraordinary new privileges and powers and rights to just one interest. Foreign investors are privileged vis-a-vis domestic companies, vis-a-vis the government of a country, [and] vis-a-vis other private sector interests").

35. EU-Vietnam Free Trade Agreement: Agreed text as of January 2016, EUROPEAN COMM'N, http://trade.ec.europa.eu/doclib/press/index.cfm?id=1437.

36. Comprehensive and Economic Trade Agreement, E.U.-Can. (unratified as of Feb. 2017), ch.

This combination of substantive and procedural protections for foreign investors has resulted in a robust and far-reaching legal regime.[37] Indeed, investment treaty arbitration has been analogized to judicial review or to an international human rights court.[38] Arbitral tribunals scrutinise the sovereign conduct of the executive, legislative, or judicial branches of host States to assess compliance with the standards of protection set out in the relevant IIA.[39] It is a potent mechanism: to date, several tribunals have ordered the respondent State to pay investors over a billion U.S. dollars in compensation for treaty violations.[40] Additionally, notorious inconsistencies notwithstanding, the sheer volume of claims and resulting arbitral awards has revolutionised the practice of public international law in little over fifteen years.[41]

There is an inherent tension between State regulatory power and investment treaty arbitration. By entering into IIAs, States consent to delegate some of their sovereignty to an international tribunal to determine when an investor is entitled to compensation for an attributable sovereign act.[42] The rub is that most investment treaty claims today do not concern bright-line cases of direct expropriation – a government's takeover of a factory plant, for example – but may seek to impugn general regulatory measures directed at environmental protection, public health, prudential economic regulation or other key public welfare interests.[43] This entails obvious economic and political implications for respondent States. As practitioner Toby Landau explains:

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8: Investment, art. 8.27, available at http://ec.europa.eu/trade/policy/in-focus/ceta/ceta-chapter-by-chapter/ [hereinafter CETA].

37. Investor-State Dispute Settlement: Review of Developments in 2015 - IIA Issues Note No.2, UNCTAD (July 2016), http://investmentpolicyhub.unctad.org/Upload/ISDS%20Issues%20Note%202016.pdf ("A record high of 70 investor-State dispute settlement (ISDS) cases were filed in 2015. The overall number of publicly known ISDS claims reached 696. Following the recent trend, a high share of new cases in 2015 (about 40 per cent) was brought against developed countries, including many cases by European investors against European Union member States.").

38. Paul Barker, *Investor-State Arbitration as International Public Law: Deference, Proportionality and the Standard of Review, in* INVESTMENT TREATY ARBITRATION AND INTERNATIONAL LAW 244 (I. Laird & T. Weiler eds., 2015).

39. *Id.* at 244–245.

40. *See, e.g.*, Occidental Petroleum Corporation and Occidental Exploration and Production Company v. the Republic of Ecuador, Case No. ARB/06/11, Award, ICSID Arbitral Tribunal, 308 (Oct. 5, 2012); Hulley Enterprises Ltd. (Cyprus) v. The Russian Federation, PCA Case No. AA 226, Final Award, UNCITRAL, 577 (July 18, 2014); Venezuela Holdings, B.V., et al. (case formerly known as Mobil Corporation, Venezuela Holdings, B.V., Mobil Cerro Negro Holding, Ltd., Mobil Venezolana de Petróleos Holdings, Inc., Mobil Cerro Negro, Ltd., & Mobil Venezolana de Petróleos, Inc.) v. Bolivarian Republic of Venezuela, Case No. ARB/07/27, Award, ICSID Arbitrual Tribunal, 133 (Oct. 9, 2014).

41. Barker, *supra* note 38, at 235–36.

42. *Id.*

43. Paul Barker, *Legitimate Regulatory Interests: Case Law and Developments in IIA Practice, in* REASSERTION OF CONTROL OVER THE INVESTMENT TREATY REGIME 232–33 (Andreas Kulick ed., 2016).

> Your mandate [as an arbitrator in investment arbitration case] unlike commercial arbitration is to review the exercise of discretion by a sovereign by way of its executive, its legislative even its judiciary. [. . .] You are supposedly to rule upon the interest of an individual investor and yet in doing so, you may well impact upon a whole community [. . .] And, you do so with the ability to impose damages unlike many public law municipal systems and those damages may be significant. You have the power to affect the most extraordinary allocation of public funds.[44]

Indeed, investor-State tribunals have recently considered *inter alia*: emergency powers exercised during national economic crises;[45] the regulation of public utilities;[46] the regulation of harmful substances;[47] the protection of cultural property or heritage;[48] and non-discrimination and affirmative action policies.[49] Two claimants in particular have caught the public's attention:[50] Phillip Morris,

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44. Toby Landau, Response to the Report, Rethinking the Substantive Standards of Protection Under Investment Treaties (Dec. 14, 2010), 367–68, https://pca-cpa.org/wp-content/uploads/sites/175/2016/01/Mauritius-International-Arbitration-Conference-2010.pdf.

45. CMS Gas Transmission Co v. Argentina, Case No. ARB/01/8, Award, ICSID Arbitral Tribunal, 108 (May 12 2005); LG&E Energy Corp, LG&E Capital Corp, LG&E International Inc v. Argentina, Case No. ARB/02/1, Decision on Liability, ICSID Arbitral Tribunal, 29 (Oct. 3, 2006); Sempra Energy International v. Argentina, Case No ARB/02/16, Award, ICSID Arbitral Tribunal, 72-73 (Sept 28, 2007); Enron Corp and Ponderosa Assets, LP v. Argentina, Case No ARB/01/3, Award, ICSID Arbitral Tribunal, 59 (May 22, 2007); BG Group plc v. Argentina, Case No ARB/03/9, Final Award, UNCITRAL Arbitral Tribunal, 115 (Dec. 24, 2007); Continental Casualty Co v. Argentina, Case No. ARB/03/9, Award, ICSID Arbitral Tribunal, 122 (Sept. 5, 2008); National Grid plc v. Argentina, Award, UNCITRAL Arbitral Tribunal, 96–97 (Nov. 3, 2008); Suez, Sociedad General de Aguas de Barcelona SA, InterAguas Servicios Integrales del Aguas SA v. Argentina, Case No. ARB/03/17, Award, ICSID Arbitral Tribunal, 90–91 (July 30, 2010); Daimler Financial Services AG, *supra* note 14; Poštová & ISTROKAPITAL SE v. Hellenic Republic, Case No. ARB/13/8, Award, ICSID Arbitral Tribunal, (Apr. 9, 2015); Cyprus Popular Bank Public Co. Ltd v. Hellenic Republic, Case No. ARB/14/16, ICSID Arbitral Tribunal.

46. *See* Biwater Gauff (Tanz.) Ltd. v. United Republic of Tanz., ICSID Case No. ARB/05/22, Award (July 24, 2008), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1589_En&caseId=C67; Aguas del Tunari S.A. v. Republic of Bol., ICSID Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction (Oct. 21, 2005), 16 ICSID Rep. 303 (2005).

47. *See* Methanex Corp. v. United States, Final Award of the Tribunal on Jurisdiction and Merits, NAFTA Arbitral Trib., 16 ICSID Rep. 40 (2005).

48. *See* S. Pac. Properties (Middle East) Ltd. v. Arab Republic of Egypt, ICSID Case No. ARB/84/3, Award (May 20, 1992), 3 ICSID Rep. 189 (1992); Glamis Gold, Ltd. v. United States, Award, NAFTA Arbitral Trib., http://www.state.gov/documents/organization/125798.pdf.

49. *See* Piero Foresti v. Republic of South Africa, ICSID Case No. ARB(AF)/07/1, Award (Aug. 4, 2010), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1651_En&caseId=C90.

50. European Comm'n, *Fact sheet: Investment Protection and Investor-to-State Dispute Settlement in EU agreements* 5 (Nov. 2013), http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151916.pdf.

which introduced two claims (both recently dismissed) against Australia and Uruguay relating to public health measures (tobacco plain-packaging legislation);[51] and Vattenfall, which commenced an arbitration under the Energy Charter Treaty against Germany for the termination of that country's nuclear energy programme following the Fukushima disaster.[52]

States have been recalibrating their IIAs in response to the rapidly developing body of international investment law.[53] In recent years, States have sought to reassert control over the international investment law regime when drafting new investment treaties, for example by limiting tribunals' discretion in the interpretation of the FET treatment and indirect expropriation standards of protection.[54] Respondent States have consistently argued in arbitral proceedings that IIAs do not impose liability for *bona fide* and non-discriminatory measures affecting foreign investors.[55] However, the series of awards finding Argentina liable for FET violations arising out of measures taken during its financial crisis,[56] and the recent NAFTA award in *Bilcon v. Canada*,[57] demonstrate how potentially far-reaching a tribunal's review of host State regulatory measures can be.

The right to regulate is centre-stage in the current negotiation of major IIAs.[58] For example, responding to widely publicised concerns, the European Commission's policy is that all future EU IIAs will provide a detailed set of provisions giving guidance to tribunals, "[i]n particular, [that] when the state is protecting the public interest in a non-discriminatory way, the right of the state to regulate should prevail over the economic impact of those measures on the

51. Philip Morris Brands Sàrl, *supra* note 15 (dismissing Philip Morris' claims on the merits, finding that the measures were a reasonable bona fide exercise of police powers for the protection of public health, were not arbitrary, grossly unfair, unjust, discriminatory or disproportionate, and were therefore non-compensable); Philip Morris Asia Ltd. (Hong Kong) v. Commonwealth of Australia, PCA Case Repository Case No. 2012-12, Award on Jurisdiction and Admissibility (Dec. 17, 2015), https://www.pcacases.com/web/sendAttach/1711 (dismissing Philip Morris' claims on jurisdictional grounds).

52. Vattenfall AB v. Germany, ICSID Case No. ARB/12/12, Notice of Arbitration (May 31, 2012).

53. *See* Policy Options for IIA Reform: Treaty Examples and Data, UNCTAD (June 25, 2015), http://investmentpolicyhub.unctad.org/Upload/Documents/Policy-options-for-IIA-reform-WIR-2015.pdf.

54. *Id.* at 11–13.

55. *See* the submissions of States in, *e.g.*, Pope & Talbot, Inc. v. Government of Canada, Interim Award, NAFTA Arbitral Trib. (June 26, 2000), http://www.naftaclaims.com/disputes/canada/pope/pope-phase-10.pdf; Saluka Investments B.V. v. Czech Republic, Case No. 2001-04, Partial Award, Perm. Ct. Arb. (Mar. 17, 2006), https://pcacases.com/web/sendAttach/880; Philip Morris Brands Sàrl, *supra* note 15.

56. *See e.g.* CMS Gas Transmission Co., *supra* note 46; LG&E Energy Corp., *supra* note 46; Sempra Energy Int'l, *supra* note 46; Enron Corp. and Ponderosa Assets, LP, *supra* note 46; BG Group Plc., *supra* note 46; Continental Casualty Co., *supra* note 46; National Grid P.L.C., *supra* note 46.

57. William Ralph Clayton, William Richard Clayton, Douglas Clayton, Daniel Clayton & Bilcon of Delaware Inc. v. Canada, Case No. 2009-04, Award on Jurisdiction and Liability, Perm. Ct. Arb. (Mar. 17, 2015), https://pcacases.com/web/sendAttach/1287.

58. European Comm'n, *supra* note 50, at 2.

investor."[59] In February 2016, an express right to regulate provision was added to a revised text of the CETA.[60] As discussed further below, in contradistinction to the dispute settlement mechanism agreed by the States Parties to the TPP, the EU is also demanding that its IIA counterparties replace arbitration with a new standing investment court and appellate mechanism on the grounds that it will safeguard EU Member States' right to regulate.[61] Both the revised CETA text and EU-Vietnam FTA concluded in December 2015 incorporate the EU's proposed investment court system.[62]

These developments raise the prospect of regional divergence or fragmentation of international investment law as States respond differently to arbitral awards and criticisms of the regime. Indeed, the ICJ judge and eminent arbitrator, James Crawford, has stated that:

> Some would say investment arbitration has reached its half-life. Emerging from, or in reaction against, earlier inter-state forms [diplomatic protection, FCN treaties] it has a kind of 'boom-and-bust' feel to it. Ad hoc tribunals have produced an erratic pattern of decisions, with reasoning often impressionistic and displaying a certain disregard for state regulatory prerogatives. This is leading in turn to a reaction by some host states. Meantime there is much that is uncertain and unpredictable.[63]

States' assertion of their right to regulate under international investment law has coincided with increasing public opposition to IIAs on the grounds that they undermine the host State's right to regulate in the public interest.[64]

As demonstrated in the section below, the States Parties to the TPP have likewise reacted to the prevailing concerns regarding their right to regulate. However, the TPP member States appear to have favoured evolution rather than wholesale change to the basic features of the regime of international investment law.[65]

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59. European Comm'n, *supra* note 50, at 2, 7–8.

60. CETA, *supra* note 36, art. 8.9. .

61. European Comm'n Press Release MEMO/15/6060, Why the new EU proposal for an Investment Court System in TTIP is beneficial to both States and investors (Nov. 12, 2015).

62. European Comm'n, *EU-Vietnam Free Trade Agreement Now Available Online*, TRADE (Jan. 29, 2016), http://trade.ec.europa.eu/doclib/press/index.cfm?id=1449; European Comm'n Press Release IP/16/399, CETA: EU and Canada agree on new approach on investment in trade agreement (Feb. 29, 2016).

63. James Crawford, *Foreword* to ZACHARY DOUGLAS, THE INTERNATIONAL LAW OF INVESTMENT CLAIMS xxi (Cambridge Univ. Press 2009).

64. Andrew Walker, *TTIP: Why the EU-US trade deal matters*, BBC.COM (May 13, 2015), http://www.bbc.com/news/business-32691589.

65. *See* Alexander W. Resar, *The Evolution of Investor-State Arbitration in the Trans-Pacific Partnership Agreement*, 34 BERKELY J. INT'L L. 159 (2016).

## III. STATES' RIGHT TO REGULATE AND THE TPP'S INVESTMENT CHAPTER

The TPP would empower a protected investor (either an individual or corporation) from one of the States Parties to commence international arbitration against the government of another TPP party for measures violating the broad standards of investment protection set out in the Investment Chapter.[66] The Obama Administration argued that:

> TPP will result in higher levels of labor and environmental protections in most TPP countries than they have today. [. . .] We can't change the standards in the more than 3,000 agreements among other countries. Most of those agreements will continue to exist, with or without TPP. But through TPP, we can set a new, higher set of standards, stronger safeguards and better transparency provisions.[67]

The States Parties to the TPP have sought to safeguard their right to regulate in their drafting of the Investment Chapter, which provides: (i) express language asserting the inherent rights of states to regulate in the public interest;[68] (ii) denial of benefits clauses excluding specific types of claim, such as tobacco regulations;[69] and (iii) more detailed guidance in order to limit tribunal discretion in the interpretation of the standards of protection.[70] To that extent, the Investment Chapter is consistent with the approach taken in other IIAs, in particular recent U.S. treaties.[71]

It remains to be seen whether the TPP's articles addressing host States' right to regulate will have a substantive impact on tribunal rulings. It is significant, however, that the States Parties to the TPP have not done away with the essential features of the investment treaty regime, for example by retaining investor-State arbitration.[72] Indeed, the final agreed language of the Investment Chapter could be interpreted as an affirmation by the States Parties of the basic legitimacy of international investment law and broad acceptance of its development by arbitral tribunals rather than an attempt to overhaul the entire system from the top down.

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66. TPP, *supra* note 1, ch. 9, art. 9.12.

67. Jeffrey Zients, *Investor-State Dispute Settlement (ISDS) Questions and Answers*, THE WHITE HOUSE: BLOG (Feb. 26, 2015), http://www.whitehouse.gov/blog/2015/02/26/investor-state-dispute-settlement-isds-questions-and-answers.

68. TPP Made in America: 9 Investment, USTR, https://ustr.gov/sites/default/files/TPP-Chapter-Summary-Investment.pdf (last visited Dec. 18, 2016).

69. TPP, *supra* note 1, ch. 9, art. 9.15.

70. *See* TPP, *supra* note 1, ch. 9.

71. *See* Todd Allee & Andrew Lugg, *Who wrote the rules for the Trans-Pacific Partnership?*, RESEARCH & POLITICS (July-Sep. 2016), http://rap.sagepub.com/content/3/3/2053168016658919.full.pdf+html.

72. Shawn Donnan, *U.S. looks to TPP to reform arbitration system*, FINANCIAL TIMES (Nov. 8, 2015), https://www.ft.com/content/d7379996-862b-11e5-90de-f44762bf9896.

### *A. The use of express language asserting the inherent right of States to regulate in the public interest*

The TPP contains express provisions on the right to regulate for the public welfare and public health, the environment, and for financial stability. The TPP's Preamble provides:

> [The Parties recognize] their inherent right to regulate and resolve to preserve the flexibility of the Parties to set legislative and regulatory priorities, safeguard public welfare, and protect legitimate public welfare objectives, such as public health, safety, the environment, the conservation of living or non-living exhaustible natural resources, the integrity and stability of the financial system and public morals.[73]

Although the Preamble is non-binding, this language may be consequential. Pursuant to the rules of treaty interpretation codified in Article 31 of the Vienna Convention on the Law of Treaties (VCLT)[74], a tribunal should consider the context of the terms used and the treaty's object and purpose.[75] Article 31(2) of the VCLT expressly provides that the preamble is part of the context for the purpose of the interpretation of a treaty.[76] On this basis, certain tribunals have justified broad interpretations of investor protections on the basis of language in the IIA preamble stating the object and purpose of the treaty to be investment promotion and protection.[77]

The substantive standards of protection in the TPP also include express language on the right to regulate. Article 9.16 provides:

> Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental, health or other regulatory objectives.[78]

This provision is consistent with the argument that the United States has successfully made in defending NAFTA claims that a non-discriminatory regulation aimed at the general welfare will not ordinarily violate IIA standards.[79] Although Article 9.16 is arguably a signal that States intend for international

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73. TPP, *supra* note 1, at Preamble.

74. Vienna Convention on the Law of Treaties art. 31, opened for signature May 23, 1969, 1155 U.N.T.S. 331.

75. *Id.*

76. *Id.* art. 31(2).

77. *See, e.g.*, Metalclad Corp. v. United Mexican States, ICSID Case No. ARB(AF)/97/1, Award, ¶¶ 70, 76 (Aug. 30, 2000), 5 ICSID Rep. 212 (2000); Lauder v. Czech Republic, Final Award, UNCITRAL Arbitral Trib., (Sept. 3, 2001), http://www.italaw.com/documents/LauderAward.pdf.

78. TPP, *supra* note 1, ch. 9, art. 9.16.

79. *See* Glamis Gold, Ltd. v. United States, Counter Memorial of Respondent United States of America 197, UNCITRAL Arbitral Trib. (Sept. 19 2006), http://www.state.gov/documents/organization/73686.pdf.

tribunals to show deference in their review of non-discriminatory *bona fide* regulatory measures, it has been criticized for the perhaps circular language stating that regulatory measures must still be consistent with the provisions of the Investment Chapter.[80] Indeed, in finding Argentina liable to pay compensation, the tribunal in *Daimler*[81] did not deny that States have a right to regulate in accordance with their international obligations.[82]

### *B. General exceptions and denial of benefits clauses excluding specific types of claim, such as tobacco regulations*

Chapter 29 sets out the Exceptions and General Provisions to the TPP.[83] Article 29.3 of Chapter 29 provides that "temporary safeguard measures" are permitted in response to a financial crisis, for example "serious balance of payments and external financial difficulties or threats thereof[,]" or where capital movements cause or threaten to cause "serious difficulties for macroeconomic management."[84] Hodgson suggests that "the shadow of the Argentina investment jurisprudence looms large – various Asian-Pacific countries themselves had to deal with a scarring financial crisis around the same time."[85] Any measure taken pursuant to Article 29.3 must, however, not be inconsistent with the National Treatment, Most-Favoured-Nation Treatment and Expropriation provisions of the Investment Chapter, and must not *inter alia* exceed 18 months in duration (subject to the right to seek an extension from the other TPP States Parties).[86]

As expected, the TPP contains an express carve out for tobacco control measures at Article 29.5.[87] This innovative denial of benefits clause is a direct response to the controversial (and recently dismissed) treaty claims brought by Philip Morris, a global cigarette and tobacco company, against Australia and Uruguay relating to tobacco plain-packaging legislation enacted on public health grounds.[88] In order to protect the TPP member states against such claims, Article 29.5 provides that:

> A Party may elect to deny the benefits of Section B of Chapter 9 (Investment) with respect to claims challenging a tobacco control measure of the Party. Such a claim shall not be submitted to arbitration

80. Amokura Kawharu, *Expert Paper #2 TPPA: Chapter 9 on Investment*, WORDPRESS.COM: TPP LEGAL (Dec. 2015), at 9, https://tpplegal.files.wordpress.com/2015/12/ep2-amokura-kawharu.pdf.

81. *See* Daimler Financial Services AG, *supra* note 16.

82. *See* Daimler Financial Services AG, *supra* note 16, ¶ 100.

83. TPP, *supra* note 1, ch. 29.

84. TPP, *supra* note 1, art. 29.3.

85. Hodgson, *supra* note 20, at 1.

86. *See* TPP, *supra* note 1, ch. 9, art. 9.4–9.5, ch. 10, art. 10.3–10.4, ch. 11, art. 11.3–11.4.

87. TPP, *supra* note 1, at ch. 29, art. 29.5.

88. Philip Morris Brands Sàrl, *supra* note 15 (rejecting claimants arguments, with a partial dissenting opinion of Gary Born); Philip Morris Asia Ltd., *supra* note 52; *see* IA Reporter story, http://www.iareporter.com/articles/breaking-australia-prevails-in-arbitration-with-philip-morris-over-tobacco-plain-packaging-dispute/ (in which the tribunal dismissed Philip Morris' claims on jurisdictional grounds).

> under Section B of Chapter 9 (Investment) if a Party has made such an election. If a Party has not elected to deny benefits with respect to such claims by the time of the submission of such a claim to arbitration under Section B of Chapter 9 (Investment), a Party may elect to deny benefits during the proceedings. For greater certainty, if a Party elects to deny benefits with respect to such claims, any such claim shall be dismissed.[89]

Prior awards have taken contrasting views on whether denial of benefits clauses operate retrospectively[90] or with prospective effect only.[91] By contrast, Article 29.5 makes clear that a host State may elect to deny benefits after an investor has brought a dispute.[92] It is notable that in contrast to Article 29.5, the denial of benefits provision in Article 9.15 does not contain such language.[93] It is therefore arguable whether a respondent State can invoke Article 9.15 after the

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89. TPP, *supra* note 1, ch. 29, art. 29.5 Tobacco control measures are defined in footnote 12 to Chapter 29 as follows:

> . . . a measure of a Party related to the production or consumption of manufactured tobacco products (including products made or derived from tobacco), their distribution, labeling, packaging, advertising, marketing, promotion, sale, purchase, or use, as well as enforcement measures, such as inspection, recordkeeping, and reporting requirements. For greater certainty, a measure with respect to tobacco leaf that is not in the possession of a manufacturer of tobacco products or that is not part of a manufactured tobacco product is not a tobacco control measure.

90. Ulysseas, Inc. v. Ecuador, Interim Award, ¶ 173, UNCITRAL Arbitral Trib. (Sept. 28, 2010), http://www.italaw.com/sites/default/files/case-documents/ita1045.pdf (stating that the tribunal sees "no valid reasons to exclude retrospective effects" of the denial of benefits provision, reasoning that the very existence of a denial of benefits provision in an investment agreement alerts potential investors that "the protection afforded by the [investment treaty] is subject during the life of the investment to the possibility of a denial of the [investment treaty's] advantages").

91. Plama Consorium Ltd. v. Republic of Bulgaria, ICSID Case No. ARB/03/24, Decision on Jurisdiction, ¶¶ 159–65 (Feb. 8, 2005), 13 ICSID Rep. 272; Veteran Petroleum Ltd. (Cyprus) v. Russian Federation, Case No. 2005/05/AA228, Interim Award on Jurisdiction and Admissibility, ¶¶ 514–15, Perm. Ct. Arb., (Nov. 30, 2009), https://pcacases.com/web/sendAttach/423; *see also* Philip Morris Asia Ltd., *supra* note 52, ¶¶ 38, 58; Liman Caspian Oil BV & NCL Dutch Investment BV v. Republic of Kazakhstan, ICISD Case No. ARB/07/14, Excerpts of the Award, ¶ 225, (June 22, 2010), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC3392_En&caseId=C106.

92. TPP, *supra* note 1, ch. 29, art. 29.5.

93. TPP, *supra* note 1, ch. 9, art. 9.15 states:

> 1. A Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of that other Party and to investments of that investor if the enterprise: (a) is owned or controlled by a person of a non-Party or of the denying Party; and (b) has no substantial business activities in the territory of any Party other than the denying Party.
>
> 2. A Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of that other Party and to investments of that investor if persons of a non-Party own or control the enterprise and the denying Party adopts or maintains measures with respect to the non-Party or a person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments.

commencement of the proceedings.[94] It also remains unclear whether arbitral tribunals interpreting other IIAs may consider that the denial of benefits clause in that IIA cannot be invoked after the start of the proceedings where the clause does not contain the type of express language found in Article 29.5.

### *C. Detailed provisions regarding investment protection standards*

Earlier generations of IIAs are typically skeletal documents of little more than ten pages, setting out "provisions for investor rights without addressing in a comprehensive fashion the relationship of these to continuing powers of State regulation."[95] However, since around the turn of the century, newer IIAs have sought to clarify that they "do not purport to promote and protect investment at the expense of other key values such as health, safety, labour protection and the environment."[96] The result is that newer IIAs contain more detailed drafting. By contrast to the skeletal treaties of old,[97] the TPP's Investment Chapter is 54 pages long.[98]

The TPP's Investment Chapter generally tracks the approach of recent U.S. BITs and FTAs.[99] Notably, the language of Annex 9-B to the Investment Chapter, which provides guidance on the distinction between indirect expropriations and non-compensable regulatory measures, is almost exactly the same as the 2004 and 2012 U.S. Model BITs.[100]

In determining whether an action or a series of actions constitutes an indirect expropriation, TPP Annex 9-B directs the tribunal to conduct:

> [A] case-by-case, fact-based inquiry that considers, among other factors: (i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred; (ii) the extent to which the government action interferes with distinct, reasonable investment-

94. Notwithstanding the footnote attached to the Article 29.5 that states that the Article does not prejudice the operation of Article 9.15 (Denial of Benefits).

95. Benedict Kingsbury & Stephan Schill, INVESTOR-STATE ARBITRATION AS GOVERNANCE: FAIR AND EQUITABLE TREATMENT, PROPORTIONALITY AND THE EMERGING GLOBAL ADMINISTRATIVE LAW 23 (New York University Public Law and Legal Theory Working Papers, 2009).

96. U.N. Conference on Trade and Development, *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking*, ¶ 4, UNCTAD/ITE/IIT/2606/5, (Feb. 2007).

97. *See, e.g.*, Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Union of Soviet Socialist Republics for the Promotion and Reciprocal Protection of Investments, Apr. 6, 1989, Treaty Series No. 3 (1992);
Agreement between the Argentine Republic and the Republic of Italy on the Promotion and Protection of Investment, May 22, 1990; Agreement between the Government of the Hellenic Republic and the Government of the Republic of Albania for the Encouragement and Reciprocal Protection of Investments, Aug. 1, 1991.

98. TPP, *supra* note 1, ¶ 9.

99. *See* TPP, *supra* note 1; 2012 U.S. Model BIT, *supra* note 22.

100. *Compare* 2012 U.S. Model BIT, *supra* note 22; TPP, *supra* note 1, at Annex 9-B.

backed expectations; and (iii) the character of the government action.[101]

Annex 9-B also reflects language intended to safeguard the right to regulate first introduced in the 2004 U.S. Model BIT that has been widely copied in subsequent IIAs worldwide.[102] The annex directs the tribunal that "non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriations, except in rare circumstances."[103]

Interestingly, the States Parties to TPP rowed back from earlier draft language that reportedly would have limited the circumstances in which a measure amounts to a compensable treaty violation.[104] For example, in previous drafts, "rare circumstances" were limited to situation in which the host state breached a prior binding written commitment to investors or discriminated against it.[105] The States Parties also rejected language in an earlier draft providing that non-discriminatory law making for legitimate public welfare objectives shall not be regarded as expropriation.[106]

While the clause does not provide express guidance, it is likely that "rare circumstances" will be interpreted narrowly.[107] The tribunal in the recent *Philip Morris v. Uruguay*[108] award held similar language found in the 2012 U.S. Model BIT and other IIAs reflects the position under general international law that compensation is not required where a bona fide regulatory measure is within the State's police powers.[109] Nevertheless, neither the police powers doctrine nor the TPP provide blanket exceptions from compensation for States' regulatory measures.[110] As explained by the *Pope & Talbot* tribunal "much creeping expropriation could be conducted by regulation and a blanket exception for regulatory measures would create a gaping loophole in international protections

101. TPP, *supra* note 1, at Annex 9-B(3)(a). In a footnote, Annex 9-B clarifies "for greater certainty" that whether "investor's investment-backed expectations are reasonable depends, to the extent relevant, on factors such as whether the government provided the investor with binding written assurances and the nature and extent of governmental regulation or the potential for government regulation in the relevant sector." TPP, *supra* note 1.

102. Expropriation - A Sequel, *supra* note 13, ¶ 60.

103. TPP, *supra* note 1, at Annex 9-B(3)(b).

104. Kawharu, *supra* note 80, at 12.

105. Kawharu, *supra* note 80, at 12.

106. Kawharu, *supra* note 80, at 12.

107. Kawharu, *supra* note 80, at 12.

108. Philip Morris Brands Sàrl, *supra* note 15.

109. Philip Morris Brands Sàrl, *supra* note 15, at 294, 300. By contrast to the 2012 U.S. Model BIT and recent U.S. IIAs, the TPP Annex 9-B guidance on the distinction between expropriation and non-compensable regulatory measures does not state that the Investment Chapter's provisions on expropriation and compensation are intended to reflect customary international law.

110. Chemtura Corporation v. The Government of Canada, Ad Hoc NAFTA UNCITRAL Arbitral Tribunal, Award, ¶ 266, (Aug. 2, 2010) (the police powers doctrine operates within certain limits "so that it is not abused by governments who might enact police measures as a pretext to an expropriation.").

against expropriation."[111] It follows that the form of measure is not determinative to the existence of expropriation and the formal characterisation or status of a government measure will not prevent a tribunal from assessing whether it is expropriatory or not.[112]

By contrast to the 2012 U.S. Model BIT and recent U.S. IIAs, the TPP Annex 9-B guidance on the distinction between expropriation and non-compensable regulatory measures does not state that the Investment Chapter's provisions on expropriation and compensation are intended to reflect customary international law.[113]

TPP Article 9.6, as supplemented by Annex 9-A, prescribes the minimum standard of treatment to be afforded to protected investments.[114] The Article provides that the concepts of "fair and equitable treatment [and] full protection and security . . . do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights."[115] This is a continuation of existing U.S. practice and is consistent with the 2001 NAFTA Free Trade Commission's Interpretative Note clarifying that the Minimum Standard of Treatment ("MST") provision in NAFTA was not additive to the customary international law standard.[116]

To what extent does linking FET with the customary international law minimum standard help safeguard host States' right to regulate? The answer is not clear. On the one hand, FET clauses that are linked to the MST have been interpreted as having a higher threshold of liability than other unlinked/ autonomous FET clauses.[117] On the other hand, some tribunals have interpreted the MST so broadly as to reduce the differences between the autonomous FET standard and the MST.[118] For example, the *Merrill & Ring* tribunal stated that the

111. Pope & Talbot, Inc v. The Government of Canada, NAFTA Arbitral Tribunal 34 (June 26, 2000).

112. *See, e.g.,* RosInvestCo UK Ltd. v. The Russian Federation, Arbitration Institute of the Stockholm Chamber of Comerce Case No. V079/2005, Final Award, ¶ 628 (Sept. 12, 2010).

113. *Compare* 2012 U.S. Model BIT, *supra* note 20, at Annex B, ¶1 (stating "The Parties confirm their shared understanding that. . . . Article 6 [Expropriation and Compensation](1) is intended to reflect customary international law concerning the obligation of States with respect to expropriation."); TPP, *supra* note 1, ch. 9, Annex B (does not contain this language).

114. TPP, *supra* note 1, art. 9.6(2).

115. TPP, *supra* note 1, art. 9.6(2).

116. NAFTA Free Trade Comm'n, *Notes of Interpretation of Certain Chapter 11 Provisions*, ORGANIZATION OF AMERICAN STATES, 2 (July 31 2001), http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding_e.asp.

117. PATRICK DUMBERRY, THE FAIR AND EQUITABLE TREATMENT STANDARD: A GUIDE TO NAFTA CASE LAW ON ARTICLE 1105, 321 (Kluwer Law International, 2013) (stating ". . . the existence of this high threshold of severity is a predominant characteristic of NAFTA case law. It is, indeed, one aspect that clearly differentiates it from awards rendered by non-NAFTA tribunals which have often used a lower threshold of liability. This is certainly the case of non-NAFTA tribunals when interpreting an unqualified FET clause").

118. Merrill & Ring Forestry LP v. The Government of Canada, UNCITRAL and NAFTA Arbitral Tribunal, ICSID Administered, Award, (Mar. 31, 2010).

customary MST "protects against all such acts or behavior that might infringe a sense of fairness, equity and reasonableness."[119] Furthermore, the Tribunal stated that the customary MST "provides for the fair and equitable treatment of alien investors within the confines of reasonableness."[120]

Moreover, even when formally adopting the MST's high threshold, the extent of the tribunal's review can be potentially far-reaching. Take *Bilcon v. Canada*,[121] which concerned the rejection by a joint federal-provincial environmental review panel of the claimants' application to develop a mining and marine terminal project in Canada. In that case, a majority of the tribunal held that Canada had violated the MST and national provision provisions of NAFTA.[122] The majority considered that the conduct of the joint review was arbitrary for the purposes of the NAFTA MST standard because it departed from the methodology required by Canadian law.[123] This, the majority held, had the effect of depriving the claimants of a fair opportunity to have their proposal considered in accordance with applicable laws. The majority concluded that Canada thereby frustrated claimants' legitimate expectations that their project would obtain environmental permission if it complied with the environmental review process prescribed by domestic law.[124] A forceful dissent challenged the foundation of such a legitimate expectation,[125] and considered whether Canadian law had been complied with was arguable, since "the Tribunal did not have the benefit of a determination by a Canadian federal court on the matter."[126] Rather, the dissenting arbitrator concluded, the award constitutes a "significant intrusion into domestic jurisdiction and will create a chill on the operation of environment review panels."[127]

TPP Article 9.6 also includes two sub clauses, which elaborate that measure that are inconsistent with an investor's expectations, and the withdrawal or amendment of a subsidy or grant, are deemed insufficient by themselves to constitute a breach of the MST (arts 9.6.4 and 9.6.5 respectively).[128]

Notably, Article 9.6(4) provides that "the mere fact that a Party takes or fails to take an action that may be inconsistent with an investor's expectations" does not constitute a breach of the MST, "even if there is loss or damage to the covered

119. *Id.* at ¶ 210.

120. *Id.* at ¶ 213.

121. William Ralph Clayton, William Richard Clayton, Douglas Clayton, Daniel Clayton and Bilcon of Delaware Inc v. Canada, Permanent Court of Arbitration, Case No 2009-04, Notice of Intent, (Feb. 5, 2008).

122. William Ralph Clayton, *supra* note 57.

123. William Ralph Clayton, *supra* note 57, ¶ 591, 604.

124. William Ralph Clayton, *supra* note 57, ¶¶ 447, 603.

125. William Ralph Clayton, *supra* note 57, ¶ 733.

126. William Ralph Clayton, William Richard Clayton, Douglas Clayton, Daniel Clayton and Bilcon of Delaware Inc. v. Government of Canada, UNCITRAL Arbitral Tribunal, Permanent Court of Arbitration, Case No. 2009-04, Dissenting Opinion of Professor Donald McCrae, ¶ 34 (Mar.10, 2015).

127. *Id.* ¶ 48.

128. TPP, *supra* note 1, art. 9.6(4–5).

investment as a result."[129] It has been suggested that the provision on legitimate expectations "seems to rule out the possibility that a state's mere thwarting of a *subjective* expectation of an investor can trigger an MST breach."[130] Other scholars suggested that this provision may indicate that "expectations-based claim may still be possible, where a state arbitrarily departs from reasonable expectations."[131] Both interpretations could arguably reduce the intended effect of the clause. The wording of the clause does not qualify its impact to *subjective* expectations.[132] The clause clarifies that legitimate expectations may be a factor in establishing a violation of the FET standard but they cannot give rise to a stand-alone obligation of the host state.[133] The clause could also be interpreted as insuring that even if the customary MST will develop one day to include legitimate expectations as a stand-alone obligation, the FET obligation under the TPP will not include legitimate expectations as a stand-alone obligation.

Finally, the TPP contains important language on non-discrimination against foreign investors. Article 9.4(2) sets out the national treatment obligation:

> Each Party shall accord to covered investments treatment no less favourable than that it accords, in like circumstances, to investments in its territory of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.[134]

A footnote to Article 9.4 expressly provides that the tribunal should consider the State's right to regulate in determining a discrimination claim:

> For greater certainty, whether treatment is accorded in 'like circumstances' under Article 9.4 (National Treatment) or Article 9.5 (Most-Favoured-Nation Treatment) depends on the totality of the

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129. TPP, *supra* note 1, art. 9.6(4).

130. Luke Eric Peterson, *A First Glance at the Investment Chapter of the TPP Agreement: A Familiar US-Style Structure with a Few Novel Twists* 2, INVESTMENT ARBITRATION REPORTER (Nov. 6, 2015), https://www.iareporter.com/articles/a-first-glance-at-the-investment-chapter-of-the-tpp-agreement-a-familar-us-style-structure-with-a-few-novel-twists/.

131. Kawharu, *supra* note 0, at 11.

132. *See* TPP, *supra* note 1, art. 9.6(4) (stating "For greater certainty, the mere fact that a Party takes or fails to take an action that may be inconsistent with an investor's expectations does not constitute a breach of this Article, even if there is loss or damage to the covered investment as a result.").

133. This interpretation is also in light with the understanding of other TPP members. *See, e.g.*, Spence Int'l Investments, LLC, Berkowitz Et Al., v. The Republic of Costa Rica, ICSID Case No. UNCT/13/2, Submission of the United States of America, ¶ 17, (Apr. 17, 2015), http://www.italaw.com/sites/default/files/case-documents/italaw4249.pdf. ("Neither the concepts of 'good faith' nor 'legitimate expectations' are component elements of 'fair and equitable treatment' under customary international law that give rise to an independent host State obligation"). Nevertheless, it should be emphasized that a breach of legitimate expectation can be a factor in analyzing stand-alone obligations (*see e.g.,* Mobil Investments Canada Inc. & Murphy Oil Corp. v Canada, Decision on Liability and on Principles of Quantum, ICSID Arbitral Tribunal, Case No. ARB(AF)/07/4, ¶ 153, (May 22, 2012), http://www.italaw.com/sites/default/files/case-documents/italaw1145.pdf.

134. TPP, *supra* note 1, art. 9.4(2).

> circumstances, including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives.[135]

Whether such language would have affected the tribunal's analysis in *Bilcon* is again debatable. Johnson and Sachs argue that the non-discrimination standard should expressly require that the investor was discriminated against on grounds of nationality.[136] Johnson and Sachs appear to object to the extent of the tribunal's discretion in determining whether "legitimate public welfare objectives" exist.[137] However, the inclusion of right to regulate language necessarily requires tribunals to probe such questions, and much will depend on the standard of review that the tribunal applies.[138]

## IV. CONCLUSION

The TPP's Investment Chapter continues the recent trend in IIA practice to include language intended to safeguard host States' legitimate public welfare objectives. As summarised above, the TPP preamble contains express language reaffirming the right to regulate, and the Investment Chapter itself provides guidance on the standards of investment protection as they apply to regulatory measures, as well as general exceptions, including the high profile tobacco control measure denial of benefits clause and a carve out for temporary safeguard measures in financial crises. However, the extent to which the Investment Chapter pushes the envelope is debatable. Indeed, its provisions are remarkably consistent with U.S. IIA practice since the 2004 Model BIT.[139] Moreover, the final agreement rejected earlier proposals for an express carve out for non-discriminatory regulatory measures. In their critique, Johnson and Sachs question why taxation measures continue to be expressly carved out from the MST provision when environmental or health measures are not; if States Parties are "unwilling to trust" tribunals with the former then why, Johnson and Sachs ask, not exclude the latter?[140]

The irony of the new U.S. administration's trade policy is that the TPP arguably represented an expansion of influence of U.S. treaty practice into the Asia-Pacific region. But it is not the only show in town. By contrast to the TPP, the

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135. TPP, *supra* note 1, art. 9.4 n.14.

136. Lise Johnson & Lisa Sachs, *The TPP's Investment Chapter: Entrenching, rather than reforming, a flawed system*, COLUMBIA CENTER ON SUSTAINABLE INVESTMENT, 10, (Nov. 2015), http://ccsi.columbia.edu/files/2015/11/TPP-entrenching-flaws-21-Nov-FINAL.pdf.

137. *Id.*

138. Caroline Henckels, *Balancing Investment Protection and the Public Interest: The Role of the standard of Review and the Importance of deference in Investor-State Arbitration*, 4 J. OF INT'L DISPUTE SETTLEMENT 197 (Jan. 12, 2013) (stating that 'the standard of review applied by tribunals is "a central means by which to calibrate the balance of power between host states and foreign investors in international investment law.").

139. *See* Allee, *supra* note 71.

140. Johnson & Sachs, *supra* note 136, at 2.

China-Australia FTA[141] ('ChAFTA'), which was signed in 2015, has taken an innovative approach to the right to regulate issue.[142] Unlike the TPP, ChAFTA expressly excludes legitimate and non-discriminatory regulatory measures from treaty protection.[143] ChAFTA goes further still. Whereas the European Union has placed its faith in an investment court system to better protect member states' right to regulate, ChAFTA provides that a respondent State facing a claim arising out of a regulatory measure may issue a "public welfare notice" which suspends the investor-State proceedings for 90 days, during which the States Parties have the opportunity to agree whether the complaint falls within the exception for legitimate and non-discriminatory regulatory measures or not.[144] If the States Parties are unable to agree, the tribunal decides if the measure violates the treaty.[145]

The TPP's Investment Chapter may not be radical, but its provisions arguably reinforce the legal foundation for States' right to regulate for the public welfare without incurring liability under international investment law. This may not, however, be enough to satisfy increasingly sceptical politicians and citizens of the merits of IIAs.[146]

141. Free Trade Agreement between the Government of Australia and the Government of the People's Republic of China, Austl.-China, June 17, 2015 [hereinafter *CHAFTA*].

142. Anthea Roberts and Richard Braddock, *Protecting public welfare regulation through joint treaty party control: a CHAFTA Innovation* , COLUMBIA FDI PERSPECTIVES ON TOPICAL FOREIGN DIRECT INVESTMENT ISSUES 1, 2, p. 176 (June 20, 2016).

143. *CHAFTA*, *supra* note 143, art. 9.11(4) (stating "Measures of a Party that are non-discriminatory and for the legitimate public welfare objectives of public health, safety, the environment, public morals or public order shall not be the subject of a claim under this Section.").

144. *CHAFTA*, *supra* note 141, art. 9.11(6).

145. *CHAFTA*, *supra* note 141, art. 9.12.

146. *See, e.g.*, Lawrence Summers, *Voters deserve responsible nationalism not reflex globalism*, FINANCIAL TIMES, (July 10, 2016), http://www.ft.com/cms/s/2/15598db8-4456-11e6-9b66-0712b3873ae1.html#axzz4F0zkdD22.

# INVESTOR-STATE MEDIATION AND THE RISE OF TRANSPARENCY IN INTERNATIONAL INVESTMENT LAW: OPPORTUNITY OR THREAT?

*SHAHLA F. ALI & ODYSSEAS G. REPOUSIS

## I. INTRODUCTION

Today, more than ever, the role of investor-state mediation cannot be appraised without regard to the mounting concerns against investor-state arbitration. Investment treaties typically protect nationals of one Contracting Party (natural persons or corporations) when realizing investments in the other Contracting Party State.[1] The most common form of such treaties is the bilateral investment treaty (BIT). As of today, more than 2,800 BITs have been concluded, 2,100 of which are in force.[2] To these treaties one may add regional free trade agreements that include investment chapters or regional investment treaties. One of the many examples is Chapter 11 of the North American Free Trade Agreement (NAFTA) that covers investments.[3] All of these treaties provide for substantive rights and protections such as the prohibition against uncompensated expropriation and various non-discriminatory standards.[4] However, investment treaties have

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1. JESWALD W. SALACUSE, THE LAW OF INVESTMENT TREATIES 158-60, 169-71 (2009); RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 235-37 (2008); KENNETH J. VANDEVELDE, BILATERAL INVESTMENT TREATIES: HISTORY, POLICY, AND INTERPRETATION 2-4 (2010); CHRISTOPHER F. DUGAN, DON WALLACE, JR., NOAH D. RUBINS & BORZU SABAHI, INVESTOR-STATE ARBITRATION 51–52 (2008).

2. U.N. Conf. on Trade & Dev. (UNCTAD), Inv. Pol'y Hub: Int'l Inv. Agreements, http://investmentpolicyhub.unctad.org/IIA.

3. *See* North American Free Trade Agreement, art. 1131, ¶ 2, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993) [hereinafter NAFTA]; MEG N. KINNEAR, ANDREA K. BJORKLUND & JOHN F. G. HANNAFORD, INVESTMENT DISPUTES UNDER NAFTA: AN ANNOTATED GUIDE TO NAFTA CHAPTER 11 (2006); Andrea K. Bjorklund, *NAFTA*, *in* COMMENTARIES ON SELECTED MODEL INVESTMENT TREATIES 506 (Chester Brown ed., 2013).

4. *See* ZACHARY DOUGLAS, THE INTERNATIONAL LAW OF INVESTMENT CLAIMS (2009); JESWALD W. SALACUSE, THE LAW OF INVESTMENT TREATIES (2nd ed. 2015); DOLZER & SCHREUER, *supra* note 1, at 119; DUGAN ET AL., *supra* note 1; RUDOLPH DOLZER & MARGRETE STEVENS, BILATERAL INVESTMENT TREATIES (1995); JESWALD W. SALACUSE, THE THREE LAWS OF INTERNATIONAL INVESTMENT: NATIONAL, CONTRACTUAL, AND INTERNATIONAL FRAMEWORKS FOR FOREIGN CAPITAL (2013); THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW (Peter

attained their present recognition due to their dispute settlement provisions and particularly the investor-state arbitration clause almost mechanically inserted in the majority of such treaties. This arbitration clause enables investors to directly sue the host state for breaches of the investment treaty in an international arbitral tribunal typically comprised of three members.[5] Investor-state arbitrations are either *ad hoc* or institutional,[6] with the most well regarded institutional body being the International Centre for the Settlement of Investment Disputes (ICSID) established by the Washington 1965 Convention.[7]

Over the past three decades, investor-state arbitration proliferated with ICSID registering fifty cases per year and administering more than two hundred at any given time.[8] The most frequent respondent states are Argentina (more than fifty cases), Venezuela, Czech Republic, Egypt, Canada, Mexico, Ecuador, India, Ukraine, Poland, and the United States.[9] The increasing use of investor-state arbitration has also been met with opposition and a widespread consensus for the need of reform.[10] Over the past few years, Bolivia, Ecuador and Venezuela withdrew from the ICSID Convention and terminated a considerable number of BITs.[11] More recently, South Africa and Indonesia have also filed notices to

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Muchlinski, Federico Ortino & Christoph Schreuer eds., 2008); CAMPBELL MCLACHLAN QC, LAURENCE SHORE & MATTHEW WEINIGER, INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES (2007); NOAH RUBINS & N. STEPHAN KINSELLA, INTERNATIONAL INVESTMENT, POLITICAL RISK AND DISPUTE RESOLUTION: A PRACTITIONER'S GUIDE (2005); VANDEVELDE, *supra* note 1.

5. Convention on the Settlement of Investment Disputes between States and Nationals of Other States, § 2, art. 37, ¶ 37(2)(b), Mar. 18, 1965, 575 UNTS 159 (entered into force on Oct. 14, 1966) [hereinafter ICSID Convention].

6. Compare Corona Materials, LLC. v. Dom. Rep., ICSID Case No. ARB(AF)/14/3, Award on the Respondent's Expedited Preliminary Objection, (May 31, 2016), with Occidental Petroleum Corp. and Occidental Exploration & Prod. Co. v. Republic of Ecuador, ICSID Case No. ARB/06/11, Decision on Annulment, (Nov. 2, 2015).

7. ICSID Convention, *supra* note 5, § 1, art. 1; *see* ANTONIO R. PARRA, THE HISTORY OF ICSID (2012); CHITTHARANJAN F. AMERASINGHE, JURISDICTION OF SPECIFIC INTERNATIONAL TRIBUNALS 433–35 (2009).

8. INTERNATIONAL CENTRE FOR THE SETTLEMENT OF INVESTMENT DISPUTES, *2015 Annual Report* 21 (Sept. 4, 2015).

9. U. N. Conf. on Trade & Developments, *Investor-State Dispute Settlement: Review of Developments in 2014*, 2 IIA Issues Note at 2–3, UNCTAD/WEB/DIAE/PCB/2015/2 (May 2015), http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d2_en.pdf.

10. *See* Christoph Schreuer, *Denunciation of the ICSID Convention and Consent to Arbitration*, *in* THE BACKLASH AGAINST INVESTMENT ARBITRATION: PERCEPTIONS AND REALITY 353-68 (Michael Waibel et al. eds., 2010); *see also* DOLZER & SCHREUER, *supra* note 1, at 243; JEAN E. KALICKI & ANNA JOUBIN-BRET (EDS.), RESHAPING THE INVESTOR-STATE DISPUTE SETTLEMENT SYSTEM: JOURNEYS FOR THE 21ST CENTURY (2015).

11. *See briefly* U. N. Conference on Trade & Development, *Denunciation of the ICSID Convention and BITs: Impact on Investor-State Claims*, 2 IIA Issues Note at 1, UNCTAD/WEB/DIAE/IA/2010/2 (Dec. 2010) http://unctad.org/en/Docs/webdiaeia20106_en.pdf; *see* Ricardo Dalmaso Marques, *Notes on the Persistent Latin American Countries' Attitude Towards Investment Arbitration and ICSID*, WOLTERS KLUWER: KLUWER ARBITRATION BLOG (July 24, 2014), http://kluwerarbitrationblog.com/blog/2014/07/24/some-notes-on-the-latin-american-countries-attitude-towards-investment-arbitration-and-icsid.

terminate BITs.[12]

The opposition towards investor-state arbitration stems, in many regards, from the characteristics of such contemporary dispute settlement procedures. In a nutshell, a significant number of investment arbitration cases involve investment in public service sectors and public utilities;[13] investment claims arising out of emergency economic measures or civil unrest;[14] and cases that revolve around issues of public health, environmental regulation,[15] and human rights, in general.[16] Moreover, investor-state cases often involve allegations of state misconduct and corruption,[17] are costly dispute settlement procedures, and the payment of compensation in connection with any arising arbitration awards is borne by the taxpayers of the host state.[18] All these factors are to the interest of the local population as the objectives of foreign investors, governments, and local populations are oftentimes conflicting.[19] Investor-state arbitration has also been criticized for enabling the so-called "regulatory chill",[20] which is a hesitancy to implement a higher degree of regulation in fear of investment arbitration claims.[21]

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12. Jonathan Lang, *Bilateral Investment Treaties: A shield or a sword?*, BOWAN GILFILLAN: CORPORATE NEWSFLASH, http://www.bowman.co.za/FileBrowser/ArticleDocuments/South-African-Government-Canceling-Bilateral-Investment-Treaties.pdf.

13. *See* Biwater Gauff (Tanz.) Ltd. v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Procedural Order N° 3, ¶ 60 (Sept. 29, 2006); Vattenfall AB v. Federal Republic of Germany, ICSID Case No. ARB/12/12 (Oct. 2016); Tradex Hellas S.A. v. Republic of Albania, ICSID Case No. ARB/94/2, Award, § G, Art. 4 (Apr. 29, 1999), 5 ISCID Rep. 70 (2002).

14. *See, e.g.*, Poštová banka, a.s. v. Hellenic Republic, ICSID Case No. ARB/13/8, Award, ¶ 46 (Apr. 9, 2015); Abaclat v. Argentine Republic, ICSID Case No. ARB/07/5 (formerly named Giovanna a Beccara v. the Argentine Republic).

15. *See, e.g.*, *Methanex Corp. v. United States of America*, Final Award of the Tribunal on Jurisdiction & Merits, Part III, ¶ 56 (NAFTA Trib. Aug. 3, 2005), http://www.naftaclaims.com/disputes/usa/Methanex/Methanex_Final_Award.pdf; Vattenfall AB, ICSID Case No. ARB/12/12; *Philip Morris Asia Ltd. v. Commonwealth of Australia*, PCA Case No. 2012-12, Award on Jurisdiction & Admissibility, ¶ 102, 111, 390-92, https://www.pcacases.com/web/sendAttach/1711.

16. *See, e.g.*, Piero Foresti v. Republic of South Africa, ICSID Case No. ARB(AF)/07/1, Award, § 2(B).

17. *See, e.g.*, Spyridon Roussalis v. Romania, ICSID Case No. ARB/06/1, Award, Chap. IV, ¶ 154.; World Duty Free Co. Ltd. v. Republic of Kenya, ICSID Case No. ARB/00/7, Award, § II, ¶ 74 (Oct. 4, 2006).; *see generally* ALOYSIUS P. LLAMZON, CORRUPTION IN INTERNATIONAL INVESTMENT ARBITRATION (2014).

18. *See Yukos Universal Ltd. (Isle of Man) v. Russian Federation*, PCA Case No. AA 227, Final Award, ¶ 635, 1887 (July 18, 2014) (award of USD 60,000,000).

19. *See* Charles N. Brower & Sadie Blanchard, *What's in a Meme? The Truth about Investor-State Arbitration: Why It Need Not, and Must Not, Be Repossessed by States*, 52 COLUM. J. TRANSNAT'L L. 689, 719-20 (2014); Laurence Boisson de Chazournes, *Making the Proceedings Public and Allowing Third Party Interventions: Are the New Generation Bilateral Investment Treaties (U.S., Canada) Bifurcating Investment Arbitration from International Commercial Arbitration?*, 6 J. WORLD INV. & TRADE 105, 105-08 (2005); Nigel Blackaby & Caroline Richard, *Amicus Curiae: A Panacea for Legitimacy in Investment Arbitration?*, *in* THE BACKLASH AGAINST INVESTMENT ARBITRATION: PERCEPTIONS AND REALITY 253, 253–55 (Michael Waibel et al. eds., 2010).

20. Scott Miller, *Investor-State Dispute Settlement*, CENTER FOR STRATEGIC & INT'L STUDIES (Mar. 24, 2015), https://www.csis.org/analysis/investor-state-dispute-settlement.

21. Kyla Tienhaara, *Regulatory Chill and the Threat of Arbitration: A View from Political*

As later discussed in this article, another source of concern for investor-state arbitration is the lack of transparency in such transnational proceedings.[22] Finally, another concern that is frequently raised is the use of investor-state arbitration to circumvent national courts and the perceived bias of arbitrators, that act both as counsel and as arbitrator in related proceedings.[23]

The above concerns have influenced the drafting of contemporary investment treaties and have also led to initiatives seeking to reform some of the perceived deficiencies of international investment law. The most notable of such initiatives is the rise of transparency discussed in Part IV of this article.[24] Suffice however to say, that it should not be hard to see that greater transparency in investor-state arbitration is aimed at alleviating some of the concerns referred to above. Investor-state mediation is nevertheless a pre-arbitration dispute resolution method that, if successful, eliminates the need to pursue investor-state arbitration. However, as we will see, mediation in general and investor-state mediation in particular, is highly confidential. Would this then mean that investor-state mediation may be used as a medium to circumvent the increasing standards of transparency and other public concerns that are sought to be addressed when it comes to investor-state arbitration? In other words, if the concerns raised with regard to investor-state arbitration have merit, why shouldn't they be applicable with respect to any investor-state dispute settlement proceeding? In addition to these questions, one should also take into account that the United Nations Commission on International Trade Law (UNCITRAL) is considering a multilateral convention on the enforcement of mediated settlements.[25] If this treaty were to be concluded, would it mean that investor-state mediation would not only be a convenient method to avoid

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*Science*, *in* EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION 606, 607 (Chester Brown & Kate Miles eds., 2011).

22. *See* N. Jansen Calamita, *Dispute Settlement Transparency in Europe's Evolving Investment Treaty Policy: Adopting the UNCITRAL Transparency Rules Approach*, 15 J. WORLD INVEST. & TRADE 645, 650-53 (2014).

23. *See* Michael Waibel et al., *The Backlash against Investment Arbitration: Perceptions and Reality*, *in* THE BACKLASH AGAINST INVESTMENT ARBITRATION: PERCEPTIONS AND REALITY xxxvii, xxxvii-li (Michael Waibel et al. eds., 2010).

24. *See infra* Part IV.

25. *See generally* Laila El Shentenawi, *A New York Convention for Mediation May be Coming Soon*, LEXOLOGY (Aug. 28, 2015), http://www.lexology.com/library/detail.aspx?g=416b9435-39bb-4fa7-a3b0-1039f0007e7f; UNCITRAL Rep., Forty-Seventh Session, UN Doc A/69/17, ¶ 124 (July 7-18, 2014) stating that:

> Support was expressed for possible work in that area on many of the bases expressed above. Doubts were also expressed as to the feasibility of the project and questions were raised in relation to that possible topic of work, including: (a) whether the new regime of enforcement envisaged would be optional in nature; (b) whether the New York Convention was the appropriate model for work in relation to mediated settlement agreements; (c) whether formalizing enforcement of settlement agreements would in fact diminish the value of mediation as resulting in contractual agreements; (d) whether complex contracts arising out of mediation were suitable for enforcement under such a proposed treaty; (e) whether other means of converting mediated settlement agreements into binding awards obviated the need for such a treaty; and (f) what the legal implications for a regime akin to the New York Convention in the field of mediation might be.

the high levels of transparency now paradigmatic to investor-state arbitration, but would also enjoy high levels of international enforceability?

For now, these arguably legitimate concerns may be kept as a working hypothesis, or an issue to be determined after the apposition of three tenets. The first is the role of negotiation and pre-arbitration consultations in international investment law discussed in Part II of this article. With respect to this tenet, this article shows that investment treaties usually provide for negotiation and pre-arbitration consultation periods as a means to promote the amicable resolution of disputes between investors and host states. Given however that investor-state mediation is a distinct dispute resolution method, an examination of negotiation and pre-arbitration consultation periods is required in order to more fully detail the role and potential use of investor-state mediation. The second tenet is dealt with in Part II that focuses on the development and evolution of investor-state mediation as a distinct pre-arbitration dispute resolution procedure.[26] Specific weight is given to two recent developments, the adoption by the International Bar Association (IBA) of a distinct set of rules for investor-state mediation that took place in 2012,[27] and the appearance of distinct investor-state mediation provisions in recent investment treaties.[28] Finally, the third tenet is the rise of transparency in investor-state arbitration that is discussed in Part III.[29] In particular, this part lays out the main characteristics of the UNCITRAL Rules on Transparency and of the Mauritius Convention on Transparency in investor-state arbitration.[30] With these three tenets in place, Part V analyzes the implications of transparency in international investment law to the future role and importance of investor-state mediation.

## II. INVESTOR-STATE MEDIATION AND OTHER PRE-ARBITRATION OPTIONS

### *A. Amicable Consultations and Negotiation*

Investment treaties typically include a series of pre-arbitration requirements that can be broken down into amicable consultation periods, waiver and consent provisions,[31] and prior-litigation requirements.[32] This section only focuses on the

26. *See infra* Section II.

27. *See* International Bar Association, *Rules for Investor-State Mediation*, art. 1, ¶ 1 (Oct. 4, 2012), http://www.ibanet.org/LPD/Dispute_Resolution_Section/Mediation/State_Mediation/Default.aspx.

28. Comprehensive Economic & Trade Agreement, Can.-E.U., art. 8.2, Sept. 14, 2016, 10973 Council of European Union 16; Agreement on the Reciprocal Promotion & Protection of Investments, Belg.-U.A.E., art. 12, ¶ 1, Mar. 8, 2004, UNCTAD Inv. Pol'y Hub.

29. *See infra* Section III.

30. Rep. of the Comm'n on Int'l Trade Law, at Annex 1, U.N. Doc. A/68/17 (Jan. 2014); G.A. Res. 69/116, at 2/7 (Feb. 2015).

31. *See* J.C. Thomas, *Investor-State Arbitration under NAFTA Chapter 11*, 37 CAN. Y.B. INT'L L. 99, 115-19 (1999); Jacob S. Lee, *No "Double-Dipping" Allowed: An Analysis of* Waste Management, Inc. v. United Mexican States *and the Article 1121 Waiver Requirement for Arbitration under Chapter 11 of NAFTA*, 69 FORDHAM L. REV. 2655, 2669 (2001).

32. *See, e.g.*, Agreement on the Reciprocal Promotion & Protection of Investments, Arg.-Spain, art. X, ¶ 3(a), Oct. 3, 1991, 1699 U.N.T.S. 29403 (a claim may be submitted to investment arbitration if

first pre-arbitration requirement, which is often referred to as "consultation and negotiation."[33] A typical investment treaty provision of this kind usually reads as follows:

> The disputing parties should first attempt to settle a claim through consultation or negotiation.[34]

The verb "shall" is sometimes replaced by the verb "should."[35] However, investment treaties are generally not particularly specific as to the form and procedure that this effort to amicably settle investment disputes needs to take. Some investment treaties nevertheless require the filing of a "written request" for consultations or negotiations[36] as well as set specific timeframes for the holding of such amicable procedures.[37] Furthermore, the amicable settlement requirement

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"after a period of eighteen (18) months has elapsed from the moment when the dispute was submitted to the competent tribunal of the Contracting Party in whose territory the investment was made, the said tribunal has not given its final decision, or where the final decision has been made but the parties are still in dispute."); *see also* Agreement for the Promotion & Protection of Investments, Arg.-U.K.-N. Ir. B.I.T., art. 8, ¶ 2(a), Dec. 11, 1990, 1765 U.N.T.S. 30682; Treaty on the Encouragement & Reciprocal Protection of Investments, Arg.-Ger., art. 10, ¶ 3(a), Apr. 9, 1991, 1091 U.N.T.S. 32583.

33. *See, e.g.*, U.S. DEP'T OF STATE, 2012 U.S. MODEL BILATERAL INV. TREATY, art. 23 (2012), http://www.state.gov/e/eb/ifd/bit.; Italian 2003 Model B.I.T., art. X, ¶ 1 (2003), http://www.italaw.com/investment-treaties [hereinafter Italian Model BIT]. Such consultation and negotiation may also include the use of non-binding third-party procedures. *See e.g.*, Ass'n of Southeast Asia Nations Comprehensive Inv. Agreement, art. 31, ¶ 1 (2007), http://investmentpolicyhub.unctad.org/Download/TreatyFile/3095 [hereinafter ASEAN CIA].

34. NAFTA, *supra* note 3, art. 1118. *See also* Draft Agreement Between the Government of the Republic of France and the Government of the Republic of [Country] on the Reciprocal Promotion and Protection of Investments, art. 7 (2006), http://www.italaw.com/investment-treaties ("Any dispute concerning the investments occurring between one Contracting Party and a national or company of the other Contracting Party shall be settled amicably between the two parties concerned.") [hereinafter France Model BIT]; *see also* Agreement Between the Government of the Republic of India and the Government of the Republic of [Country] for the Promotion and Protection of Investments, art. 9, ¶ 1 (2003), http://www.italaw.com/investment-treaties [hereinafter India Model BIT]; Free Trade Agreement, China-Peru, art. 139, ¶ 1 (Apr. 28, 2009) Agreement for the Strengthening of Economic Partnership, http://fta.mofcom.gov.cn/bilu/annex/bilu_xdwb_en.pdf [hereinafter China-Peru FTA]; Agreement for the Strengthening of the Economic Partnership, Japan-Mex., art. 77 (Sept. 17, 2004) Ministry of Foreign Affairs of Japan, http://www.mofa.go.jp/region/latin/mexico/agreement/agreement.pdf.

35. Treaty between the Federal Republic of Germany and [Country] Concerning the Encouragement and Reciprocal Protection of Investments, art. 10, ¶ 1 (2008), http://www.italaw.com/investment-treaties [hereinafter German Model BIT]; Agreement Between the Kingdom of Norway and [Country] for the Promotion and Protection of Investments, art. 15, ¶ 2 (2007), http://www.italaw.com/investment-treaties. *See* Energy Charter Treaty, art. 26, ¶ 1, Dec. 17, 1994, 280 U.N.T.S. 36116 (entered into force Apr. 16, 1998) (The ECT employs the verb "shall" along with the "if possible" proviso. "Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III shall, if possible, be settled amicably.") [hereinafter ECT].

36. *See, e.g.*, ASEAN CIA, *supra* note 33, at art. 31, ¶ 1 (" . . . consultations shall be initiated by a written request for consultations delivered by the disputing investor to the disputing Member State.").

37. *Compare* Agreement Between Canada and [Country] for the Promotion and Protection of Investments, art. 25, ¶ 2 (2004), http://www.italaw.com/investment-treaties ("Consultations shall be held within 30 days of the submission of the notice of intent to submit a claim to arbitration, unless the

found in investment treaties is in principle supplemented by a specific cooling-off period[38] that usually ranges between three,[39] six,[40] and twelve months.[41]

Failing to amicably settle a dispute within the given cooling-off period allows for an investor to bring an investor-state arbitration claim.[42] However, investor-state tribunals have not been uniform in approaching pre-arbitration consultation periods. For example, an issue of great divide has been the ability of an investor to resort to arbitration if amicable consultations/negotiations failed or are futile but the cooling-off period has not yet lapsed.[43] In this respect, a possible way to determine the nature of pre-arbitration consultation periods would be to examine the language used by the contracting parties to an investment treaty. However, this is not an easy task since treaty stipulations differ as well as rarely provide for any

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disputing parties otherwise agree."), *with* ASEAN CIA, *supra* note 33, at art. 31, ¶ 2 (which however refers to "30 days of receipt by the disputing Member State of the request for consultations . . . ").

38. DOLZER & SCHREUER, *supra* note 1, at 249–50.

39. *See, e.g.*, ECT, *supra* note 35, art. 26, ¶ 2; Agreement on Mutual Encouragement and Protection of Investments, Bulg.-Cyprus, art. 4.1, June, 18, 1988, UNCTAD Inv. Pol'y Hub; Agreement for the Promotion & Protection of Investments, Kyrg.-N. Ir. - U.K., art. 8, ¶ 1, Dec. 8, 1994, UNCTAD Inv. Pol'y Hub; Agreement for the Promotion & Reciprocal Protection of Investments, Russ.-N. Ir.-U.K., art. 8, ¶ 2, Apr. 6, 1989, UNCTAD Inv. Pol'y Hub; U.K.-Hung., art. 8, ¶ 1, Mar. 9, 1987; Agreement on the Promotion & Protection of Investments, Aust.-FYROM, art. 12, ¶ 1, Mar. 28, 2001, 2195 U.N.T.S 191; Agreement on Encouragement & Reciprocal Protection of Investments, Neth.-Rom., art. 8, ¶ 2, Oct. 27, 1983, UNCTAD Inv. Pol'y Hub.

40. NAFTA, *supra* note 3, art. 1120, ¶ 1; Agreement on the Promotion & Reciprocal Protection of Investments, Lat.-Swed., art. 8, ¶ 2, Mar. 10, 1992, 1823 U.N.T.S. 31209; Agreement Regarding the Promotion & Mutual Protection of Investments, Cyprus-Russ., art. 7, ¶ 2, Apr. 11, 1997, UNCTAD Inv. Pol'y Hub; Agreement on the Promotion & Reciprocal Protection of Investments, Geor.-Greece, art. 8, ¶ 2, Nov. 9, 1994, UNCTAD Inv. Pol'y Hub; Agreement on the Promotion & Reciprocal Protection of Investments, Croat.-Slovn., art. 8, ¶ 2, Dec. 12, 1997, 2366 U.N.T.S. 42665; Agreement Concerning the Reciprocal Protection & Promotion of Investments, Belg.-Hung., art. 9, ¶ 2, May, 14, 1986, UNCTAD Inv. Pol'y Hub; Convention for the Protection & Promotion of Investments, Spain-Russ., art. 10, ¶ 1, Oct. 26, 1990, UNCTAD Inv. Pol'y Hub; Treaty on the Promotion & Mutual Protection of Investments, Germ.-Ukr., art. 11, ¶ 1, Feb. 15, 1993; Free Trade Agreement, China-Pak., art. 54, ¶ 2, Nov. 24, 2006, China FTA Network, http://fta.mofcom.gov.cn/topic/enpakistan.shtml; China-Peru FTA, *supra* note 34, art. 139, ¶ 2.

41. *See, e.g.*, Agreement on the Reciprocal Promotion & Protection of Investments, Pol.-Turk., art. 8, ¶ 1, Aug. 21, 1991, UNCTAD Inv. Pol'y Hub; Agreement on the Reciprocal Encouragement & Protection of Investments, China-Pak., art. 10, Feb. 12, 1989, UNCTAD Inv. Pol'y Hub.

42. *See, e.g.*, German Model BIT, *supra* note 35, at art. 10, ¶ 2 ("If the dispute cannot be settled within six months of the date on which it was raised by one of the parties to the dispute, it shall, at the request of the investor of the other Contracting State, be submitted to arbitration."); France Model BIT, *supra* note 34, art. 7 ("If this dispute has not been settled within a period of six months from the date on which it occurred by one or other of the parties to the dispute, it shall be submitted at the request of either party to [arbitration] . . . ."); India Model BIT, *supra* note 34, art. 9, ¶ 2 ("Any such dispute which has not been amicably settled within a period of six months may, if both Parties agree, be submitted [to arbitration]"); Italian Model BIT, art. X, ¶ 3 ("In the event that such dispute cannot be settled as provided for in paragraph 1 [amicable settlement] of this Article within six months from the date of the written application for settlement, the investor in question may submit at his choice the dispute for settlement to . . ."); NAFTA, Article 1120(1): ". . .provided that six months have elapsed since the events giving rise to a claim, a disputing investor may submit the claim to arbitration . . .".

43. *See infra* p. 8–9.

clarifications whatsoever. For example, the NAFTA provides that the "disputing parties *should* first attempt to settle a claim through consultation or negotiation."[44] Contrarily, the ECT employs the verb "shall" but also adds the proviso "if possible."[45] The indeterminacy associated with the obligatory nature of pre-arbitration consultation periods is best reflected in the rulings of the tribunals in *Abaclat v. Argentina*[46] and *Ambiente v. Argentina,*[47] both of which were established under the Argentina-Italy BIT.[48] In these cases, the tribunals were divided in interpreting the amicable consultations clause.[49] The first tribunal found that "the consultation requirement" of the above BIT "is not to be considered of a mandatory nature but as the expression of the good will of the Parties to try firstly to settle any dispute in an amicable way"[50] and it "only refers to the possibility of such amicable settlement talks, whereby such term is to be reasonably understood as referring not only to the technical possibility of settlement talks, but also to the possibility, i.e. the [likelihood], of a positive result."[51] Contrarily, the second tribunal found that the Argentina-Italy BIT created a "multi-layered, sequential dispute resolution system constituting mandatory jurisdictional requirements"[52] and the amicable consultations clause "clearly suggests that it creates a duty for the Parties to enter into consultations."[53]

The above findings clearly indicate the indeterminacy of pre-arbitration consultation periods and question the obligatory nature of such consultations.[54] At the same time, the disputing parties to an investor-state arbitration can always engage in negotiations for the settlement of their dispute. In fact, the latest ICSID caseload statistics indicate that with regard to concluded cases, thirty six percent were settled or otherwise discontinued.[55] Indeed, a prominent commentator has noted that "[i]t is unclear whether settlement negotiations are mandatory"[56] since "nothing prevents [the parties] from engaging in settlement negotiations after the

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44. NAFTA, *supra* note 3, art. 1118 (emphasis added).

45. *See* ECT, *supra* note 35, art. 26 ¶ 1 ("Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III shall, if possible, be settled amicably.").

46. *Abaclat v. Argentine Republic,* ICSID Case No. ARB/07/5 (*formerly named Giovanna a Beccara v. the Argentine Republic*), Decision on Jurisdiction and Admissibility (Aug. 4, 2011).

47. *Ambiente Ufficio S.P.A. v. Argentine Republic,* ICSID Case No. ARB/08/9 (*formerly named Giordano Alpi v. Argentine Republic*), Decision on Jurisdiction and Admissibility (Feb. 8, 2013).

48. Agreement for the Promotion & Protection of Investments, Arg.-It., 1990, Investor-State LawGuide, http://www.investorstatelawguide.com.

49. *Id.* at art. 8, ¶ 1.

50. *Abaclat,* ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, ¶ 564.

51. *Id.*

52. *Ambiente,* ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility, ¶ 570.

53. *Id.* ¶ 577.

54. *See Abaclat,* ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility; *Ambiente,* ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility.

55. INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES, THE ICSID CASELOAD – STATISTICS (ISSUE 2016-1) 13 (2016).

56. Bjorklund, *supra* note 3, at 504.

arbitration has commenced."[57] All these statements lead to the conclusion that while investment treaties usually provide for amicable consultations or negotiation, the mandatory nature of such pre-arbitration procedures is not always clear.[58] At the same time, settlement negotiations are always available to the disputing parties even after the initiation of the arbitration claim.[59] With these remarks in place, one may wonder how investor-state mediation can provide an alternative avenue for the pre-arbitration settlement of investment disputes.

*B. Why then mediate? An Introduction*

In order to understand the current need for investor-state mediation, two main issues should be taken into consideration. First, due regard should be had to the downsides of investor-state arbitration and contemporary international arbitration proceedings. Second, investor-state mediation should be appraised in light of pre-arbitration consultations and negotiation.

With respect to the first issue, arbitration has theoretically been regarded as a swift and cost-effective mechanism to resolve disputes among parties.[60] However, in the context of investor-state arbitration, empirical evidence appears to suggest the contrary.[61] The "sheer expense" of investor-state arbitrations are noted in recent decisions.[62] The average costs of an investor-state arbitration "skyrocketed"[63] from around $1 or 2 million USD before 2007[64] to around $8 million USD in 2012.[65] In some arbitrations, parties incurred costs of over $30 million USD.[66] The OECD's finding in 2012 corresponds to the research result by UNCTAD, quoting several examples of high legal costs within the range of $5 million USD to $10 million USD incurred for ISDS cases.[67] The average length of an investor-state arbitration was found to be around 3.6 years from the filing of the

57. *Id.*

58. *Abaclat,* ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, ¶ 564; *Ambiente,* ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility, ¶ 570; Bjorklund, *supra* note 3, at 504.

59. *Abaclat,* ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, ¶ 564; *Ambiente,* ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility, ¶ 570; Bjorklund, *supra* note 3, at 504.

60. U.N. CONF. ON TRADE & DEV., INVESTOR-STATE DISPUTES: PREVENTION AND ALTERNATIVES TO ARBITRATION, at 14, U.N. Doc. UNCTAD/DIAE/IA/2009/11, U.N. Sales No. E.10.II.D11 (2010) [hereinafter UNCTAD, Investor-State Disputes].

61. *Id.* at 16–17.

62. David P. Riesenberg, *Fee Shifting in Investor-State Arbitration: Doctrine and Policy Justifying Application of the English Rule*, 60 DUKE L. J. 977, 990 (2011).

63. UNCTAD, Investor-State Disputes, *supra,* note 60, at 16.

64. David Gaukrodger & Kathryn Gordon, *Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community*, ORG. FOR ECONOMIC CO-OPERATION & DEV. [OECD] WORKING PAPERS ON INTERNATIONAL INVESTMENT 2012/03, at 22 (2012), http://www.oecd.org/daf/inv/investment-policy/WP-2012_3.pdf.

65. *Id.* at 19.

66. *Id.*

67. UNCTAD, Investor-State Disputes, *supra* note 60, at 17–18.

request for arbitration to the date of the final award.[68] The UNCTAD shared a similar view, noting that it would take around 3 to 4 years for a case to be heard and finally settled.[69]

Regarding the reasons for the high costs of investor-state arbitration, scholars have noted a number of contributing factors including: 1) limited arbitrator availability;[70] 2) nature and role of the parties' counsel and their approaches to litigation[71] (i.e. attributed to the use of expensive litigation techniques borrowed from corporate litigation practices); 3) high billing rates of arbitration lawyers;[72] 4) substantial time spent on the selection of arbitrators;[73] 5) proliferation of procedural, jurisdictional and discovery issues;[74] 6) expanded use of high-cost party-appointed experts on a range of issues;[75] 7) complexity of the legal and factual issues in international investment law;[76] 8) high damages claims;[77] 9) number and length of written pleadings;[78] and, 10) uncertain cost shifting rules.[79]

Investor state mediation, on the other hand, has the potential of offering a relatively efficient alternative.[80] In some cases, it may assist parties to explore creative and innovative solutions that may lie outside strict legal remedies.[81] Such remedies may be of particular relevance in polycentric, policy issues involving complex issues of *force majeur* arising from unforeseen natural disasters.[82] As noted by Fuller, mediation can be of particular benefit in cases where adjudication has reached its "limits" such as in "polycentric disputes" where there are no clear issues subject to proofs and contentions.[83] The case of *Vattenfall v. Germany,*[84] arising following the Fukushima nuclear disaster and subsequent decision of the German government to phase out nuclear power production by 2022, arguably

68. Anthony Sinclair, *ICSID Arbitration: How Long Does it Take?* INT'L J. OF COM. & TREATY ARB. (Oct. 29, 2009), http://www.goldreserveinc.com/wp-content/uploads/2016/01/ICSID-arbitration-How-long-does-it-take.pdf.

69. UNCTAD, Investor-State Disputes, *supra* note 60, at 18.

70. *Id.* at 16–17.

71. *Id.* at 20.

72. *Id.* at 17.

73. *Id.* at 14.

74. UNCTAD, Investor-State Disputes, *supra* note 60, at 18.

75. *Id.* at 17.

76. Catherine M. Amirfar, *Dispute Settlement Clauses in Investor-State Arbitration: An Informed Approach to Empirical Studies About Law a Response to Professor Yackee* 12 SANTA CLARA J. INT'L L. 303, 310 n. 17 (2014).

77. UNCTAD, Investor-State Disputes, *supra* note 60, at 17.

78. Amirfar, *supra* note 76.

79. UNCTAD, Investor-State Disputes, *supra* note 60, at 17.

80. Shahla Ali, *Prospects of Utilizing Investor-state Mediation and UNCITRAL Rules on Transparency for Polycentric Environmental Disaster-Related Disputes: The Case of* Vattenfall v. Germany, *in* TRADE DEVELOPMENT THROUGH HARMONIZATION OF COMMERCIAL LAW 137 (Muruga Perumal Ramaswamy & João Ribeiro eds., 2015).

81. *Id.*

82. *Id.*

83. Lon L. Fuller, *Mediation: Its Forms and Functions,* 44 S. CAL. L. REV. 305, 329–30 (1971).

84. Vattenfall AB, ICSID Case No. ARB/12/12.

raises multi-dimensional issues of public policy and force majeure.[85] From both a process as well as efficiency perspective, investor state mediation may prove a viable alternative.

With respect to the second issue, the previous Section indicated that amicable consultations are rather indeterminate in international investment law and many investment treaties are unclear or silent with respect to their mandatory nature.[86] In this regard, investor-state mediation presents an alternative solution that can provide the platform to effectively and expeditiously resolve a dispute prior to filing an investor-state arbitration claim.[87] In this sense, investor-state mediation can also be more effective when compared to pre-arbitration consultations as well as negotiation. To a certain extent, negotiation is an umbrella notion that covers both the pre-arbitration phase, whereupon an investor-state mediation might take place, and the arbitration phase, that could be initiated after an unfruitful investor-state mediation.[88] These initial remarks aim to set the limitations of investor-state mediation and also set its relation to other forms of alternative dispute resolution in the international investment law arena. Regardless, the purpose of this article is to show how the rise of transparency in investor-state arbitration could affect the dynamics of investor-state mediation. In order to appraise this working hypothesis, the next Part delineates the IBA Rules on Investor-State Mediation and emerging models of investor-state mediation clauses in investment treaties. Before however examining the emerging models of investor-state mediation, it is worth looking at "quasi-mediation proceedings" that already exist under the auspices of the World Bank, particularly under the ICSID Conciliation Proceedings.

### *C. ICSID Conciliation Proceedings*

Under the ICSID Convention, the "purpose of the Centre shall be to provide facilities for conciliation and arbitration of investment disputes between Contracting States and nationals of other Contracting States in accordance with the provisions of this Convention."[89] Pursuant to this mandate the Centre in 1967 promulgated the ICSID Conciliation Rules[90] and subsequently in 1978 the ICSID

85. *See* Vattenfall AB, ICSID Case No. ARB/12/12; NATHALIE BERNASCONI-OSTERWALDER & MARTIN DIETRICH BRAUCH, INT'L INST. FOR SUSTAINABLE DEV., THE STATE OF PLAY IN VATTENFALL V. GERMANY II: LEAVING THE GERMAN PUBLIC IN THE DARK 2 (Dec. 2014), http://www.iisd.org/sites/default/files/publications/state-of-play-vattenfall-vs-germany-II-leaving-german-public-dark-en.pdf.

86. *See supra* Section IIA.

87. Jean E. Kalicki, *Mediation of Investor-State Disputes: Revisiting the Prospects*, KLUWER ARB. BLOG (June 13, 2013), http://kluwerarbitrationblog.com/2013/06/14/mediation-of-investor-state-disputes-revisiting-the-prospects/.

88. Jeswald W. Salacuse, *Is There a Better Way? Alternative Methods of Treaty-Based, Investor-State Dispute Resolution* 31(1) FORDHAM INT'L L. J. 138, 155 (2007).

89. *See* ICSID CONVENTION, *supra* note 7, art. 1(2).

90. The original Conciliation Rules were adopted on Sept. 25, 1967 and were effective as of Jan.1, 1968. The Conciliation Rules have subsequently been amended three times. The first amendment was approved and took immediate effect on Sept. 26, 1984. The second amendment was approved on Sept. 29, 2002 and was effective on Jan. 1, 2003. The current Conciliation Rules were approved by

Additional Facility Conciliation Rules.[91] Nevertheless, as of December 31, 2016, ICSID had registered 597 cases,[92] of which merely eight under the Conciliation Rules and two under the Additional Facility Conciliation Rules.[93]

While ICSID Conciliation proceedings encompass many of the core characteristics paradigmatic to mediation,[94] they also create a rigid arbitration-like procedural framework. In fact, it has been observed that the Conciliation Rules provide for

> a lengthy process, particularly in the beginning. It can take over four months to constitute a conciliation commission under the ICSID Rules, and then another sixty days to have a first session, facts that exacerbate the perception of ICSID Conciliation as a protracted process that does little to create momentum. It is natural, therefore, that parties seeking resolution of their disputes would not opt for a process that is perceived to simply prolong (or prevent) the production of a binding legal document.[95]

The limited publicly available information supports the accuracy of the above statement. In fact, in two recent conciliation cases, the proceedings lasted for about three years and appear to have taken the form of hard-fought trials.[96] Based on the

written vote of the Administrative Council in 2006 and were effective from Apr. 10, 2006: (ICSID Rules (2006). *See* https://icsid.worldbank.org/en/Pages/icsiddocs/ICSID-Convention-Conciliation-Rules.aspx.

91. The original Additional Facility Conciliation Rules were adopted in 1978. The Additional Facility Conciliation Rules have subsequently been amended twice. The first amendment was approved on Sept. 29, 2002 and was effective on Jan. 1, 2003. The current rules were approved by written vote of the Administrative Council in early 2006 and was effective from Apr. 10, 2006: ICSID Additional Facility Rules (2006). *See* https://icsid.worldbank.org/en/Pages/icsiddocs/ICSID-Conciliation-(Additional-Facility)-Rules.aspx.

92. *See* THE ICSID CASELOAD – STATISTICS (ISSUE 2017-1), ICSID, https://icsid.worldbank.org/en/Documents/resources/ICSID%20Web%20Stats%202017-1%20(English)%20Final.pdf.

93. *See* Xenofon Karagiannis v. Republic of Albania, ICSID Case No. CONC/16/1; Republic of Equatorial Guinea v. CMS Energy Corporation and others, ICSID Case No. CONC(AF)/12/2; Hess Equatorial Guinea, Inc. and Tullow Equatorial Guinea Limited v. Republic of Equatorial Guinea, ICSID Case No. CONC(AF)/12/1; RSM Production Corporation v. Republic of Cameroon, ICSID Case No. CONC/11/1; Shareholders of SESAM v. Central African Republic, ICSID Case No. CONC/07/1; Togo Electricité v. Republic of Togo, ICSID Case No. CONC/05/1; TG World Petroleum Limited v. Republic of Niger, ICSID Case No. CONC/03/1; SEDITEX Engineering Beratungsgesellschaft für dieTextilindustrie m.b.H. v. Madagascar, ICSID Case No. CONC/94/1; Tesoro Petroleum Corporation v. Trinidad and Tobago, ICSID Case No. CONC/83/1; SEDITEX Engineering Beratungsgesellschaft für die Textilindustrie m.b.H. v. Democratic Republic of Madagascar, ICSID Case No. CONC/82/1;

94. *See* ICSID CONVENTION, *supra* note 7, arts. 28–35.

95. *See* Margrete Stevens & Ben Love, *Investor-State Mediation: Observations on the Role of Institutions* 23, www.cedr.com/about_us/arbitration_commission/.

96. *See* Republic of Equatorial Guinea v. CMS Energy Corporation and others, ICSID Case No. CONC(AF)/12/2 (Procedural Details: June 29, 2012, The Secretary-General registers a request for the institution of conciliation proceedings; July 4, 2012, Following the appointment by the parties, Claus von Wobeser (Mexican) accepts his appointment as Sole Conciliator; Mar. 15, 2013, The Sole Conciliator holds a first session in New York; Sept. 16, 2013, Each party files a written statement of its position pursuant to Article 33 of the ICSID Conciliation (Additional Facility) Rules; Oct. 18, 2013 –

above, it would appear that ICSID conciliation proceedings cannot readily be equated to investor-state mediation, as this has recently emerged, and is further discussed in Part III of this article.

## III. THE EVOLUTION OF INVESTOR-STATE MEDIATION

### *A. The IBA 2012 Rules on Investor-State Mediation*

#### 1. Background

The IBA rules for Investor-State mediation ("The Rules") have as their primary purpose the establishment of a set of concrete measures to be followed in an investor-state mediation context to increase resort to mediation for investor-state disputes.[97] The State Mediation subcommittee of the Mediation committee, housed under the IBA, promulgates The Rules.[98] Formally adopted on October 4, 2012, The Rules are divided into 12 articles, and facilitate the resolution of disputes between States and States entities.[99] The Rules establish clear guidelines for the commencement of mediation and for the appointment of a mediator in absence of party agreement.

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Oct. 19, 2013, The Sole Conciliator visits the place connected with the dispute pursuant to Article 30 (4)(c) of the ICSID Conciliation (Additional Facility) Rules; Nov. 1, 2013, Each party files a second written statement of its position pursuant to Article 33 of the ICSID Conciliation (Additional Facility) Rules; Mar. 25, 2014 - Mar.27, 2014, The Sole Conciliator holds a hearing on conciliation in New York; Jan. 12, 2015, The Sole Conciliator declares the proceeding closed in accordance with Article 37(2) of the Conciliation (Additional Facility) Rules; May 12, 2015, The Sole Conciliator renders its Report); RSM Production Corporation v. Republic of Cameroon, ICSID Case No. CONC/11/1 (Procedural Details: Sept. 19, 2011, The Secretary-General registers a request for the institution of conciliation proceedings; Dec. 6, 2011, Following appointment by the Claimant, J. Caleb Boggs III (U.S.) accepts his appointment as conciliator; Dec. 23, 2011, Following appointment by the Respondent, Jean-Pierre Ancel (French) accepts his appointment as conciliator; Feb. 17, 2012, Following appointment by the Chairman, Marino Baldi (Swiss) accepts his appointment as Commission President; Apr. 4, 2012, The Commission holds a first session in Paris; Apr. 30, 2012, The Respondent files a request for the Commission to order the joinder of a third-party to the conciliation proceedings; May 14, 2012, The Claimant files observations on the Respondent's request of April 30, 2012; June 15, 2012, The Commission decides on the Respondent's request of April 30, 2012; Aug. 9, 2012, The Commission issues Procedural Order No. 1 regarding the participation of a third-party to the proceedings; Aug. 17, 2012, The Commission issues Procedural Order No. 2 concerning the procedural calendar; Sept. 7, 2012, The Claimant files a statement of facts; Sept. 28, 2012, The Respondent files a statement of facts; Oct. 24, 2012 - Oct. 25, 2012, The Commission holds a hearing on the merits in Paris; Dec. 19, 2012 - Dec. 20, 2012, The Commission holds a hearing on the merits in Paris; April 15, 2013, The Commission declares the proceeding closed in accordance with Article (34)(2) of the ICSID Convention and ICSID Conciliation Rule 30(2); June 11, 2013, The Commission renders its Report).

97. International Bar Association Mediation Committee, State Mediation Subcommittee, *IBA Rules for Investor-State Mediation*, art. 1 (Oct 2012), *available at* http://www.ibanet.org/Document/Default.aspx?DocumentUid=8120ED11-F3C8-4A66-BE81-77CB3FDB9E9F.

98. *Id.*

99. *Id.*

2. Scope and Application

The Rules are designed for mediation of investment-related disputes involving States and States entities.[100] The Rules apply when the mediating parties have agreed on the rules or authorized a mediator to apply the rules.[101] The Rules may be varied or excluded partially or wholly at any time.[102] Local provisions of law take precedence over The Rules.[103]

3. News and Commentary

Wolters Kluwer N.V. commented that The Rules contain mostly standard clauses seen in other mediation rules, but also contain innovative regulations such as the clause on "Mediation Management Conference" (Article 9).[104] It was also relatively optimistic on the future application of The Rules and the entrance of Mediation into the arena of Investor-State mediation.[105] Herbert Smith Freehills commented on the relatively new development of including provisions for co-mediators, as well as the requirement of disclosure of any personal interest or personal conflict in a "statement of independence and availability."[106]

*B. The emerging EU Model and Investor-State Mediation*

A growing number of bilateral and multilateral trade agreements have recently integrated provisions for investor-state mediation into their respective frameworks as will be discussed below.[107]

The EU-Canada Comprehensive Economic and Trade Agreement (CETA), includes distinct investor-state mediation provisions.[108] In particular, the investor-state mediation clause reads as follows:

> The disputing parties may at any time agree to have recourse to mediation.

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100. *See id.* art. 1.

101. *See id.* art. 1(a).

102. International Bar Association Mediation Committee, State Mediation Subcommittee, *IBA Rules for Investor-State Mediation*, art. 2 (Oct 2012), *available at* http://www.ibanet.org/Document/Default.aspx?DocumentUid=8120ED11-F3C8-4A66-BE81-77CB3FDB9E9F.

103. *See id.* art. 3.

104. *Id.* art. 9; Kalicki, *supra* note 87.

105. *See* Munir Maniruzzaman, *A Rethink of Investor-State Dispute Settlement*, KLUWER ARB. BLOG (May 30, 2013), http://kluwerarbitrationblog.com/blog/2013/05/30/a-rethink-of-investor-state-dispute-settlement/.

106. *See* Herbert Smith Freehills, *International Bar Association launches investor-state mediation rules* (Oct. 23, 2012), http://hsfnotes.com/adr/2012/10/23/international-bar-association-launches-investor-state-mediation-rules/.

107. *See, e.g.*, Comprehensive Economic and Trade Agreement, EU-Can., Annex 8-D, Oct. 30, 2016 [hereinafter CETA], *available at* http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf; EU-Vietnam Free Trade Agreement, EU-Viet, art 20, Feb. 1, 2016 [hereinafter EU-Viet. FTA]; Trans-Pacific Partnership Trade Agreement, art 9.5, Feb. 4, 2016 [hereinafter TPP].

108. *See* CETA, *supra* note 107.

> Recourse to mediation is without prejudice to the legal position or rights of either disputing party under this Chapter and is governed by the rules agreed to by the disputing parties including, if available, the rules for mediation adopted by the Committee on Services and Investment pursuant to Article 8.44.3(c).
>
> The mediator is appointed by agreement of the disputing parties. The disputing parties may also request that the Secretary-General of ICSID appoint the mediator.
>
> The disputing parties shall endeavour to reach a resolution of the dispute within 60 days from the appointment of the mediator.
>
> If the disputing parties agree to have recourse to mediation, Articles 8.19.6 and 8.19.8 shall not apply from the date on which the disputing parties agreed to have recourse to mediation to the date on which either disputing party decides to terminate the mediation. A decision by a disputing party to terminate the mediation shall be transmitted by way of a letter to the mediator and the other disputing party.[109]

Annex 29-C of CETA sets out Mediation Procedures for disputes between the Contracting Parties, which could potentially also influence investor-state mediation proceedings.[110] These Articles describe the process of initiating the mediation process, selecting the mediator, the mediation rules, implementation, confidentiality, time limits, cost allocation, and puts in place a mechanism for ongoing review of the Procedures.[111]

Similarly, the EU-Singapore FTA under its Annex 9-E and 9-F sets out a Mediation Mechanism for Investor-State Disputes and a Code of Conduct For Arbitrators and Mediators.[112] These provisions are quite similar to those found in CETA derive from a common objective of assisting parties to "facilitate the finding of a mutually agreed solution through a comprehensive and expeditious procedure."[113] The same model is expected to be followed in all future investment chapters included in EU's FTAs, as is evidenced by the recent conclusion of the EU-Vietnam FTA, that also includes an investor-state mediation clause.[114]

Further reflecting the trend toward the integration of mediation mechanisms into investor-state dispute resolution, the Trans-Pacific Partnership Trade Agreement (TPP)[115] sets out a provision for mediation under its article 9.18 as follows:

> 1. In the event of an investment dispute, the claimant and the respondent should initially seek to resolve the dispute through consultation and

109. *Id.* art. 8.20.

110. *Id.* at Annex 29-C, art. 1–9.

111. *Id.* at Annex 29-C, art. 1–9.

112. EU-Sing. Free Trade Agreement, EU-Sing., June 29, 2015 [hereinafter EU-Sing. FTA], Annex 9-E and 9-F.

113. *Id.*

114. EU-Viet. FTA, *supra* note 107, art. 5.

115. TPP, *supra* note 107, art. 9.18.

> negotiation, which may include the use of non-binding, third party procedures, such as good offices, conciliation or mediation.
>
> 2. The claimant shall deliver to the respondent a written request for consultations setting out a brief description of facts regarding the measure or measures at issue.
>
> 3. For greater certainty, the initiation of consultations and negotiations shall not be construed as recognition of the jurisdiction of the tribunal.[116]
>
> However, unlike the EU mediation model, the TPP provides little if at all details on the procedure to be followed in investor-state mediation cases.

*D. The Convention on the Enforcement of Mediated Settlements*

The Convention on the Enforcement of Mediated Settlements (CEMS)[117], proposed in July 2014 during a session of UNCITRAL, aims to establish provisions on the enforceability of international commercial settlement agreements reached through mediation/conciliation.[118] Working Group II ("WGII"), one of six working groups established by UNCITRAL to perform the substantive preparatory work, received a mandate in July 2015 to explore the development of either (i) a guidance text, (ii) model legislative provisions, or (iii) a convention on the enforcement of mediated settlements.[119] The aim of such a convention is to build on the success of the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("NY Convention") in the development, promotion and use of international mediation worldwide.[120] Observers have noted that if the Convention is adopted with the same enthusiasm as the NY Convention:

> [I]t will (i) create a strong international legal framework for mediation, that will (ii) encourage more parties to use this mechanism and (iii) result in many more disputes being settled without the time and expenses of litigation and arbitration, leading to (iv) greater and more effective access to justice.[121]

These developments and especially the possibility of the conclusion of the CEMS, will on the one hand enhance the international enforceability of mediated settlements but on the other hand may raise serious concerns with respect transparency. For if CEMS were to be concluded, could it mean that investor-state mediation would now be convenient method to avoid the high levels of transparency now paradigmatic to investor-state arbitration? To respond to this issue, it is first necessary to turn to the current state of transparency in investor-

116. *Id.*, art. 9.18.

117. *See generally* Shentenawi, *supra* note 25.

118. *Id.*

119. *Id.*

120. U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York, June 10, 1958.

121. Shentenawi, *supra* note 25.

state arbitration.

## IV. THE RISE OF TRANSPARENCY IN INVESTOR-STATE ARBITRATION

Transparency in investor-state arbitration has recently entered a completely new phase,[122] with the adoption of the 2014 UNCITRAL Rules on Transparency[123] and the conclusion of the United Nations Convention on Transparency in Treaty-Based Investor-State Arbitration (known as Mauritius Convention).[124] The basic characteristics of these instruments are further discussed below. Suffice it to say, however, the surge in transparency requirements in investor-state arbitration was caused by generally the same reasons driving the so-called backlash against this method of international dispute settlement. These reasons were briefly discussed in the introduction to this article, and among others revolve around public interest concerns and the nature and sectors where investor-state arbitration cases arise. The purpose of this Section is to delineate the main tenets of the UNCITRAL Rules on Transparency[125] and the Mauritius Convention[126] and thus pave the way for the next Section that will appraise these developments in light of investor-state mediation and the proposed Convention on the Enforcement of Mediated Settlements.

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122. *See generally* Stephan W. Schill, *Editorial: The Mauritius Convention on Transparency*, 16 J. WORLD INV. & TRADE 201, 201-04 (2015) [hereinafter Schill, *Editorial*]; Stephan W. Schill, *Editorial: Five Times Transparency in International Investment Law*, 15 J. WORLD INV. & TRADE 363, 369-72 (2014); Lise Johnson, *The Transparency Rules and Transparency Convention: A good start and model for broader reform in investor-state arbitration*, COLUM. FDI PERSPECTIVES, July 21, 2014, *available at* ccsi.columbia.edu/files/2013/10/No-126-Johnson-FINAL1.pdf (last visited Aug. 27, 2015); Samuel Levander, *Resolving "Dynamic Interpretation": An Empirical Analysis of the UNCITRAL Rules on Transparency*, 52 COLUM. J. TRANSNAT'L L. 506, 540-41 (2014); Luke Eric Peterson, *As Transparency Rules Take Effect, And UN Launches Case Registry, How Much Of ISDS Universe Will Be Laid Open Through This New Portal?*, INVEST. ARB. REP., Apr. 1, 2014, *available at* www.iareporter.com/articles/as-transparency-rules-take-effect-and-un-launches-case-registry-how-much-of-isds-universe-will-be-laid-open-through-this-new-portal/ (last visited Aug. 27, 2015).

123. *See* UNCITRAL, UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration (2014), as adopted by Resolution of the General Assembly 68/109, U.N. Doc. A/68/462 (Dec. 16, 2013), *available at* www.uncitral.org/pdf/english/texts/arbitration/rules-on-transparency/Rules-on-Transparency-E.pdf [hereinafter Transparency Rules].

124. *See* UNCITRAL, U.N. Convention on Transparency in Treaty-based Investor-State Arbitration, G.A. Res. 69/116, U.N. Doc. A/69/496 (Dec. 10, 2014), *available at* www.uncitral.org/pdf/english/texts/arbitration/transparency-convention/Transparency-Convention-e.pdf [hereinafter Mauritius Convention]; *see also* UNCITRAL, U.N. Commission on International Trade Law Approves Draft UNCITRAL Convention on Transparency in Treaty-Based Investor-State Arbitration, U.N. Press Release UNIS/L/202 (July 10, 2014), *available at* www.unis.unvienna.org/unis/en/pressrels/2014/unisl202.html.

125. Transparency Rules, *supra* note 123.

126. Mauritius Convention, *supra* note 124.

### *A. The UNCITRAL Rules on Transparency*

#### 1. Background

The UNCITRAL Rules on Transparency in Treaty-based investor-State Arbitration (the "Rules on Transparency"), which came into effect on April 1, 2014, "comprise a set of procedural rules that provide for transparency and accessibility to the public of treaty-based investor-State arbitration."[127] The aim is to facilitate public disclosure of arbitration awards. This follows transparency trends within other areas of international arbitration (such as ICSID) and can give rise to greater consistency in awards.[128]

#### 2. Scope

The Rules on Transparency in general apply to investor-state arbitration under the UNCITRAL Arbitration Rules, but only for investment treaties concluded on or after April 1, 2014.[129] For investment treaties prior to that date, as well as for treaties that fall within the above temporal scope, the Rules can apply by agreement of the disputing parties.[130]

#### 3. Content

In terms of substance and content, the Rules on Transparency deal with four main aspects of transparency considerations in investor-state arbitration.[131] In brief, these are the publication of documents arising from such proceedings, the openness of investor-state arbitration hearings, the participation of the Contracting Parties to an investment treaty and the participation of amicus curiae.[132]

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127. *See UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration*, UNCITRAL, http://www.uncitral.org/uncitral/uncitral_texts/arbitration/2014Transparency.html (last visited Nov. 19, 2016).

128. *See* Christina Knahr, *The New Rules on Participation of Non-Disputing Parties in ICSID Arbitration – Blessing or Curse?*, *in* EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION 319 (Chester Brown & Kate Miles eds., 2011); Christina Knahr & August Reinisch, *Transparency versus Confidentiality in International Investment Arbitration – The Biwater Gauff Compromise*, 6 LAW & PRAC. INT'L CTS. & TRIBUNALS 97, 97-118 (2007); LUCY REED ET AL., GUIDE TO ICSID ARBITRATION 141 (2d ed. 2011); Margie-Lys Jaime, *Relying Upon Parties' Interpretation In Treaty-Based Investor-State Dispute Settlement: Filling The Gaps In International Investment Agreements*, 46 GEO. J. INT'L L. 261, 287 (2014). *See also* ICSID Convention, *supra* note 7, art. 48(5); ICSID Convention Arbitration Rules, rules 37(2) and 48(4) (2006); *see also* ICSID Arbitration (Additional Facility) Rules, art. 53(3) (2006).

129. *See* Transparency Rules, *supra* note 115, art. 1(1); *see also id.* art. 1(2); Luke E. Peterson, *UN Working Group Finalizes UNCITRAL Transparency Rules, But They Won't Apply Automatically To Stockpiles Of Existing Investment Treaties*, INVEST. ARB. REP., Feb. 14, 2013, *available at* www.iareporter.com/articles/un-working-group-finalizes-uncitral-transparency-rules-but-they-wont-apply-automatically-to-stockpiles-of-existing-investment-treaties/ (last visited Aug. 27, 2015); Julia Salasky & Corinne Montineri, *UNCITRAL Rules on Transparency in Treaty-Based Investor-State Arbitration*, 31 ASA BULLETIN 774, 774–76 (2013).

130. *See* Transparency Rules, *supra* note 123, art. 1(2), art. 1(9).

131. *Id.* art. 3(1).

132. *Id.*

With respect to the publication of documents arising from investor-state arbitration, the Rules on Transparency list a series of documents that are subject to public disclosure, including expert reports and witness statements.[133] The exhibits themselves are generally excluded from public disclosure but a table listing all exhibits should nevertheless be disclosed.[134] Specific provisions also provide for the protection of confidential information, that are subject to redaction prior to the disclosure of documents arising from investor-state arbitration.[135] The wide scope of transparency is also linked to oral hearings that are generally open to the public and through any means, including live transmission on the web.[136] Certainly, parts of the hearings can be conducted *in camera* when "there is a need to protect confidential information or the integrity of the arbitral process."[137] The participation of Contracting Parties and amicus curiae deals with the participation of non-disputing parties *lato sensu*.[138] Contracting Parties to an investment treaty - usually the investor's home state- can make submissions with regard to "issues of treaty interpretation"[139] and following the consultation of the disputing parties, an arbitral tribunal can also allow submissions "on further matters within the scope of

133. *Id.* art. 3(2).

134. *Id.* art. 3(1). *Compare* U.S. Model Bilateral Investment Treaty, art. 29(1) (2004) [hereinafter U.S. Model BIT 2004], *with* U.S. Model Bilateral Investment Treaty, art. 29(1) (2012) [hereinafter U.S. Model BIT 2012].

135. Transparency Rules, *supra* note 115, art. 7(2)–(7), 7(3)–(4) state:

> 3. The arbitral tribunal, after consultation with the disputing parties, shall make arrangements to prevent any confidential or protected information from being made available to the public, including by putting in place, as appropriate: (a) Time limits in which a disputing party, non-disputing Party to the treaty or third person shall give notice that it seeks protection for such information in documents; (b) Procedures for the prompt designation and redaction of the particular confidential or protected information in such documents; and (c) Procedures for holding hearings in private to the extent required by article 6, paragraph 2. Any determination as to whether information is confidential or protected shall be made by the arbitral tribunal after consultation with the disputing parties. 4. Where the arbitral tribunal determines that information should not be redacted from a document, or that a document should not be prevented from being made available to the public, any disputing party, non-disputing Party to the treaty or third person that voluntarily introduced the document into the record shall be permitted to withdraw all or part of the document from the record of the arbitral proceedings.

*See also* Federico Ortino, *Transparency of Investment Awards: External and Internal Dimensions*, *in* TRANSPARENCY IN INTERNATIONAL TRADE AND INVESTMENT DISPUTE SETTLEMENT 119, 132–34 (Junji Nakagawa ed., 2013); JOACHIM DELANEY & DANIEL B. MAGRAW, PROCEDURAL TRANSPARENCY 751–76 (2008); Calamita, *supra* note 22, at 649–50; Barnali Choudhury, *Recapturing Public Power: Is Investment Arbitration's Engagement of the Public Interest Contributing to the Democratic Deficit?*, 41 VAND. J. TRANSNAT'L L. 775, 786–87 (2008).

136. Transparency Rules, *supra* note 123, art. 6(3) ("tribunal shall make logistical arrangements to facilitate the public access to hearings ("including where appropriate by organizing attendance through video links or such other means as it deems appropriate.")

137. Transparency Rules, *supra* note 123, art. 6(2).

138. *See* Jaime, *supra* note 128, at 287. Anthea Roberts, *Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System*, 107 AM. J. INT'L L. 45 (2013).

139. Transparency Rules, *supra* note 123, art. 5(1).

the dispute."[140] On the other hand, *amicus curiae* submissions or briefs refer to submissions of non-state actors, such as NGOs.[141] Such third parties are allowed to file submissions under a certain procedure[142] ensuring that the subject matter of such submission is within the scope of the dispute, that such submission "would assist the arbitral tribunal in the determination of a factual or legal issue",[143] does not "disrupt or unduly burden the arbitral proceedings, or unfairly prejudice any disputing party",[144] and that the disputants "are given a reasonable opportunity to present their observations on any submission by the third person."[145] Amici are nevertheless not allowed to participate in the arbitration hearing and present oral evidence.

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140. Transparency Rules, *supra* note 123, art. 5(2).

141. *See* Lucas Bastin, *Amici Curiae in Investor-State Arbitration: Eight Recent Trends*, 30 ARB. INT'L 125, 127–40 (2014); Lucas Bastin, *The Amicus Curiae in Investor-State Arbitration*, 1 CAMBRIDGE J. INT'L & COMP. L. 208, 214–21 (2012); Laurence Boisson de Chazournes, *Transparency and Amicus Curiae Briefs*, 1 J. WORLD INT'L & TRADE 333 (2004); Alexis Mourre, *Are Amici Curiae the Proper Response to the Public's Concerns on Transparency in Investment Arbitration?*, 5 LAW & PRAC. INT'L CTS. & TRIBUNALS 257, 257–71 (2006); Andrea Bjorklund, *The Participation of Sub-National Government Units as Amici Curiae in International Investment Disputes*, *in* EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION 298, 298–316 (Chester Brown & Kate Miles eds., 2011); Jorge Viñuales, *Amicus Intervention in Investor-State Arbitration*, 61(4) DISP. RES. J. 72 (2007); J. Anthony VanDuzer, *Enhancing the Procedural Legitimacy of Investor-State Arbitration Through Transparency and Amicus Curiae Participation*, 52 MCGILL L. J. 681, 697–705 (2007); Julie Lee, *UNCITRAL's Unclear Transparency Instrument: Fashioning the Form and Application of a Legal Standard Ensuring Greater Disclosure in Investor-State Arbitrations*, 33 NW. J. INT'L L. & BUS. 439, 493-56 (2013); Andrea K. Bjorklund, *The Emerging Civilization of Investment Arbitration*, 113 PENN ST. L. REV. 1269, 1286–90 (2009); Epaminontas E. Triantafilou, *Amicus Submissions in Investor-State Arbitration After Suez v. Argentina: The Gillis Wetter Prize*, 24 ARB. INT'L 571 (2008); Tomoko Ishikawa, *Third Party Participation In Investment Treaty Arbitration*, 59 INT'L & COMP. L.Q. 373, 373–412 (2010); Eugenia Levine, *Amicus Curiae in International Investment Arbitration: The Implications of an Increase in Third-Party Participation*, 29 BERK. J. INT'L L. 200, 200–24 (2011).

142. Transparency Rules, *supra* note 115, art. 4(1)–(2) states:

> After consultation with the disputing parties, the arbitral tribunal may allow a person that is not a disputing party, and not a non-disputing Party to the treaty ('third person(s)'), to file a written submission with the arbitral tribunal regarding a matter within the scope of the dispute. A third person wishing to make a submission shall apply to the arbitral tribunal, and shall, in a concise written statement, which is in a language of the arbitration and complies with any page limits set by the arbitral tribunal: (a) Describe the third person, including, where relevant, its membership and legal status (e.g., trade association or other non-governmental organization), its general objectives, the nature of its activities and any parent organization (including any organization that directly or indirectly controls the third person); (b) Disclose any connection, direct or indirect, which the third person has with any disputing party; (c) Provide information on any government, person or organization that has provided to the third person (i) any financial or other assistance in preparing the submission; or (ii) substantial assistance in either of the two years preceding the application by the third person under this article (e.g. funding around 20 per cent of its overall operations annually); (d) Describe the nature of the interest that the third person has in the arbitration; and (e) Identify the specific issues of fact or law in the arbitration that the third person wishes to address in its written submission.

143. *Id.* art. 4(3)(b).

144. *Id.* art. 4(5).

145. *Id.* art. 4(6).

The above delineation of the Rules on Transparency elucidates the drastic change that these rules endeavor to make in the field of international investment law. The limitation of their temporal scope to investment treaties concluded on or after April 1, 2014, has recently been addressed by the Mauritius Convention discussed below.[146]

*B. The Mauritius Convention*

1. Background

The United Nations Convention on Transparency in Treaty-Based Investor-State Arbitration was approved by the UN General Assembly in the Fall of 2014,[147] and was opened for signature in Port Louis on March 17, 2015 (hence the name "Mauritius Convention").[148]

2. Scope

Unlike the Rules on Transparency, the Mauritius Convention applies to investment treaties concluded before April 1, 2014[149] and to investor-state arbitrations initiated under such treaties after the Mauritius Convention enters into force.[150] For the Convention to enter into force, three ratifications are required, but as of today, Mauritius is the only country that has ratified the Convention.[151] Furthermore, subject to a reservation stating otherwise, when the host state (respondent state) but not the investor's home state has ratified the Convention, the Transparency Rules will apply to an investment treaty concluded before April 1, 2014, at the election of the disputing investor (unilateral offer of application).[152]

3. Content

The Mauritius Convention does not include substantive provisions in its body but merely incorporates by reference the Rules on Transparency discussed above. The Convention nevertheless adopts a slightly different approach with respect to its application. Unlike the Rules on Transparency that generally apply to investor-state arbitration under the UNCITRAL Arbitration Rules, unless the disputing parties otherwise agree, the Convention applies to any investor-state arbitration.[153] Certainly, this broader application is to a certain degree limited by a set of reservations that are available to the contracting parties that eventually choose to

146. Mauritius Convention, *supra* note 124.

147. *See* U.N. Convention on Transparency, *supra* note 124.

148. Mauritius Convention, *supra* note 124; *States Sign Convention on Transparency*, 10(2) GLOBAL ARB. REV. 7, 7 (2015); Lise Johnson, *The Mauritius Convention on Transparency: Comments on the treaty and its role in increasing transparency of investor-State arbitration*, CCSI Policy Paper, Sept. 2014, *available at* http://ccsi.columbia.edu/files/2013/12/10.-Johnson-Mauritius-Convention-on-Transparency-Convention.pdf (last visited Jan. 12, 2016).

149. Mauritius Convention, *supra* note 124, art. 1(1).

150. *Id.* art. 5.

151. *Id.* art. 9.

152. *Id.* art. 2(2).

153. *Id.* art. 2(1).

ratify the Convention. Whether they will also make reservations and thus limit the application of the Mauritius Convention to certain investment treaties or investor-state arbitration under certain arbitration rules, remains to be seen in the near future.[154]

## V. ARE TRANSPARENCY AND MEDIATION ANTITHETIC IN NATURE?

### *A. Investor-State Mediation as a threat to Transparency?*

For cases that continue to raise sensitive issues of a confidential nature, parties may consider the confidentiality requirements associated with investor state mediation. Confidentiality has been considered as an essential element in mediation. It has been conceived that confidentiality encourages parties to speak freely and openly in the mediation while ensuring the integrity of the process.[155] However, there is always a tension between confidentiality of mediation process and the administration of justice. When parties wish to litigate on issues related to topics addressed during mediation, in most cases the courts are not permitted to rely on mediated discussions unless special circumstances exist.[156] Only in circumstances where pre-existing information which is admissible in trial is also disclosed in mediation, or information is shared that is generally available to the public, or the parties allege breach of duty or professional misconduct of the mediator, can the limits of confidentiality in mediation be said to be reached.[157]

Notwithstanding the general approach to confidentiality within the mediation process, there have been several examples of non-confidential public sector resource mediation, which demonstrate the possibilities for transparency in select investor-state mediation cases. For example, take the mediation involving the Snake River Basin in the United States involving $200 million USD in damages and raising over 150,000 water rights claims employed a public mediation process.[158] The case involved legal issues pertaining to treaty and statutory interpretation of federal and constitutional statutes.[159] Parties included an Idaho Power Company and a plethora of interested federal entities including the Department of the Interior, the Department of Agriculture, the Department of Energy, the Bureau of Indian Affairs, the Council of Environmental Quality, and the Fish and Wildlife Services to name a few.[160] The issues varied from "fishing in

154. The available reservations are of three kinds: (a) the Rules on Transparency will not apply with respect to a specific investment treaty. Mauritius Convention, *supra* note 116, art. 3(1)(a); the Rules on Transparency will only apply with respect to arbitrations under the UNCITRAL Rules. Mauritius Convention, *supra* note 116, art. 3(1)(b); the unilateral offer will not apply in cases in which a state is the respondent. Mauritius Convention, *supra* note 124, art. 3(1)(c).

155. ALEXANDER NADJA, INTERNATIONAL AND COMPARATIVE MEDIATION: LEGAL PERSPECTIVES 245 (2009).

156. *Id.* at 247.

157. *Id.* at 282–285.

158. Francis McGovern, *Mediation of the Snake River Basin*, 42 IDAHO L. REV. 547, 548–53 (2006).

159. *Id.* at 553.

160. *Id.* at 553–54.

general" of particular species like Salmon, to fishing passage, fish rearing and water flow along with channel maintenance, industrial and municipal pollution, and recreational uses of the river.[161] The conflict was also riddled with legal issues pertaining the interpretation of Treaties of 1855[162], 1863[163] and 1893,[164] and U.S. federal statutes such as The Endangered Species Act (ESA)[165] and the Clean Water Act[166] The main issues largely involved how statutes for the maintenance of the quality of the river could be enforced if the resources were shared and clarifying the fragile relationship between the federal government and the Indian tribes in terms of resource management responsibilities.[167]

In terms of the mediation process employed in this public sector dispute, a problem-solving and forward looking approach was taken.[168] The ultimate success of the mediation was attributed to the focus on "future" and a realistic and "doable" settlement possibilities.[169] The process lasted for six years reaching settlements on "water flows, endangered species, resource allocation and management, and governmental cooperation."[170] The parties arrived at a settlement of federal funding in the amount of $200 million USD and an agreement of cooperative management for maintenance of water quality and flows of creeks and streams. This creative, multi-pronged settlement was made possible through the help of a small team of lawyers, stakeholders, and the use of a problem-solving model, all of which was feasible in the context of mediation, but very likely a result that could not have been achieved through an adjudication process.[171]

Similarly, the mediation involving the management of the endangered Allagash river resources employed a public mediation process.[172] The parties - a group of 23 stakeholders and advisors, including environmentalists, native sportsmen, Maine residents, and state canoeists - had been embroiled in a long term conflict with "no prospect of 'victory.'"[173] These parties agreed to meet over a 30 hour mediated deliberation in the backdrop of a retreat at the River Divers Restaurant in Millinocket, Maine.[174] The mediator spent considerable time with the stakeholders individually so as to understand their concerns and ascertain

161. *Id.* at 555.

162. *Id.* at 548.

163. Francis McGovern, *Mediation of the Snake River Basin*, 42 IDAHO L. REV. 547, 548 (2006).

164. *Id.*

165. Endangered Species Act of 1973, Pub. L. No. 93–205, 87 Stat. 884 (1982), *available at* https://www.fws.gov/laws/lawsdigest/esact.html.

166. Clean Water Act of 1977, Pub. L. No. 95–217, 91 Stat. 1566 (1977).

167. McGovern, *supra* note 150, at 555.

168. *Id.* at 557.

169. *Id.* at 561.

170. *Id.* at 562.

171. *Id.*

172. Jonathan W. Reitman, *The Allagash: A Case Study of a Successful Environmental Mediation*, MEDIATE.COM (2003), http://www.mediate.com/articles/reitmanJ.cfm.

173. *Id.*

174. *Id.*

priorities.[175] At issue was the "original intent"[176] of the documents entailing the creation of the waterway as well as a set of related or "tiered" issues.[177] Mediation proved effective in arriving at a "one-text"[178] agreement addressing a diverse set of interests formulated and signed by all concerned parties.[179]

The above examples demonstrate that in some cases, transparent public-sector mediation can prove effective in resolving complex multi-party disputes at the domestic level. This experience is useful in considering the potential applicability of transparent multi-party investor state mediation in a select category of cases.

*B. Investor-State Mediation as a supplementary, gap-filling mechanism*

Many scholars have begun to consider the potential of investor-state mediation as a supplementary gap-filling mechanism in the world of investor-state disputes.[180] This is due not only to the rigidity and financial cost associated with investor-state arbitration as described above, but also due to the often symbiotic relationship between host and investor, potential "policy costs", relational damage and possibility for non-compliance.[181]

In terms of relational considerations, the host state in many cases is often "dependent upon the continued provision by the investor of the needed public service" while the investor "having submitted substantial capital to the privatized enterprise, is dependent on the host country for continued revenues."[182] Cases involving long-term relational commitments are often seen as most conducive to mediated settlements.

Such relational considerations come in to play when considering the question of enforcement. When agreements are imposed and not arrived at through mutual consent, investors often run the risk of a nation choosing not to comply with an adverse award or repeal a given underlying treaty if the award amount is considered burdensome.

In addition to relational considerations and the financial costs of the arbitration process, the "policy cost" of investor state arbitration requiring a "host country to repeal or modify measures that were implemented for the public good"[183] are leading potential parties to look beyond arbitration for resolution.

The case of Metalclad v. Mexico[184] is illustrative. The Chief Executive

175. *Id.*

176. *Id.*

177. Jonathan W. Reitman, *The Allagash: A Case Study of a Successful Environmental Mediation*, MEDIATE.COM (2003), http://www.mediate.com/articles/reitmanJ.cfm.

178. *Id.*

179. *Id.*

180. *See* Timothy Gracious, Investor-State Mediation/Conciliation in India, MEDIATE.COM (2015), http://www.mediate.com/articles/TimothyG3.cfm#.

181. *Id.*

182. *Id.*

183. *Id.*

184. Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AF)/97/1 (May 19, 1997).

Officer of Metalclad, Grant Kesler, noted that after winning a $17 million USD arbitral award against Mexico, in hindsight and despite "winning" the case, felt that "the arbitration had been so dissatisfying that [he] wished the company had relied on other options to resolve the dispute."[185] Such cases illustrate the increasing openness on the part of parties to look beyond arbitration for resolution processes that build upon consensual solutions that respect legitimate policy considerations and preserve on-going relationships.

## VI. CONCLUSION

Reconciling the freedom of expression facilitated through confidential mediation communications and the public interest in transparency is a delicate balance to strike. Cases do exist of effective transparent public sector mediated outcomes at the domestic level with high rates of compliance as described in this paper. Yet, cases also exist requiring a high degree of discretion because they involve trade secrets, sensitive government protocols, and policy concerns that may not be effectively mediated in the glare of the public eye. In light of the above factors, it is suggested that in the early stages of the development of investor-state mediation, confidentiality be preserved. As the process becomes more fully established, familiarity is gained, expertise is developed, and selected mediated cases become public through party consent, the question of transparency in investor-state mediation can also be re-examined with an eye toward gradual openness in the long term.

185. Gracious, *supra* note 180.

# WHEN GREEN INCENTIVES GO PALE: INVESTMENT ARBITRATION AND RENEWABLE ENERGY POLICYMAKING

*FERNANDO DIAS SIMÕES

## I. INVESTMENT LAW AND RENEWABLE ENERGY

The use of renewable sources of energy, along with the implementation of eco-friendly technologies, plays a pivotal role in addressing the predicaments caused by climate change. States, the industry, international organizations, and other stakeholders have been striving to develop and employ new solutions that allow a shift from the current model, based on fossil fuel production and consumption, to one based on low-carbon options,[1] so as to ensure a sustainable future. This global quest for greener alternatives led to the emergence of an international market for renewable energy technologies and equipment.[2] Over the last decade this market attracted gigantic flows of capital.[3] Foreign direct investment is particularly welcome as it can not only provide fresh funds but also induce the transfer of knowledge and technology.[4] From a broader perspective,

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1. *See, e.g.*, ERIC SPIEGEL, NEIL MCARTHUR & ROB NORTON, ENERGY SHIFT: GAME-CHANGING OPTIONS FOR FUELING THE FUTURE (2009) – a general discussion about the changing attitudes towards renewable energy as the technology to create more sustainable living becomes more prevalent and easily available to the general public and state governments.

2. *See generally*, RENEWABLE ENERGY: A GLOBAL REVIEW OF TECHNOLOGIES, POLICIES AND MARKETS (Dirk Assmann et al. eds, 2006), offering an overview of the changes in technologies, policies and markets towards renewable energy.

3. *See, e.g.*, Omar Ellabban et al., *Renewable Energy Resources: Current Status, Future Prospects and their Enabling Technology*, 39 RENEWABLE & SUSTAINABLE ENERGY REV. 748, 758 (2014).

4. Gaëtan Verhoosel, *Foreign Direct Investment and Legal Constraints on Domestic*

foreign investment is a key component of any agenda for sustainable development.[5]

The financial viability of investments in renewable energies is frequently dependent upon public support.[6] All over the world, governments have designed and implemented renewable energy support mechanisms so as to encourage private investment, often in the form of subsidies and incentive tariffs.[7] Among the different available variants, feed-in-tariffs became especially popular.[8] Under this scheme, the electricity generated from renewable or high-efficiency cogeneration installations is paid at a fixed minimum price, generally set higher than the market

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*Environmental Policies: Striking a Reasonable Balance Between Stability and Change*, 29 LAW & POL'Y INT'L BUS. 451, 452 (1998); *see also* Anatole Boute, *The Potential Contribution of International Investment Protection Law to Combat Climate Change*, 27 J. ENERGY & NAT. RESOURCES L. 333, 334–35 (2009) (citing Int'l Inst. For Sustainable Dev. [IISD], *Foreign Investment: Making It Work for Sustainable Development* 6 (Sep. 2002), https://www.iisd.org/sites/default/files/publications/trade_ee_investment.pdf [hereinafter *The Potential Contribution*]; Kyoto Protocol to the United Nations Framework Convention on Climate Change, Dec. 11, 1997, U.N. Doc FCCC/CP/1997/7/Add.1, 37 I.L.M. 22 (1998); *see also* Valentina Vadi, *Balancing Human Rights, Climate Change and Foreign Investment Protection*, *in* CLIMATE CHANGE AND HUMAN RIGHTS: AN INTERNATIONAL AND COMPARATIVE LAW PERSPECTIVE 189, 193 (Ottavio Quirico & Mouloud Boumghar eds., 2016).

5. Andrew Newcombe, *Sustainable Development and Investment Treaty Law*, 8(3) J. OF WORLD INVESTMENT & TRADE 357 (2007) (citing *Agenda 21: Report of the United Nations Conference on Environment and Development*, ¶ 2.23, U.N. Doc. A/CONF.151/26/Rev. 1, (June 14, 1992); *see also* Markus Gehring & Andrew Newcombe, *An Introduction to Sustainable Development in World Investment Law*, *in* 30 SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW 3, 9 (Marie-Claire Segger et al. eds., 2011).

6. WORLD BANK, INCLUSIVE GREEN GROWTH: THE PATHWAY TO SUSTAINABLE DEVELOPMENT 20–22 (2012), http://siteresources.worldbank.org/EXTSDNET/Resources/Inclusive_Green_Growth_May_2012.pdf.

7. *See, e.g.*, Richard L. Ottinger & Rebecca Williams, *Renewable Energy Sources for Development*, 32 ENVTL. L. 331, 359–67 (2002); Bradford Gentry & Jennifer Ronk, *International Investment Agreements and Investments in Renewable Energy*, *in* FROM BARRIERS TO OPPORTUNITIES: RENEWABLE ENERGY ISSUES IN LAW IN POLICY 25, 59–77 (pre-publication draft), http://environment.yale.edu/publication-series/documents/downloads/0-9/11-03-Gentry_Ronk.pdf; Richard Ottinger et al., *Renewable Energy in National Legislation: Challenges and Opportunities*, *in* BEYOND THE CARBON ECONOMY: Energy LAW IN TRANSITION 183, 186–206 (Donald Zillman et al. ed. 2008).

8. *See, generally,* MIGUEL MENDONÇA, FEED-IN TARIFFS: ACCELERATING THE DEPLOYMENT OF RENEWABLE ENERGY (Routledge ed., 2007); MIGUEL MENDONÇA ET AL., POWERING THE GREEN ECONOMY: THE FEED-IN TARIFF HANDBOOK (Routledge ed., 2010) [hereinafter POWERING THE GREEN ECONOMY]; WILSON RICKERSON, U.N. ENVT. PROG. REP. ON FEED-IN TARIFFS AS A POLICY INSTRUMENT FOR PROMOTING RENEWABLE ENERGIES AND GREEN ECONOMIES IN DEVELOPING COUNTRIES (2012); DAVID JACOBS, RENEWABLE ENERGY POLICY CONVERGENCE IN THE EU: THE EVOLUTION OF FEED-IN TARIFFS IN GERMANY, SPAIN AND FRANCE (John J. Kirton & Miranda Schreurs, eds., 2012); TOBY COUTURE ET AL., A POLICYMAKER'S GUIDE TO FEED-IN TARIFF POLICY DESIGN, NATIONAL RENEWABLE ENERGY LABORATORY (2010), available at http://www.nrel.gov/docs/fy10osti/44849.pdf; ANNE HELD ET AL., FEED-IN SYSTEMS IN GERMANY, SPAIN AND SLOVENIA: A COMPARISON, (Energy Econ. Group et al., 2007), http://www.mresearch.com/pdfs/docket4185/NG11/doc44.pdf.

price and guaranteed over a specified period of time.[9]

Investments in the energy field are highly capital intensive and require a lengthy payback period.[10] Regulatory risks loom large – the possibility that the rules in force at the moment the investment was made are altered, threaten the ability of investors to recover and earn a profit on their investments.[11] Governments may decide to change the regulatory framework once investments take place and costs are "sunk."[12] Renewable energy support mechanisms are designed to attract capital flows into the renewable energy market; thus, they play a central role in determining both the period of time and the rate of return on the investment. Changes to economic mechanisms are a critical risk factor surrounding such investments, since the level of public support is the most important element influencing expected profits.[13] Therefore, investors seek to ensure the stability of the regulatory framework that underpins their investments and secure protection from unwarranted policy changes.

In order to attract cross-border investment, states must provide adequate security and protection to foreign investors, namely through the creation of adequate regulatory frameworks. These legal instruments generally take two forms: investment contracts and international investment treaties.[14] Investment contracts provide some consistency through the development of stabilization

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9. MENDONÇA, *supra* note 8, at 8. The European Commission describes this mechanism as follows:

> 'These systems are characterised by a specific price, normally set for a period of around several years, that must be paid by electricity companies, usually distributors, to domestic producers of green electricity. The additional costs of these schemes are paid by suppliers in proportion to their sales volume and are passed through to the power consumers by way of a premium on the kWh end-user price. These schemes have the advantages of investment security, the possibility of fine tuning and the promotion of mid- and long-term technologies (. . .).

Communication from the Commission: The Support of Electricity from Renewable Energy Sources. COM (2005) 627 Final, of 7 December 2005.

10. Yulia Selivanova, *The Energy Charter and the International Energy Governance,* 2012 EURO. Y.B. INT'L ECON. L. 307, 315.

11. RORY SULLIVAN & WILLIAM BLYTH, CLIMATE CHANGE POLICY UNCERTAINTY AND THE ELECTRICITY INDUSTRY: IMPLICATIONS AND UNINTENDED CONSEQUENCES, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2469897 (last visited June 8, 2016); *see also* Boute, *supra* note 4, at 337–38; Nigel Bankes, *Decarbonising the Economy and International Investment Law*, 30(4) J. OF ENERGY & NAT. RESOURCES LAW 497, 502 (2012).

12. Mario E. Bergara et al., *Political Institutions and Electric Utility Investment: A Cross-Nation Analysis*, 40(2) CALIF. MGMT. REV. 18, 19 (1998); Ralf Dickel, *Impact of Liberalisation on Investment Performance in the Power Sector*, *in* ELECTRICITY TRADE IN EUROPE: REVIEW OF THE ECONOMIC AND REGULATORY CHALLENGES 69, 76 (Janusz Bielecki & Melaku Desta eds., 2004).

13. Boute, *supra* note 4, at 342; *see also* Anatole Boute, *A Comparative Analysis of the European and Russian Support Schemes for Renewable Energy: Return on European Experience for Russia*, 4(2) J. WORLD ENERGY L. & BUS. 157, 175 (2011) [hereinafter *A Comparative Analysis*]; ECONOMIST INTELLIGENCE UNIT, MANAGING THE RISK IN RENEWABLE ENERGY 10–11 (Oct. 2011), http://digitalresearch.eiu.com/risksandrenewables/report.

14. *See, generally*, Peter Cameron, *In Search of Investment Stability*, *in* RESEARCH HANDBOOK ON INTERNATIONAL ENERGY LAW 124 (Kim Talus ed., 2014) (discussing the various models of treaties and contracts for investment in renewable energy and the attempt to find a stabilizing choice).

clauses,[15] but often prove inadequate when dealing with sovereign states.[16] As a result, international investment agreements have become especially important over the past few decades. These legal instruments aim to create a "level playing field" for investments in the energy sector, and minimize non-commercial risks associated with such investments.[17] They can help lower regulatory and political risks, thus boosting investor confidence and increasing international investments into renewable sources of energy.[18]

The association between investment law and the energy market has a long history, taking into account the global nature of this area of business.[19] Like in many other fields of the economy, the significant increase in foreign investments into the energy market, which have taken place over the last decade, would have been more difficult without the existence of a transnational system of substantive and procedural guarantees.[20] Currently, the international legal framework governing foreign investments to the energy market consists of a vast network of international investment agreements supplemented by the general rules of international law. [21] These agreements include bilateral investment treaties ("BITs"), regional free trade agreements, and sectorial treaties including investment obligations.[22] While international investment agreements differ in many important respects, they are composed by two essential elements: first, they include a set of standards of promotion and protection of foreign investment; second, they provide for mechanisms on the settlement of any possible disputes between the foreign investor and the host state.[23]

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15. *See* Thomas Waelde & George Ndi, *Stabilizing International Investment Commitments: International Law Versus Contract Interpretation,* 31 TEX. INT'L L. J. 215 (1996) (examining stabilization clauses in international contracts)*; see also* Peter D. Cameron, *Stability of Contract in the International Energy Industry*, 27 J. ENERGY & NAT. RESOURCES L. 305 (2009) (continuing the discussion on the importance of stability clauses in international contracts)[hereinafter *Stability of Contract*].

16. Bankes, *supra* note 11, at 498.

17. Kaj Hobér, *Investment Arbitration and the Energy Charter Treaty*, 1(1) J. INT'L. DISP. SETTLEMENT 153, 155 (2010).

18. BRADLY CONDON & TAPEN SINHA, THE ROLE OF CLIMATE CHANGE IN GLOBAL ECONOMIC GOVERNANCE 93 (Oxford Univ. Press ed., 2013).

19. Bankes, *supra* note 11, at 497.

20. *See* RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 23 (Oxford Univ. Press ed., 2008).

21. *See* ANDREW NEWCOMBE & LLUÍS PARADELL, LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT 448–49 (Kluwer L. Int'l ed., 2009).

22. Examples of BITs include, *e.g.*, US-China BIT, US-Germany BIT, US-UK BIT. Examples of Regional FTAs include, *e.g.*, NAFTA, CAFTA, ASEAN FTA, EU FTA, etc. Examples of sectorial treaties including investment obligations include, *e.g.*, ECT, WTO, MAI.

23. *See e.g.*, Christoph Schreuer, *Investments, International Protection*, MPEPIL 1533, ¶¶ 13–15, 31, 44, 54, 110–112 (June 2013), http://opil.ouplaw.com/view/10.1093/law:epil/9780199231690/law-9780199231690-e1533; *see also*, Marie-France Houde, *Most-Favoured-Nation Treatment in International Investment Law* 2–3, 11, 13 (Org. Econ. Cooperation & Dev. Publishing, Working Paper No. 2004/02, Sep. 2004), http://dx.doi.org/10.1787/518757021651; *see also*, Lise Johnson, Lisa Sachs & Jeffrey Sachs, *Investor-State Dispute Settlement Public Interest and U.S. Domestic Law*, 3-4, 8, 16 (Colum. Ctr. Sustainable Inv., Working Paper, May 2015),

Investment agreements are a form of international law that creates a series of obligations owed by the host state towards foreign investors.[24] The numbers of BITs and multilateral agreements entering into force have increased throughout the past few decades.[25] The Energy Charter Treaty[26] ("ECT"), a multilateral treaty signed in 1994 and entered into force in 1998, that establishes a legal framework to promote long-term cooperation in the energy field, is especially relevant.[27] The ECT currently has 54 member-states.[28] The ECT's investment provisions build upon the content of BITs as they have developed during the last half-century.[29]

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http://ccsi.columbia.edu/files/2015/05/Investor-State-Dispute-Settlement-Public-Interest-and-U.S.-Domestic-Law-FINAL-May-19-8.pdf.

24. *See, e.g.*, RUDOLF DOLZER & MARGRETE STEVENS, BILATERAL INVESTMENT TREATIES 58-66, 119-20 (Martinus Nijhoff Publ. ed., 1995); DOLZER, *supra* note 20; NEWCOMBE, *supra* note 21, at 449; M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 90–91, 101, 119 (Cambridge Univ. Press 3rd ed., 2010); JESWALD SALACUSE, THE LAW OF INVESTMENT TREATIES 191, 285, 353 (Oxford Univ. Press 2nd ed., 2015).

25. *International Investment Agreement Navigator*, UNCTAD (2015), http://investmentpolicyhub.unctad.org/IIA (reports there were less than 500 investment agreements prior to 1980. Today there are over 3,000).

26. *The Energy Charter Treaty*, 34 I.L.M. 360 (Dec. 17, 1994) [hereinafter *ECT*].

27. *Id.* at art. 3, 9.

28. *See* Hobér, *supra* note 17, at 154-55; Selivanova, *supra* note 10 (general discussion of the ECT and its framework in handling disputes); THE LEGAL COUNSEL OF THE IEA, THE ENERGY CHARTER TREATY: A DESCRIPTION OF ITS PROVISIONS (Int'l Energy Agency et al., 1994); JULIA DORÉ, THE ENERGY CHARTER TREATY: ORIGINS, AIMS, AND PROSPECTS xiv (Royal Inst. Int'l Aff. ed., 1995)( offering a detailed description of the ECT); THE ENERGY CHARTER TREATY: AN EAST-WEST GATEWAY FOR INVESTMENT AND TRADE (Thomas Wälde ed., 1996); THOMAS WÄLDE, SUSTAINABLE DEVELOPMENT AND THE 1994 ENERGY CHARTER TREATY (Univ. of Dundee et al. ed., 1997); MIRIAN OMALU, NAFTA AND THE ENERGY CHARTER TREATY: COMPLIANCE WITH, IMPLEMENTATION, AND EFFECTIVENESS OF INTERNATIONAL INVESTMENT AGREEMENTS (Seymour J Rubin & Dean C. Alexander eds., 1999); ENERGY CHARTER SECRETARIAT, THE ENERGY CHARTER TREATY: A READER'S GUIDE 8 (Int'l Energy Charter, 2002); ENERGY CHARTER SECRETARIAT, THE ENERGY CHARTER TREATY AND RELATED DOCUMENTS: A LEGAL FRAMEWORK FOR INTERNATIONAL ENERGY COOPERATION (Int'l Energy Charter, 2004), http://www.ena.lt/pdfai/Treaty.pdf; *see also* Andrei Konoplyanik & Thomas Wälde, *Energy Charter Treaty and Its Role in International Energy*, 24 J. ENERGY NAT. RESOURCES L. 523, 542 (2006) (discussing the number of members that are part of international organizations); *see also* Justin D'Agostino & Oliver Jones, *Energy Charter Treaty: A Step Towards Consistency in International Investment Arbitration*, 25 J. ENERGY NAT. RESOURCES L. 225, 237 (2007) (discussing the membership of the ECT); INVESTMENT ARBITRATION AND THE ENERGY CHARTER TREATY (Graham Coop & Clarisse Ribeiro eds., 2008); HAMSU YAHAYA, MULTILATERAL INVESTMENT TREATIES: IS THE ENERGY CHARTER TREATY AN EFFECTIVE INSTRUMENT FOR PROTECTING INTERNATIONAL INVESTMENTS? (Grin Verlag et al., eds., 2009); ENERGY DISPUTE RESOLUTION: INVESTMENT PROTECTION, TRANSIT AND THE ENERGY CHARTER TREATY (Graham Coop ed., 2011); THOMAS ROE & MATTHEW HAPPOLD, SETTLEMENT OF INVESTMENTS DISPUTES UNDER THE ENERGY CHARTER TREATY (James Dingemans ed., 2011); Yulia Selivanova, *The Energy Charter and the International Energy Governance, reprinted in* REGULATION OF ENERGY IN INTERNATIONAL TRADE LAW: WTO, NAFTA AND ENERGY CHARTER 373 (Yulia Selivanova et al. eds., 2011) (discussion of the ECT and the governance between the members); Tarcisio Gazzini, *Energy Charter Treaty: Achievements, Challenges and Perspectives*, *in* FOREIGN INVESTMENT IN THE ENERGY SECTOR: BALANCING PRIVATE AND PUBLIC INTERESTS 105 (Eric de Brabandere & Tarcisio Gazzini, Brill & Nijhoff, eds., vol. 2, 2014).

29. *See* Hobér, *supra* note 17, at 155.

While there are differences between the scope and content of the different legal instruments, there is a shared core content: they normally include the obligation to treat foreign investors fairly and equitably; provide foreign investors full protection and security; and not to expropriate foreign investment except under certain conditions, including the payment of compensation.[30] Besides including a set of standards of promotion and protection of foreign investments, international investment agreements also contain procedural protections. They typically include dispute resolution clauses that enable foreign investors to initiate arbitration proceedings against the host state, known as "investor-state arbitrations."[31] For instance, Article 26 of the ECT provides investors with the opportunity to file arbitration claims directly against member-states for violations of protections under the treaty.[32] The investor is given the option of choosing among:

a) *Arbitration before the International Centre for Settlement of Investment Disputes (ICSID).* Established pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of other States (ICSID Convention), if the contracting party of the investor and the contracting party to the dispute are both parties to the ICSID Convention, or under the rules governing the Additional Facility of the ICSID, if the contracting party of the investor or the contracting party to the dispute, but not both, is a party to the ICSID Convention;[33]

b) *Arbitration under the Arbitration Institute of Stockholm Chamber of Commerce Rules*;[34] or

*c) ad hoc arbitration under the Rules of the United Nations Commission on International Trade Law (UNCITRAL Rules).* In such disputes, the foreign investor brings a claim before the arbitral tribunal alleging that certain acts, or omissions of

30. *See* NEWCOMBE ET AL., *supra* note 21, at 147.

31. *See, generally*, ARBITRATING FOREIGN INVESTMENT DISPUTES: PROCEDURAL AND SUBSTANTIVE LEGAL ASPECTS (Norbert Horn et al. eds., vol. 19, 2004) (overview of arbitration on the international level with foreign investors); INTERNATIONAL INVESTMENT LAW AND ARBITRATION: LEADING CASES FROM THE ICSID, NAFTA, BILATERAL INVESTMENT TREATIES AND CUSTOMARY INTERNATIONAL LAW (Todd Weiler ed., 2005); CAMPBELL MCLACHLAN ET AL., INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES (Loukas Mistelis et al. eds., 2007); INTERNATIONAL INVESTMENT, PROTECTION AND ARBITRATION: THEORETICAL AND PRACTICAL PERSPECTIVES (Christian Tietje ed., 2008); CHRISTOPHER DUGAN ET AL., INVESTOR-STATE ARBITRATION (Oxford Univ. Press ed., 2008); MARIEL DIMSEY, THE RESOLUTION OF INTERNATIONAL INVESTMENTS DISPUTES: CHALLENGES AND SOLUTIONS (Ingeborg Schwenzer ed., vol. 1, 2008); ZACHARY DOUGLAS, THE INTERNATIONAL LAW OF INVESTMENT CLAIMS (Cambridge Univ. Press ed., 2009); THE FUTURE OF INVESTMENT ARBITRATION (Catherine Rogers & Roger Alford eds., 2009); EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION (Chester Brown & Kate Miles eds., 2011); THOMAS WEBSTER, HANDBOOK OF INVESTMENT ARBITRATION (Sweet & Maxwell ed., 2012); ARBITRATION UNDER INTERNATIONAL INVESTMENT AGREEMENTS: A GUIDE TO THE KEY ISSUES (Katia Yannaca-Small ed., 2010); TONY COLE, THE STRUCTURE OF INVESTMENT ARBITRATION (Routledge ed., 2013); LITIGATING INTERNATIONAL INVESTMENT DISPUTES: A PRACTITIONER'S GUIDE (Chiara Giorgetti ed., 2014); JOHAN BILLIET ET AL., INTERNATIONAL INVESTMENTS ARBITRATION: A PRACTICAL HANDBOOK (Maklu Pub. ed., 2016).

32. *ECT*, *supra* note 26, art. 26(4)(a)(ii).

33. *ECT*, *supra* note 26, art. 26(4)(c).

34. *ECT*, *supra* note 26, art. 26.

organs of the central government or local authorities, resulted in damages to his investment or violate the host state's obligations under an international investment agreement. If the host state is a party to the ECT or another international investment treaty and has consented to investor-state arbitration, the arbitral tribunal has jurisdiction to hear the claims of the investor against the state for violation of its obligations under the treaty.[35]

## II. DISPUTES OVER CHANGES IN RENEWABLE ENERGY SUPPORT MECHANISMS

Over the years, arbitration has become the principal technique for resolving disputes in the energy sector.[36] International investments in energy represent a huge percentage of overall investments and, consequently, a substantial part of international commercial and investment disputes relates to this field.[37] Arbitration increases are well evidenced by the new era of "mega cases"[38] in the oil and gas industries.[39] While billion dollar claims were virtually unheard of twenty years ago, they are now ordinary.[40] As a result, energy-related dispute resolution, in particular international arbitration, is a growing area of practical and academic interest.[41] Specifically in the area of investor-state arbitration, Whitsitt and Bankes[42] arrange energy-related disputes into four categories: disputes involving significant economic or political structural adjustment in the host state; disputes triggered by the efforts of states seeking to claim an enhanced share of resource rents; disputes in which states seek to enhance the environmental or social regulatory regime within which existing investments operate; and disputes where the states seek to withdraw economic support mechanisms for a policy measure that was introduced to support a particular energy or environmental policy.[43]

The number of disputes fitting the latter category surged in the last two years.[44] With a view to increasing the production of clean energy, many countries

35. Michael Feit, *Responsibility of the State under International Law for the Breach of Contract Committed by a State-Owned Entity*, 28 BERKELEY J. INT'L L. 142, 168–176 (2010); *see also* Catherine Yannaca-Small, *Definition of Investor and Investment in International Investment Agreements*, *in* INTERNATIONAL INVESTMENT LAW: UNDERSTANDING CONCEPTS AND TRACKING INNOVATIONS 7–100 (OECD Publishing ed. 2008).

36. A. Timothy Martin, *Dispute Resolution in the International Energy Sector: An Overview*, 4(4) J. WORLD ENERGY L. BUS. 332, 339 (2011).

37. ERIC DE BRABANDERE, THE SETTLEMENT OF INVESTMENT DISPUTES IN THE ENERGY SECTOR 130 (Eric de Brabandere & Tarcisio Gazzini eds., vol. 2, 2014) (citing Martin, *supra* note 36).

38. George Kahale, III, *Is Investor-State Arbitration Broken?* 9 TRANSNAT'L DISP. MGMT. 1, 28–32 (2012); *see also* Julian Cardenas Garcia, *The Era of Petroleum Arbitration Mega Cases*, 35 HOUS. J. INT'L L. 537 (2013) (discussing the Occidental v. Ecuador case in regard to mega cases).

39. Kahale, *supra* note 38, at 31.

40. Kahale, *supra* note 38, at 28; Garcia, *supra* note 38.

41. Alexandra Wawryk, *International Energy Law: an Emerging Academic Discipline*, *in* LAW AS CHANGE: ENGAGING WITH THE LIFE AND SCHOLARSHIP OF ADRIAN BRADBROOK 223, 224–25, 228 (Paul Babie & Paul Leadbeter eds., 2014).

42. Elizabeth Whitsitt & Nigel Bankes, *The Evolution of International Investment Law and Its Application to the Energy Sector*, 51 ALTA. L. REV. 207, 211 (2013).

43. *Id.* at 211, 213.

44. *Id.* at 213.

introduced incentives to encourage investment in the renewable energy sector.[45] As originally intended, the introduction of these mechanisms led a substantial number of companies and individuals making investments in this field.[46] While economic incentives attracted significant amounts of investment, several countries have began reducing or eliminating them. Since 2008, Spain has introduced several measures affecting the renewable energy sector.[47] In 2010, the Spanish government reduced feed-in tariffs in the solar energy sector and enacted measures that substantially cut some incentives granted to wind generation. Subsequently, the Spanish government imposed a limit on the feed-in tariffs of 25 years and imposed an annual cap on the number of hours of electricity the investors could sell at the above-market rates.[48]

In 2013, the Spanish government abrogated the feed-in tariff system altogether.[49] Fourteen domestic producers filed a suit against the Spanish government arguing that such measures generated legal uncertainty and had retrospective nature.[50] In a ruling handed down in January 2014, the Spanish Supreme Court rejected the claims holding that investors had assumed a regulatory risk, were highly sophisticated, and had access to quality technical and legal

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45. *Id.*

46. *See* Onno Kuik & Sabine Fuss, *Renewables in the Energy Market: A Financial-Technological Analysis Considering Risk and Policy Options, in* FINANCIAL ASPECTS IN ENERGY: A EUROPEAN PERSPECTIVE 33 (André Dorsman et al. eds., 2011).

47. *See* Arif Hyder Ali, *In the Eye of the Storm: Spain's Nexus to Investment Disputes*, 18 SPAIN ARB. REV. 5 (2013); PABLO DEL RIO & PERE MIR-ARTIGUES, A CAUTIONARY TALE: SPAIN'S SOLAR PV INVESTMENT BUBBLE 1 (Global Subsidies Initiative & Int'l Inst. for Sustainable Dev., Feb. 2014), https://www.iisd.org/gsi/sites/default/files/rens_ct_spain.pdf; Mejia, *The Protection of Legitimate Expectations and Regulatory Change: The Spanish Case*, 21 SPAIN ARB. REV. 113 (2014); CECILIA OLIVET & PIA EBERHARDT, PROFITING FROM CRISIS: HOW CORPORATIONS AND LAWYERS ARE SCAVENGING PROFITS FROM EUROPE'S CRISIS COUNTRIES 7, 26–31 (The Transnat'l Inst. Mar. 7, 2014), https://corporateeurope.org/sites/default/files/profiting-from-crisis_0.pdf; Jose Luis Iriarte & Lupicinio Rodriguez, *The increasing number and methods of arbitration claims brought against Spain for its renewable energy measures*, WORLD ARB. REP. 26 (2014), http://www.weil.com/~/media/files/pdfs/WWAR_Newsletter_Spring2014.pdf; Charles Patrizia et al., *Investment Disputes Involving the Renewable Energy Industry Under the Energy Charter Treaty, in* THE GUIDE TO ENERGY ARBITRATIONS 73, 74–76 (J. William Rowley et al. eds., 2015); Joseph M. Tirado, *Renewable Energy Claims Under the Energy Charter Treaty: An Overview*, 13(3) OIL GAS & ENERGY L. INTEL. 1, 6–7 (2015); Daniel Behn & Ole Kristian Fauchald, *Governments Under Cross-fire? Renewable Energy and International Economic Tribunals*, 12(2) MANCHESTER J. INT'L ECON. L. 117, 121–22 (2015); Thomas Dromgool & Daniel Enguix, *The Fair and Equitable Treatment Standard and the Revocation of Feed in Tariffs – Foreign Renewable Energy Investments in Crisis-Struck Spain*, in LEGAL ASPECTS OF SUSTAINABLE DEVELOPMENT: HORIZONTAL AND SECTORIAL POLICY ISSUES 389, 391–400 (Volker Mauerhofer ed.,2016); Daniel Behn et al., *Promoting Renewable Energy in the EU: Shifting Trends in Member State Policy Space* 9–10 (PluriCourts, Working Paper No. 15–23, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2704333.

48. Joseph Tirado & Jerry Bloom, *Renewable Energy Reforms in Europe: Growing Threats to International Investors*, LEXOLOGY (2014), http://cdn2.winston.com/images/content/8/4/v2/84476/IA-RenewableEnergyReformEurope-6-9-2014.pdf.

49. *Id.*

50. *Id.*; *see also* OLIVET, *supra* note 47, at 6–7, 26, 28, 30–31.

advice.[51] In the court's view, investors were not entitled to expect that the economic regime regulating the retribution of their investments would remain unchanged.[52] In June 2016, the Spanish Supreme Court rendered another decision, holding that the 2014 government decree reducing subsidies in the renewable energy sector did not violate the Spanish Constitution or European Union law.[53]

Other European governments have enacted legislative measures, which have impacted the renewable energy market. In 2011, the Czech Republic introduced a new 26% retroactive tax on all producers of solar energy and modified its feed-in tariffs policy.[54] Between 2010 and 2013, the Italian government reduced feed-in tariffs and eliminated incentives granted to photovoltaic plants situated in agricultural land.[55] In June 2013, the Romanian Government excluded some photovoltaic plants from the government's support scheme.[56] In 2014, Bulgaria imposed a 20% fee on income from wind and solar power installations and limited the volume of electricity purchased at feed-in tariff rates.[57] Other countries like Slovakia, Latvia, Greece, Belgium, the United Kingdom, and France have also made significant modifications to their support schemes.[58]

National policies for the promotion of renewable energy generation have been introduced by European states in an effort to achieve national binding targets mandated under the Renewable Energy Directive.[59] Economic support mechanisms were seen as indispensable to kick-start investments in renewable energies due to the high cost of production. While renewable energy promotion is at the very heart of the European Union's environmental policy,[60] the European Union has also been changing its approach to economic support mechanisms. The Communication from the European Commission "Guidelines on State Aid for Environmental Protection and Energy 2014-2020," published in 2014, recommends that subsidies and exemptions become phased out in a degressive way.[61]

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51. *See Supreme Court Backs Cuts to the Solar Power Producers' Earnings*, EL PAÍS (Jan. 21, 2014), http://elpais.com/elpais/2014/01/21/inenglish/1390306709_143350.html; Iriarte, *supra* note 47, at 27.

52. Iriarte, *supra* 47, at 29.

53. *See* Reyes Rincón, *Spain's Supreme Court Backs Renewable Energy Cuts*, EL PAÍS (June 2, 2016), http://elpais.com/elpais/2016/06/02/inenglish/1464860925_523010.html?id_externo_rsoc=LK_CC.

54. *See* Anna De Luca, *Withdrawing Incentives to Attract FDI: Can Host Countries put the Genie Back in the Bottle?*, COLUMBIA U. ACAD. COMMONS 2 (Issue No. 125, 2014), http://ccsi.columbia.edu/files/2013/10/No-125-De-Luca-FINAL.pdf; Behn & Fauchald, *supra* note 47, at 123–124; Patrizia et al., *supra* note 47, at 76–77; Tirado, *supra* note 47, at 8; Behn, *supra* note 47, at 11–12.

55. Tirado & Bloom, *supra* note 48, at 8–11; Behn, *supra* note 47, at 12–14.

56. Tirado & Bloom, *supra* note 48.

57. Angel Bangachev, *New Rules for Wind and Solar Energy Producers in Bulgaria*, LEXOLOGY (Jan. 9, 2014), http://www.lexology.com/library/detail.aspx?g=8e409dc6-4c5e-470d-9599-4b7feac75905; Vadi, *supra* note 4, at 197.

58. Behn, *supra* note 47, at 6.

59. Council Directive 2009/28/EC, 2009 O.J. (L 140) 16–62.

60. Dromgool & Enguix, *supra* note 47, at 390.

61. *Guidelines on State aid for environmental protection and energy 2014-2020,* at 1–55, COM

Several European countries have made legislative changes to their renewable energy markets, which has resulted in the surfacing of numerous arbitral proceedings where investors claim that such measures breach the protection afforded by international investment agreements, namely the ECT.[62] According to figures from the ICSID, as of December 31, 2015, 17% of all ICSID cases regarded electric power and other sources of energy.[63] Forty two percent of the new cases registered in 2015 related to electric power and other sources of energy, with the ECT being the legal instrument invoked in 33% of the cases.[64] In at least twenty cases initiated in 2015, investors challenged legislative reforms in the renewable energy sector.[65] As of June 15, 2016, 43 cases had been initiated relating to changes in economic support programs in the renewable energy market.[66] This number, however, may not be totally accurate. Arbitral proceedings

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(June 28, 2014).

62. *See* Tirado & Bloom, *supra* note 48; *see also* Patrizia, *supra* note 47, at 32–33.

63. ICSID Secretariat, *The ICSID Caseload – Statistics*, Issue 2016-1 (2016), https://icsid.worldbank.org/apps/icsidweb/resources/pages/icsid-caseload-statistics.aspx.

64. *Id.* at 26.

65. UNCTAD, *Investor-State Dispute Settlement: Review of Developments in 2015*, 6 (June 8, 2016), http://investmentpolicyhub.unctad.org/Upload/ISDS%20Issues%20Note%202016.pdf.

66. Cases administered by the ICSID: EVN AG v. Republic of Bulgaria, ICSID Case No. ARB/13/17 (Dec. 2, 2013); RREEF Infrastructure (G.P.) Limited & RREEF Pan-European Infrastructure Two Lux S.à.r.l. v. Kingdom of Spain, ICSID Case No. ARB/13/30 (June 6, 2016); Antin Infrastructure Services Luxembourg S.à.r.l. & Antin Energia Termosolar B.V. v. Kingdom of Spain, ICSID Case No. ARB/13/31(Aug. 7, 2014); Eiser Infrastructure Limited & Energía Solar Luxembourg S.à.r.l. v. Kingdom of Spain, ICSID Case No. ARB/13/36 (July 28, 2014); Masdar Solar & Wind Cooperatief U.A. v. Kingdom of Spain ICSID Case No. ARB/14/1(July 18, 2014); Blusun S.A., Jean-Pierre Lecorcier & Michael Stein v. Italian Republic, ICSID Case No. ARB/14/3 (June 12, 2014); NextEra Energy Global Holdings B.V. & NextEra Energy Spain Holdings B.V. v. Kingdom of Spain ICSID Case No. ARB/14/11 (Jan. 23, 2015); InfraRed Environmental Infrastructure GP Limited & others v. Kingdom of Spain, ICSID Case No. ARB/14/12 (Nov. 26, 2014); RENERGY S.à.r.l. v. Kingdom of Spain, ICSID Case No. ARB/14/18 (Feb. 13, 2015); RWE Innogy GmbH & RWE Innogy Aersa S.A.U. v. Kingdom of Spain ICSID Case No. ARB/14/34 (Nov. 4, 2015); Stadtwerke München GmbH, RWE Innogy GmbH, & others v. Kingdom of Spain, ICSID Case No. ARB/15/1 (Dec. 16, 2015); STEAG GmbH v. Kingdom of Spain, ICSID Case No. ARB/15/4 (Oct. 25, 2016); 9REN Holding S.a.r.l v. Kingdom of Spain, ICSID Case No. ARB/15/15 (Feb. 8, 2016); BayWa r.e. Renewable Energy GmbH & BayWa r.e. Asset Holding GmbH v. Kingdom of Spain, ICSID Case No. ARB/15/16 (Nov. 6, 2015); ENERGO-PRO a.s. v. Republic of Bulgaria, ICSID Case No. ARB/15/19 (Feb. 9, 2016); Cube Infrastructure Fund SICAV & others v. Kingdom of Spain, ICSID Case No. ARB/15/20 (Dec. 8, 2015); Mathias Kruck & others v. Kingdom of Spain ICSID Case No. ARB/15/23 (Jan. 19, 2016); KS Invest GmbH & TLS Invest GmbH v. Kingdom of Spain ICSID Case No. ARB/15/25 (Dec. 7, 2015); JGC Corporation v. Kingdom of Spain, ICSID Case No. ARB/15/27 (Jan. 4, 2016); Cavalum SGPS, S.A. v. Kingdom of Spain, ICSID Case No. ARB/15/34 (Jan. 22, 2016); E.ON Finanzanlagen GmbH & E.ON Iberia Holding GmbH v. Kingdom of Spain, ICSID Case No. ARB/15/35 (Jan. 21, 2016); OperaFund Eco-Invest SICAV PLC & Schwab Holding AG v. Kingdom of Spain, ICSID Case No. ARB/15/36 (Mar. 28, 2016); Silver Ridge Power BV v. Italian Republic, ICSID Case No. ARB/15/37 (Pending until Jan. 16, 2017); SolEs Badajoz GmbH v. Kingdom of Spain, ICSID Case No. ARB/15/38 (Feb. 16, 2016); Belenergia S.A. v. Italian Republic, ICSID Case No. ARB/15/40 (May 18, 2016); Hydro Energy 1 S.à.r.l. & Hydroxana Sweden AB v. Kingdom of Spain, ICSID Case No. ARB/15/42 (May 3, 2016); Holdings S.à.r.l. & others v. Kingdom of Spain, ICSID Case No. ARB/15/44 (Mar. 31, 2016); Landesbank Baden-Württemberg & others v. Kingdom of Spain, ICSID

may be administered by institutions that, differently from the ICSID, do not disclose the initiation of proceedings publicly. Furthermore, they may also be conducted *ad-hoc*, with no supervising institution. Due to this lack of transparency, the exact number of disputes already initiated is unknown and the legal basis on which such claims are made is not totally clear. In any case, it is safe to say that we are witnessing a boom in renewable energy arbitration under the ECT, particularly in Europe. The implementation of the "Guidelines on State Aid for Environmental Protection and Energy 2014-2020" may create further tension between national, European and international legal systems and result in additional arbitral proceeding against member states in the near future.[67]

The anatomy of these cases is substantially different from the prototype of energy-related disputes submitted to arbitration in the past. For years, states have enacted regulations to protect the environment by limiting environmentally detrimental investments.[68] Commentators have expressed concern that investors could initiate arbitral proceedings, claiming that climate-related regulatory measures breached relevant investment treaty provisions.[69] Such cases posed a risk

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Case No. ARB/15/45 (June 7, 2016); Eskosol S.p.A. in liquidazione v. Italian Republic, ICSID Case No. ARB/15/50 (Oct. 19, 2016); Eurus Energy Holdings Corporation & Eurus Energy Europe B.V. v. Kingdom of Spain, ICSID Case No. ARB/16/4 (May 2, 2016); ESPF Beteiligungs GmbH, ESPF Nr. 2 Austria Beteiligungs GmbH, & InfraClass Energie 5 GmbH & Co. KG v. Italian Republic, ICSID Case No. ARB/16/5 (July 26, 2016). Cases administered by the Permanent Court of Arbitration under the UNICTRAL rules: Antaris Solar & Dr. Michael Göde v. Czech Republic (PCA Case Repository, May 8, 2013); Cases administered by the Arbitration Institute of the Stockholm Chamber of Commerce: Charanne & Construction Investments v. Kingdom of Spain, Case No. 62/2012 (Arb. Inst. Stockholm Chamber of Comm., 2013); Isolux Infrastructure Netherlands B.V. v. Kingdom of Spain (Arb. Inst. Stockholm Chamber of Comm., registered 2013); S.à.r.l. v. Kingdom of Spain (Arb. Inst. Stockholm Chamber of Comm., registered June 2013); Greentech Energy Systems & Novenergia v. Italian Republic (Arb. Inst. Stockholm Chamber of Comm., registered July 7, 2015); Alten Renewable Energy Developments BV v. Kingdom of Spain (Arb. Inst. Stockholm Chamber of Comm., registered March 2015). Ad hoc cases under the UNCITRAL Rules: PV Investors v. Kingdom of Spain (UNCITRAL, registered Nov. 2011); Natland Investment Group NV, Natland Group Limited, G.I.H.G. Limited, & Radiance Energy Holding S.A.R.L. v. Czech Republic (UNCITRAL, registered May 8, 2013); Voltaic Network GmbH v. Czech Republic (UNCITRAL, registered May 8, 2013); ICW Europe Investments Limited v. Czech Republic (UNCITRAL, registered May 8, 2013); Photovoltaik Knopf Betriebs-GmbH v. Czech Republic (UNCITRAL, registered May 8, 2013); WA Investments-Europa Nova Limited v. Czech Republic (UNCITRAL, registered May 8, 2013); Mr. Jürgen Wirtgen, Mr. Stefan Wirtgen, & JSW Solar (zwei) v. Czech Republic (UNCITRAL, registered June 2013).

67. Ernesto Bonafé & Gökçe Mete, *Escalated Interactions Between E.U. Energy Law and the Energy Charter Treaty*, 9(3) J. WORLD ENERGY L. BUS. 174, 185–86 (2016).

68. *See generally* Thomas Waelde & Abba Kolo, *Environmental Regulation, Investment Protection and Regulatory Taking in International Law*, 50 INT'L & COMP. L.Q. 811 (2001); HELD ET AL., *supra* note 8; Nii Lante Wallace-Bruce, *Global Investments and Environmental Protection: The Battle Lines are yet to Emerge!*, 49(2) NILR 195, 197–8 (2002); Julie A. Soloway, *Environmental Regulation as Expropriation: The Case of NAFTA's Chapter 11*, 33 CAN. BUS. L.J. 92 (2000); KEVIN ROSNER, INCENTIVE MECHANISMS FOR PUBLIC-PRIVATE INVESTMENT IN RENEWABLE ENERGY PROJECTS IN FRONTIER ECONOMIES (SEI, Technical Report 2016-01, Feb. 2016).

69. Lise Johnson, *International Investment Agreements and Climate Change: The Potential for Investor-State Conflicts and Possible Strategies for Minimizing it*, 39 ENV'T L. REP. 11147, 1150 [hereinafter Johnson, *International Investment Agreements*].

that international investment agreements could have a constraining effect ("regulatory chill") on climate change mitigation measures and restrain the host-state's policy space significantly.[70] The adoption of climate change-related regulatory measures can affect the economic interests of private actors, by requiring (or not requiring) technological upgrades and specific economic behavior.[71] Foreign investors can argue that such measures violate investment treaty provisions, in particular, the prohibition of unlawful expropriation, and the fair and equitable treatment standard.[72]

Differently, the new wave of disputes refers to cases where states are reducing or eliminating the economic incentives which they introduced years ago in order to lure investments into the renewable energy market.[73] Investors are complaining that such regulatory changes diminish or exhaust the commercial viability of their investments.[74] Host states argue that support mechanisms have proven too popular (and therefore, more expensive than anticipated); that they became too generous because the production costs for the new technology have decreased significantly; or that they simply cannot afford these initiatives due to the ongoing financial crisis.[75] The crux of the question is whether investors can seek compensation under

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70. *See, e.g.*, Soloway, *supra* note 68, at 92, 95, 104. ERIC NEUMAYER, GREENING TRADE AND INVESTMENT: ENVIRONMENTAL PROTECTION WITHOUT PROTECTIONISM 68–78 (Earthscan Publ. ed., 2001); Kevin R. Gray, *Foreign Direct Investment And Environmental Impacts – Is The Debate Over?*, 11(3) REV. EUR. COMMUNITY & INT'L ENV'T L. 306, 310–11 (2002); Wallace-Bruce, *supra* note 68, at 195, 211–13; Jacob Werksman, Kevin A. Baumert & Navroz K. Dubash, *Will International Investment Rules Obstruct Climate Protection Policies? An Examination of the Clean Development Mechanism*, 3(1) INT'L ENVTL. AGREEMENTS POL. L. & ECON. 59 (2003)(discussing the Kyoto Protocol and how disputes are solved both in and outside of court and the effect on the international arena); Ole K. Fauchald, *International Investment Law and Environmental Protection*, 17(1) Y.B. INT'L ENVTL L. 3, 8, 29 (2007); Stephan Schill, *Do Investment Treaties Chill Unilateral State Regulation to Mitigate Climate Change?* 24(5) J. INT'L ARB. 469 (2007); Johnson, *International Investment Agreements*, *supra* note 70, at 11147, 1150, 1152–53; Kate Miles, *Arbitrating Climate Change: Regulatory Regimes and Investor-State Disputes*, 1 CLIMATE L. 63 (2010) (discussing the various international mechanisms implemented to regulate climate change and the conflicts that have arisen between foreign investors and host-states); Kate Miles, *Sustainable Development, National Treatment and Like Circumstances in Investment Law*, *in* SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW 265 (Marie-Claire Segger et al. eds., 2011); Cristina L. Beharry & Melinda E. Kuritzky, *Going Green: Managing the Environment Through International Investment Arbitration*, 30 AM. U. INT'L L. REV. 383, 422 (2015); Albert Cho & Navroz Dubash, *Will Investment Rules Shrink Policy Space for Sustainable Development? Evidence from the Electricity Sector* 38 (World Resources Inst., Working Paper, Sep. 5, 2003), http://www.iisd.org/pdf/2003/trade_investment_rules.pdf; Aaron Cosbey et al., *Clean Energy Investment. Project Synthesis Report* 8, 61, 70 INT'L INST. FOR SUSTAINABLE DEV. (July 2008), http://www.iisd.org/pdf/2008/cei_synthesis.pdf.

71. Vadi, *supra* note 4, at 193.

72. *Id.* at 194; Schill, *supra* note 70, at 470–76.

73. Patrizia, *supra* note 47, at 1.

74. De Luca, *supra* note 54, at 1–2; Behn & Fauchald, *supra* note 47, at 120.

75. Bankes, *supra* note 11, at 502; Whitsitt, *supra* note 42, at 213–14; James Prest, *The Future of Feed-in Tariffs: Capacity Caps, Scheme Closures and Looming Grid Parity*, 2012(1) RENEWABLE ENERGY L. & POL'Y Rev. 25, 34–6 (2012); DEL RIO, *supra* note 47, at 12–14; Ioannis Glinavos, *Solar Eclipse: Investment Treaty Arbitration and Spain's Photovoltaic Troubles*, *in* LESSONS FROM THE GREAT RECESSION: AT THE CROSSWORDS OF SUSTAINABILITY AND RECOVERY 251, 254 (Constantin

investment treaties when governments encourage investment via economic support schemes, but decide to reduce or eliminate them after the investment has been made. Again, we may have a clash between energy-related policies and investment law.[76]

These disputes raise a classic problem in investment arbitration: how to strike a balance between foreign investors' reliance on the regulations that underpin their long-term investments and the host state's right to adapt regulations to new needs.[77] The introduction of changes to economic support mechanisms typically involves governmental measures adopted for public purposes, whether for financial or other reasons.[78] The host state intervenes as the regulation of energy production, distribution, and consumption is a key element of national economic law and policy.[79] The novelty in this new wave of disputes is that challenged measures work against the protection of the environment, while in the past they were eco-friendly.[80] The crux of the question is the following: to what extent can investors expect that the level of incentives granted initially will be protected by investment treaties throughout the life of the investment?

## III. BETWEEN INVESTMENT PROTECTION AND NATIONAL REGULATORY SPACE

Over the last decade, governments around the world have implemented policies designed to encourage private investment in renewable sources of energy.[81] For various reasons, some of them have recently decided to introduce changes to those policies. Incentives and other benefits are easy to grant but difficult to withdraw. Economic support mechanisms may be reasonable in the initial phases of development because of the environmental and social benefits of renewable energy. However, they also have disadvantages. Feed-in tariffs, for instance, can lag behind the technology change they create, thus generating windfall profits and over-subsidizing the renewable industry.[82] As a result, the regulatory framework underpinning these incentives becomes outdated. This leads to a paradoxical situation: while feed-in tariffs are frequently praised for creating certainty, they themselves become uncertain.[83]

Trying to adjust to new scenarios, governments may decide to interfere with

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Gurdgiev et al. eds., vol. 18, 2016).

76. *See, e.g.*, JORGE E. VIÑUALES, FOREIGN INVESTMENT AND THE ENVIRONMENT IN INTERNATIONAL LAW: AN AMBIGUOUS RELATIONSHIP, 17–23 (James Crawford & John S. Bell eds., 2012).

77. *See* DOLZER, *supra* note 20, at 145–49.

78. VIÑUALES, *supra* note 76, at 30, 50; *see also* Gray, *supra* note 70, at 311–13.

79. Markus Krajewski, *The Impact of International Investment Agreements on Energy Regulation*, 2012 EUR. Y.B. OF INT'L ECON. L. 343, 345.

80. *See* Rachel A. Nathanson, *The Revocation of Clean-Energy Investment Economic-Support Systems as Indirect Expropriation Post-Nykomb: A Spanish Case Analysis*, 98 IOWA L. REV. 863, 865 (2013).

81. RICKERSON, *supra* note 8, at 2, 24, 63, 187.

82. Lincoln L. Davies & Kirsten Allen, *Feed-in Tariffs in Turmoil*, 116 W. VA. L. REV. 937, 940 (2013).

83. *Id.* at 941.

the amount and duration of the support mechanism. Feed-in tariffs guarantee renewable energy producers a fixed price for their energy over a fixed period of time.[84] Even though such incentives are designed to reduce financial risk, the truth is that they are not immune from political risk. As a result, relying on this type of mechanism makes renewable energy investors particularly vulnerable to policy changes.[85] The cases mentioned above illustrate this possibility. While support schemes may help to attract foreign investments, subsequent changes to regulatory frameworks affecting foreign investors might be challenged under international investment law.

International investment agreements impose certain standards regarding the protection afforded by host states to foreign investors. However, in some situations, these canons may conflict with the regulatory power of the host state. The disciplines of international investment law may "chill" governments from enacting regulations that might affect foreign investments – in the cases under analysis, by changing the structure of economic incentives that supported investments in renewable energies.[86] Fundamentally, the notion of regulatory chill suggests that the investment law and arbitration system may impact the normal course of policy development and implementation.[87] In some circumstances, governments may fail to modify, enact, or enforce new regulatory measures because they are afraid of a perceived risk of having to face arbitration proceedings.[88]

The protection afforded to investors under international investment agreements is not absolute. Arbitration tribunals have in the past acknowledged the host state's sovereign right to regulate.[89] Host states may try to argue that the substantial modification or withdrawal of economic support mechanisms was justified by objectives of public policy, namely, the state's right to adapt the level and duration of support to avoid overcompensation of investments.[90] However, such arguments may be used to disguise attempts to reduce public debt or decrease energy prices for consumers in advance of upcoming elections, imposing the financial burden on investors.[91]

While investor-state arbitral proceedings are generally confidential, making it difficult to have a clear picture of the claimants' arguments, they will probably

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84. COUTURE ET AL., *supra* note 8, at vii, xi, 7, 11, 19, 22–23, 34, 50.

85. Kim Talus, *Introduction: Renewable Energy Disputes in Europe and Beyond: An Overview of Current Cases*, 13(3) OIL GAS & ENERGY L. INTELLIGENCE (2015).

86. Whitsitt, *supra* note 42, at 213–14, 223–24.

87. *Id.* at 211, 213.

88. *See* Kyla Tienhaara, *Regulatory Chill and the Threat of Arbitration: A View from Political Science*, *in* EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION 806 (Chester Brown & Kate Miles eds., 2011).

89. Whitsitt, *supra* note 42, at 215, 219, 229–30.

90. Boute, *supra* note 4, at 176 (citing Case 201/08, Plantanol GmbH & Co. KG v. Hauptzollamt Darmstadt 2009 E.C.R. I-08343); Anatole Boute, *Combating Climate Change through Investment Arbitration*, 35 FORDHAM INT'L L.J. 613, 648 (2012) (citing Plantanol GmbH & Co. KG v. Hauptzollamt Darmstadt, 2009 E.C.R. I-08343) [hereinafter Boute, *Combating Climate Change*].

91. Boute, *Combating Climate Change*, *supra* note 90, at 648.

focus on two standards of protection typically found in international investment agreements: the prohibition of expropriation and the principle of fair and equitable treatment.[92]

Among the different investment disciplines, protection against expropriation is a principal cause of action for investors.[93] While the language of treaties varies, they generally protect investors from measures involving the transfer of title or outright physical seizure of an investor's property (direct expropriation); but also from measures that are not considered direct takings but permanently destroy the economic value of the investment or deprive the owner of its ability to control it in a meaningful way (indirect expropriations).[94] The possibility of a direct expropriation seems only plausible in cases where there is a deprivation of a foreign investor's acquired rights and the transfer of ownership rights to the state or a third person through the revocation of feed-in tariffs.[95] Allegations of indirect expropriation are much more likely, as indirect expropriation is by far the most common form of expropriation in international investment law.[96]

However, drawing the line between the right of host state to regulate in the public interest and indirect expropriation is quite challenging. According to the "sole effect" doctrine followed by some tribunals, the "effect" of the governmental action on the investment is the preponderant factor in assessing whether there has been an expropriation.[97] From this perspective, the policy objectives pursued by the challenged regulatory measures do not alter the legal character of the taking, requiring compensation in any case. Differently, other tribunals have followed the "police powers" theory, which recognizes the host states' right to regulate in the public interest and takes this power into account when assessing the impact of these measures on the investment.[98] Arbitration panels have taken into account the nature, objectives, and character of the measures challenged in order to distinguish between indirect expropriations and valid regulatory interventions of the host state, which are not subject to compensation.[99] Specifically, in the energy sector, recent decisions have focused on striking a balance between the host state's right to regulate in the public interest and the protection of investor's rights by

92. De Luca, *supra* note 54, at 1; Mejia, *supra* note 47, at 130; Patrizia, *supra* note 47, at 77.

93. *See* Christoph Schreuer, *The Concept of Expropriation Under the ECT and Other Investment Protection Treaties*, *in* INVESTMENT ARBITRATION AND THE ENERGY CHARTER TREATY 108 (Clarisse Ribeiro ed., 2006); August Reinisch, *Expropriation*, *in* THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 407 (Peter Muchlinski et al. eds., 2008); ENERGY CHARTER SECRETARIAT, EXPROPRIATION REGIME UNDER THE ENERGY CHARTER TREATY (2012), http://www.energycharter.org/fileadmin/DocumentsMedia/Thematic/Expropriation_2012_en.pdf.

94. U.N. CONF. ON TRADE & DEV., EXPROPRIATION: UNCTAD SERIES ON ISSUES IN INTERNATIONAL INVESTMENT AGREEMENTS II, at 5–12, U.N. Doc. UNCTAD/DIAE/IA/2011/7, U.N. Sales No. E.12.II.D.7 (2012), http://unctad.org/en/Docs/unctaddiaeia2011d7_en.pdf [hereinafter EXPROPRIATION].

95. Dromgool & Enguix, *supra* note 47, at 402.

96. DOLZER, *supra* note 20, at 101.

97. *Id.* at 112.

98. *Id.*

99. EXPROPRIATION, *supra* note 95, at 78–90.

incorporating notions of reasonableness or proportionality into the decision making process.[100]

According to some authors, it might be possible for investors to invoke the non-expropriation standard successfully.[101] This scenario seems more likely in cases where the economic support measure is completely eliminated. However, it can also be argued that feed-in tariffs merely entitle investors to fixed prices and that these may not be traded independently from the main electricity transaction. From this perspective, since these incentives are incapable of independent economic exploitation and investors will likely not lose control of their installations, any interference may not be considered expropriation.[102] The revocation of feed-in tariffs will normally not amount to an indirect expropriation, since the investors usually still retain control of their power plants and receive the profits of the electricity output.[103] It is uncertain whether arbitral tribunals will conclude that changes to support mechanisms deprive investors of the use and benefit of their investment to such an extent as to constitute an indirect expropriation.

The threshold for establishing an indirect expropriation is high.[104] Given the stringent requirements for the qualification of regulatory measures as "indirect expropriation", investors will probably turn to the fair and equitable treatment standard.[105] This is the most frequently invoked standard and also the most promising against the revocation of economic support mechanisms.[106] Still, the content of the fair and equitable treatment standard is contentious and may vary depending on the precise way in which it is expressed.[107] Notwithstanding its

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100. Whitsitt, *supra* note 42, at 230.

101. *See* Thomas Wälde & Kaj Hobér, *The First Energy Charter Treaty Arbitral Award*, 5 TRANSNAT'L DISP. MGMT. 15 (2005); Boute, *Combating Climate Change*, *supra* note 90, at 631–35; Iriarte, *supra* note 47, at 26-29.

102. Boute, *Combating Climate Change*, *supra* note 90, at 658; Vyoma Jha, *Trends in Investor Claims Over Feed-in Tariffs For Renewable Energy*, INV. TREATY NEWS (July 19, 2012), https://www.iisd.org/itn/2012/07/19/trends-in-investor-claims-over-feed-in-tariffs-for-renewable-energy.

103. Boute, *supra* note 4, at 363; Dromgool & Enguix, *supra* note 47, at 402.

104. Boute, *Combating Climate Change*, *supra* note 90, at 631; Bankes, *supra* note 11, at 507-08.

105. *See generally* DOLZER, *supra* note 20, at 130; Catherine Yannaca-Small, *Fair and Equitable Treatment Standard In International Investment Law* (Org. for Econ. Co-operation & Dev., Working Paper No. 2004/03, 2004); Christoph Schreuer, *Fair and Equitable Treatment (FET): Interactions with Other Standards*, *in* INVESTMENT ARBITRATION AND THE ENERGY CHARTER TREATY 63 (Graham Coop & Clarisse Ribeiro eds., 2008) [hereinafter Schreuer, *Fair and Equitable Treatment*]; U.N. CONF. ON TRADE & DEV., FAIR AND EQUITABLE TREATMENT: UNCTAD SERIES ON ISSUES IN INTERNATIONAL INVESTMENT AGREEMENTS II, U.N. Doc. UNCTAD/DIAE/IA/2011/5, U.N. Sales No. E.11.II.D.15 (2012); ROLAND KLÄGER, 'FAIR AND EQUITABLE TREATMENT' IN INTERNATIONAL INVESTMENT LAW (2013).

106. Boute, *supra* note 4, at 333; Boute, *Combating Climate Change*, *supra* note 90, at 613; U.N. CONF. ON TRADE & DEV., WORLD INVESTMENT REPORT 2010: INVESTING IN A LOW-CARBON ECONOMY, at 137, U.N. Sales No. E.10.II.D.2 (2010), http://unctad.org/en/Docs/wir2010_en.pdf; Nigel Bankes et al., *International Trade and Investment Law and Carbon Management Technologies*, 53 NAT. RES. J. 285, 318 (2013).

107. *See* Schreuer, *Fair and Equitable Treatment*, *supra* note 106, at 65; Rufolf Dolzer, *Fair and*

elusive nature, arbitral tribunals and commentators generally agree that transparency, stability, non-discrimination, due process, and the investor's legitimate expectations are all key ingredients in defining the fair and equitable standard.[108]

Several arbitral tribunals have concluded that the host state has an obligation to maintain a stable and predictable legal and business framework in line with the investor's legitimate expectations.[109] Legitimate expectations and the protection of a stable and predictable legal and business environment are closely linked as they both relate to the investment framework, which investors legitimately expect.[110] Two different approaches have been used in arbitral practice to determine when investor expectations are reasonable.[111] The first approach requires the host state to have made clear assurances to the investor regarding the specific business relationship; under the second, more permissive approach, expectations can be created based on assurances provided in generally applicable laws of a country, and more generally, upon the existing framework at the time of the investment.[112] The latter interpretation is frequently used in investment claims regarding changes in a host state's legal framework.[113] Tribunals will have to analyze the legal nature of the normative framework establishing incentives.[114] Investors may find it more difficult to obtain protection when their expectations arise out of general legislative provisions that are not protected from subsequent amendments, and there are no specific guarantees of stability specifically addressed to investors.[115]

The fair and equitable treatment standard provides an important tenet of investment protection. Investors build their business cases on the basis of these economic support schemes. Since public support is vital, support schemes and tariff commitments often constitute the essential foundations of the investment.[116] Investors make decisions on the financial viability of the investment relying upon the implementation of support incentives by host states. Therefore, it is not surprising when an investor expects and relies upon the predictability and stability of these mechanisms.[117] The modification or withdrawal of support mechanisms

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*Equitable Treatment: Today's Contours*, 12 SANTA CLARA J. INT'L L. 7, 7–33 (2014); Patrick Dumberry, *The Protection of Investor's Legitimate Expectations and the Fair and Equitable Treatment Standard Under NAFTA Article 1105*, 31(1), J. INT'L ARB. 47, 47–49 (2014).

108. *See* MCLACHLAN ET AL., *supra* note 31, at 234; DOLZER, *supra* note 20, at 119; André von Walter, *The Investor's Expectations In International Investment Arbitration*, *in* INTERNATIONAL INVESTMENT LAW IN CONTEXT 175 (Christina Knahr & August Reinisch, eds., 2007); Roland Kläger, *'Fair and Equitable Treatment' and Sustainable Development*, *in* SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW 241, 251 (Marie-Claire Segger et al. eds., 2011).

109. Krajewski, *supra* note 79, at 358–59.

110. *Id.* at 359; *see also* DOLZER, *supra* note 20, at 113.

111. DUGAN ET AL., *supra* note 31, at 513.

112. *Id.* at 513.

113. Whitsitt, *supra* note 42, at 223-24.

114. Dromgool & Enguix, *supra* note 47, at 391.

115. De Luca, *supra* note 54, at 1–2.

116. Boute, *supra* note 4, at 364.

117. Cameron, *supra* note 15, at 326; Dromgool & Enguix, *supra* note 47, at 402.

might constitute a substantial change of the regulatory conditions and legitimate expectations contemporary to the investment.[118] In assessing whether the legitimate expectations of the investor have been met, arbitral tribunals examine the law at the time when the investment was made and any specific representations made by the host State to the investor.[119]

Another element that arbitral tribunals consider is the investor's own conduct, namely, whether they diligently assessed the risks associated with their investment.[120] Investors are under a duty of due diligence to reasonably assess the risk, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural, and historical conditions prevailing in the host State. Thus, the investor's own conduct constitutes a general limitation to his legitimate expectations.[121]

Investors should not reasonably expect that the circumstances existing at the time the investment was made would remain unchanged. Some tribunals have acknowledged that legal and economic frameworks are not immutable and must necessarily evolve.[122] In order to determine whether the frustration of the foreign investor's expectations is justified and reasonable, the host state's legitimate right to regulate domestic matters in the public interest must also be taken into consideration.[123] From this perspective, the legitimate expectations and the requirement of stability of the legal framework do not affect the host state's right to exercise its sovereign regulatory powers, per se.[124] In the cases under discussion, states may invoke their right to adapt their support regimes in order to avoid overcompensation.[125] The defendant state's right to regulate may establish a limitation to the protective scope of the fair and equitable treatment standard.[126]

However, the exercise of the host state's legitimate right to regulate in the public interest should not be accepted when the main goal of its measures was to reduce an energy tariff deficit which was, at least in part, its own fault.[127] While international investment law is not supposed to force countries to keep in place subsidy programs that are inefficient and unintended in their consequences, renewable energy investors may legitimately expect the maintenance of an "economic equilibrium", at least in terms of the viability of their business.[128] If tribunals find that revocation measures constitute a breach of legitimate expectations and, hence, a violation of the fair and equitable treatment standard,

118. Boute, *supra* note 4, at 364; Mejia, *supra* note 47, at 131.

119. DOLZER, *supra* note 20, at 134.

120. Dromgool & Enguix, *supra* note 47, at 405–08.

121. *Id.* at 409.

122. *See, e.g.*, Saluka Investments BV (*Neth.)* v. Czech Republic (UNCITRAL), Partial Award, ¶ 305 (Perm. Ct. Arb., Mar. 17, 2006).

123. Boute, *Combating Climate Change*, *supra* note 90, at 647–61; Patrizia, *supra* note 47, at 79.

124. DOLZER, *supra* note 20, at 148–49.

125. Boute, *Combating Climate Change*, *supra* note 90, at 648.

126. *Id.*

127. Dromgool & Enguix, *supra* note 47, at 414.

128. *Id.* at 415.

they may decide to award a compensation that takes into account the losses of the investors, the inappropriate regulation of the state, and the financial limitations of the country due to the crisis.[129] Ultimately, arbitral tribunals have to balance the legitimate and reasonable expectations of the investor against the right of states to intervene in the public interest.[130] Reality is in perennial flux. Arbitral tribunals assess the suitability of the parties behavior to changing conditions, namely by examining the reasonableness and correctness of the legal framework initially set forth by the state and its interest in adjusting regulatory structures to new social and economic conditions.[131] In the end, disputing parties should demonstrate that their expectations (either of maintenance of the economic mechanisms, or of their adjustment to new conditions) are legitimate, and that implies that they are anchored in the reality that surrounded the investment and supervening developments.

## IV. CHARANNE V. SPAIN: A FIRST VICTORY FOR THE HOST STATE

To date, only one award has been rendered in disputes relating to alterations to economic support programs in the renewable energy market.[132] On January 21, 2016, the tribunal in *Charanne and Construction Investments v. Spain* ruled in favor of the validity of the host state's regulatory changes.[133] The case regarded the legislation passed by Spain in 2010, scaling back the incentives offered to investors in the photovoltaic sector.[134] The claimants alleged that such regulatory measures breached the standards of protection provided for in the ECT, namely the protection against expropriation and the fair and equitable treatment standard.[135]

First, the investors argued that Spain, after having attracted its investment in the area of solar photovoltaic generation through a series of government incentives, changed the regulatory framework, thereby causing damages to the investments.[136] The claimants submitted that the regulations introduced in 2010 had such a brutal impact on the economic value of their investment that this reduction in value constituted an indirect expropriation of the value and returns of the investment, even though their ownership rights were not affected.[137] Since the claimants' investment was not in returns of the photovoltaic installations, but in shares in a company that generated and sold electricity produced by photovoltaic solar plants, the tribunal held that the measures taken had to totally or partially deprive the

129. *Id.*

130. *Id.* at 411–14.

131. *Id.*

132. *See* Charanne B.V. v. The Kingdom of Spain, Arb. No. 062/2012, Final Award (Jan. 21, 2016) [hereinafter Charanne B.V. v. Spain, Award].

133. The original award (in Spanish) and an English translation (by MENA Chambers) are available at http://www.italaw.com/cases/2082. Charanne B.V. v. El Reino de España, Arb. No. 062/2012, Laudo Final (Jan. 21, 2016); Charanne B.V. v. Spain, Award, *supra* note 132; *see* Bonafé, *supra* note 67, for an analysis of the award.

134. Charanne B.V. v. Spain, Award, *supra* note 132, ¶¶80, 96, 146, 148–49.

135. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 277.

136. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 80.

137. Charanne B.V. v. Spain, Award, *supra* note 132, ¶¶ 280, 283–84.

claimants of their rights as shareholders in order to constitute indirect expropriation.[138] The tribunal found that claimants' essential complaint was a loss of profitability of the photovoltaic installations, which in turn reduced the value of their shares.[139] The tribunal emphasized that, notwithstanding the measures, the investors continue to be shareholders in the company and that the company continued to operate and earn revenue.[140] Although the profitability had been seriously affected, it was not as serious as to be characterized as an expropriation. Tribunal simple diminution in value of shares cannot constitute an indirect expropriation.[141]

The investors also argued that Spain's 2010 regulations constituted a failure to create stable conditions for investments, including the obligation to accord fair and equitable treatments, as they created a context of instability and lack of clarity in the regulatory regime.[142] In addition, claimants submitted that Spain's actions caused them to have legitimate expectations that the regulatory regime would not be modified, and that no contract with Spain was necessary to demonstrate this.[143] The tribunal commenced its analysis by emphasizing that it was restrained by the claimants' own pleadings, which expressly excluded the subsequent regulations from the tribunal's consideration.[144] As a result, it limited itself to considering only the 2010 Regulations. The tribunal found that in that limited context, it was unable to assess the evolution of the regulatory framework and thus unable to conclude that Spain had breached its obligation to maintain regulatory stability under Article 10(1) of the ECT.[145]

In relation to the lack of clarity in the regulations, the tribunal noted that the claimants had not alleged that there was anything ambiguous or difficult to understand about the 2010 Regulations.[146] As to the question of claimants' legitimate expectations, the tribunal espoused the general principle of good faith in international customary law that a state cannot induce an investor to make an investment, generate legitimate expectations and then later ignore commitments that generated those expectations.[147] The Tribunal held that the legitimate expectations on the part of the investor must: (a) be analyzed using an objective standard (based on the circumstances), and not the mere subjective belief held by an investor; (b) be reviewed according to the relevant circumstances, which were those prevailing at the time the investment was made; and (c) be reasonable.[148] Additionally, when determining whether the regulatory framework existing at the

138. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 460.
139. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 463.
140. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 462.
141. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 465.
142. Charanne B.V. v. Spain, Award, *supra* note 132, ¶¶ 479–80.
143. Charanne B.V. v. Spain, Award, *supra* note 132, ¶¶ 296–301.
144. Charanne B.V. v. Spain, Award, *supra* note 132, ¶¶ 481–83.
145. Charanne B.V. v. Spain, Award, *supra* note 132, ¶¶ 480–84.
146. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 485.
147. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 486.
148. Charanne B.V. v. Spain, Award, *supra* note 132, ¶¶ 494–95.

time the investment was made created legitimate expectations, the tribunal made the following observations:

> (a) A State is entitled to maintain a reasonable degree of regulatory flexibility to respond to changing circumstances and the public interest;[149]
>
> (b) The fair and equitable treatment protection standard does not contemplate that the law existing at the time the investment is made will be frozen or will never change;[150] and
>
> (c) An investor cannot have a legitimate expectation in the absence of a specific commitment on the part of the State made specifically to the investor(s) that existing regulations are immutable and will not be modified in order to adapt to market needs and the public interest.[151]

The tribunal found that the host state had not infringed investors' legitimate expectations, because no specific commitments had been given to them.[152] The tribunal was of the view that neither the pre-2010 Regulations, nor the literature distributed by the Spanish government to encourage investment could be seen as specific commitments.[153] Furthermore, the tribunal found that although regulations may have limited reach, in that they might be directed to a certain portion of the population, this alone is not sufficient to elevate them to the status of a State's specific commitment.[154] An example of a specific commitment to claimants may have been in the form of a stabilization clause in the regulations or a declaration for the benefit of the investors that the regulatory framework would not be modified.[155] Finally, the tribunal opined that in order to determine whether there had been a breach of the fair and equitable standard of treatment relating to modifying regulations that had been in existence at the time of the creation of the investment, an investor had to demonstrate that the regulations were made irrationally, contrary to public interest or that they were disproportionately applied.[156]

Although the 2010 Regulations could prejudice the interests of the electricity generators, they were based on objective criteria and could not be considered irrational or arbitrary.[157] As the main functions of the 2010 Regulations were to try to limit the tariff deficit, control the rising cost of electricity to the Spanish consumer and implement safety measures in relation to the voltage in the system, it could not be said that the 2010 Regulations were not applied in the public interest.[158] As a result, the tribunal found that the investors had not demonstrated a

149. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 500.
150. Charanne B.V. v. Spain, Award, *supra* note 132, ¶¶ 501–03.
151. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 499.
152. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 490.
153. Charanne B.V. v. Spain, Award, *supra* note 132, ¶¶ 492, 496–97.
154. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 493.
155. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 490.
156. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 514.
157. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 534.
158. Charanne B.V. v. Spain, Award, *supra* note 132, ¶¶ 517, 535.

breach of Spain's obligation to accord fair and equitable treatment.[159]

The arbitrator, Guido Santiago Tawil, issued a dissenting opinion on the issue of the claimant's legitimate expectations.[160] Whilst he shared the majority's position that the finding of a violation of an investor's legitimate expectations should be based on an objective standard (and not the subjective view of the investor at the time the investment is made), he believed that this must be done on an analysis of the facts on a case by case basis.[161] Specifically, he opined that a finding that legitimate expectations had been created was not limited to situations where there was a specific commitment, whether of contractual nature or based in declarations or specific conditions granted by the host State.[162] In Mr. Tawil's view, legitimate expectations could also be derived from a host state's legal regime existing at the time the investment is made.[163] He noted that when an investor fulfills all the current regulatory requirements in order to obtain a specific and determinable benefit, a host State's subsequent disregard of the investment violates his legitimate expectations.[164]

Mr. Tawil believes that Spain's special regulatory regime was specifically designed to foster a strong incentive to invest (so that the state's objective in promoting the industry could be fulfilled), and was directed to a precise group of investors with the means to invest, on the basis that the investor could benefit from the regime for a definite period of time.[165] He further noted that the existence of these elements, namely, (i) rules created to foster investment in renewable energy, directed at a specific number of possible investors, and (ii) a brief time period in which the benefit was to be obtained, was sufficient to show that legitimate expectations on the part of the Claimants.[166] He found that once the claimants made the investment and fulfilled all of the requirements to obtain the benefits, then it did not seem legally acceptable to recognize the host State's prerogative to modify or eliminate the benefit without any legal consequences.[167] Mr. Tawil disagreed with the tribunal that this was incompatible with a State's right to modify its laws, as a State never loses that right.[168] However, if in the process of exercising that right, the State infringes legitimate expectations, he was of the view that it should provide adequate compensation.[169]

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159. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 539.

160. Charanne B.V. v. The Kingdom of Spain, Arb. No. 062/2012 (Dec. 21, 2015) (Arb. Prof. Dr. Guido Santiago Tawil, dissenting) [hereinafter Charanne B.V. v. Spain, Dissent]. Original (in Spanish) and English translation (by MENA Chambers) are available at http://www.italaw.com/cases/2082. Charanne B.V. c. El Reino de España, Arb. No. 062/2012 (Dec. 21, 2015) (Arb. del Prof. Guido Santiago Tawil, opinión disidente).

161. Charanne B.V. v. Spain, Dissent, *supra* note 160, ¶ 4.

162. Charanne B.V. v. Spain, Dissent, *supra* note 160, ¶¶ 4–5.

163. Charanne B.V. v. Spain, Dissent, *supra* note 160, ¶ 5.

164. Charanne B.V. v. Spain, Dissent, *supra* note 160, ¶ 12.

165. Charanne B.V. v. Spain, Dissent, *supra* note 160, ¶¶ 7–8.

166. Charanne B.V. v. Spain, Dissent, *supra* note 160, ¶ 9.

167. Charanne B.V. v. Spain, Dissent, *supra* note 160, ¶ 10.

168. Charanne B.V. v. Spain, Dissent, *supra* note 160, ¶ 11.

169. Charanne B.V. v. Spain, Dissent, *supra* note 160, ¶ 11.

This award is the first decision regarding legislative alterations to economic support programs in the renewable energy market.[170] Although the award is only binding for the disputing parties and not on arbitral tribunals in other pending cases, it offers important insights into how standards of investment protection might be interpreted and applied in similar disputes. The majority's decision is consistent with other arbitral tribunals' findings regarding the requirements for indirect expropriation or violations of legitimate expectations.[171] The decision also addresses the circumstances in which, in the absence of a specific undertaking, a host country may exercise its sovereign right to regulate without violating its international investment law obligations.[172] Since Spain had not made any specific commitments to the investors with respect to the stability of the incentives regime, the investors could not have expected that the renewable incentives regulatory framework would remain unchanged for the lifetime of a photovoltaic plant.[173] In the tribunal's view, the obligation to provide fair and equitable treatment to foreign investors under the ECT does not require freezing regulatory frameworks or limiting changes to regulations.[174] The arbitral panel held that investors did not demonstrate any principle of international law that prohibits a state from imposing new rules when it never signed a contract stipulating otherwise.[175] The tribunal held that the changes introduced by Spain were reasonable, proportional, made in the public interest, and not retroactive.[176] Such changes maintained all the fundamental characteristics of the regulatory regime at the time of the investment, namely the right to a subsidized tariff through the photovoltaic plant's life.[177]

An important aspect of the decision involves the relationship between investors' expectations and due diligence. In a highly regulated industry such as energy, investors must exhaustively analyze the applicable framework before they make their investment.[178] It is necessary to carry out a due diligence analysis of the legal framework of the host country on the part of the investors, in order to shape expectations.[179] The tribunal found that an investor had a duty to conduct due diligence of the legal framework of the investments, and that if the claimants would have done so, they should have expected the possibility of changes to the

170. Bonafé, *supra* note 67, at 174–75.

171. *See* CMS Gas Transmission Co. v. Argentina, ICSID Case No. ARB/01/8, Award, ¶ 277 (May 12, 2005); Continental Casualty Co. v. Argentina, ICSID Case No. ARB/03/9, Award, ¶ 258 (Sept. 5, 2008); Electrabel S.A. v. Hungary, ICSID Case No. ARB/07/19, Award, pt. VII, ¶ 7 (Nov. 25, 2015).

172. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 500.

173. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 499.

174. Charanne B.V. v. Spain, Award, *supra* note 132, ¶¶ 503–04.

175. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 548.

176. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 539.

177. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 533.

178. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 507.

179. Monica Feria-Tinta, *First Investor-State Arbitration Award In the Spanish Renewables Cases Handed Down In Favour of Spain*, 20 ESSEX STREET, http://www.20essexst.com/sites/default/files/u58/Jan2016%20-%20MFT2_1.pdf (last visited Nov. 21, 2016).

regulatory regime.[180] In the words of the tribunal:

> At least that is the level of care that would be expected of a foreign investor in a highly regulated as the energy sector, where a preliminary and comprehensive legal framework applicable to the sector analysis is essential to proceed with the investment.[181]

The degree of investor diligence operates as a factual or interpretive element in light of which the appropriateness of State action is to be assessed or, relatedly, the scope of protection of investment protection standards is to be determined.[182] From this perspective, investor diligence is a key consideration in assessing the "reasonableness" or "legitimacy" of the expectations that could potentially be protected by the fair and equitable treatment clause.[183] "[I]nvestors have a due diligence obligation, which covers not only. . .the basic regulations applicable to foreign investment transactions. . .but also. . .the entire legal framework potentially applicable to the investment, and even. . .the potential changes of such framework that are foreseeable at the time the investment is made."[184]

While the Charanne award offers important lessons, it should be stressed that it focused only on the 2010 legislative changes, and did not take into consideration further changes introduced to the legal framework.[185] In fact, the more significant legislative amendments introduced by Spain after 2010 are the subject separate claims filed more recently.[186] As a result, this award should not be seen as decisive for the outcome of the other renewable energy cases against Spain.[187] According to Behn, the key to understanding the outcomes in these cases will be in the distinctions between when the claims were initiated and against which state.[188] The earlier cases will probably be claiming violations of the ECT according to very different legislative and regulatory changes compared to the later cases. The timing of claim initiation will be critical and is likely to create substantial differences in outcomes.[189] It is also likely for later claims to be more successful, as they are be based on the more severe regulatory changes.[190] Referring to the Charanne award,

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180. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 507.

181. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 507.

182. Jorge E. Viñuales, *Investor Diligence In Investment Arbitration: An Overview of Sources and Arguments*, *in* GENERAL PRINCIPLES OF LAW AND INTERNATIONAL INVESTMENT ARBITRATION: SOURCES AND ARGUMENTS (Andrea Gattini ed.) (forthcoming 2016).

183. *Id.*

184. VIÑUALES, *supra* note 76, at 354–55.

185. Charanne B.V. v. Spain, Award, *supra* note 132, ¶¶ 481-83.

186. *See* list of disputes *supra* note 55.

187. Ramona Volciuc-Ionescu, *Energy Charter Treaty Claims: Spain Wins First Solar Case in Arbitration*, LEXOLOGY (Jan. 28, 2016), http://www.lexology.com/library/detail.aspx?g=56483dbf-aa32-4f52-a415-1f52492ad218.

188. Daniel Behn, *Spain Wins First PV Solar Arbitration: A Word of Caution in Using this Case to Predict Outcome in the more than Three Dozen Cases to Come*, U. OSLO: PLURICOURTS BLOG (Jan. 27, 2016, 9:43 AM), http://www.jus.uio.no/pluricourts/english/blog/daniel-friedrich-behn/2016-01-26-arbitration-spain.html.

189. *Id.*

190. *Id.*; *3 Takeaways From the First Spanish Solar Arbitration Award*, GLOBAL INVESTMENT PROTECTION (Feb. 2, 2016), http://www.globalinvestmentprotection.com/index.php/3-takeaways-from-

Behn argues that it would have been unreasonable to expect – absent a specific contractual guarantee between the investor and the state – that the regulatory and legislative environment governing solar projects would remain static and completely unchanged for the life of the project.[191] However, the author believes that legislative changes introduced later on, namely in 2013 and 2014, are more likely to be considered as breaches of the ECT.[192]

The outcome of the Charanne case is an important victory for host states like Spain who face several claims before international tribunals on fairly similar facts.[193] This is the first decision that analyzes the key problems arising from changes to economic support mechanisms and helps to shed some light on the validity of such measures under international law. However, it should be kept in mind that other respondent states like the Czech Republic and Bulgaria have adopted slightly different types of measures. Therefore, the takeaways from this award cannot simply be applied automatically and fully to the other solar energy disputes.[194] For now, the major lesson offered by the Charanne award is that a breach of international investment treaties in this context will not be as straightforward as some investors may have initially imagined.[195]

## V. IMPLICATIONS FOR RENEWABLE ENERGY POLICYMAKING

Energy projects entail large-scale, long-term capital investments. Because renewable energies are not mature technologies, their development depends upon public support. Economic support mechanisms need to be maintained in the form presented at the time the investment is made in order for it to be profitable.[196] Investment decisions in the energy market are surrounded by risks of ex post regulatory changes by the host state. Feed-in tariffs and similar economic support mechanisms paved the way for the expansion of the market for green energy but became a victim of their own success. In response to overgrowth within the market, several countries have decided to scale down, or eliminate, such incentives after the investment costs were already sunk.[197] In times of financial crunch feed-tariffs become especially easy targets because they are more visible than other government subsidies.[198]

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the-first-spanish-solar-arbitration-award.

191. Behn, *supra* note 188.

192. *Id.*

193. *See* list of cases *supra* note 66.

194. *3 Takeaways From the First Spanish Solar Arbitration Award*, *supra* note 190.

195. Behn, *supra* note 188.

196. Edna Sussman, *The Energy Charter Treaty's Investor Protection Provisions: Potential to Foster Solutions to Global Warming and Promote Sustainable Development*, *in* SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW 515, 528 (Marie-Claire Segger et al. eds., 2011).

197. Sussman, *supra* note 196.

198. Victor Mallet, *Shadow Falls across Spanish solar energy industry*, FINANCIAL TIMES (June 1, 2010, 3:00 AM), http://www.ft.com/cms/s/0/9ec9a138-6d15-11df-921a-00144feab49a.html?ft_site=falcon&desktop=true#axzz4RL9y7LFM; Leah Stokes, *The Politics of Renewable Energy Policies: The case of Feed-in-tariffs in Ontario, Canada*, 56 ENERGY POL'Y 490, 497 (2013).

Changes to regulatory frameworks might have a significant impact on what until recently seemed like an unstoppable move towards a low-carbon model of development, jeopardizing the credibility of renewable energy policies and generating high investment uncertainty.[199] These measures may affect the support for renewable energy in both the present and future. Governments may cut agreed subsidies for projects built or under construction but also decide not to grant any support for new projects.[200] If investors have the perception that governments might act opportunistically and change the "rules of the game" after the investment has been made, they will most likely factor in a risk premium in future projects, increasing the costs of eco-friendly policies.[201]

Changes introduced by several countries to their economic support mechanisms have triggered a wave of international arbitral proceedings.[202] Foreign investors are challenging such measures claiming that they reduce the profitability of their investments in a way that is inconsistent with the obligations borne by host states under international investment agreements.[203] Investment canons such as the prohibition of expropriation and fair and equitable treatment have, in theory, the potential to adequately protect investors from the negative effects of such decisions.[204] Modification or withdrawal of incentives can be qualified as "partial expropriation" or a violation of the fair and equitable treatment standard by frustrating an investor's legitimate expectation to benefit from public support.[205] If the impact on investors' rights and legitimate, reasonable expectations are significant, states might find it difficult to justify their actions based on public policy considerations- such as budgetary constraints or short-term economic harm.[206]

The network of international investment agreements built over the past few decades has fundamentally altered the legal framework for investors and host states in the energy sector.[207] Furthermore, the resort to the investor-state arbitration mechanism for the settlement of disputes gave arbitration panels a role

199. *Energy 2020: A Strategy for Competitive, Sustainable and Secure Energy*, at 9, COM (2010) 639 final (Nov. 10, 2010), http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52010DC0639&from=EN; *A Comparative Analysis*, *supra* note 13, at 174; DEL RIO, *supra* note 47, at 21.

200. Mallet, *supra* note 198; Gerard Marata et al., *Renewable Energy Incentives in the United States and Spain: Different Paths – Same Destination?*, 28(4) J. OF ENERGY AND NAT. RESOURCES L. 481, 499 (2010).

201. Boute, *Combating Climate Change*, *supra* note 90, at 615.

202. *See* list of cases *supra* note 66.

203. *See* JOHN A. VANDUZER ET AL., INTEGRATING SUSTAINABLE DEVELOPMENT INTO INTERNATIONAL INVESTMENT AGREEMENTS 10 (2013) (describing investor concerns over the risk of arbitrary and discriminatory treatment by host states).

204. Lise Johnson & Oleksandr Volkov, *State Liability for Regulatory Change: How International Investment Rules are Overriding Domestic Law*, INVESTMENT TREATY NEWS (Jan. 2014), https://www.iisd.org/itn/2014/01/06/state-liability-for-regulatory-change-how-international-investment-rules-are-overriding-domestic-law/.

205. Boute, *Combating Climate Change*, *supra* note 90, at 651–52.

206. *Id.* at 652.

207. *See generally* Whitsitt, *supra* note 42.

to play in national and international energy policymaking. Arbitral tribunals perform a supranational review of state acts, scrutinizing the conduct of public entities against the standards of treatment prescribed in international investment agreements.[208] The outcome of these proceedings may limit the future legislative and administrative freedom of maneuver of states, affecting their ability to pursue public welfare policies.[209] Investor-state arbitration panels have been dealing with a greater amount of energy disputes, and particularly climate-related issues. While some years ago investors were claiming that states had enacted environment-friendly regulations in a way that was detrimental to their investments, the new wave of disputes refers to cases were states are reducing or eliminating the economic incentives which they introduced years ago in order to encourage investments in the renewable energy market.[210] This new category of disputes basically results from the move from the old to the new production matrix.[211] In both sets of cases, the protections afforded to foreign investors by international investment agreements have the potential to interfere in domestic decision-making on climate-related issues. International investment agreements protect investors in general, both those who invest in renewable-energy projects and those who invest in carbon-intensive industries. Both scenarios will most likely feature in future investment arbitration proceedings.[212]

Arbitral tribunals in charge of settling renewable energy disputes have a complex task ahead of them. As final awards are rendered, they have the potential to provide guidance for pending cases and similar disputes that will surely arise in the future,[213] further defining the parameters of the host states' regulatory powers with respect to renewable energy investments.[214] "[U]nderstanding how arbitrators are giving effect to the protections for investors, while at the same time balancing the interests of host states to regulate in the public interest," will play a decisive role in future renewable energy policymaking.[215]

Tribunals will have to balance the expectations of investors against the right of states to intervene in the public interest and adjust regulatory structures according to the specific circumstances that surround those cases. This assessment will likely focus on whether governments act with consistency, transparency, and reasonableness when modifying or eliminating the existing incentives regime, and, above all, whether investors have reasonable and legitimate expectations that were breached as a result of the state's measures.[216]

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208. *Id.* at 209.

209. *Id.* at 209–10.

210. *Id.*

211. Jorge E. Viñuales, *Foreign Investment and the Environment in International Law: The Current State of Play, in* RESEARCH HANDBOOK ON ENVIRONMENTAL AND INVESTMENT LAW (Kate Miles ed.) (forthcoming 2016).

212. Miles, *supra* note 70, at 86.

213. Nathanson, *supra* note 80, at 865.

214. Patrizia, *supra* note 47, at 83.

215. Whitsitt, *supra* note 42, at 208.

216. Patrizia, *supra* note 47, at 78.

As divergent interpretations persist about when the investors' expectations deserve protection under the fair and equitable treatment standard, any evaluation will be deeply dependent upon the specific circumstances and facts of each particular case.[217] Past arbitral practice allows for diverging interpretations of the existing investment standards. This divergence is explained by three different reasons. "First, different international investment agreements adopt different languages and formulate investment standards in diverse ways. . ."[218] Second, these legal instruments normally have a wide scope of application and are not specifically designed for investments in a particular area or industry.[219] [Lastly], there is no. . . binding precedent in investment arbitration."[220] Arbitral tribunals can interpret the applicable investment treaties differently and apply them to the specific facts of the case according to their own appreciation.[221] This underlines the importance of the specific nature and circumstances of each dispute for the decision. While international investment tribunals do not create precedent that is binding upon other tribunals, some of the standards of investor protection are actually primarily shaped by prior rulings and not by reference to other sources of international law or state practice.[222] Investment treaty arbitration has developed a strong, albeit persuasive – that is, non-binding – system of precedent.[223] Still, the approach of different international investment arbitrators to similar issues can vary considerably, creating a degree of uncertainty regarding the outcome of international investment disputes.[224]

This lack of certainty raises the question of the necessity to create a specific investment regime for low-carbon investments. The last decades witnessed the emergence of what can be called "International Energy Investment Law",[225] mainly composed of bilateral investment treaties and the ECT. These international instruments afforded a certain degree of certainty and security to investors, significantly increasing the availability of funds for investment in renewable energy projects.[226] Against a background of financial crisis, the present wave of disputes makes the call for a widely adopted multi-lateral energy investment treaty all the more urgent. Investment treaty analysis and climate change concerns have developed since the drafting of the ECT and political changes and realignments have occurred which may require some fine-tuning or adjustments in the ECT

217. Cameron, *supra* note 14, at 312-13; Patrizia, *supra* note 47, at 80.

218. Fernando Dias Simões, *The Role of Investment Arbitration in Water Services Governance*, WATER POLICY (2016), http://wp.iwaponline.com/content/ppiwawaterpol/early/2016/11/28/wp.2016.032.full.pdf.

219. *Id.*

220. *Id.*

221. Boute, *Combating Climate Change*, *supra* note 90, at 652.

222. *Id.*

223. STEPHAN SCHILL, INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC Law 18 (Stephan Schill ed., 2010).

224. CONDON, *supra* note 18, at 93.

225. Krajewski, *supra* note 79, at 352–54.

226. Sussman, *supra* note 196, at 528.

provisions.[227]

The Energy Charter Secretariat has been discussing the benefits of a non-binding declaration and/or an interpretative note on the promotion of low-carbon investments.[228] It is argued that such a statement would improve legal certainty in the application of the ECT, reducing the normative and political risks and investment related disputes.[229] Moreover, a clear political statement on low-carbon investments by the Energy Charter Conference would send an important signal to the international community and to investors on its commitment to sustainable development and climate change mitigation. The overall objective being the protection and balance the interests of ECT members and of international investors.[230]

Some authors go farther and argue that the current system is problematic, as it allows foreign investors to initiate arbitration against the host state without having first consulted and received some sort of an authorization from their home government.[231] In the cases against Spain, it is reported that a number of foreign states have notified the Spanish authorities, more or less officially, of their concern regarding the commercial interests of their nationals.[232] From this perspective, foreign investors should first seek at least the opinion of its home government, and preferably its assent, before initiating an international conflict that can grow well beyond the economic dispute that originated it. The relative lack of practical effect of many investor-state disputes calls into question whether state-to-state dispute settlement would be more efficient.[233]

In the European context, economic support mechanisms for the promotion of renewable energy have led not only to the wave of investment arbitration but also to market distortions and state aid investigations.[234] According to Behn and Fauchald, this is the result of two major sets of conditions.[235] On the one hand, external conditions, namely, the global financial recession and the unanticipated

227. *Id.* at 532.

228. *See* Energy Charter Secretariat, *Energy Charter 2013 Annual Report* 25–26, http://www.energycharter.org/fileadmin/DocumentsMedia/AR/AR_2013_en.pdf (last accessed Dec. 10, 2015); *see also* Energy Charter Secretariat, *Energy Charter 2014 Annual Report* 19, http://www.energycharter.org/fileadmin/DocumentsMedia/AR/AR_2014_en.pdf (last accessed Dec. 10, 2015).

229. *See* Energy Charter Secretariat, *Energy Charter 2013 Annual Report* 25–26, http://www.energycharter.org/fileadmin/DocumentsMedia/AR/AR_2013_en.pdf (last accessed Dec. 10, 2015); *see also* Energy Charter Secretariat, *Energy Charter 2014 Annual Report* 19, http://www.energycharter.org/fileadmin/DocumentsMedia/AR/AR_2014_en.pdf (last accessed Dec. 10, 2015).

230. *Energy Charter 2013 Annual Report*, *supra* note 228, at 26.

231. Iriarte, *supra* note 47.

232. *Id.*

233. Ramon Torrent et al., *Reforming the Present International Legal Framework for Foreign Direct Investment (FDI): Basic Elements for an Analytical and Policy Framework* 6–7 (Legal Studies Research Paper No. 2015-25, 2015), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2570596.

234. Behn & Fauchald, *supra* note 47.

235. *Id.* at 127.

decline in the cost of solar panels.[236] On the other hand, an internal condition – the regulatory structure established to implement support schemes. While the external conditions were unanticipated, regulatory structures were inflexible and unable to quickly respond to changing market conditions.[237] Because investments were originally over-incentivized, when regulators and legislators realized that feed-in tariffs were unsustainable, it was too late and drastic emergency-type measures were required to control new investment in the sector.[238]

This is recognized by the European Commission itself, who has stated that:

> [R]igid national support schemes were generally unable to adapt rapidly enough to . . . falling costs, raising profits and creating a rate and scale of installations in some countries almost excessive in a time of general economic crisis. The result has been sudden and unpredictable changes to a number of national support schemes, which will . . . curtail investment . . .[239]

The European Commission recognizes that:

> Given the prominent role that financial support schemes play in developing renewable energy today, and given the growing prominence (and cost) of renewable energy use in the electricity sector, urgent efforts are needed to reform support schemes to ensure that they are designed in a cost effective, market-oriented manner. The Commission's guidance is necessary to ensure that support schemes are adjusted regularly and quickly enough to take account of falling technology costs and to ensure reforms make renewable energy producers part of the energy market . . . to ensure such market interventions are correcting market failures and not adding or maintaining market distortions . . . Many national reforms have had a negative impact on the investment climate. Most critical have been changes that reduce the return on investments already made. Such changes alter the legitimate expectations of business and clearly discourage investment, at a time when significantly more investment is needed.[240]

The European Commission's concern with renewable energy disputes is eloquently evidenced by its own involvement in the arbitral proceedings.[241] In *Charanne and Construction Investments v. Spain*, the European Commission was permitted to file an amicus curiae brief.[242] The European Commission is also reported to have sought leave to intervene in other proceedings against Spain[243]

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236. *Id.*

237. *Id.*

238. *Id.*

239. *Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Renewable Energy Progress Report*, at 5, 175, COM (Mar. 27, 2013).

240. *Id.* at 9.

241. Charanne B.V. v. Spain, Award, *supra* note 132.

242. Charanne B.V. v. Spain, Award, *supra* note 132, ¶ 56.

243. Namely, Antin Infrastructure Services Luxembourg S.à.r.l. & Antin Energia Termosolar B.V.

and the Czech Republic,[244] but there is no further information available. Non-disputing party applications have been filed to intervene in other energy-related ICSID cases against Spain[245] and Italy,[246] yet it remains unclear whether the European Commission has filed these applications.

The European Commission seeks authorization to take part in the arbitral proceedings in order to clarify issues concerning the scope and content of European Law, which are connected to the disputes. Being the "Guardian of the Treaties", the European Commission possesses a vested interest in becoming involved in such arbitrations and helping the tribunal to elucidate potential conflicts of legal rules and principles.[247] In the different proceedings against the Czech Republic being arbitrated under the UNCITRAL Rules, the European Commission is reported to have raised a conflict with the provisions of European Union Law. According to the Commission, former benefits and incentives accorded to solar investors could constitute state aid that needed to be eliminated in order for the Czech Republic to remain in compliance with European Union

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v. Kingdom of Spain, ICSID Case No. ARB/13/31(Aug. 7, 2014); Eiser Infrastructure Limited & Energía Solar Luxembourg S.à.r.l. v. Kingdom of Spain, ICSID Case No. ARB/13/36 (July 28, 2014); and Isolux Infrastructure Netherlands B.V. v. Kingdom of Spain (Arb. Inst. Stockholm Chamber of Comm., registered 2013); *see* Luke Peterson, *European Commission Wades into Solar Arbitrations Against Spain, Intervening in One Case a Week Before Final Hearing*, INVESTMENT ARBITRATION REPORTER (Nov. 17 2014), https://www.iareporter.com/articles/european-commission-wades-into-solar-arbitrations-against-spain-intervening-in-one-case-a-week-before-final-hearings; Valentina Vadi, Beyond Known Worlds: Climate Change Governance by Arbitral Tribunals?, 48(5) VANDERBILT J. OF TRANSNT'L L. 1285, 1341 (2015).

244. Antaris Solar & Dr. Michael Göde v. Czech Republic (PCA Case Repository, May 8, 2013); Natland Investment Group NV, Natland Group Limited, G.I.H.G. Limited, & Radiance Energy Holding S.A.R.L. v. Czech Republic (UNCITRAL, registered May 8, 2013); Voltaic Network GmbH v. Czech Republic (UNCITRAL, registered May 8, 2013); ICW Europe Investments Limited v. Czech Republic (UNCITRAL, registered May 8, 2013); Photovoltaik Knopf Betriebs-GmbH v. Czech Republic (UNCITRAL, registered May 8, 2013); WA Investments-Europa Nova Limited v. Czech Republic (UNCITRAL, registered May 8, 2013); *see* Luke Peterson, *Brussels' Latest Intervention Casts Shadow Over Investment Treaty Arbitrations Brought by Jilted Solar Energy Investors*, INVESTMENT ARBITRATION REPORTER (Sept. 8, 2014), http://www.iareporter.com/articles/brussels-latest-intervention-casts-shadow-over-investment-treaty-arbitrations-brought-by-jilted-solar-energy-investors; Pietro Ortolani, *Intra-EU Arbitral Awards vis-à-vis Article 107 TFEU: State Aid Law as a Limit to Compliance*, 6 J. INT'L DISP. SETTLEMENT 118, 126 (2015).

245. RREEF Infrastructure (G.P.) Limited & RREEF Pan-European Infrastructure Two Lux S.à.r.l. v. Kingdom of Spain, ICSID Case No. ARB/13/30 (June 6, 2016); Masdar Solar & Wind Cooperatief U.A. v. Kingdom of Spain ICSID Case No. ARB/14/1(July 18, 2014); NextEra Energy Global Holdings B.V. & NextEra Energy Spain Holdings B.V. v. Kingdom of Spain ICSID Case No. ARB/14/11 (Jan. 23, 2015); InfraRed Environmental Infrastructure GP Limited & others v. Kingdom of Spain, ICSID Case No. ARB/14/12 (Nov. 26, 2014); RENERGY S.à.r.l. v. Kingdom of Spain, ICSID Case No. ARB/14/18 (Feb. 13, 2015); *see* Decisions on Non-Disputing Party Participation, ICSID, https://icsid.worldbank.org/apps/ICSIDWEB/process/Pages/Decisions-on-Non-Disputing-Party-Participation.aspx.

246. Blusun S.A., Jean-Pierre Lecorcier & Michael Stein v. Italian Republic, ICSID Case No. ARB/14/3 (June 12, 2014).

247. Christina Knahr, *The New Rules on Participation of Non-Disputing Parties in ICSID Arbitration: Blessing or Curse?*, *in* EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION 319, 320 (Chester Brown & Kate Miles eds., 2011).

law.[248] The intervention of the European Commission in the proceedings may, naturally, raise the technical complexity of the proceedings due to the potential conflict between obligations arising under BITs and under European Union law.[249]

Greater policy coordination between the European Union and its member states is needed.[250] The European Commission is currently working to devise a European policy on renewable energy promotion.[251] In this regard, the design of support schemes is of paramount importance. While economic support mechanisms have demonstrated important successes, they have also evidenced a number of policy failures.[252] Feed-in tariffs are useful support mechanisms, but should not be irreversible. These tools must inevitably adapt to changing circumstances, namely varying costs. However, this is no easy task. Governments may face significant political resistance if they decide to change or terminate feed-in tariffs. Investors always resist any change to regulatory structures that affects these mechanisms and impacts their investments. As incentives become a key piece in the overall system, the renewables industry may gain more political suasion, making the problem even harder to solve.[253]

The current wave of disputes may be the consequence of insufficient planning and administrative capabilities. It should be seen as a serious warning for governments to act cautiously when implementing policies that may have important implications for international investment.[254] Governments need to understand renewable energy policies in general – and financial support mechanisms in particular – as a permanent exercise of re-evaluation and re-adaptation. Markets change continuously, and so does the market for renewable energy sources. Policies need to adapt accordingly. The challenge is for policymakers to adjust quickly and adequately to ever-changing markets in order to maximize their regulatory frameworks' efficacy and efficiency. Governments should be aware that making long-term commitments to attract investment may result in expensive international arbitration claims in the future. Feed-in tariffs must be designed prudently to allow for flexibility when market conditions change. Well-designed schemes are in the best interest of both governments and investors, because the alternative is an explosion of disputes where everyone loses except the arbitration industry.[255] Governments should factor in some flexibility into the regulatory structure so as to eliminate the risk of legitimate policy decisions giving rise to legal disputes, while at the same time providing adequate assurances to

248. Peterson, *supra* note 244; Vadi, *supra* note 243, at 1340–41.

249. Knahr, *supra* note 247, at 320.

250. Behn, *supra* note 47, at 2, 6.

251. *Id.* at 2.

252. *Id.*

253. Davies, *supra* note 82, at 998.

254. Behn & Fauchald, *supra* note 47, at 138.

255. Kyla Tienhaara, *Does the Green Economy Need Investor–State Dispute Settlement?*. INVESTMENT TREATY NEWS (Nov. 15, 2015), https://www.iisd.org/itn/2015/11/28/does-the-green-economy-need-investor-state-dispute-settlement/ (last visited Dec. 10, 2016).

investors.[256] Policymakers need to design feed-in tariff schemes that are flexible enough to accommodate changes in the market without disrupting the stability of the regime itself. Those who fail to strike this balance risk regulatory collapse.[257]

Nevertheless, it should also be added that regulatory risks associated with renewable energy investment are also evolving. As renewable energy develops and matures, its costs will sooner or later fall below the price of conventionally produced electricity. Once this "tipping point" has been reached, feed-in tariffs will have delivered their promise, and will only be needed on a limited basis, if at all.[258] As a result, they will be increasingly unnecessary to entice investment in renewable energies. When this moment comes, investment disputes resulting from the elimination of such incentives will disappear as well.[259]

Disagreements in the international energy industry normally lead to high profile disputes. Once a controversy arises, parties seek to exhaust all options to reach a settlement before resorting to arbitration. Many disputes are amicably settled before an arbitral award is rendered. The cases that do reach the award stage are more likely to reflect investor-state relationships that are beyond repair.[260] The astounding amount of disputes currently pending before arbitral tribunals signals a failure by governments in adjusting their regulatory structures without destabilizing the market for renewable energies. Regardless of the final outcome of these disputes, they indicate a significant level of conflict between host states and investors. Monitoring the evolution of these disputes is especially difficult since part of the information is confidential or otherwise unavailable.[261] Whether parties will be able to avoid further confrontation and reach to reasonable settlements remains to be seen.

In any case, it is important to ensure that bridges between states and investors are not burned. The transition to a low-carbon model of development requires long-term cooperation between parties.[262] Countries will continue to strive to design and implement energy policies that allow them to face climate change. Investors are essential partners in this process, and governments need to be able to encourage them to make their contribution in future ventures. In designing new policies or adjusting existing ones, governments need to take into account that the legal framework that supports renewable energy investment is not confined to national regulations. The legal obligations borne by states towards investors encompass obligations in domestic law (contract and administrative law) but also in international law, namely international investment law.[263] The challenge for governments is to strike a balance between regulation that discourages foreign

256. Jha, *supra* note 102.
257. Davies, *supra* note 82, at 998.
258. POWERING THE GREEN ECONOMY, *supra* note 8, at xxiii.
259. Tienhaara, *supra* note 256.
260. *Stability of Contract*, *supra* note 15, at 313.
261. Viñuales, *supra* note 211.
262. Tienhaara, *supra* note 255.
263. *Id.*

investment and foreign investment protection that discourages regulation.[264]

Countries need to adopt a holistic approach to renewable energy policymaking so as to avoid possible clashes between different legal frameworks. The different layers of regulation applicable to investments in renewable energies all serve to protect investments in this field. Legal instruments, international investment law in particular, can help to mobilize the huge investments required to transform the energy sector to cleaner forms of generation.[265] The challenge is to shape national policies in ways that do not breach the rights of foreign investors under international investment agreements. This can only be achieved if host states are truly aware of the scope of their obligations to foreign investors when they design and implement their renewable energy policies.[266] This requires a clear understanding of the disciplines of international investment law and how they may limit or impact upon national regulation.

Investment standards of protection may have a chilling effect on the domestic regulatory space. While in the past concerns have been voiced that arbitration awards could end up crystallizing environmentally detrimental rules, now they may ultimately have an environmentally friendly freezing effect. Governments should be cognizant of the commitments that they undertake under international investment treaties. In particular, the fair and equitable treatment standard narrows down the discretionary space of host states.[267] Its application may inhibit necessary adjustments and changes in the legal framework, which the investor did not expect or which are seen as irrational or unjustifiable by the investment tribunals.[268] The risk that host state measures may conflict with investment-backed expectations may, however, be substantially reduced by governments if they ensure regulatory transparency and due process.[269]

States can also reduce the risk of overly broad interpretations of investment disciplines by using more precise language in new investment agreements or include explicit language that allows them to justify changes to regulatory frameworks by reference to broad social or environmental objectives. However, both of these measures only apply to future disputes. As for existing international investment agreements, states can provide authoritative interpretive guidance as to the terms of the treaty. A good example of this approach is the interpretive note issued by the three member-states to the North American Free Trade Agreement (NAFTA) in relation to the fair and equitable treatment standard.[270]

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264. CONDON, *supra* note 18, at 93.

265. CONDON, *supra* note 18, at 93.

266. *Id.*

267. Krajewski, *supra* note 79.

268. *Id.* at 360.

269. Åsa Romson, *International Investment Law and the Environment*, *in* SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW 37, 40 (Marie-Claire Segger et al. eds., 2011).

270. *North American Free Trade Agreement (NAFTA), Notes of Interpretation of Certain Chapter 11 Provisions*, GLOBAL AFFAIRS CANADA, http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/nafta-interpr.aspx?lang=eng (last accessed Dec. 10, 2015).

The numerous claims over changes in economic support mechanisms that have surfaced in the past few years provide evidence that states to rethink and reshape their renewable energy policies. The determination of what is reasonable for the investor to expect is important for any reform of legal frameworks. Shifts in both policy and the development of countries make this determination different from country to country.[271] The creation of efficient and sustainable markets for renewable sources of energy is a tremendous financial and legal challenge. This endeavor can only be achieved through a thorough knowledge of the functioning and possible implications of the economic mechanisms and legal frameworks that underpin foreign investments in the renewable energy market.

271. Romson, *supra* note 269, at 40.

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