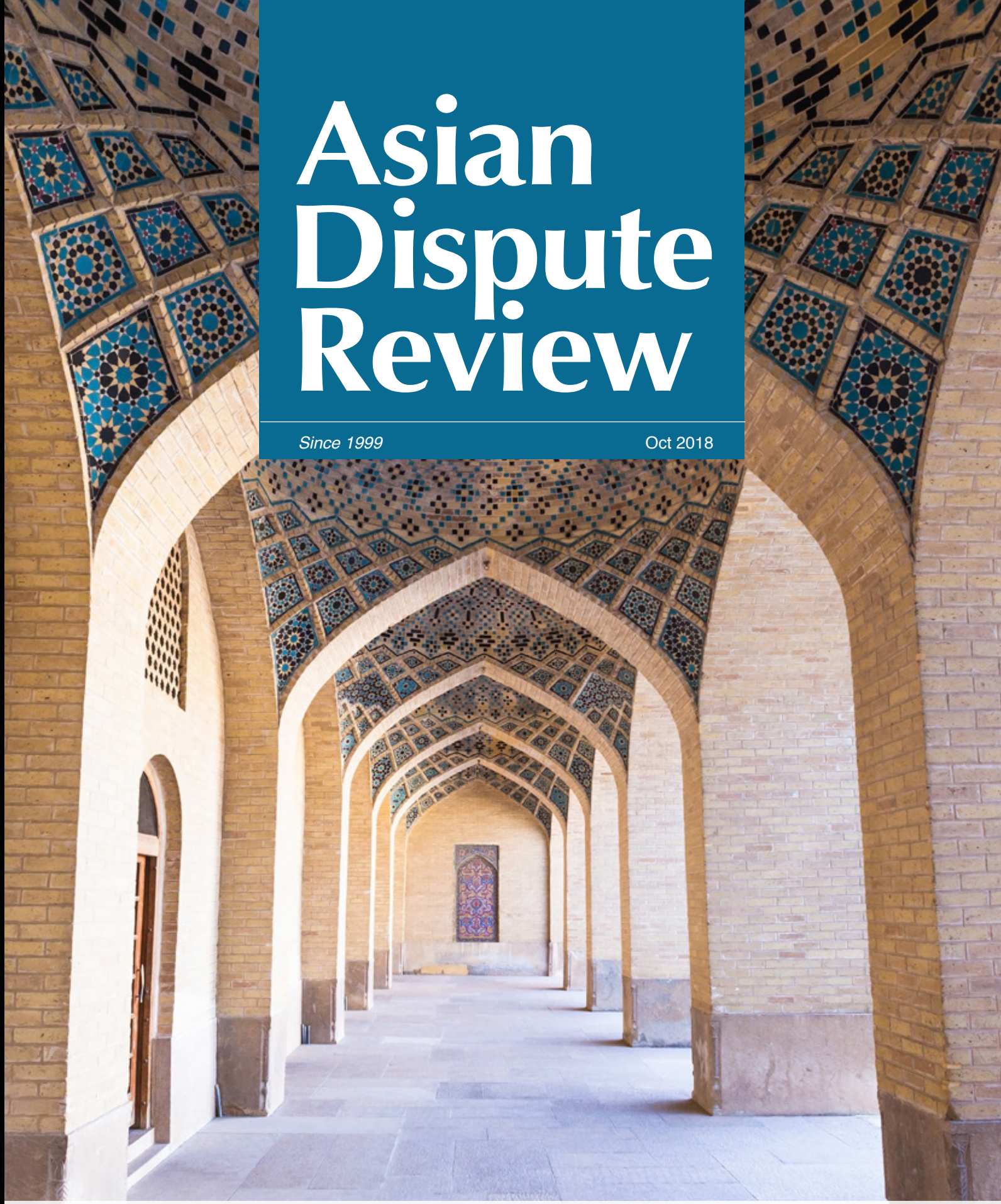
ASIAN DISPUTE REVIEW
OCTOBER 2018
pp. 151 - 191

Asian Dispute Review

Since 1999 Oct 2018



SPONSORED BY

- HONG KONG INTERNATIONAL ARBITRATION CENTRE
- CHARTERED INSTITUTE OF ARBITRATORS (EAST ASIA BRANCH)
- HONG KONG INSTITUTE OF ARBITRATORS
- HONG KONG MEDIATION COUNCIL

THE PUBLISHING TEAM

General Editors


Romesh Weeramantry


John Choong

Consulting and Technical Editor


Robert Morgan

Editorial Advisory Board

Cao Lijun
Henry Chen
Michael Hwang SC
Neil Kaplan CBE QC SBS
Gabrielle Kaufmann-Kohler
Julian Lew QC
Michael Moser
Yoshimi Ohara
Hi-Taek Shin

Supervisory Board

Paul Barrett *(Chartered Institute of Arbitrators, East Asia Branch)*
Chiann Bao *(Hong Kong International Arbitration Centre)*
Vod K S Chan *(Hong Kong Mediation Council)*
Sylvia Siu *(Hong Kong Institute of Arbitrators)*

Editorial Assistants

Jonathan Mackojc
Filip Nordlund

All enquiries to the *Asian Dispute Review's* Editors should be sent to asiandr-editor@hkiac.org

PUBLISHER

HKIAC 香港國際仲裁中心 Hong Kong International Arbitration Centre

Hong Kong International Arbitration Centre

38/F, Two Exchange Square
8 Connaught Place, Central
Hong Kong
www.hkiac.org

Design

KAC Design

Advertising Contacts

Kirti Ladharam: kirti@hkiac.org
Karen Tan: karen@hkiac.org
Tel: (852) 2525 2381

Sponsoring Organisations

Hong Kong International Arbitration Centre
Chartered Institute of Arbitrators, East Asia Branch
Hong Kong Institute of Arbitrators
Hong Kong Mediation Council

www.asiandr.com

CONTENTS

October 2018

Past issues of the Asian Dispute Review are also available at www.kluwerarbitration.com

EDITORIAL

This issue of *Asian Dispute Review* commences with a thought-provoking article by Toby Landau QC, adapted from his Keynote Address delivered at Hong Kong International Arbitration Week in 2017. It explores the extent to which the arbitration process is capable of shaping external events, particularly with regard to State conduct.

Sarah Grimmer takes readers on a journey highlighting HKIAC's Tribunal Secretary Service, its success and key milestones. Her article also addresses common concerns and offers insights into HKIAC's statistics. This is followed by an article co-authored by Kate Parlett and Mark Tushingham which navigates important measures adopted by States in favour of regulation to protect the environment and how they are dealt with by investor-State arbitration.

The 'In-house Counsel Focus' article by John Scott QC, SC, JP discusses party non-participation and awards in default of appearance, offering readers practical solutions.

The 'Jurisdiction Focus' article by Professor Arthur P Autea explores judicial restraint, interim relief, the finality of arbitral awards and other interesting developments and case law in the Philippines.

This issue concludes with a book review by Dr Mariel Dimsey of *UNCITRAL Arbitration* by Jan Paulsson and Georgios Petrochilos.

We will, as usual, return in January with a new issue and look forward to offering more insights and commentary on dispute resolution in Asia in 2019.

General Editors

CONTRIBUTORS

Dr Mariel Dimsey
CMS Hasche Sigle, Hong Kong LLP
Hong Kong

Sarah Grimmer
Hong Kong International Arbitration Centre
Hong Kong

Toby Landau QC
Essex Court Chambers
London

Arthur P Autea
Founding Principal, Arthur Autea and Associates
Manila, Philippines

Kate Parlett
20 Essex Street
London

John Scott QC, SC, JP
Des Voeux Chambers
Hong Kong

Mark Tushingham
20 Essex Street
London

Recalibrating the Balance Between Protecting Foreign Investments and Protecting the Environment: Is Asia Taking the Lead?

Kate Parlett & Mark Tushingham

This article focuses on recent treaty practice in relation to the rising number of investment claims against environmental protection measures enacted in the public interest by States in the Asia-Pacific region. It considers how States have sought to shift the balance in new investment treaties in favour of regulation to protect the environment, how these provisions have been applied in recent investment treaty cases and the lessons that might be drawn for future investment disputes.

Introduction

In a number of recent investment treaty cases, investors have sought to challenge environmental measures enacted by States on the ground that such measures have violated investors' rights under investment treaties. Examples of challenged measures include bans on the import and export of chemical substances,[1] decrees ordering the closure of businesses to preserve ecological areas[2] and refusals to approve construction projects following environmental reviews.[3]

These disputes have triggered a debate about whether investment treaties strike an appropriate balance between foreign investors' rights and the ability of States to regulate to protect the environment. Some critiques have gone so far as to suggest that investment treaties positively threaten a State's ability to enact environmental measures because of concerns about obligations to compensate investors if such measures affect their interests, allegedly resulting in a so-called 'regulatory chill'.

Recent treaty practice in the Asia-Pacific region suggests that some States have responded to these issues by including new provisions in investment treaties to recalibrate the balance between foreign investors' rights and environmental protection.

> "Examples of challenged measures include bans on the import and export of chemical substances, decrees ordering the closure of businesses to preserve ecological areas and refusals to approve construction projects following environmental reviews."

Recent treaty practice

In the last decade, there has been an explosion of mega-regional investment treaties and comprehensive free trade agreements in the Asia-Pacific region. Many of these treaties are now in force. They include:

(1) the China-ASEAN Agreement on Investment (2010) between the People's Republic of China, Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam (China-ASEAN AOI);
(2) the ASEAN Comprehensive Investment Agreement (2012) between Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam (ASEAN CIA);
(3) the China-Canada Agreement for the Promotion and Reciprocal Protection of Investments (2014) (China-Canada APRP);
(4) the China-South Korea Free Trade Agreement (2015) (China-South Korea FTA); and
(5) the China-Australia Free Trade Agreement (2015) (ChAFTA).

Other treaties have been finalised or signed but are not yet in force. They include:

(1) the European Union-Singapore Investment Protection Agreement (2018) (EU-Singapore IPA); and
(2) the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (2018) between Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam (CPTPP).

All of these treaties include provisions that attempt to strike a new balance between the protection of foreign investors' rights and the protection of the environment. The treaties aim to achieve this objective in three different ways:

(1) by clarifying the test for an indirect expropriation in cases in which a State adopts a measure to protect the environment;
(2) by including express exceptions that affirm the right of States to regulate on environmental matters; and
(3) by excluding the rights of investors to resort to arbitration in respect of certain environmental measures.

Each of these drafting techniques is considered in further depth in the following sections.

> "Some critiques have gone so far as to suggest that investment treaties positively threaten a State's ability to enact environmental measures because of concerns about obligations to compensate investors if such measures affect their interests, allegedly resulting in a so-called 'regulatory chill'."

(1) Clarifying the test for an indirect expropriation

Investment treaties generally provide protection against direct expropriation (ie, the formal transfer of title to or outright seizure of an investment by a State) and indirect expropriation (ie, measures passed by a State that have an effect equivalent to a direct expropriation but do not involve any formal transfer of title or an outright seizure). Investment proceedings to challenge environmental measures often raise claims that a State has indirectly expropriated an investor's investment.

Newer investment treaties, including those referred to above, seek to clarify the test for what constitutes an 'indirect expropriation' by requiring the treaty to be interpreted together with an expropriation annex setting out the States parties' "shared understanding" of the expropriation provision. An example can be found in the China-Canada APRP, which provides as follows:[4]

> "Except in rare circumstances, such as if a measure or series of measures is so severe in light of its purpose that it cannot be reasonably viewed as having been adopted and applied in good faith, a non-discriminatory measure or series of measures of a Contracting Party that is designed and applied to protect the legitimate public objectives for the well-being of citizens, such as health, safety and the environment, does not constitute indirect expropriation."

Provisions of this kind are based on the US Model Bilateral Investment Treaty (BIT).[5] The treaties do not give any further guidance as to what might constitute "rare circumstances" that are "so severe" as to justify a conclusion that a measure has indirectly expropriated an investor's investment. However, it is clear from the language of these provisions that the bar has been set high before an environmental measure passed in the public interest can be found to have indirectly expropriated an investor's investment.

To determine whether a measure amounts to an 'indirect expropriation' in accordance with this elevated test, investment tribunals may consider it necessary to conduct a modified proportionality balancing exercise, weighing the importance of the measure's objective against its impact on an investment to determine whether the impact is "so severe … that it cannot be reasonably viewed as having been adopted and applied in good faith". It is apparent from this treaty language that in conducting this balancing exercise the scales are tipped heavily in favour of the measure, ie, very much in favour of the State's regulatory power.

> "Investment proceedings to challenge environmental measures often raise claims that a State has indirectly expropriated an investor's investment. … This type of provision has not yet been directly interpreted by any arbitral tribunal."

This type of provision has not yet been directly interpreted by any arbitral tribunal.[6] However, in *Philip Morris Brands SARL v Uruguay*, an ICSID tribunal referred to this recent treaty practice and observed that the purpose of these provisions clarifying the meaning of an 'indirect expropriation' was to give States greater powers to regulate in the public interest (albeit in that case, the tribunal applied the analogous police powers doctrine under customary international law, rather than any particular treaty provision, to support its conclusion that regulations passed by Uruguay mandating the sale of cigarettes in plain packaging did not amount to an indirect expropriation of the claimant's investment).[7]

(2) Express exceptions affirming the right of States to regulate

Another drafting technique found in modern investment treaties is to include express exceptions which affirm the right of States to regulate on environmental matters. An example

can be found in the China-ASEAN OIA, which provides that "nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Party of measures" which (*inter alia*):

(1) are necessary to protect human, animal or plant life or health; or
(2) relate to the conservation of exhaustible natural resources.[8]

Exceptions of this kind have long formed part of international trade treaties, including art XX of the General Agreement on Tariffs and Trade (GATT). Similar exceptions have only recently been included in investment treaties and have not yet been tested in many investment disputes. It is, however, doubtful (as discussed below) that these exceptions would provide a complete defence to a State if it has otherwise infringed an investment treaty provision (eg, a fair and equitable treatment provision or an expropriation provision).

> "Another drafting technique found in modern investment treaties is to include express exceptions which affirm the right of States to regulate on environmental matters. … It is, however, doubtful … that these exceptions would provide a complete defence to a State if it has otherwise infringed an investment treaty provision …"

The requirement in these exceptions that the measure should be "necessary" or "related" to a particular environmental

objective before the exception can be engaged suggests that investment tribunals may have to carry out a proportionality balancing exercise similar to that considered at (1) above in connection with the new test for indirect expropriation. In particular, tribunals may need to consider the relative importance of the environmental measure as compared with the harm inflicted by the measure on the investor's investment. The WTO Appellate Body has adopted a similar approach in trade law when applying art XX of the GATT.[9]

A useful illustration of how these exceptions have been applied in practice can be found in the recent decision in *Bear Creek Mining Corp v Republic of Peru*.[10] In this case, Peru had revoked the claimant's concession to operate a silver mine on the ground that it was no longer in the national interest for mining operations to continue. The claimant argued that the respondent had expropriated its investment in breach of the Peru-Canada FTA.

In its defence, Peru relied on the exception set out in art 2201 of the FTA which provided that nothing in the investment chapter of the FTA could be construed to prevent Peru from adopting measures necessary "to protect human, animal or plant life or health, which the Parties understand to include environmental measures necessary to protect human, animal or plant life or health". Peru argued that the order revoking the claimant's concession was necessary to protect human life and the environment.

The ICSID tribunal held that Peru had unlawfully expropriated the claimant's investment and that it was not entitled to invoke the exception in art 2201 of the FTA because the order by which Peru had revoked the claimant's concession to operate the mine made no mention of the fact that it had been passed to protect human life or the environment. Instead, this purported justification was raised by Peru for the first time in the proceedings.[11] This suggests that before a State may rely on an exception of this kind, the measure must either expressly or impliedly indicate that it is being passed to, for example, protect the environment.

The tribunal also held that the exception in art 2201 did not "offer any waiver from the obligation in Article 812 to compensate for the expropriation" and that Peru had "failed to explain why it was necessary for the protection of human life not to offer compensation" to the claimant.[12] This suggests that exceptions in investment treaties which affirm the right of States to regulate on environmental matters would not excuse a State from its obligation to compensate investors for measures that constitute an expropriation.

As to this latter point, it is relevant to note that the CPTPP contains a similar exception to those considered above and 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."[13]
>
> (Emphasis added)

On a plain reading, this provision does not provide any defence or excuse for measures that are otherwise inconsistent with States' obligations to investors. It does, however, draw attention to States' interests in environmental protection regulation and might be used to assist tribunals in interpreting and applying substantive investment protections, indicating that States parties did not intend for investment protection to trump completely their regulatory objectives.

(3) Excluding the rights of investors to resort to arbitration

A third drafting technique found in some investment treaties is to exclude the rights of investors to resort to arbitration in respect of certain environmental measures. Of the treaties referred to earlier in this article, only the ChAFTA contains a provision of this kind. It provides that non-discriminatory measures passed for legitimate public welfare objectives (including the environment) "shall not be the subject of a claim".[14]

If an investor challenges such a measure, the respondent State can issue a "public welfare notice" explaining the basis for its position (art 9.11(5)). This notice triggers a 90-day consultation period between the host State of the investment and the State of nationality of the investor and any arbitration proceedings that have been commenced by an investor are automatically suspended (art 9.11(6)). If the two States agree that the measure is of the kind referred to in art 9.11(4), that decision "shall be binding on a tribunal and any decision or award issued by a tribunal must be consistent with that decision" (art 9.18(3)).

"A third drafting technique found in some investment treaties is to exclude the rights of investors to resort to arbitration in respect of certain environmental measures. … [Such a provision] … is … the most pro-State of the three drafting techniques as it carves out the most significant power for States to regulate in the public interest."

This provision has not yet been applied in any publicly available investment disputes. However, on a plain reading, it has the potential to exclude from arbitration *any claim* by an investor concerning environmental measures, if the two States agree that the measures are non-discriminatory and were adopted to address legitimate objectives. This goes much further than the traditional denial of benefits provisions, which has remained subject to arbitral scrutiny, because there is no provision for the decision of the two States to be reviewed or appealed. It is, therefore, the most pro-State of the three drafting techniques as it carves out the most significant power for States to regulate in the public interest.

“Although it remains to be seen how these new provisions will be interpreted and applied by tribunals in practice, it seems clear that they will go some way towards recalibrating the balance in favour of States’ interests in regulating to protect the environment and may limit the protection available to investors whose investments are affected by such regulations.”

Conclusion

New and emerging investment treaties, particularly in the Asia-Pacific region, seek to reserve to States more powers to regulate in the public interest, including to protect the environment. Although it remains to be seen how these new provisions will be interpreted and applied by tribunals in practice, it seems clear that they will go some way towards recalibrating the balance in favour of States’ interests in regulating to protect the environment and may limit the protection available to investors whose investments are affected by such regulations.

1 *Methanex Corp v United States of America*, UNCITRAL, Final Award, 3 August 2005; *Chemtura Corp v Government of Canada,* UNCITRAL, Award, 2 August 2010.

2 *Empresas Lucchetti SA v Republic of Peru,* ICSID Case No ARB/03/4, Award, 7 February 2005; *Bear Creek Mining Corp v Republic of Peru*, ICSID Case No ARB/14/21, Award, 30 November 2017.

3 *Clayton and Bilcon of Delaware Inc v Government of Canada,* PCA Case No 2009-04 (UNCITRAL), Award on Jurisdiction and Liability, 17 March 2015.

4 Annex B.10, para 3. Similar provisions can be found in Annex 2(4) of the Asian CIA, Annex 12-B(3) of the China-South Korea FTA, Annex 1(2) of the EU-Singapore IPA and Annex 9-B(3) of the CPTPP.

5 US Model BIT (2004), Annex B(4)(b); US Model BIT (2012), Annex B(4)(b).

6 A similar provision was relied upon in *Railroad Development Corp v Republic of Guatemala*, ICSID Case No ARB/07/23, Award, 29 June 2012, but the tribunal there found that the interference did not amount to an indirect expropriation: see paras 151-152.

7 *Philip Morris Brands SARL v Oriental Republic of Uruguay*, ICSID Case No ARB/10/7, Award, 8 July 2016 (Bernadini P, Born & Crawford) at paras 295-301.

8 Article 16. Similar provisions can be found in art 17(1) of the ASEAN CIA, art 33(2) of the China-Canada APRP and art 9.8(1) of the ChAFTA.

9 WTO Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161,169/AB/R, adopted 10 January 2001, para 164.

10 *Bear Creek Mining Corp v Republic of Peru*, ICSID Case No ARB/14/21, Award, 30 November 2017 (Böckstiegel P, Pryles & Sands).

11 *Ibid*, para 475.

12 *Ibid,* para 477.

13 Article 9.16.

14 Article 9.11(4).