INTERGRATING ENVIRONMENTAL MANAGEMENT IN THE DIRECT FOREIGN INVESTMENT REGIME WITHIN A SUSTAINABILITY FRAMEWORK

A THESIS SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS OF THE DEGREE OF MASTERS OF LAWS (LL.M) OF THE UNIVERSITY OF NAIROBI

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NAIROBI, NOVEMBER 2011.
DECLARATION

I, Gilbert Nyamweya Omoke, hereby declare that this thesis is original and has never been presented in any other institution. I also declare that any secondary information obtained and used has been acknowledged in this thesis.

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PROF. ALBERT MUMMA
This thesis examined the way in which the foreign direct investment (FDI) regime impacts of sustainable environmental management in host states. The study was conducted under a sustainability framework. This framework also adopted an integrative approach in so far as integrating the norms, values and principles of environmental management into the FDI regime.

The thesis offered a discussion of the linkage between FDI and environmental management relying on both conceptual and empirical perspectives. It then developed a model of sustainability approach drawn from the scholarly literature and applied it to the assessment of FDI protection regime and its relationship to environmental management.

The thesis explored the extent to which the FDI protection regime integrates the principles of sustainable environmental management within host states. The key players involved in the process of environmental management within the FDI context were identified as the host state, foreign investors and local communities. The thesis established the norms, values and principles of sustainable management. The study analysed key document containing data on the FDI protection and environmental management.

The thesis constructed the FDI regime by examining the principles of FDI protection. These principles are the principle of international minimum standard, the rule against uncompensated expropriation, the national treatment principle and the most-favoured-nation treatment principle. These principles conflict with those of sustainable environmental management. The protective character of this regime manifests itself in the resolution of disputes concerning environmental regulation and accountability within an FDI context in order to shield concerned investors from responsibility.

Non-integration of the norms, values and principles of sustainable environment in the FDI regime emerged. This negatively impacts on sustainable environmental management in host states. Reform and reconstruction of the regime is now ripe.
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DEDICATION

For: Evelyn, Mosero and Graca,

and

Mum and Dad.
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LIST OF ABBREVIATIONS

BITs  Bilateral Investment Treaties
EIA  Environmental Impact Assessment
E.A.P.L.R.  East African Protectorate Law Reports
FCNs  Friendship, Commerce and Navigation treaties
FDI  Foreign Direct Investments
ICJ  International Court Justice
ICSID  International Center for the Settlement of Investment Disputes
IIAs  International Investment Agreement
ILM  International Legal Materials
MFN /  Most Favoured Nation
MNCs  Multinational Corporations
MNEs  Multinational Enterprises
NAFTA  North America Free Trade Area
PSNR  Permanent Sovereignty over Natural Resources
RECIEL  Review of European Community and International Environmental Law
TNCs  Transnational Corporations
UN  United Nations
UNCTAD  United Nations Conference on Trade and Development
UNEP  United Nations Environment Programme
US  United States of America
WTO  World Trade Organization
CHAPTER ONE

INTRODUCTION

1.1. Background to the Study

One of the ultimate objectives of economies is attainment of economic growth and development. The pursuit of this objective is by diverse means. One of those means is foreign direct investment (FDI). FDI contributes to a country’s development from the perspective of economic growth. However, development should be viewed more broadly by integrating other dimensions of life such as human rights and the environment. Sustainable development is the guiding yardstick in this equation. The environment is central in the developmental process. The impact of FDI activity on the environment should be borne in mind in the developmental process.

There, however, exists a bottleneck in the process of integrating FDI with the environment premised on the legal principles applicable to each which are strikingly distinct. FDI is primarily governed by international investment law also known as FDI law. The environment, on the other hand, is governed by environmental law. The objectives of these two legal regimes and the principles upon which they are founded are quite distinct, and often clash. The problem of sustainable environmental management posed by the FDI protection regime takes on an urgent and practical character when real cases of environmental regulation and environmental damage are examined. This study will unravel the implication of this phenomenon in constructing stronger environmental management regimes in host states where FDI takes place.

1.2. Statement of the Problem

The overall research problem is to investigate the challenges the FDI protection regime poses to construction of sustainable environmental management systems in host states. The problem flows from the non-integration of environmental management principles into the legal regime of FDI. Consequently, tension between the principles of FDI law and those of environmental management inevitably occurs. Whereas environmental
management strives to ensure sustainable utilization of the environment, FDI legal regime is concerned with protection of FDI against host state interference. Environmental management has its roots buttressed in the right to a clean environment as a human right and as a norm incorporating higher values' such as the protection of intergenerational equities and sustainable utilisation. In contradiction, FDI legal regime does not generally promote comprehensive protections for the environment, individuals or communities in host states.3

The legal regime that governs FDI is known as international investment law or FDI law. Its overall objective is the protection of FDI. While giving rise to FDI protection principles FDI law did not establish and integrate corresponding investor responsibility principles such as environmental management. Consequently, accountability and responsibility for environmental management in an FDI context is weak. This hinders and stifles the host state’s broader function of environmental control and regulation of FDI activities. Historically, the purpose of FDI law has been to protect the rights of foreign investors.5 The rationale for protection is grounded on the fact that FDI is seen as risky since foreign investors are not on an equal footing with the state in which they own, manage, or do business. Alone, private investors would be unable to protect their foreign assets.6 This characteristic of FDI law evolved from a colonial and imperial setting. This law has hardly changed over time and modern FDI law retains its colonial vestiges. It


5 Anderson, supra note 3, at 6.

6 Ibid.

2
limits intervention by host states in the foreign activities of transnational corporations within their territorial jurisdiction.\textsuperscript{7}

Moreover, FDI law is largely a fragmented body of law. It lacks a multilateral FDI framework. This has consequently left a vacuum reflected in the absence of an international organisation and international agreement in FDI.\textsuperscript{8} Bilateral investment treaties (BITs) are flourishing in this vacuum. BITs are a progeny of Treaties of Friendship, Commerce, and Navigation (FCN). FNC is an international agreement used by colonising countries to allocate rights to colonial territories among themselves and extend their respective nationals protection of their investments.\textsuperscript{9} The content of BITs is markedly FDI protection. Even though FDI issues are lately being incorporated into multilateral, regional, and bilateral trade agreements such as the WTO Agreements on Trade-Related Investment Measures, the General Agreement on Trade in Services, and the North American Free Trade Agreement, BITs are the predominant source of FDI protection alongside principles derived from customary international law. They however omit many rights of and protections for the environment, individuals and communities in host countries.\textsuperscript{10} They focus on specific rights of and protections for FDI by nationals of countries that are a party to a BIT treaty.\textsuperscript{11} BIT statistics analysed by Anderson reveal that approximately ninety percent of the world’s countries have entered into BITs. The increased number of BITs and their narrow objective depict the gap in the regulation of FDI by international law.

Customary international law and BITs protect the assets of transnational corporations from uncompensated expropriation\textsuperscript{12} (both direct and indirect)\textsuperscript{14}. The principle of

\textsuperscript{7} Ibid, at 14.
\textsuperscript{8} Ibid.
\textsuperscript{9}Ibid.
\textsuperscript{10} Anderson, supra note 3, at 13.
\textsuperscript{11} Ibid.
\textsuperscript{12} Ibid.

\textsuperscript{14} Ibid, at 92.
expropriation has the propensity of construing environmental regulation as indirect expropriation also referred to as "disguised" or "creeping expropriation".\(^{15}\) Inference of indirect expropriation from environmental regulation would have the effect of constraining environmental management in host states. This flows from the fact that the inference has the effect of creating an obligation on the part of the host state to compensate the affected foreign investor. In this sense, the principle creates a "regulatory chill" situation in which the host state will likely be afraid to environmentally regulate. It also potentially reverses the "polluter pays" principle. The conceptual problem of whether host states will be paying in order to environmentally regulate, and reversal of the "polluter pays" principle, arises. This happened in the case of *Ethyl Corporation v Canada*\(^{16}\) whereby the Canadian government settled a claim by agreeing to rescind a regulation banning import of a manganese-based gasoline additive (MMT) and paying compensation to the claimant foreign investor even before the claim was determined on merit. The ban had been based on the ground that MMT was a pollutant and harmful to human health. This withdrawal of environmental regulations in light of a compensatory claim for indirect expropriation reflects a "regulatory chill" scenario.

Protection of FDI is also grounded on the international minimum standard of treatment. This principle includes "the fair and equitable treatment standard". Its essence is the "stability of the legal and business framework."\(^{17}\) Majority of BITs contain stabilization clauses whose effect is to freeze the law of the host state as at the time of entry.\(^{18}\) Stabilisation clauses would assure that the operating conditions and regulatory environment will remain constant throughout the life of the relevant FDI. This static state effectively constrains the host state's capacity to refine or update environmental laws. This has the effect of freezing domestic regulatory mechanisms including environmental

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\(^{16}\) *Ethyl Corporation v Canada* (Award on Jurisdiction) (1998) 38 ILM 708.

\(^{17}\) *Occidental Exploration and Production Co v Republic of Ecuador* (Award) LCIA No. UN 3467 (UNCITRAL, 2004) para. 183.

management. A situation overly favourable to investors\(^8\) results which constrains environmental regulation and environmental decision-making in host states. In *Metalclad v Mexico*\(^20\) it was held that Mexico failed to provide a transparent and predictable framework for business planning and investment. Consequently, Mexico was held to be in violation of the international minimum standard of treatment.

The two related principles of national treatment and most-favoured nation treatment also have a bearing on environmental management. They require that a host state does not treat foreign investors less favourably than it treats domestic investors or investors from other countries in like circumstances, respectively. They are instructive that any differences cannot disadvantage the foreign investor relative to domestic or other competitors. As a result, regulation of general application can breach national treatment obligations if it affects a foreign investor to a greater degree than domestic investors,\(^21\) even though that effect is not the intention of the regulation. The application of these two principles poses complex decision making problems in environmental regulation. This complexity arises from the difficulty of comparing investment activities that may be inappropriate to compare in connection with the environment. For instance, applying these principles to let in a new FDI activity as long as it is in like circumstances as a domestic investment or an already existing foreign investment omits consideration of other important factors such as the environmental pollution absorptive capacity of the proposed project site. It may be the case that the environment of the proposed investment site may not have capacity to sustain further environmentally extractive or pollutive activity.

The protective character of FDI law is manifested in the practical problems of holding foreign investors accountable for environmental damage resulting from their activities.


\(^{20}\) *Metalclad Corporation v Mexico* (Award), ICSID Case No. ARB(AF)/97/1, 2000.

Harten, *supra* note 19, at 85 - 86.
This is apparent in the dispute resolution process involving a foreign investor and the host state or its nationals who suffer environmental damage. For example, BITs provide for direct reference to international arbitration. This undermines the principle of exhaustion of local remedies before resorting to international dispute resolution mechanisms. As a result, the importance of exhausting local remedies is overlooked. This denies domestic courts where environmental effects are felt the opportunity of adjudicating on investment disputes touching on environmental management concerns. Lack of a strong FDI accountability and responsibility replicates itself in dispute resolution processes leading to avoidance of environmental liability. This may happen through collusion of the foreign investor, host state and the home state of the investor. FDI law innovatively borrows heavily from principles of other branches of the law such as *forum non conveniens*, limited liability and separate legal entity arguments to shield foreign investors who are mainly multinational corporations from environmental responsibility.

It is in light of the foregoing that this study takes the opportunity to unravel the implication of FDI legal protection regime on environmental management in host states. The possibility of constructing an environmentally responsible FDI legal regime which integrates sustainable development will be pursued. This will be aided by answering the following questions:

(i) What impact does FDI legal protection regime have on environmental management? How do the principles of the two legal regimes clash?

(ii) Does dispute settlement under FDI legal regime promote environmental responsibility?

(iii) What reforms are necessary in constructing an environmentally responsible FDI legal regime?
1.3. Literature Review

The existing literature related to this study is mainly on the effects of FDI on the environment. The literature also considers FDI protection generally in which environmental management is only a sub-component. They do not seem to reveal in-depth consideration of the implication of FDI protection regime on environmental management. The literature is to be found mainly in text books and other scholarly journals and periodicals as a narrow aspect of studies in both FDI law and environmental law. This section reviews this literature in order to identify existing gaps and opportunities to inform this study.

David Hunter, James Salzman and Durwood Zaelke in their text "International Environmental Law Policy" argue that in the global economy, owners who may benefit from environmentally damaging processes typically do not live in or near the local communities that are affected by the environmental harm, and as such less environmental protection might be expected. Andronico Adede in his text "International Environmental Law Digest" says that States have an obligation to protect and preserve the environment when exercising rights to exploit their natural resources in pursuit of development.

Elaine Johnson, in his article "The Interface between Trade, Investment and Sustainable Development: Implications for India" argues that FDI should not only be viewed from the conceptual standpoint of sustainable development, but should necessarily be packaged to achieve both sustainable development and environmental protection. He


23 Ibid.


25 Ibid.


27 Ibid, at 37-38.
argues that "international regulation of foreign investment" should be part of this concern. He argues that FDI creates a potential situation of conflict in terms of environmental regulation.  

Richardson, Mgbeoji and Botchway in their article "Environmental Law in Post-colonial Societies: Aspirations, Achievements and Limitations" address the interlinkage between sustainable development policies and environmental law reforms. They assert that many environmental problems in the developing world are closely associated with the investment activities of transnational corporations. They opine that FDI may exacerbate the inadequacies of local environmental regulation as it can be difficult to regulate transnational corporations generally, but particularly in their environmental behaviour.

James Gathii, in his article "Imperialism, Colonialism, and International Law" applies the phenomenon of exploitation of the Maasai's land in Kenya to argue that the manipulation and imposition of general principles of international law and the notions of private property under common law facilitated the exploitation and disposition of the environment of indigenous communities. The exploitation of the environment was directly linked to FDI as an expansionist strategy of British colonial powers through colonialism and imperialism. His work is invaluable in constructing the manipulative process of development of international law in the entrenchment of a starkly FDI protection regime.

Kate Miles in her article "International Investment Law: Origins, Imperialism and Conceptualizing the Environment" very directly queries the origins of FDI law and its

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29 ibid, at 48.
31 Ibid, at 416.
32 Ibid, at 437.
conceptualisation of the environment in host states. She traces the origin of FDI law in the context of colonialism and imperialism and concludes that it was formulated for the sole purpose of protecting foreign investors who were from the capital exporting states that were the colonial masters of the colonised territories. She posits that it completely lacked responsiveness to the impact of international investment activities on the local communities and the environment of the host state. On the basis of its imperial character, she concludes that this conceptualisation of the environment explains the weakening of environmental laws and standards by FDI law.

Kameri-Mbote and Philippe Cullet, in their article "Law, Colonialism and Environmental Management in Africa" argue that some of Africa's environmental challenges are traceable to colonisation which was motivated by increased access to natural resources for industrial development in Europe. They observe that colonial laws and policies relating to natural resource management were chiefly concerned with facilitating the extraction of raw materials from colonies and the resultant privatization of the rights of access to natural resources reduced access to those resources by the local communities. Their work depicts commoditisation of the environment by FDI.

Sornarajah in his article "The Clash of Globalisations and the International Law of Foreign Investment" states that the regulation of foreign investments by host states clashes with the very raison d'etre of the multinational corporation that is driven by motives of profit. He notes that when a state responds to terminate unnecessary environmental harm caused by multinationals it is often times faced with the argument

15 Ibid, at 11.
16 Ibid.

17 Ibid.
18 Ibid.
20 Ibid.
that such termination violates the underlying foreign investment agreement warranting prompt, adequate and effective compensation. He observes that the jurisprudence of FDI arbitral tribunals tends towards the position that environmental objectives do not constitute a valid reason for breaking commitments given to foreign investors. This argument lays foundation for assessing the role played by FDI dispute settlement mechanisms in the attainment of sustainable environmental management in host states. He remarks that environmental concerns should play an increasing role in ensuring that a state can assert its control over FDI in pursuit of environmental management goals.

Robert Reich, in his article "Global Social Responsibility for the Multinationals" addresses the difficulty faced by host states in exercising control over multinational corporations (MNCs), the commonplace vehicle in FDI ventures. He argues that in effect the host state does not regulate these entities as they "make laws for themselves" by employing various machinations to weaken the negotiating position of host states. MNCs possess the requisite technology for the exploitation of natural resources the host states cannot exploit on their own. In these circumstances, according to him, it becomes difficult to regulate the activities of MNCs. Although his work does not directly address the FDI protection regime, it will be pivotal in the assessment of environmental accountability and responsibility over MNCs' operations.

Antony Anghie explores the status of the principle of Permanent Sovereignty over Natural Resources (PSNR) and environmental concerns relating to FDI using the Nauru Case in his article "The Heart of My Home": Colonialism, Environmental Damage, and the Nauru Case. He recounts the grave environmental damage leading to this case.

\[^{42}\text{Ibid.}\]
\[^{43}\text{Ibid.}\]
\[^{44}\text{Ibid., at 20.}\]
\[^{45}\text{Ibid.}\]
\[^{46}\text{Robert B. Reich, "Global Social Responsibility for the Multinationals", (1973) 8 Texas International Law Journal 187.}\]
\[^{47}\text{Ibid., at 188.}\]
Nauru looked to international law as a means of remediying the environmental damage. He points out that considerable uncertainty surrounds the applicable law in the realm of environmental damage of this type\(^{34}\) and a number of complex unresolved issues connected with transborder damage surround the question of responsibility for international environmental damage/\(^{1}\)

The foregoing literature review reveals that the question of the implication of FDI legal protection regime on environmental management has not been specifically studied in a holistic manner. The existing studies address the relationship between FDI and the environment. They also consider individual principles of FDI and how they have been interpreted in relation to environmental regulations, but fail in integrating the ramifications of the FDI protection as a legal regime a framework of sustainable environmental management in host states. The present study builds upon arguments made in the literature in order to bridge the gap that exists assessing the non-integration of environmental management in the FDI protection legal regime within a sustainability framework.

1.4.  Justification and Significance of the Study

There is need to understand the effect of the FDI protection legal regime on environmental management in host states within a sustainability framework. This will add value in constructing effective environmental management and regulatory regimes in host states.

1.5.  Theoretical Framework

1.5.1.  Definition of Terms in Context

FDI in simple terms refers to the notion of one enterprise in a particular country having a degree of control over another enterprise in a different country in addition to provision of

\(^{34}\) Ibid, at 447.

\(^{51}\) Ibid, at 481 - 482.
financial capital to that enterprise.\textsuperscript{52} It is described as investment that adds to, deducts from or acquires a lasting interest in an enterprise operating in an economy arising from outside the country in order to have an effective voice in the management of the enterprise.” The investing enterprise may be known as a multinational corporation (MNC), or a multinational enterprise (MNE), or a transnational corporation (TNC). These are entities established in more than one country, and are so linked that they may co-ordinate their activities.\textsuperscript{54} FDI is governed by international investment law, also known as the international law of foreign investment or foreign direct investment (FDI) law.

The term "environment" is susceptible to several conceptions. Its definitions flow from the standpoint one conceives it. At a general Rose Ayugi coins an all inclusive conception of the environment as the "totality of all those physical, chemical, biological and socio-economic factors that impinge on an individual, a population and a community".\textsuperscript{55} She argues that "the environment is the integral natural-resources system, and it includes man and man's manipulation of this system."\textsuperscript{56} Factors surrounding the environment include human ecology, public and occupational health, safety, pollution of the air, water, land, waste reduction, management of unique habitats, aesthetic and cultural preservation.\textsuperscript{7}

The term "environment" can also be used to denote the business and legal framework within which FDI occurs. In this sense, the business and legal framework of a host state applicable to the entry, admission and regulation that is viewed as the FDI environment. This environment may be assessed as conducive, enabling or inhibiting. In this study, the term "environment" will not be applied in this sense except where it will be specified.

\textsuperscript{52} ibid.
\textsuperscript{53} ibid.
\textsuperscript{54} Rose Janet Ayugi, "Environmental Impact Assessment as a Device for the Protection and Management of the Environment: A Study in Comparative Perspective" (LLM Thesis, University of Nairobi, 1995), at 3.
\textsuperscript{55} ibid.
\textsuperscript{56} UN/ESCAP, EIA Guidelines for Application of Tropical River Basin Development, Interim Merking Commission, 1982, Thailand.
Environmental management is not, as the phrase could suggest, the management of the environment as such. Rather, it is the management of interaction by the human developmental activities with, and impact upon the environment. Environmental management is not the conservation of the environment solely for its own sake, but for mankind's sake. Suffice it to say that environmental management consists of the "measures taken to balance natural resources" or the measures a state takes to "regulate the use and development of natural resources". Environmental management revolves around control of the impact of human activities on the environment. It anticipates for purposes of control of environmentally undesirable consequences arising from developmental activities. Environmental management is, in part achieved, through the tool of environmental law. Environmental law provides "a regulatory framework for those human activities which may undermine the vital natural assets that support normal economic and social life." Focus has shifted from achieving short term goals to envisioning long term sustenance, also known as sustainability.

1.5.2. Theories of Environmental Management

The Malthusian theory, derived from the 1798 writings of Thomas Robert Malthus, is based on the fact that the environment, by its very nature, is a limited resource. It is exhaustible. It has a limited carrying capacity. This theory supports environmental management by propounding the concept of carrying capacity. Carrying capacity refers to the maximum limit of activity a particular resource can sustain. The optimal control
theory is designed to optimize a time dependent performance objective of the system.\textsuperscript{62} This theory is useful in deriving sustainable management strategies.

There are two conflicting schools of thought on the sustainable development concept,\textsuperscript{63} which have a bearing on environmental management. First is the Negative/Pessimist School, which claims to "represent the interests of the environment, consumers, the poor and the sick." It blames the developed and wealthy countries for the world's poverty, environmental degradation, disease and other problems\textsuperscript{64} by alleging that people in the rich world consume too great a proportion of the world's resources and emit too great a proportion of the world's pollution.\textsuperscript{65} The solution, asserts this group, is to limit the excessive use of the world's resources by the rich countries and their economic agents represented by multinational corporations. Second is the Positive/Optimist School, which attempts to shift the blame from the developed countries to the developing countries.\textsuperscript{66} It argues that these problems are principally created by the governments of poor and developing countries in their adoption of unsustainable policies in the development process.\textsuperscript{67}

1.5.3. FDI Schools of Thought

There are three major schools of thought that address the phenomenon of FDI in terms of its causes and effects. These are the modernisation school, the dependency school and the integrative school. First, the modernisation school is based on the neoclassical theory. This theory holds that foreign investment will stimulate the development of host states

\begin{itemize}
  \item Julian Morris, Sustainable Development: Promoting Progress or Perpetuating Poverty? (London: Profile 2002) at 255.
  \item \textsuperscript{64} Ibid.
  \item \textsuperscript{65} Ibid.
  \item \textsuperscript{66} Ibid.
  \item \textsuperscript{67} Ibid, at 256.
\end{itemize}
through the flow of capital and technology. Bergten, Horst and Moran, proponents of this school, argues that this will lead to the general wellbeing of host states. It further argue that FDI must be protected against any interference such as expropriation and nationalisation. This will facilitate the flow of FDI to engineer economic development. Theorists of this school argue that developing countries should emulate developed countries and overcome internal barriers to externally backed development through industrialisation, liberalization, and opening up the economy. Seid, for example, views FDI as a prerequisite and catalyst for sustainable growth and development. They further argue that for FDI to fulfill its crucial role, economies should open up to foreign investment and trade. In our view this theory finds expression in the principles of FDI law. Anderson supports this view by asserting that FDI largely remains under-regulated and under-enforced. On the other hand, FDI does result in economic growth. Adoption of new technology in the production process and knowledge transfer through labour training, skills acquisition, alternative management practices and better organizational arrangements flow from FDI. Kojima, a proponent of this school of thought, argues that FDI introduces superior technology into the economy. Those who argue that economic development should be the priority and once achieved environmental management will follow suit seem to rely on this school.

Second, the dependency theory addresses the impact of foreign capital and multinational corporations on host states. The influential works of this school of thought include the

64 Sornarajah, supra note 4, at 52.
Sherif Seid, Global Regulations of Foreign Direct Investment (Main Street Burlington: Ashgate Publishing Company, 2002).
79 Ibid.
ontology of dependency, Karl Marx on development and underdevelopment, Paul Baran’s analysis of economic backwardness and economic growth, Andre Gunder Frank’s analysis of the development of underdevelopment and Samir Amin on unequal development. The theory is propounded by Cardoso and Feletto commenting on the phenomenon of FDI in Latin America. Underdevelopment is thus taken to be an inescapable concomitant of the laws of unequal development inherent in the capitalist system, and it arises from the way the capitalist mode of production in the dominant countries interacts with pre-capitalist or semi-capitalist modes in the dominated economies. The links between the centre and the periphery create and maintain underdevelopment and at the same time constantly exacerbate the disparities between the two parts of the system - which in turn fosters underdevelopment. Samir Amin argues that, mainly because of the transfer of the surplus from the periphery to the centre, capital accumulation now occurs at the world and not the national level. Paul Baran uses the concept of economic surplus, defined as the difference between production and consumption. In every society, two main types of economic surplus are found: actual, which is the difference between current production and consumption; and potential, which is the difference between the potential production of a given economy and what is considered its basic consumption. According to Baran, much of the potential surplus remains unexploited in the capitalist developing countries, while much of the actual surplus is transferred to the industrialized countries.

Theories in this school see the cause of underdevelopment primarily in exploitation by the industrialised nations. It argues that foreign investment from developed countries is harmful to the long-term economic growth of developing nations. It asserts that First

78 F.H. Cardoso and E. Faletto, Capitalist Development and the State: Bases and Alternatives (University of California Press, 1979)
Samir Amin, "The Ancient World-Systems versus the Modern Capitalist World-System", in Frank and Gills (eds), The World Systems at 247 to 277, at 249.
World nations became wealthy by extracting labour and other resources from the Third World nations. It further argued that developing countries are inadequately compensated for their natural resources. This school's major contribution to the FDI-environment relationship is its focus on the consequences of FDI in host countries. According to Packenham, modernization, capitalization, and industrialization are limited to the export sector, causing other economic sectors to deliver according to export needs without reaping the benefits. It argues that the technology transferred through FDI is often disused and being hazardous it has adverse effects on the environment. This school justifies heavy environmental regulation of FDI.

Third, the integrative school is represented by the eclectic foreign direct investment paradigm and integrative theory. This school balances the perspectives of both the host countries and foreign investors on FDI. It integrates the essential elements of the dependency and modernisation school. It integrates the embrace for FDI propounded by the modernisation school and the caution made by the dependency school. The eclectic paradigm propounded by Dunning speaks to an eclectic response to other schools of thought by seeking to bring the competing theories in other schools of thought together to form a single theory of paradigm. Its basic premise is that it links together the merits of the other schools. The integrative theory propounded by Wilhems attempts to account for both the causes of FDI and for its treatment by host countries. Its focus is a bargaining or compromising approach in order to shed more light on the perspective of the host states without falling into the dependency theory's stereotype trap. It accounts for the multiplicity of heterogeneous variables involved in the FDI process. It incorporates macro-, micro- and meso-economic variables in analysing FDI. The macro-level concerns the entire economy, the micro-level looks at individual FDI firms and the meso-level represents institutions linking the macro- and micro-layers.


1.5.4. Study Framework

This study is based on a theoretical framework of FDI protection, the environment and environmental management. Broadly speaking, FDI cannot be conceived without the environment. This may be in terms of its reliance on the environment to occur. It may also be from the standpoint of its effects on the environment, whether positive or negative. Whenever speaking of FDI, its protection regime is part and parcel of it. Likewise, whenever addressing the environment its protection or management comes into the equation. The interrelation of FDI with the environment and between the legal regimes governing each of them is at the heart of this study. This study will critically examine how the principles of environmental management prescribed by environmental law are undermined by the FDI protection regime. This study is predicated upon the fact that the FDI takes place in the environment of host states capacity to ensure effective environmental regulation.

Whereas FDI contributes to development it is critical that we appreciate that if development is not sustainable it would greatly undermine the integrity of the environment. FDI protection regime should not be allowed to override environmental regulatory regimes of host countries. FDI must operate within environmental sustainability constrains, that is to say, intergenerational and intragenerational equity. Given the uncertainties and irreversibilities in environmental decision making a precautionary approach should be integrated into the FDI legal regime. Constructing an environmentally sound FDI regime underlies the theoretical framework of this study. The present study is rooted in the integrative school, and develops it further through arguments that FDI protection regime should integrate environmental management values and the standpoints of the various players.

1.6. Hypothesis

This work puts forward the hypothesis that constructing an environmentally responsible FDI regime is critical for sustainable environmental management in host states.
1.7. **Statement of Objectives**

The broad objective of this study is to interrogate the challenges of FDI legal regime on environmental management in host states. In fulfilling the aim of the study, the study seeks to achieve the following specific research objectives:

(i) to critically link FDI with the environment;
(ii) to interrogate the relationship between the FDI legal regime and sustainable environmental management in host states;
(iii) to critically analyse the clash between the principle of FDI protection and the principles of environmental law and critically link this to the resultant impact on sustainable environmental management in host states;
(iv) to critically examine the extent to which the dispute settlement mechanism of FDI shields foreign investors from environmental responsibility; and
(v) to propose the reform and reconstruction of FDI legal regime in order to integrate environmental responsibility and accountability concerns.

1.8. **Limitations**

The principal limitation anticipated in this study was the apparent lack of materials and texts in this topic in local libraries and financial constraints in sourcing them from abroad. The use of internet resource in accessing the materials will considerably overcome this challenge.

1.9. **Research Design and Methodology**

The study is designed as an exploratory research primarily based on review of literature. It will also be inquisitive, descriptive and analytical. A qualitative research method will be used to enquire into the extent of non-integration of the values, norms and principles of sustainable environmental management in the FDI protection regime. Key documents and reports containing data and information on the subject will be analysed. It will apply both primary and secondary sources of data. Various relevant textbooks, scholarly articles and reports will be reviewed to advance the arguments made in the study.
1.10. Outline of Chapters

Chapter One is introductory to the study setting out its background and the research problem. Literature review is undertaken. The chapter also contains the theoretical framework, the hypothesis, justification and objectives. It also defines the research methodology.

Chapter Two will tackle the various facets of the relationship between FDI and the environment. It will lay a foundation for environmental management linking it into the FDI legal regime. The normative values and principles of sustainable environmental management will be established. The FDI protection regime will also be laid out. Data analysis will be carried in this chapter.

Chapter Three will undertake a critical analysis of the principles of FDI protection. It will evaluate the extent to which the FDI protection regime undermines sustainable environmental management in host states. The role played by the FDI principles of the international minimum standards, uncompensated expropriation, national treatment and most-favoured-nation treatment in the process will be analysed.

Chapter Four will assess the effectiveness of the FDI dispute settlement in integrating the normative values and principles of sustainable environmental management in FDI-environment disputes. The lack of responsiveness by the FDI protection regime in holding investors accountable and responsible for environmental disasters will be critically analysed. The wisdom of unilateral reference to arbitration by foreign investors in the event of disputes some of which may involve environmental issues will be queried.

Chapter Five will conclude the study by summing up its findings and make recommendations.
CHAPTER TWO

CONCEPTUAL AND EMPIRICAL LINKAGE OF FDI TO SUSTAINABLE ENVIRONMENTAL MANAGEMENT

2.1 Introduction

This chapter will link FDI to the environment at both conceptual and empirical linkages. The need for a sustainability approach to environmental management within an FDI context will be advanced. It will set out the norms, values and principles of sustainable environmental management. The FDI protection regime will also be constructed as it presently exists and a glimpse into how it impacts on environmental management given. The foundation for FDI regulation and control in order to achieve sustainable environmental management will be laid. Data from which arguments, perspectives and findings underlying this study are drawn will analysed in this chapter. The chapter will lay a foundation for chapters three and four. Basis for arguing that FDI law is ripe for reform and transformation in order to integrate sustainable environmental management in its pillars will be established.

2.2 FDI-Environment Nexus

Linking the impact of FDI on the environment is referred to as FDI-environment nexus. FDI activity cannot be conceived independent of the environment. This nexus and interdependence can be discerned from different multiple dimensions and diverse perspectives. First, extractive forms of FDI primarily depend on the environment for their existence. Extractive FDI extracts the natural environment through activities such as mining of minerals, oil and natural gas. This has a direct impact on the natural

environment and the local communities. Excavation of large masses of earth to reach mineral deposits may lead to the displacement of indigenous peoples. Natural resource utilisation FDI has very long term effects on both environmental quality and future development patterns.²

Second, at a macro-level the FDI-environment nexus takes a regional and global perspective. Rapidly increasing levels of FDI activity have been cited as contributing towards a global-scale increase in resource depletion and pollution generation.³ Pollution may result from release of waste into the environment, discharge of greenhouse gases into the atmosphere, the production of toxic and hazardous substances and waste from chemical and manufacturing plants.⁴ We argue that global intensification of FDI activity can perpetuate unsustainable growth if it does not mainstream social and environmental considerations into the process.

Third, linking the operations of multinational corporations (MNCs) which are the principal means to FDI to environmental damage sharply brings into focus unsustainable economic growth and development. Empirical evidence from certain case studies of FDI activities of individual MNCs is indicative of consequential environmental accidents and disasters.⁵ This approach is grounded on the negative social and environmental impacts of particular foreign-owned projects leading to localised environmental degradation. Although FDI may generate economic growth in host states, it may not generally benefit the local or indigenous peoples in the vicinity of the project. This is also linked to the FDI


protection regime which is designed to protect MNCs as investors and apparently not the interests of the environment and local communities. Higher visibility of negative impacts MNCs corporate practices and operations have on local environments and communities lead to hostility towards FDI. 6

Fourth, FDI inflow has a connection with environmental standards in host states weaved into arguments of pollution havens, capital flight and regulatory chill. 4 Competition to attract FDI causes concern that states may lower their domestic environmental standards in order to be more attractive to prospective foreign investors. The practice of setting unacceptably low environmental standards is called a regulatory "race-to-the-bottom". 10 MNCs that cannot continue environmentally damaging practices in developed states, as a result of increasingly restrictive environmental protection standards, export the damaging practices to developing states with low environmental protection measures, hence the term "pollution haven". 11 Strong environmental regulations lead to industrial flight and lax regulations turn a country into a "pollution haven". Regulatory chill which speaks to the fear of loss of competitiveness in international markets and of capital flight from states with high environmental standards has led to policy-makers refraining from raising and tightening environmental standards. In mining and resource-extractive sectors

6 Kate Miles, "Transforming Foreign Investment: Globalisation, the Environment, and a Climate of Controversy", (2007) 7 Macquarie Law Journal 81, at 85.
7 Ibid.


MNCS exploit low environmental standards. Neumayer and Esty and Geradin cite examples in the European Union and United States where arguments put forward by industry lobbyists warning of capital flight and a loss of competitiveness had a chilling effect on ecological tax reform measures designed to bring about reductions in energy use and greenhouse gas emissions. Xing and Kolstad in examining the effect of the US FDI on environmental quality in host states found that developing countries tend to utilise lenient environmental regulations as a strategy to attract dirty industries from developed countries. They found that an increase in FDI inflow results in deterioration of environmental quality.

Fifth, FDI-environment linkage is also based on the positive aspects of FDI towards environmental management. It flows from the contribution of FDI to economic growth. Joysri Acharyya argues that environmental damage, in the long run, arises from the growth impact of FDI. An inverted-U relationship between output growth and the level of pollution known as the Environmental Kuznet Curve (EKC) shows this relationship. EKC is an inverted U-shaped relationship between the level of economic activity indicated by per capita income growth and environmental quality. It indicates that environmental degradation increases up to a certain level of income and begins to improve thereafter. In the short run, FDI increases pollution emission and resource depletion and higher prices for the resultant goods. In the long-run, as income grows FDI may have a favourable effect on the environment by changing demand towards relatively cleaner goods. Developed economies are more likely to have developed

15 Ibid.

17 Ibid., at 46
18 Ibid.
public institutions capable of enforcing desirable environmental norms.\textsuperscript{20} The Porter hypothesis supports this nexus to the effect that environmental quality is a normal good and as income increases with FDI inflows host states will then begin to adopt more strict environmental regulations.\textsuperscript{21} Acharrya finds empirical support for these propositions.

Sixth, FDI has environmental benefits like environmentally sound processes,\textsuperscript{22} proper accounting of environmental costs and production of alternatives to non-renewable resources. Given the technical knowhow and financial resources that support environmentally clean processes, foreign investors may meet host state environmental standards than domestic investors do.\textsuperscript{23} According to the "pollution haloes" hypothesis FDI introduces better management practices that pull environmental standards upwards.\textsuperscript{24} A study by Xian on the interface between FDI and the environment in China shows that FDI investors establish advanced pollution disposal facilities and their negative effects on the environment may be far less than those occasioned by domestic investors.\textsuperscript{25} Some FDI investors do conduct careful environmental impact assessments to avoid future disputes on environmental impact." This would certainly exert pressure on domestic investors to apply higher environmental standards in their processes.\textsuperscript{97}

### 2.3 Key Players

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Environmental resources are contained within the territory of states. The state is therefore an indispensable player in the attainment of sustainable environmental management. It formulates and makes relevant policies and decisions. It enforces appropriate legislations

\textsuperscript{20} Ibid.


\textsuperscript{21} Ibid., at 25.


\textsuperscript{23} Ibid, at 26.

\textsuperscript{24} OECD Global Forum on International Investment Conference Report, "Foreign Direct Investment and the Environment: Lessons from the Mining Sector" held at Pairs 6\textsuperscript{th} - 7\textsuperscript{th} February, 2002 at 7.


\textsuperscript{25} Ibid., at 26.

\textsuperscript{97} Ibid.
and regulations that mould the shape of sustainable environmental management. In this context, the state should play its role independent of powerful economic forces of multinational corporations (MNCs) which are the principal vehicles of FDI. Another key player is industry or business interests under which FDI falls. Business interests are at the core of economic development. It is contended that given the central role business interests play in a country's economy they may exert significant influence on state policy to the detriment of environmental sustainability. This brings to the fore the question of the state's ability to regulate business interests such as FDI entities towards effective environmental regulation. The general public, that is to say the wider community, is also at the core of environmental sustainability. The impact of FDI activities such as extractive FDI is felt more directly by the community where the activities take place. The interests of the general public should also be factored in the assessment of environmental sustainability of FDI processes.

2.4 FDI Conceptualisation of the Environment

FDI originated from the colonialism and imperialism period when colonial territories were conceived by foreign investors as instruments of expansionism. FDI was used to obtain raw materials for industries of investing states. These raw materials comprised of natural resources extracted from the environment of colonised territories. They included minerals, petroleum oil and natural gas. The environment was therefore conceptualised as a means to FDI. Imperial expansion effectively commoditised colonised territories' environment for profit motite. FDI ascribed value to the environment as a source of raw materials. The environment was seen through the lens of expansionism which resulted in shaping imperial natural resources extraction. The imperial era's commercial culture of seeing natural resources in colonial lands as a commodity for Western interests shaped FDI's narrow conceptualisation of the environment. This led to lack of responsiveness


to the impact of investor activity on the local communities and environment of the host state. FDI’s non-engagement with impacts of investor activity today results in corporate environmental misconduct in host states. It prioritises investor protection as its principal purpose whilst ignoring the health, safety and well-being of the citizens and environment of the host state. As a result, the host state remains unable to avail itself of FDI law in redress to environmental damage suffered as a result of FDI activity.

2.5 Foundation for Sustainable Environmental Management within FDI Context

2.5.1 Environmental Protection and Regulation as a Sovereign Right

Every State is considered, under international law, as a sovereign state. According to the doctrine of state sovereignty, every state has a sovereign right to govern its affairs without external interference. This external interference which is seen as a negation of state sovereignty could emanate from other sovereign states or other external or foreign parties. The doctrine of state sovereignty empowers the state to govern itself internally. All affairs within its territory and every person within its territorial jurisdiction are, according to this doctrine, subject to the authority of state. Foreign persons and their property are also subject to the sovereign power of the state. This is the basis for bringing FDI under the control of the host state. The host state is entitled to control and regulate foreign direct investments including their attendant activities.

Natural resources that get into the hands of foreign investors as means of production form part of the environment of the host state. Based on the fact that the state has sovereign power over natural resources as something within its jurisdictional competence, the question of exploitation of such natural resources does arise every so often. A host state would therefore legitimately be interested in the exploitation of natural resources within its territory. At the United National Assembly states have declared their sovereignty over their natural resources and every economic activity within their territories. In 1952 the

United Nations General Assembly resolved that every state has the right to freely exploit its natural wealth and resources. This resolution undergirds the right of states to utilise their resources as they deem fit. Thereafter, there were a series of United Nations General Assembly Resolutions which buttressed this right and affirmatively stated the principle of permanent sovereignty over natural resources (PSNR) particularly the Resolution on Permanent Sovereignty of Natural Resources of States in 1962. The tenor of this resolution is that every state has full permanent sovereignty over the natural resources and every economic activity found within its territory. There followed the United Nations General Assembly twin resolutions of 1974 substantially on the same subject, but with more emphasis on the economic significance of the doctrine of full permanent sovereignty over natural resources.

First, the United Nations General Assembly Declaration on the Establishment of the New International Economic Order (NIEO) aimed to make PSNRS a reality. Second, the United Nations General Assembly Resolution on the Program of Action on the Establishment of a New International Economic Order addressed the practical steps of implementing the NIEO. It is to be borne in mind that preceding the NIEO Resolutions was the United Nations Charter of Economic Rights and Duties of States (CERDS) whose tenor was to promote wider prosperity among all states and standards of living, promotion of economic and social progress of developing countries, protection of the environment, international co-operation in development and emphasis on the responsibility of every state to develop its own resources.


We submit that UN Resolutions buttress the basis for environmental regulation of FDI. The inalienable right of each and every state over its natural resources is deeply entrenched. They reinforced the fact that the exercise of this right of sovereignty over natural resources of a state is total.\(^6\) No other state can either directly or indirectly bring to bear pressure on other states or peoples if the latter changes the organisation of their internal structure.\(^7\) In effect, MNCs are subject to the laws and regulations of the states where they carry on their activities. Consequently, they must abide by the national jurisdiction of those states. Their activity must harmonise with the economic and social policy of the respective states. Upon these premises, we argue that FDI must accord with environmental priorities of host states. We further argue that environmental regulation of FDI is anchored on the two doctrines of state sovereignty and full permanent sovereignty over natural resources of states.

### 2.5.2 Environmental Protection Obligations of States

The responsibility of a host state in pursuing environmental protection also flows from international environmental law. It can be viewed as an obligation \textit{erga omnes}.\(^9\) Birne and Boyle point out that what each state does to protect the environment from non-state actors' activities under its jurisdiction is of "common concern" to the whole international community,\(^40\) that is to say, the common interest of all states. Thus, a state has a right and obligation to interfere in circumstances where FDI compromises environmental wellbeing. This founds basis for the state's exercise of environmental regulatory functions as a means of securing environmental protection within its territory.

Besides the doctrine of sovereignty of state, the principle of full permanent sovereignty over natural resources of states and postulates of modern international law that a state is a

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\(^6\) Birne and Boyle, \textit{International Law and the Environment} (Oxford: Oxford University Press), at 143-144.
repository of the right to safeguard the environment in the interests of mankind are also a basis for pursuit of sustainable environmental management by a state. As FDI can fuel economic activity at a scale and pace that overwhelms the regulatory capacity of the host country resulting in inefficient and irreversible environmental damage states are enjoined to sustainably manage the environment and natural resources. Sustainable development therefore becomes necessary in order to integrate the needs of both the environment and development.

Environmental protection is one of the goals of sustainable development. Broadly defined, sustainable development includes decisions on resource allocation and requirements that development should not have an adverse effect on human health and other consequential effects. Hence, host states correspondingly have the right and obligation to environmentally regulate FDI activity in meeting the needs of sustainable development and environmental management. Sustainable development is the basic foundation on which environmental law and its principles are built.

### 2.5.3 Normative Values of Environmental Management

There is progressive evolution of the right to a clean environment as a human right and as a norm incorporating higher values. This calls for sustainable environmental management which is a competing objective with developmental activities such as FDI.

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41 Sornarajah, supra note 31, at 124 - 125.

42 In Rajendra Parajuli v Shree Distillery Ltd (1996) Nepal 2 UNEF Compendia, the Supreme Court of Nepal held that a licence for industrial operations did not excuse an obligation to protect the environment, adding that in line with the principle of sustainable development "every industry has an obligation to run its development activities without creating environmental deterioration" and that environment should not be viewed in narrow terms. In the case of Minors Oposa v Secretary of the Department of Environment and Natural Resources 33 ILM 174 (1994) and (1998) 1 UNEP Compendia, the Supreme Court of Philippines held that children had the right to sue on behalf of succeeding generations because every generation has a responsibility to the next to preserve the rhythm and harmony of nature for the full enjoyment of a balanced and healthy ecology.


44 Sornarajah, supra note 31, at 86.
The normative values of sustainable environmental management are environmental justice, equity, democratic participation, future generations and the precautionary principle. These values are expressed in the principles of environmental law considered below.

First, the principle of integration of environmental exigencies into development planning and management stipulates that environmental considerations should be taken into account and to every extent possible, integrated into development planning and management. It blends with sustainable utilisation of natural resources and the environment within which they occur. The FDI integrative school supports this principle. FDFs environmental consequences should therefore be an integral part of environmental management systems of host states.

Second, the principle of sustainable utilization and intergenerational equity is at the heart of environmental management. Environmental equity calls for fairness in the way human beings relate to and care for the environment. Sustainable environmental management lays the foundation for fairness and promotes equity in balancing the values of the environment and development. It attaches critical value to the interests of future generations who are fundamental to the notion of sustainable environmental management. The interests of those yet to be born should be buttressed in the utilisation of environmental resources. All environmental management strategies should be aimed at meeting the development objectives of the present generation without undermining the interests of future generations. It requires the promotion of utilisation of natural resources while protecting the threshold of sustainability. Weiss argues that sustainable development is inherently an intergenerational question as well as an intragenerational

Principle 4 of the Rio Declaration.


Ibid.
Each generation holds the environment as a trustee or steward for its descendants. In the context of environmental concerns arising from FDI Sornarajah remarks that succeeding generations will suffer if the present generation exhausts the natural environment. The intrageneration component requires that the human species does hold the natural environment in trust for itself and other species. Therefore, all generations and species should have an equal place in relation to the environment. Each generation is under obligation to leave the environment in no worse of condition than it received in order to provide succeeding generations equitable access to environmental resources. Consequently, if one generation severely degrades the environment it undermines its intergenerational obligation. Adequate environmental controls are therefore required to ensure that future generations retain options to use irreplaceable environmental resources.

Third, the polluter pays principle entrenches the value of environmental justice to control ecological destruction of the environment. It provides that whoever is responsible for environmental degradation should be responsible for its reparation. Consequently, persons who produce toxic and hazardous waste are enjoined to control their waste and be accountable for causing any harm to the environment. The polluter pays principle is more of a response to pollution and environmental harm rather than a preventive mechanism. It implicitly acknowledges that pollution may inevitably arise, but the polluter should pay for its damage to the environment. This principle is designed to internalise environmental externalities by shifting the cost of environmental harm from

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50 Ibid.

2 Ibid, at 20.

Ibid, at 21.

55 Principles 13 and 16 of the Rio Declaration.

Sornarajah, supra note 51, at 29.
society to the person causing the harm. Thus, the costs of avoidance or removal of environmental harm or in the compensation for environmental harm or in the compensation for environmental damage should be borne by the person who was causally responsible for them thus internalising the cost of pollution. When the cost of polluting is not met by the polluter it is regarded as external. Internalisation of this cost becomes a duty under the polluter pays principle.

Fourth, the preventive principle which is built around prevention of environmental harm requires that the prevention of environmental harm should be the primary consideration in making decisions that have potentially adverse environmental effects. Its practical application boils down to mitigation of environmental harm. Environmental impact assessment requirement for proposed development projects is based on this principle. It is in this regard that preventive measures should be taken to prevent environmental damage arising from FDI activity. Whereas FDI deserves protection prevention of environmental degradation should be integrated in FDI processes.

Fifth, the precautionary principle stipulates that it is not always possible to know what environmental consequences may, at some unknown future date, flow from particular uses of the environment and its resources, nor the ways in which they may happen. It closely resembles the preventive principle, but places premium on caution. Hughes explains that this constitutes the "principle of uncertainty" according to which the law could require cautious progress until a process or project is judged "innocent" and either allow ordinary progress until findings of "guilt" are made, or no progress until intensive research has been conducted into a proposed process and its innocence has been

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David Hughes, Tim Jewell et al, Environmental Law (Oxford: Oxford University Press, 2005), at 24 - 33; also see Principles 5, 6, 15 and 17 of the Rio Declaration.
demonstrated. Unlike reparation of damage which has already occurred or the protection against threatened damage, it requires the application of preventive measures whereby the potential impairment of the environment may entirely be precluded. Every precaution and prudence should be exercised to prevent any possible deleterious environmental consequences. Any action whether individual, group and corporate which results in adverse impacts on humans and the natural environment must be controlled. Exercise of this caution should also extend to FDI activity. Environmental impact assessments which are conducted to assess environmental risks of a proposed project reinforce this principle.

Sixth, participatory decision making by the wider community should be entrenched in environmental management processes. This will encourage the values of democratic participation, transparency and accountability in the decision making process concerning environmental management. It supports the inclusion of all affected members of society in making decisions regarding environmental management. It seeks to empower members of the public in the enforcement of environmental protection through judicial and other administrative procedures.

2.6 FDI Protection Regime

It is critical to assess the level of integration of the foregoing principles of environmental management in the FDI protection regime. Sornarajah argues that the increasing recognition of the host state’s regulatory right clashes with the aim of FDI protection. He ties in the incidence of foreign investments by observing that this belief clashes with the very raison d’être of the multinational corporation that is driven by motives of profit. The FDI protection regime revolves around protection of FDI against host

Notations:
* Fuggle & Rabie, supra note 57.
Principles 10, 19, 20, 21 and 22 of the Rio Declaration.
"Ibid.
"Ibid.
state interference. The regime comprises of the principles of international minimum standard, rule against uncompensated expropriation, national treatment and most-favoured-nation treatment considered below.

2.6.1 The Principle International Minimum Standard

The fulcrum of the levers of the FDI upon which its protection hinges is the principle of international minimum standard of treatment. It is firmly entrenched in the laws governing, regulating and facilitating foreign investment. This principle incorporates a standard called "fair and equitable" standard of treatment. The essence of this standard is that aliens and their property are entitled to a special kind of protection based on international minimum standards. It is a norm of customary international law which governs the treatment of aliens, by providing for a minimum set of principles which states, regardless of their domestic legislation and practices, must respect when dealing with foreign nationals and their property. A number of basic rights established by international law that states must grant to aliens, independent of the treatment accorded to their own citizens inform this principle. Host states would therefore be expected to accord aliens this level of protection, which could be higher than is accorded to its own nationals.68

The key elements in the standard of fair and equitable treatment are the legitimate expectations of the investor regarding the regulatory framework and whether due process has been followed.64 Essentially, it requires the host to maintain a stable legal and business framework throughout the term of the investment.70 It finds expression in a vast majority of bilateral investment treaties, and is normally expressed in the form of a "fair and equitable treatment" clause.71 Fair and equitable treatment provisions bound up with

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68 Miles, supra note 29, at 42.
international minimum standard of treatment are found in nearly all bilateral and multilateral investment treaties and many international investment agreements. The proponents of the standard considered it as a safeguard against state action that violate internationally accepted norms.

The principle militates against the state's sovereignty which "permits the state to protect its territory from environmental harm". It militates against established international environmental law that "a state is a repository of the right to safeguard the environment in the interest of mankind". Environmental regulations can be challenged by a foreign investor based on the fact that they violate this standard of treatment. It essentially implies that a host state may not legislate and implement environmental measures that were not in place at the time the investor made entry into the host state. This runs counter to the national and international obligations of the host state relating to environmental protection. It has potential to stifle the regulatory function of host states, which constrains host states' efforts at sustainable environmental management.

2.6.2 Rule Against Uncompensated Expropriation Principle

At the centre of this principle is the notion of private property. It is instructive to note that FDI is really a question of private property. In this sense, the FDI protection regime emerges as a bundle of private property rights. Sornarajah argues that "any infringements on the enjoyment of the foreign investor's interests in his property will involve a creation of liability in the state." Sornarajah further observes that the notion that "[i]t is not the absolute taking of property but any diminution of interests or depreciation of the value of the property that need protection through just compensation is a particular vision that has been developed by the American courts." The early history of the United States gave

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Sornarajah, supra note 31, at 125.
75 Ibid.
76 Sornarajah, supra, note 51, at 10.
77 Ibid, at 11.
much scope for the exercise of the "police powers" of the state.\textsuperscript{78} The United States developed the concept of a "regulatory taking" over hundreds of years in order to strike a balance between necessary land use regulations and private property rights. Likewise, in the context of FDI it is recognized that the host state's power to legislate for public interest is critical.\textsuperscript{79}

International law allows the expropriation of foreign-owned property if carried out in conformity with certain internationally required preconditions such as public interest, non-discrimination, and lack of arbitrariness. These legality requirements are also reflected in landmark United Nations General Assembly Resolutions confirming the sovereign right to expropriate as an expression of the permanent sovereignty over natural resources.\textsuperscript{80} Under international law, it has variously and often interchangeably been termed as "creeping expropriation," "de facto expropriation," or "constructive taking," or "regulatory taking." "measures tantamount to expropriation," or "creeping expropriation", or "disguised expropriation". These terms are used to mean regulatory measures whose effect is to effectively deprive an investor of the use and benefit of an investment without direct physical occupation or transfer of title.\textsuperscript{81} Indirect expropriation

\textsuperscript{80} August Reinisch, "Legality of Expropriations", in August Reinisch (ed.), Standards of Investment Protection (Oxford: Oxford University Press, 2008) at 171 to 204, at 173.
\textsuperscript{81} Supra notes 32 and 33.
\textsuperscript{82} See: Burns H. Weston, "'Constructive Takings' Under International Law: A Modest Foray into the Problem of 'Creeping Expropriation'," 16 Vanderbilt Journal of International Law 105 - 106. "Constructive takings" refers to the notion that governments may effectively deprive foreign investors of the use and enjoyment of their property without physical occupation or transfer of title.
\textsuperscript{83} A regulatory taking would be where a measure is taken for traditional regulatory purposes but has such impact on a foreign investor that it is deemed an expropriation.
\textsuperscript{84} A measure tantamount to expropriation would apply where a measure while not directly taking the property has the same impact in effect of depriving the owner of all benefits of the property.
\textsuperscript{85} Creeping expropriation would involve the use of a series of measures in order to achieve a direct or indirect expropriation. In this case, no individual measure in itself would amount to an expropriation but the sum of the measures, i. e., taken together could be construed as such.
takes the form of a diminution in property rights or interference with property interests without a formal transfer of ownership. It has been termed as an affront to economic liberalization and free and fair flow of investment across borders. Most investment agreements both multilateral and bilateral investment treaty agreements incorporate a clause against expropriation. It is now common place to find this principle captured in BITs and may take the terminologies of "indirect expropriation" and "measures tantamount to expropriation."[90]

In the exercise of such sovereign rights a state can nationalize or expropriate foreign investment provided it is for a legitimate public purpose. It is however not a straightforward task to ascertain where the legitimate exercise of governmental regulatory authority ends and compensable expropriation occurs. The critical question is whether environmental regulation for purposes of fostering environmental management in host states should be construed as indirect expropriation. If so construed, another question that emerges is how effective will environmental regulation be in the face of FDI protection. It raises question whether the host state's sovereign regulatory right to protect environment is subservient to FDI protection. Does this not amount to piercing the veil of sovereignty? Does regarding environmental regulation as amounting to expropriation requiring compensation reversing the polluter pays principle of environmental law to "pay the polluter" principle? Concern whether states will be required to compensate foreign investment in order to be able to environmentally regulate resonates in this discourse. Distinguishing legitimate non-compensatory regulations that affect the value


90 Muse-Fisher, supra note 78, at 502.


Alexander Fachiri, "Expropriation and International Law", 6 (1925) British Year Book of International Law 159, at 170.
of property or an investment from indirect expropriation is also at the heart of this discourse. The principle informs the regulatory chill which constrains host states' efforts in raising and tightening environmental standards. Question arises as to whether focus should change from the "effects" approach to "intent" approach in tagging environmental regulations as constituting indirect expropriation.

2.6.3 The Principles of National and Most-Favoured-Nation Treatment

These standards of treatment have their roots in the old Friendship, Commerce and Navigation treaties. The purpose of national treatment clauses is to oblige a host state "to make no negative differentiation between foreign and national investors when enacting and applying its rules and regulations." Guarantees of national treatment will be found in investment treaties with the effect of according foreign investors and their investments treatment no less favourable than that which the host state accords to its own investors. The essence of the most-favoured-nation treatment standard is that the nationals of the parties should benefit from favourable treatment that may be given to nationals of third states by either contracting state. These standards introduce an external test for the treatment and control of FDI. In so far as environmental management is concerned, whether the foreign investor and the domestic investor are placed in a comparable setting, or in a like situation, or in like circumstances is critical. Comparison of foreign investments and domestic investments on the same wave length may not be simple. They may not be operating in the same industry or sector. Their methods of production may be different. To claim that foreign investments must be accorded treatment that is not less favourable than that accorded domestic investors or investors from third states in like circumstances can constrain host states in their effort to regulate in critical matters such as the environment.

Wagner, supra note 56, at 469-471; also generally see Sornarajah, supra note 51.
2.7 Environmentally Responsive and Accountable FDI Protection Regime

When the spotlight is turned on the wider effects of FDI activities and practices, environmental damage comes out prominently. An international FDI regulatory regime that integrates postulates of environmentally responsive and accountable FDI to support and supplement regulatory efforts of host states is critical. Presently, there is an apparent vacuum in this regard which has prompted ad hoc interventions. For instance, the business community has responded with the adoption of voluntary codes of environmental corporate conduct and the integration of corporate social responsibility programmes into their operations. A corporate culture of responsible environmental management aimed at reducing commercial risks in foreign investment activities, is being constructed as a gateway to harmonious foreign investment-environment relationship. Voluntary schemes in this direction are the CERES Principles, the Business Charter for Sustainable Development established by the International Chamber of Commerce, the Equator Principles, and the Principles for Responsible Investment launched through the UN Global Compact and UNEP Finance Initiative.  

The CERES Principles is an initiative of the Coalition for Environmentally Responsible Economies (CERES) developed in the United States in the aftermath of the Exxon-Valdez oil spill in Alaska in 1989. It sought to bring about changes in corporate culture and practice through a two-fold approach: one, the development of a series of guiding principles to which companies commit and then implement throughout their operations on a continuing basis; and two, the promotion of environmentally, socially and financially responsible investment policies.  

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The International Chamber of Commerce Business Charter for Sustainable Development calls for a global shift in corporate practices so as to achieve sustainable development. It aims to encourage the widest possible range of corporations, across all sectors, to commit to responsible environmental corporate governance systems and practices, to improve corporate environmental performance overall, to change management structures and practices so as to assist with achieving that improvement, to assess progress towards these environmental goals, and to report publicly, as well as internally, on any such progress. It roots for infusion of environmental considerations in corporate decision-making in order to promote sustainable development.

The Equator Principles is a voluntary code developed by the World Bank's International Finance Corporation and private investment banking houses to promote an environmentally and socially responsible approach to project finance. It articulates criteria and procedures for assessing the environmental and social impacts of a proposed project, and requires banks to decline to provide finance on projects where the borrower is unable to comply with the environmental and social standards set by the bank. Projects are scrutinised for their potential environmental and social risks and are classified accordingly. The borrower must then provide to the financier a Social and Environmental Assessment addressing those issues identified. Accepting finance from an Equator Bank also commits the borrower to the environmental and socially-related conditions of the loan. The Principles for Responsible Investment is a voluntary code aimed at institutional investors developed by the UN Global Compact and UNEP Finance Initiative.

The Global Compact was established in 2000 with the aim of uniting corporations with UN Agencies and NGOs in the implementation of environmentally and socially responsible principles. It is meant to assist investors with infusing environmentally and socially responsible policies and practices throughout their operations. It is important that the FDI regime functions in a way that incorporates broader economic and environmental

concerns. This will go a long way in ensuring that the FDIO regime functions in a way that is more efficient and conducive to growth and development.10b

It is our recommendation that an international investment organisation be established to consolidate the foregoing voluntary efforts at ensuring responsible environmental corporate practices. This organisation will serve as a central body to promulgate standard rules and regulations governing FDI. Among these should be environmental rules and guidelines. This approach will help integrate the principles of sustainable environmental management into the FDI protection regime. It is submitted that with the integration of the principles of environmental management in the FDI regime an all encompassing constructive and purposeful interpretation of FDI protection principles will emerge. This will also be quite useful in diffusing the tension between FDI protection and sustainable environmental management. This will create an impetus for the development of an alternative and more comprehensive approach to investment regulation which will integrate minimum standards for corporate environmental responsibility with effective mechanisms for ensuring adherence to those standards. Such a framework should give rise to substantive rules that more carefully balance the need to protect foreign investors and the rights of host states to regulate in public interest according to national priorities.

2.8 Analysis of Empirical Data

2.8.1 FDI and Environmental Impact

Negative environmental impacts of FDI can be looked at from the perspective of certain environmental accidents involving FDI investments. This does not, in any way, suggest that such negative impacts result from FDI activity only. They can as well result from processes of domestic investment. The context of taking this perspective is to assess the particular environmental damage resulting from FDI. Some of the examples of reported FDI environmental damage are:

(a) The Bhopal Gas Tragedy

This tragedy involved a lethal gas leak from a pesticide factory owned by a subsidiary of Union Carbide Corporation, a United States of America corporation. Reports document that approximately 3,800 people died. The number of undocumented deaths may never be known but estimates set it at over 10,000. 520,000 people were exposed to the gases, 100,000 people suffered permanent injuries and thousands others sustained partial disabilities.\(^{106}\)

(b) Petroleum exploitation in Ecuador

Since 1972, companies have extracted almost two billion barrels of crude oil and in the process have released billions of gallons of untreated toxic wastes and oil directly into the environment. Crude oil and its toxic constituents can adversely affect health, from short-term effects such as dermatitis to long-term life-threatening diseases such as cancers. The Center for Economic and Social Rights carried a study in Ecuador to assess environmental damage resulting from petroleum exploitation and made various findings. The findings reveal that: waste water samples at the point of emission into the environment contained extremely high levels of toxic compounds and volatile organic compounds leading to increased risk of serious and non-reversible health effects such as cancers and neurological and reproductive problems.\(^{107}\)


It has been reported\textsuperscript{108} that as a result of mining of phosphate deposits in the Nauru Island, vast majority of soil and vegetation had been stripped away which prevents agriculture from taking place. The Island was rendered a scarred wasteland. It is very difficult for a viable ecosystem to establish itself and flourish. This is in addition to the combination of a pillar and pit landscape on Nauru and the loss of vegetation which creates a very hot interior, such that rising hot air prevents rain clouds from settling over the island contributing to frequent droughts.

These environmental damage events have been set out to show a link between FDI and the environment. More importantly, they are applied in the assessment of the level of FDI responsibility and accountability towards the environment. They are the hallmark of the study in chapter four of this work in which they have been analysed on the baseline of remediing environmental damage resulting from FDI activity.

### 2.8.2 Environmental Management Documents

The study reviewed the United Nations General Assembly Resolution on Permanent Sovereignty over Natural Resources.\textsuperscript{109} This resolution is significant for the host state's right to protect its environment in that it declared the right of states in disposal of their wealth according to national development policies without external coercion. The United Nations Resolution on Permanent Sovereignty over Natural Resources on Developing Countries\textsuperscript{111} which reiterated this right was also reviewed.

It committed the international community to protection of the human environment. The 1987 report of the World Commission on Environment and Development, "Our Common Future"\textsuperscript{111} gave the concept of sustainable development prominence. The Commission


\textsuperscript{109} supra note 32.


Supra note 42.
had been appointed by the United Nations in 1983 and was chaired by the then Prime Minister of Norway, Gro Harlem Brundtland, hence reference to it as the Brundtland Report. This report was reviewed in the development of the sustainability framework that underlies this study. The report sets out a programme for integrating environmental concerns with economic goals by governments and the private sector at international, national and local levels. It places importance on balancing environmental and developmental imperatives. This study has borrowed this approach and made a case for an integrative approach in FDI protection and environmental management.

This study found the Rio Declaration indispensable. The declaration was a culmination of the work of a conference held in Rio de Janeiro in June 1992 under the auspices of the United Nations Conference on Environment and Development. By that time the concept of sustainable development had taken centre stage in approaches taken towards environmental management and developmental processes. The conference was the Rio Declaration which took the gauntlet to declare soft law environmental principles that have become the touchstone of modern environmental law. These principles form a core foundation of the framework within which this study has been undertaken.

### 2.8.3 Key FDI Reports

This study reviewed the following reports:

(a) The Report of the United Nations Conference on Trade and Development on the social responsibility of transnational corporations highlights negative environmental impacts of transnational corporations in their FDI practices. The report advocates for principles of corporate social responsibility including responsible environmental practices as a response mechanism.

The Report of the United Nations Conference on Trade and Development on Lessons from the Multilateral Investment Agreement (MAI)\textsuperscript{113} states that the overarching goals of the MAI negotiations were to consolidate what the Organisation of Economic Co-operation and Development (OECD) had achieved by then on investment rules into a single instrument. This was meant to allow for a more structured dynamic for the liberalization process and give the rules a legal and binding effect. It intended to make the legally-binding nature of the rules clear by adding provisions for the settlement of investment disputes arising out of the agreement.\textsuperscript{114} Matters usually appearing in BITs were covered. The report outlines the controversial points which led to the collapse of the MAI initiative some of which related to environmental issues and unilateral reference to international arbitration.\textsuperscript{115}\textsuperscript{a} There was concern on the distinction of the right to regulate to safeguard the environment and regulatory taking inferred from such environmental regulation.

The UNCTAD World Investment Report of 2003 on FDI Policies for Development: National and International Perspectives points out that host countries’ right to regulate in public interest such as for purposes of environmental protection has gained prominence in FDI protection.\textsuperscript{116} The report notes that this right is under threat from the FDI principles of expropriation and national treatment.\textsuperscript{117}


\textsuperscript{115} Ibid, at 1.

\textsuperscript{116} Ibid, at 17-19.

The UNCTAD World Investment Report of 1999 on Foreign Direct Investment and the Challenge of Development reports a review of developments in bilateral and regional investment agreements including the key issues of the discussion on a possible multilateral agreement on investment. It looks at the impact of FDI on key objectives of economic development including environmental management. The report considers the impact of FDI on the environment. Both negative and positive impacts are brought out by the report.

The report notes that an assessment of the environmental impacts of FDI takes both a micro and macro perspective.

### 2.8.4 Bilateral Investment Treaty Provisions

Bilateral investment treaties (BITs) exhibit a certain pattern of uniformity in their structure and content. Elements common to virtually all such treaties are the use of a broad definition of the term "investment", the inclusion of certain general standards of treatment of foreign investment, such as minimum standard of treatment, fair and equitable treatment, constant protection and security, specific standards of protection regarding expropriation and compensation, transfer of funds, and the protection of foreign investment in case of civil strife. They also provide for national and MFN treatment. They also provide for resort to international arbitration.

We reviewed 43 BITs as a representative sample of BITs around the world with respect to the elements of FDI protection that have a bearing on environmental management. A list of these BITs is annexed hereto as "ANNEX F: The source of this data and information is mainly the United Nations' compendium of investment instruments. These BITs contain provisions incorporating the principles of FDI

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119 Ibid, at 294.


protection. Certain versions of the provisions that form the basis of this study sampled as shown in "ANNEX II" hereto. These provisions indicate that the FDI regime is deeply entrenched in BITs. The principles forming the pillar of FDI protection are incorporated in the BITs.

2.8.5 Regional Investment Agreements

(a) The Pacific Basin Charter on International Investments " was drafted by the Pacific Basin Economic Council (PBEC). The PBEC Committee on Foreign Direct Investment approved the Charter on 16 November 1995. The Charter incorporates the rule against expropriation. It provides that only when a host government finds it necessary in the furtherance of a public purpose, it may expropriate an enterprise belonging to international investors. When expropriation, or any other measure having a similar effect is carried out, it should be done so on a nondiscriminatory basis and provide for full and prompt settlement to the international investors. It is worth noting that it requires foreign investors and host state governments to ensure that investment projects will have minimum adverse effect on the environment.

(b) The North-American Free Trade Agreement " is a treaty between Canada, Mexico and the United States of America designed to foster trade between these countries. Its chapter 11 which deals with foreign direct investment was reviewed and the relevant provisions to this study are set out below.

**Article 1102: National Treatment:** [1]. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments. [2]. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
Article 1103: Most-Favored-Nation Treatment: [1]. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments. [2]. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

Article 1105: Minimum Standard of Treatment: [1]. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

Article 1110: Expropriation and Compensation: [1]. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment (“expropriation”), except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation.

2.9 Conclusion

In this chapter the linkage between FDI and the environment has been offered. It has provided an overview of the sustainability framework on which this study is premised and how it links into the two correlated fields of FDI protection and environmental management. The FDI-environment is constructed by the aid of multidimensional perspectives. FDI conceptualises the environment as a tool for exploitation. It has also been argued that the FDI protection regime omits to integrate concerns of environmental management. The protection FDI enjoys tends to override the objectives of environmental management. Basis for sustainable environmental management has been laid. The FDI regime should integrate the principles of environmental management so as to construct an environmentally accountable and responsive FDI regime. It is critical that an international investment organisation be formed by the international community to consolidate best practices recommended by various voluntary schemes in the field of FDI environmental management. The chapter also indicates sources of data and formation used in this study.
CHAPTER THREE

FDI PROTECTION REGIME AND SUSTAINABLE ENVIRONMENTAL MANAGEMENT

3.1 Introduction

This chapter builds upon chapter two. It critically analyses the FDI protection regime in connection with sustainable environmental management in host states. This is broken down into the principles of FDI comprising its protection regime. The principles of the international minimum standards, the rule against expropriation without compensation, the national treatment and the most-favoured-nation treatment are interrogated from the standpoint of environmental management in host states. The interaction of these principles with the principles of environmental management is critically explored. Their effect on environmental protection and regulation measures is questioned.

3.2 International Minimum Standard and Environmental Management

The principle of international minimum standard of treatment includes "the fair and equitable treatment standard." This standard of protection has a bearing on environmental management in host states. There is evidence that the standard can constrain environmental regulation and environmental decision-making in host states. Open good faith efforts by the host state that deviate from a foreign investor's expectations may be treated as a violation of this standard. Such open good faith efforts include environmental regulations aimed at promoting sustainable environmental management. The standard prohibits unfair and inequitable treatment. This implicates administrative decision-making that impacts on an investment either in the form of a

Which entails that the host state informs the investor of all rules and regulations that will govern the investment for its duration and requiring the host state to maintain a stable legal and business framework throughout the term of the investment.

See the award in Metalclad v Mexico ICSID case No ARB/AF/97/1 and Clayton v Canada "Www.appletonlaw.com/Media/2008/Bilcon%20NAFTA%20Notice%20Intent.pdf> accessed 13 September 2010.
denial of permission to carry out an activity or in a change in the law.\(^3\) It has been held that the "stability of the legal and business framework is thus an essential element of fair and equitable treatment."\(^4\) A claim of this nature is best illustrated by the case of *Clayton v Canada*\(^5\) where a notice of intent to submit a claim to arbitration was filed by the investor against Canada under NAFTA. The investor alleged a breach of fair and equitable treatment as guaranteed under article 1105 of NAFTA, contending that an environmental review of its investment activity was inconsistent with the legitimate expectations of the investor or principles of due process.

Fair and equitable treatment has been interpreted to mean a stable and predictable legal and business regulatory framework. Gus Van Harten argues that this is an expansive interpretation of the minimum standard of treatment which is overly favourable to investors. In *Teemed v Mexico*, the tribunal centrally focused on the breach of the investor's expectations for fair and equitable treatment. Here, the bar for government behaviour was set fairly high, with the Tribunal in effect requiring the host state to act in a manner that is among other things transparent, free from ambiguity, and consistent. These, of course, are reasonable expectations. But by holding them to be elements of a minimum international standard of treatment, the Tribunal effectively elevated them beyond expectations to legally binding obligations.

This approach has significant implications for the ability of host states to change their regulatory regimes, and, in particular, may have the potential to stifle the strengthening of domestic environmental protection regimes. For instance, if a more stringent environmental regulatory regime is brought in to achieve a legitimate public purpose, such as the mitigation of climate change impacts, it will need to meet the stable legal and

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business environment test before a host state can legislate in this way without triggering a right of compensation. This is a sizable barrier on the ability of governments to make policy decisions and legislate in public interest. Sornarajah argues that the principle of fair and equitable treatment standard only extends to foreign investors and is heavily weighed towards furthering their interests.\(^9\) It excludes host states from the protective principles of FDI law.\(^10\) Little weight is placed on the host states’ legitimate regulatory function in environmental protection. Sornarajah queries why the fair and equitable standard of treatment extends only to investors so as to shield multinational corporations from accountability for their activities.\(^1\) He possesses the question: "[I]s it not fair and equitable to create defenses for host states where investors have engaged in conduct that violates human rights or harms the environment of the host state?" \(^2\) Under it, the host state largely remains, in the words of Kate Miles, "unable to call upon the rules of international investment law to address damage suffered at the hands of foreign investors."\(^3\) Non-responsiveness of this standard to the needs of the host state is a reflection of the imperial origins of FDI law as an instrument of FDI protection.\(^4\) It is submitted that the standard of "fairness and equity" required of host states should be reciprocal. They should afford the host state some protection in essential areas such as the protection of the environment.

Allegations of a breach of the fair-and-equitable-treatment standard arise in investor challenges to administrative decision-making, prohibitions on certain activities, and the introduction of new regulations.\(^5\)\(^\*)\) Arbitral awards have expounded on the meaning of the term "fair and equitable treatment" such as to cover environmental regulations. The most


Sornarajah, supra note 9, at 174.

\(^1\) Miles, supra note 10, at 11; also see Sornarajah, supra note 9, at 184 - 185.

\(^4\) Kate Miles, supra note 10, at 44.

\(^5\) M.Uchlan, supra note 3, at 233 - 234.
significant elements of it comprise adherence to the legitimate expectations of the investor, due process, and maintenance of a stable legal and business environment. Over and above considering the specific representations made to the investor, tribunals examine the law in existence at the time of entering into the investment as well. The impugned regulatory changes are then assessed in juxtaposition with the original state of the law to establish whether or not the legitimate expectations of the investor have been met. Although this requirement to maintain a stable legal and business environment does not mean that regulation will be static and never change, it has the potential to constrain host-state policy space. It has been regarded as an essential element of attaining the fair and equitable treatment standard.

This standard of treatment presupposes a favourable approach towards FDI. This was established in the case of *Azurix Corp. v Republic of Argentina* ("Azurix"). This case involved the privatisation of water utilities in Buenos Aires, Argentina. In 1999, the American-owned company, Azurix, acquired a 30-year concession to operate the water facilities within the province. The project led to the contamination of local water supplies with toxic bacteria which rendered the water undrinkable. The government issued a warning, urging residents not to drink the water and to minimise exposure to it through limiting showers and baths. The local authorities considered this to be a matter of protection of public health and imposed a fine on Azurix for non-compliance with its obligations regarding water quality under the concession agreement. The authorities also issued regulations prohibiting Azurix from invoicing residents for water services during the contaminated water crisis. Azurix filed a request for arbitration with the International Center for the Settlement of Investment Disputes (ICSID) pursuant to the United States-Argentine Republic bilateral investment agreement. Azurix alleged, amongst other

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See the award in *Occidental Exploration and Production Co v Republic of Ecuador* (Award), Case UNCTAD/DS212, UNCTRAL, at para. 183 (2004).

*Azurix Corp v Argentine Republic* (Award), ICSID Case No. ARB/01/12 (2006).
complaints, that the regulatory action taken by the local authorities amounted to expropriation and a breach of fair and equitable treatment standards. The subject of the complaints included the administration of the billing and tariffs zoning system applicable to the water services provided by Azurix and the prohibitions on charging for those water services during the contamination period. It also argued that the water quality problems were a result of failures on the part of local authorities to provide necessary infrastructure. Azurix claimed in excess of US$600 million in damages. In upholding the claim for breach of fair and equitable treatment the tribunal stated thus:

"A third element is the frustration of expectations that the investor may have legitimately taken into account when it made the investment. The standards of conduct agreed by the parties to a BIT presuppose a favorable disposition towards foreign investment, in fact, a pro-active behavior of the State to encourage and protect it. To encourage and protect investment is the purpose of the BIT. It would be incoherent with such a purpose and the expectation created by such a document to consider that a party to the BIT has breached the obligation of fair and equitable treatment only when it has acted in bad faith or its conduct can be qualified as outrageous or egregious."

Upholding of this standard in this case effectively set aside the action taken by the Argentinean government in order to achieve sustainable management of the environment. Various environmental management principles such as the preventive principle, the precautionary principle and the polluter pays principle were overlooked in favour of FDI protection. The emergence of this approach in investor-state arbitral jurisprudence is a significant cause for concern in the implementation of new environmental protection measures. It is reasonable to expect that host state will and should, from time to time, seek to respond to changing environmental conditions and to implement evolving international environmental obligations. As a matter of necessity, they would respond through the enactment of new regulations and policies. They may find it inevitable to Prioritise their response by regulating certain sectors or projects, which may, for instance, polluting at greater levels. In other words, the introduction of new policies will be

inevitable. That, as a sequel to this response, they may so fundamentally and invariably change the legal and regulatory landscape in which established investors are required to operate, in a manner that could not have been foreseen at the time of the original investment” is also significant. With this effect, legitimate and well merited environmental regulation and decision-making can be exposed to allegations of violating the fair and equitable-treatment standard. This state of affairs point to the possibility that each new environmental measure that may become necessary to put in place such as climate-change-related measures for established carbon-intensive investments, will be faced with allegations grounded on failure to maintain a stable legal and business environment.

In Metalclad v Mexico— the tribunal said that Mexico failed to provide a transparent, predictable framework for business planning and investment, and demonstrated a lack of orderly process and timely disposition in relation to an investor. The tribunal further held that the decision by a local government authority to withhold planning permission to construct a facility by Metalclad for the disposal of hazardous waste in accordance with the agreement between the company and the Mexican national government was regarded as treatment that did not meet the standard of fair and just treatment under NAFTA. For this reason, Mexico was held to be in violation of the international minimum standard of treatment.

A further affront to environmental protection is the trend of tribunals widening the fair and equitable treatment standard. They tend to apply the law on the strength of the fair and equitable treatment standard more liberally in favour of foreign investors, without due regard for other equally important competing interests such as environmental protection.


* Metalclad v Mexico ICSID case No ARB/AF/97/1.

Surya P. Subedi, "The Challenge of Reconciling the Competing Principles with the Law of Foreign Investment with Special Reference to the Recent Trend in the Interpretation of the Term 'Propriation'", (2006) 40 The International Lawyer 121, at 127.
protection. The award in *Pope & Talbot Inc. v Canada* (UNCITRAL-NAFTA 2001) is instructive. In this case, the ICSID tribunal held that investors under NAFTA are entitled to the international law minimum, plus the fairness elements, effectively suggesting that NAFTA provides greater protection than provided under international law. However, this interpretation was criticised by a Canadian Court as an incorrect interpretation of article 1105 of NAFTA that requires "treatment in accordance with international law, including fair and equitable treatment and protection and security," implying that the fairness elements were part and parcel of international law.\

State parties to NAFTA Canada, Mexico and the United States were also not very satisfied with the "over-inclusion" of the fairness and equitable standard of treatment. As a result, they endorsed the position taken by the Canadian Court stating that "[t]he 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 customary international law minimum standard of treatment of aliens."\

Breach of national treatment was found based on the requirement to produce what was termed excessive documentation for export permits in the forestry sector in Canada.

### 3.3 Indirect Expropriation and Environmental Management

#### 3.3.1 Environmental Regulation as Indirect Expropriation

Environmental regulations that may affect FDI are construed as amounting to indirect expropriation. This is based on interpretation of regulatory measures instituted by governments as a taking of property. Such intervention will be construed as a taking of the foreign investment, inevitably to be accompanied by the payment of prompt, adequate and effective compensation. Environmental regulation is arguably one of the

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\* North American Free Trade Agreement (NAFTA), Article 1105.

\(,\) *United Mexican States v Metalclad Corp.*, [2001] 95 b.c.l.r. (3D) 169.

most contentious issues in the foreign investment-environment discourse due to the classification of domestic environmental regulation as a form of 'indirect expropriation' of foreign-owned property requiring compensation. The issue is so controversial that it was recorded as one of the chief causes of the collapse of the MAI initiative that was to establish a global regime for regulating transnational investment. There was no consensus on the "concept of national environmental regulation of investment by the host state with the concept of prohibitions on expropriation or excessive state interference in foreign investment". The MAI contained a prohibition on uncompensated expropriation, which entrenched fear that host states would not be able to take environmental regulation measures. It was feared that it would entrench a chilling effect on host states in their attempts at taking environmental protection measures. This is due to anxiety over the possible liability calling for payment of compensation to affected foreign investors.

3.3.2 Affront to Environmental Management Principles

FDI law does not prohibit expropriation as such. A host state can expropriate an investment provided that it meets certain conditions. One such condition is payment of compensation. It is therefore correct to say that what FDI law prohibits expropriation without compensation. As such, if a state were to take steps to terminate environmental harm caused by a foreign investment activity or terminate the foreign investment entirely based on environmental concerns it will be met with a claim for compensation of the foreign investor concerned. The requirement for the foreign investor to be compensated by a host state that is attempting to put in place environmental measures contradicts the polluter pays principle of environmental management. It potentially reverses that principle to pay polluter principle.


The case of Ethyl Corporation v Canada\textsuperscript{11} points to a situation whereby a host state will undergo a "regulatory chill" for fear of facing a compensation claim based on expropriation. There, a claim was made that any depreciation in the value of shares caused by a contemplation of a ban on a pollutive substance exclusively manufactured by the foreign investor amounted to a taking under the relevant investment treaty. The Canadian government had introduced legislation banning intra-provincial and international trade in the fuel additive, methylcyclopentadienyl manganese tricarbonyl ("MMT"), citing human health and environmental protection purposes. The measure was issued with the interest of protecting the environment and human health, of promoting the harmonization of fuel standards in North America and of reducing economic burdens over car companies. There had been significant disagreement at the time as to the health and environmental impacts of MMT. Ethyl Corp. filed a claim under NAFTA’s Chapter 11 provisions alleging that the MMT ban constituted an expropriation of its investment in Canada and claimed US$251 million in compensation. A little more than a year after the legislation was passed, Canada settled the matter with Ethyl Corp. Canada agreed to repeal the MMT ban, to pay approximately US$13 million, and to issue a statement to the effect that there was no evidence that MMT in low amounts was harmful to human health. The MMT legislation had been enacted as a precautionary measure in response to inconclusive scientific evidence as to the toxic effects of MMT. This precautionary intent was ignored by the tribunal.

3.3.3 Effect versus Purpose of Environmental Regulation

Under the FDI protection regime, the effect of regulatory measures is given more weight than its purpose or intent. Under environmental management, the purpose and intent of environmental regulations should be given weight as opposed to the extent to which they affect FDI. The effects-based approach was applied in the case of Metalclad Corporation v The United States of Mexico\textsuperscript{17} ("Metalclad") which involved the development of a hazardous waste treatment site in Mexico, San Luis Potosi. Metalclad, a U.S. corporation, purchased a hazardous waste landfill which had previously received authorisation from...
the Mexican federal government. Later, the municipality ordered Metalclad to cease building for lack of a local construction permit. An application to the municipality for a local construction permit was made whilst construction was underway. The municipality declined the application after construction had already been completed. Additionally, the municipality filed an administrative complaint and a preliminary injunction against operation of the landfill. The Governor of San Luis Potosi issued an Ecological Decree declaring the area encompassing the landfill a Natural Area for the protection of rare cactus, and permanently precluding its use as a landfill. Metalclad on the basis of expropriation made a claim under Chapter 11 of NAFTA for compensation. It alleged that decree constituted a measure tantamount to expropriation. The tribunal found that "covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or significant part, of the use or reasonably-to-be-expected economic benefit of property is tantamount to expropriation. This holding suggests that the FDI protection regime considers the effect rather than the intent of the government action. The Tribunal in this case ruled that "[T]he Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree/" The fact that there was substantial interference was enough to establish expropriation, and it was unnecessary in its view to ask why that interference had occurred. This is a clear case of thwarting environmental protection in a host state by merely looking at the effect of an environmental measure as opposed to its intention or purpose. The decree was made for the legitimate purpose on the strength of land use and environmental regulations. This was to prevent environmental degradation of the area where the landfill was to be located. This was consistent with the preventive principle of environmental law which was not taken into account in the tribunal's decision.

The Tribunal in Pope & Talbot,18 considering whether that company's Canadian forest Products export business had been expropriated by Canadian forest management regulations, took a similar approach. The Tribunal remarked that the test of whether there has been an expropriation has nothing to do with the measure's objectives but is judged "only by whether the degree of interference is great enough. The case of Compañía del

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*Oesarrollo de Santa Elena, S.A. v Costa Rica*\(^1\) ("Santa Elena") involved the expropriation of property owned by a Costa Rican company that had been formed by an American syndicate (CDSE) and in which the majority of shareholders were American citizens. CDSE had purchased in 1970 for tourism development the property known as "Santa Elena", consisting over 30 kilometres of Pacific coastline. In 1978, Costa Rica issued a decree ordering expropriation of this property from CDSE, in order to use Santa Elena for environmental purposes, and proposed to pay CDSE US$ 1,900,000 in compensation. The issue at stake was the amount of compensation due to the investor. CDSE disagreed with the offered amount (under its own assessment done also in 1978, the value of the property was US$ 6,400,000). The subsequent court proceedings before Costa Rican national courts that dragged for 20 years did not lead to any definite result. In 1995, under the political pressure from the US, Costa Rica agreed to submit the dispute to ICSID arbitration. In the arbitral proceedings CDSE claimed US$ 40,000,000 including the current value of the property and interest.

In awarding the investor compensation, the tribunal observed that even a host state's international environmental obligations would not matter. The property was situated in an area characterised by its unique marine and tropical rainforest biodiversity. This was designed to protect the surrounding environment. Costa Rica argued that it was under an international legal obligation to protect such an exceptional ecological site. It argued that it was under an obligation to preserve the area pursuant to several international environmental agreements, including the Convention Concerning the Protection of the World Cultural and Natural Heritage, the Ramsar Convention on Wetlands of International Importance Especially Waterfowl Habitat, the Convention on Biological Diversity, and the Central American Regional Convention for the Management and Conservation of Natural Forest Ecosystems. It further argued that its international obligations and the environmental purposes for which the taking was carried out should be taken into account in the methodology for valuing the property. It urged the tribunal to into account the environmental objective of the expropriation and adopt an "appropriate" valuation as opposed to the "full compensation" at a "market" valuation

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sought by the investor. The Tribunal held that the environmental objectives of the expropriation, and the fact that it was done in fulfilment of international environmental obligations, did not alter the application of international investment rules. The tribunal held that a host state’s international environmental obligations were not relevant considerations in determining the valuation methodology for compensation assessment. It further held that the purpose of protecting the environment for which the property was taken does not alter the legal character of the taking for which adequate compensation must be paid.

In the case of Teemed v Mexico\(^a\) the Mexican government effectively shut down a hazardous waste processing plant by refusing to re-issue its operating permit. In determining that the non-renewal of an operating licence constituted an expropriation of the investment, the tribunal emphasized that the primary concern in questions of indirect expropriation is with the effect of the governmental measure rather than its object. It observed that the government’s intention is less important than the effects of the measures on the owner of the assets or on the benefits arising from such assets affected by the measures. The Tribunal went on to state that the measures adopted by a State, whether regulatory or not, are an indirect *de facto* expropriation if they are irreversible and permanent.\(^b\)

In *Azurix Corp. v Republic of Argentina*\(^c\) in an arbitration under the United States Argentine Republic BIT the investor claimed that the regulatory action taken by the local authorities against water contamination by bacteria resulting from the investment amounted to expropriation. The tribunal observed that the issue is not so much whether the measure concerned is legitimate and serves a public purpose, but whether it is a measure that gives rise to a compensation claim. In *Middle East Cement Shipping and Handling Co. S.A. v Arab Republic of Egypt* a claim arose concerning extraction of minerals from a park. The investor was restricted from entering the park where the land

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\(^a\) Ibid.

\(^b\) Ibid.


\(^d\) *Middle East Cement Shipping and Handling Co. S.A. v Arab Republic of Egypt* Award, 12th April 178.

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on which extraction right had been given and authorization for the import and storage of bulk cement. Annulment of this authorization was held to be an indirect expropriatory act. This decision disregarded the priority of protection of fauna in the park and its ecology. It disregarded the principle of intra-generational equity in sustainable environmental management.

The above case law interpreting existing BITs in the context of FDI protection reveals that national environmental laws and regulations may be challenged where they affect the property rights of foreign investors. The tribunals' effects-based approach effectively extended the meaning of expropriation beyond its traditional scope and exposed health and environmental regulations to the risk of wide-ranging challenges from foreign investors. The implementation of international environmental obligations may not be sufficient justification for reducing or dispensing with the amount of compensation paid to investors affected by environmental protection measures taken by host states. Focus is placed on the effect of environmental regulation rather than its intent or purpose. This situation constitutes an affront to host states' legitimate environmental regulatory functions. As a result, public welfare regulation is construed as a treaty violation. This leads to the assertion that the FDI protection regime's attack of public welfare regulation without regard for its intended purpose stifles environmental management in host states. Taxpayers should not be paying investors to alter behaviour that is contrary to public interest. Regulators who are held liable for their impacts on investors will not regulate to the extent that they should leading to a "regulatory capture" situation.

Environmental regulations have a potential of being construed as indirect expropriation. Host states may shy away from environmental regulation of foreign investments for fear of being called upon to pay compensation to the foreign investor. It is our argument that the possibility of environmental regulation being construed as an indirect expropriation is a negation of the host state's sovereign right to environmentally regulate foreign investments. This contributes towards undermining of environmental laws and standards. Essentially therefore, even though environmental regulation may be seen as a regulatory ^ing against foreign investment in a particular case, it should not attract the sanction of

It is our argument that the purpose and intent of environmental regulations
ould be given weight as opposed to simply looking at the extent to which they affect reign investment activity. They should be exempt on the basis of their *bona fides* and their public welfare objectives.

### 3.4 Distinction between Environmental Regulation and Expropriation

is critical to strike a balance between the public interest and the interest of foreign investors. The balancing of the clash between competing principles and interests is intricate. Placing regulation to the extreme end and presuming it as expropriation through a road statement is not workable. A balancing of this view is highly desirable. This is particularly so for environmental regulation. Both FDI protection and environmental management are noble and legitimate ideals. Regulations that apply to all firms, in the sense that they are non-discriminatory regulations of general application should not be viewed as constituting expropriation. They should be exempt on the basis of their *bona fides* and their public welfare objectives.

is critical that legitimate public-welfare regulation be excluded from the scope of investment treaties. Already, this jurisprudence is beginning to emerge in some FDI arbitral decisions concerning environmental regulation. The *Pope & Talbot Case* arose as a result of a Softwood Lumber Agreement (SLA) between the United States and Canada, governing Canadian softwood lumber exports. Pope & Talbot, a U.S. corporation operated in British Columbia and controlled three softwood lumber mills. Until 1996, Pope & Talbot exported a vast majority of its softwood lumber to the U.S. In 1996, U.S. and Canada entered into the SLA, which required Canada to place softwood lumber on the Export Control List and to require a Federal export permit for each exportation to the U.S. Further, the agreement levied export duty based on the amount to *d* exported by an exporter. Pope & Talbot claimed under Chapter 11 of NAFTA arguing, *nec alia*, that the Export Control Regime based on an expropriation claim that successive reductions in the quantity of exports permitted to pass the border free of


charge. The tribunal held that the degree of interference with Pope & Talbot’s operations did not give rise to an expropriation because it was not sufficiently restrictive to support a conclusion that the property had been taken from the owner. The upshot of this holding is that it is the degree of interference with a property right that distinguishes between a proper regulation and an expropriation.

The case of Methanex Corporation v United States\(^6\) involved Californian health and environmental regulations that Methanex, a Canadian producer, alleged had a discriminatory effect. A fuel additive, methyl tertiary butyl ether (MTBE) which increases the oxygen levels in unleaded petrol and operates as an octane enhancer for fuel was found to be leaking from storage tanks. It was detected in drinking water systems in California. California considered that MTBE-contaminated water posed a significant threat to human health and safety and to the quality of the environment and its Governor issued an Executive Order declaring that use of the chemical would be phased out. Methanex filed a claim under NAFTA, seeking US$970 million in damages for alleged regulatory expropriation of its investment. It argued that the Californian measures not only deprived it of a substantial portion of its customer base, goodwill, and market for methanol in California, but effectively transferred its market share to its competitor, the US ethanol industry. The tribunal rejected these arguments based on the reasoning that under general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alia, a foreign investor or investment is not deemed expropriatory and compensatory unless specific commitments had been given to the then putative foreign investor contemplating investment that the government would refrain from such regulation. In holding that the regulations were not measures "tantamount to expropriation," the tribunal relied on the non-discriminatory nature of the regulations of the methanol industry. This decision did not lay any importance to the effect of the regulations on the undertaking such as the degree of the economic interference with the private investor's investment. Worth-noting also> the tribunal established that loss of market share on its own does not constitute expropriation.

3.4 Challenges of National Treatment to Environmental Management

Moltke observes that in the context of environmental regulations affecting investments, the application of the principle of national treatment is not straightforward. Environmental management is inherently characterised by two significant consequences which blur the picture when the standards of national treatment are applied. First, there is the difficulty of objectively measuring "likeness" of investment projects with precision to determine the degree of likeness, and the extent to which such an establishment will be affected by certain environmental regulations. Investments and their facilities are rarely "like" from an environmental perspective. Second, environmental measures applied to otherwise "like" facilities at different times are liable to be significantly different given that the environment itself is dynamic in nature. Environmental management is also a dynamic activity, "responding to growing knowledge about the environment and anthropogenic threats to it, as well as to changing perceptions about the seriousness of these threats."

From an environmental perspective, the critical issue is determining when circumstances are said to be "like" under the national treatment principle. It requires deciding in some fashion whether treatment received by two different investors is alike. The differentiating criterion is key here. Circumstances of two investors in the case of environmental considerations would hardly be identical. Assessment of whether a host state has actually breached this standard requires a consideration of whether or not the foreign and domestic investors and their investments are in "like circumstances." This involves the comparison of the foreign investor with the domestic investor. The criteria by which such assessments are made are, therefore, significant for the outcome of determinations of like circumstances. The test of "like circumstances" also gives rise to difficulty in...
comparing incomparable entities. Sornarajah remarks that "[A] large multinational corporation as an investor is never in "like circumstances" because of its size and vertically integrated global organisation."02

The commonly used criteria have been limited to commercial considerations, framing the assessment in terms of the same business or economic sector.03 The setback of this approach is that it does not encompass social and environmental impacts as distinguishing factors, which means that domestic and foreign investors will be in "like circumstances" if the sole difference is the treatment's impact on social or environmental conditions. Accordingly, a host state's attempt to differentiate through regulation or decision-making on these grounds so as to support environmentally responsible objectives would be at risk of challenge as a breach of national-treatment obligations.04 Hence, if a domestic investor were to be treated differently from a foreign investor owing to the fact that its production process was more environmentally sustainable, the host state might be sued for breach of the national treatment obligation.

The absorptive capacity of the natural environment represents a scarce resource, to which there are no precisely delimited property rights, entailing a complex allocation process involving both public and private interests.05 This may necessitate application of different levels of treatment to new entrants, distinct from those applied to earlier investment projects so as to keep the levels of pollution low. For instance, consider a situation where there are several existing firms already established at a location with emission permits that exhaust the receptive capacity of the relevant ecosystem. Due to the exhausted


Moltke, *supra* note 49.
receptive environmental capacity a state may issue an investment permit with much more stringent requirements to subsequent investors. For example, later "like" facilities, located in a watershed or within the distribution range of atmospheric pollutants, must take into account the prior emitters which must in turn be subjected to new conditions to make room for new sources. The preventive principle of environmental management will require that further pollution be prevented at the environmentally exhausted site. It is for this reason that environmental impact assessment (EIA) to determine whether a new entrant foreign investment should be admitted. Yet the national treatment standard may be applied to compel the host state to admit the new investment regardless of the outcome of an EIA. This is primarily the case as the national treatment principle requires that such an investor should be accorded similar treatment as is accorded to the already existing investors who may be domestic. Environmental management will likely be disregarded in a bid to accord new entrants the same opportunity being enjoyed by nationals of the host state. The preventive principle will consequently be disregarded.

We contend that states should approach the problems arising from the dynamic and complex character of environmental management differently. Each kind of investment has unique characteristics specific to it, arising from the technology employed, and thus having different effects on the environment. EIA should be allowed room to consider all relevant environmental factors and circumstances surrounding a proposed investment. EIA will give an objective criteria for taking into account the interests of environmental management before admitting FDI. Most critically, EIA will integrate the dynamic attributes of the environment.

Shifting priorities of public policy may also render comparisons virtually impossible. For example, administrative practice in one country may allow the continuous tightening of permits so that environmental management is a continuous process of negotiation between the investor and public authorities. In another country much more weight may be placed on long-term security of permits. New permits will tend to be much more stringent, and much closer to the limits of current technologies than in the first country, after several years the requirements in the first country may become more onerous.

and surpass those in the second country. Finding the point of "likeness" in these circumstances can be a complex process, occurring continuously in all countries where equal treatment before the law is upheld. Admittedly, faced with the challenge of developing appropriate environmental standards, issuing permits and licences, and ensuring that all relevant measures have been complied with, "environmental authorities in all countries are forced to engage in some form of selective enforcement."67 States must set priorities for enforcement based on criteria such as the nature of the environmental threat, the history of an investment facility, or public pressure in its society. Under these circumstances, determining what represents "national treatment" can be a daunting task.

There is also concern that this treatment outrightly suggests that domestic investors will be expected to comply with environmental regulations, or at least at a higher standard than foreign investors. Moltke captures this concern by observing that "[0]ne of the paradoxes of the principle of national treatment when applied to investments is that it does not put foreign and domestic investors on equal footing as it does when applied to goods in trade.” It provides foreign investors with rights not enjoyed by their domestic counterparts, in addition to ensuring that they enjoy all "domestic" rights the latter have.

The national treatment principle has the effect of constraining host states in the development of legitimate environmental protection policies and in the design of regulatory responses to environmental challenges/9 National treatment does not take into account the purpose of environmental measures. Instead, it looks at the effect the measures have on a foreign investment. A departure from this traditional approach to the consideration of "like circumstances" and adoption of a paradigm shift in the thinking informing this area in Parkerings-Compagniet A.S. v Republic of Lithuania60 (Parkerings") which considered cultural heritage and environmental impacts as a component of the criteria for "like circumstances". It was held that the difference in the

67 Ibid., at 58.
69 Ibid.

*Kate Miles, Arbitrating Investor Disputes, (2010) 1 Climate Law 1 at 63-92, at 77.
*Kakerings-Compagniet AS v Republic of Lithuania, ICSID Arbitration Case No. ARB/05/8, Award, September 2007, at paras. 375, 392 <http://ita.law.uvic.ca/documents/Pakerings.pdf> accessed 20
*Pember 2010.
archaeological and environmental impacts between two otherwise very similar investment undertakings rendered them not in "like circumstances". Accordingly, the local authority's decision to approve one project as opposed to the other on the grounds of archaeological preservation and environmental protection was not in violation of national treatment obligations. If this approach is followed the potential for national-treatment requirements in constraining legitimate host-state policy space would be significantly mitigated. In *S D Myers v Canada* the tribunal stated that "the assessment of 'like circumstances' must also take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest". The tribunal ruled that a Canadian processor of hazardous waste was in like circumstances with a Canadian office established by the U.S. investor for the purpose of brokering the export of hazardous waste. That being established, it was a simple matter to show that an export ban on hazardous waste accorded very different treatment to the two and, therefore, represented de facto discrimination.

The effect of the domestic measure on the investment rather than the need for any intent to discriminate against the foreign investor takes precedence. This essentially looks at a measure as a *de facto* form of discrimination rather than a *de jure* one. It has serious implications for the introduction and implementation of new environmental regulations. Its implication is that regulation of general application can breach national-treatment obligations if it affects a foreign investor to a greater degree than domestic investors. In *S. D. Myers v Canada* the tribunal was not persuaded by the justification argument, even though the regulation was enacted to implement Canada's obligations under a multilateral environmental agreement. It was argued by Canada that the impugned measure was made in compliance with the Convention on the Control of Transboundary

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61 *Myers v Canada*, 40 ILM 1408.

62 *McLachlan et al.*, supra note 3, at 251; *Dolzer and Schreuer, supra* note 18, at 181.

63 *arten, supra* note 22, at 85 - 86.


65 Ibid.
Movement of Hazardous Wastes and their Disposal. The case was ultimately decided on the basis of national treatment, given the fact that the tribunal found that Canada's motivation to issue the measure was not based on an environmental concern, but with the purpose of protecting its local market. Even though prima facie the measure was nationality neutral, for the tribunal it was clear that this measure had a specific effect over the non-Canadian company.

3.5 Most-Favoured-Nation Treatment and Environmental Management

The most-favoured-nation (MFN) treatment requires that a host country should not grant less favourable treatment to nationals of a state than is granted to nationals of another state. Essentially, this requires an identical treatment of nationals of different countries in like circumstances. The principle applies to FDI and international trade.

The challenge that abounds in the application of the MFN treatment is that environmental effects of various investments from different countries are unlikely to be identical. For instance, an investment by a major enterprise from a country with rigorous environmental controls may attract different levels of scrutiny than comparable investments from other countries. Investments from tax havens, where there is no environmental activity at all should necessarily be subject to different environmental standards of treatment. This is primarily because such investments will not have gained experience in putting in place environmental safety standards. The grant of MFN treatment for investments has created problems for China particularly those involving ozone depleting substances from Hong Kong and Taiwan. The need for environmental management may demand greater control over these investment activities whether or not this results in contravention of the Principle of MFN. For sustainable environmental management, it would seem prudent to consider home-country practices when admitting a new foreign FDI entrant.

Morike, supra note 23, at 60.
Ibid.
Ibid.
To avoid bearing liability of blame for violating the MFN principle, a host state may refrain from giving concessions to a particular investor to promote investment since it will be faced with a floodgate of overwhelming demands to extend the same concessions to every investor. This will exacerbate environmental pollution. It is important that caution be exercised in the application of this principle based on the level of pollution a host state is prepared to endure. If floodgates are opened, then such caution will be overridden. Further, given that BITs provide for reference to arbitration by the foreign investor an investor who is not covered by such a treaty may apply this principle to found jurisdiction on an arbitral tribunal in a dispute involving environmental regulation. This possibility is likely to expose a host state to investor-environmental regulation disputes that may lead to a "regulation chill" on the part of a foreign investor.

The principle's merit in promoting better environmental standards ought not to be ignored. It is imperative to appreciate the important role that the principle of MFN may play in promoting environmental protection. Investors can use environmental standards as competitive tools to exert pressure on other investors. For example, an investor with extensive experience in managing the environmental aspects of a particular industrial or production undertaking in his or her home country may seek more stringent environmental standards when investing in another country, expecting that MFN treatment will lead to the spread of these standards to competitors without equivalent experience. The net effect will therefore be improved environmental protection.

3.6 Conclusion

The FDI protection regime coalesces around four principles. These principles are the international minimum standard, rule against uncompensated expropriation, national treatment and most-favoured nation. These principles have been shown to impede sustainability of environmental management in host states. These principles significantly constrain host states' regulatory function in pursuit of sustainable environmental management. To achieve harmony between FDI and sustainable environmental Management it is important to apply these principles. This will secure environmental regulatory measures that may be well meaning, but because of their effect may be said to teaching these principles to the detriment of a foreign investor. Balance between the
application of FDI protection principles and the principles of environmental management
principles in an FDI setting is critical.

A paradigm shift in the interpretation of FDI protection principles is necessary. In this
connection, the soundness of the FDI principles is not in issue as such. The focus is on
their application in the realm of environmental management. Application and
interpretation of the principles in a manner that integrates environmental regulatory
functions of the host state should be embraced.
CHAPTER FOUR

DISPUTES SETTLEMENT IN FDI AND ENVIRONMENTAL MANAGEMENT

4.1 Introduction

This chapter will analyse some FDI disputes touching on environmental damage and seek to assess the extent to which their resolution entrenched the protective character of the FDI regime. The level of non-integration public interest of host states in the FDI protection regime will be gauged. Adequacy of the FDI protection regime in accountability for the malpractices of MNCs will be assessed. The norms of the FDI protection regime that may defeat the efforts of a host state in holding foreign investors responsible for environmental damage by way of compensation to remedy the damage will also be considered. The application of unilateral reference of such disputes to arbitration by the foreign investor will be queried. The extent of collusion of home state of the investor or the investor itself with the host state to defeat foreign investment-environmental damage claims will be analysed. Usage of such legal concepts as forum non conveniens, limited liability concept and the doctrine of separate legal entity will also be critically examined. This will lay basis for making a case for a paradigm shift towards the "corporate enterprise liability" concept in attributing environmental liability to MNCs.

4.2 Local Remedies Rule and Unilateral Reference to Arbitration

In the past, disputes arising from treaties were resolved by state-to-state arbitration or adjudication at the International Court of Justice. Since the early 1980s, bilateral investment treaties (BITs) have introduced investor-to-state arbitration rules under which a foreign investor can directly sue a host state for an alleged violation of certain treaty Provisions. This effectively takes away the disputes from the jurisdiction of the courts of host states. The sovereign right of the host state in controlling foreign investors is thereby

undermined. Ideally, foreign investors should also be subject to the jurisdiction of the host state like national investors. Arbitration tribunals for settlement of investment disputes involving the foreign investor and the host state have become the norm. BITs that are negotiated between host states and capital exporting states on behalf of their nationals entrench a unilateral right on the part of foreign investors to take investment disputes to arbitration. In harking back to chapters two and three of this work, it will be recalled that FDI law is enmeshed with the principle of minimum international standard of treatment which brings external standards of treatment into the investor-host state equation. This seems to be the foundation for granting arbitral tribunals jurisdiction and effectively taking away investment disputes out of the reach of domestic courts.

Investor-state arbitration opens up the host state to challenge of its sovereign authority. Its efforts at protecting the environment through new environmental legislation or regulations are met with arbitral claims. Thus, a range of measures that would not be challengeable in domestic courts under traditional administrative law rules are brought to arbitration under a mechanism for redress only available to foreign investors. We argue that foreign investments should be subject to the national courts of the host state to the fullest extent. Courts of the host state are better placed to appreciate and balance the competing interests of FDI protection and environmental management. Gathii argues that international investment arbitration proceedings indicate how FDI law has empowered private actors, such as multinational corporations, to bring suit against States hosting their investments. He further argues that by giving private actors the power to sue and have a choice with regard not only as to forum but also choice of law, vests these actors with enormous legal authority over host States over which they may already exercise significant market leverage.

Investment arbitration embodies the confidential and secretive nature of the international commercial arbitration process. Neither the pleadings nor the oral hearings are typically disclosed in public. The proceedings are conducted in private and the outcome of disputes is not made public unless the parties agree to it.


*Ibid*
made available or accessible to the public, and the final decisions of the tribunal are released only with the consent of the parties. Arbitral tribunals being privately constituted and as they conduct their business in private and confidence important public interest matters such as environmental management could be suppressed. Foreign investors often refer disputes to the arbitral tribunals at their instance, that is to say, unilaterally. The host state does not, normally, have footing to initiate the arbitral proceedings.

Moreover, a tendency has developed amongst such arbitral tribunals in disregarding environmental protection functions of host states in deciding FDI disputes as emerged in chapters two and three of this work. Kate Miles points out that foreign investment protection law and environmental protection measures have clashed in a series of arbitral decisions.\(^5\) This has given rise to an outcry by host states. For instance, Bolivia denounced the ICSID Convention and withdrew from it, arguing that multinational corporations have used the ICSID Tribunal to resist the exercise of sovereign responsibilities such as promulgation and enforcement of environmental laws and standards.\(^6\) It is submitted that FDI protection law as applied in investor-state arbitration has the de facto effect of constraining governments in decision-making on domestic policy such as the protection of human health and the environment. The approach of dealing with such matters should not be dictated by the FDI protection regime.


International Centre for Settlement of Investment Disputes (ICSID), List of Contracting States and Other Signatories to the Convention 2\(\text{http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ContractingStates}\) and eqFrom=Main accessed on 1 October 2010.
4.3 The Cases

Various notable conflicts and controversies that have taken place in the past test the level of non-engagement of the FDI protection regime with the impact of investor activities on the local communities and environments of host states. These include: the Chevron Texaco Corporation case in Ecuador\(^7\); the Broken Hill Proprietary Company ("BHP")\(^8\) dispute in Ok Tedi, Papua New Guinea; the Union Carbide case in Bhopal, India; the Kenyan Maasai case of Ole Njogo v Attorney General\(^10\); and the Nauru case\(^11\).

4.3.1 The Broken Hill Case of the Ok Tedi Mine

The case of The Broken Hill Proprietary Company Limited and Another v Dagi and Others\(^17\) involved an environmental dispute resulting from FDI activity in a mining operation at Ok Tedi in the state of New Papua Guinea. The Broken Hill Proprietor Company Limited ("BHP") was the majority shareholder. The mining operation released 70 million tons of mine tailings and waste rock residue into the Ok Tedi and Fly Rivers every single year since 1984.\(^13\) This toxic sediment raised the river beds, causing the flooding of a 1,300 kilometer area and smothering of rainforest in a process the United Nations Environment Programme ("UNEP") christened "dieback".\(^14\) As a consequence.

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Chesterman supra note 7, Jessie Connell, "Trans-National Environmental Disputes: Are Civil Remedies More Effective for Victims of Environmental Harm?" (2007) 10 Asia Pacific Journal of Environmental Law 39; Also see NGO commentary on the environmental degradation from mine tailings on Polly Ghazi; World Resource Institute, Unearthing Controversy at the Ok Tedi Mine (July 2003) <http://newsroom.wri.org/wrifeatures_text.cfm/contentID=1895> accessed on 1 October 2010.


\(^{10}\) Ole Njogo v Attorney General (1913) 5 E.A.P.L.R. 70.


\(^*\) The Broken Hill Proprietary Company Limited and Another v Dagi and Others (1997) 2 VR. 117.


UNEP, Waste from Consumption and Production - The Ok Tedi Case supra note 13.
the waters became heavily polluted and in turn poisoned vegetation, fish, and animals. The ecology of the substantial parts of the rivers was left virtually lifeless. The contaminated rivers and soil affected the subsistence lifestyles of local indigenous peoples reliant on the environment for survival. Hunting lands, gardens and crops were lost, fish in the rivers were destroyed, drinking water was contaminated and the number of birds and wildlife were diminished.

In seeking redress for this damage caused by the mining operations of BHP's subsidiary, the local indigenous peoples brought action in the domestic courts of the investor BHP in Australia, Victorian Supreme Court. It proved difficult to obtain compensation from the parent company for the environmental degradation. The jurisdictional doctrine of forum non conveniens was not directly invoked in this case. The Australian legal position on the doctrine of forum non conveniens is that a stay of proceedings will only be granted if the forum is "clearly inappropriate", that is to say, it is oppressive or vexatious. Knowing this position BHP could not raise it, as, clearly, it would have been futile to do so. Effectively, the jurisdictional doctrine of forum non conveniens was raised indirectly in contempt proceedings that ensued. BHP sought to prevent the proceedings through collusion with the government of Papua New Guinea. The government agreed to enact legislation criminalizing the bringing of compensation claims against BHP. The plaintiffs then filed an application in the Supreme Court of Victoria requesting that BHP be found in contempt of court, arguing that BHP’s actions in collusion with the New Papua Guinea government were "designed to intimidate them and dissuade them from continuing to press their claims before the court." The court upheld the plaintiffs

Heather G. White, "Including Local Communities in the Negotiation of Mining Agreements: The Ok Tedi Example", (1995) 8 Transnational Law 303, at 312.


o’loth v Manildra Flour Mills Pty Ltd (1990) 171 C.L.R. 538, at 551.

^ Miles, supra note 5, at 29.

^ sterman, supra note 7, at 322 - 323.

The Broken Hill Proprietary Company Ltd v Dagi (1996) 2 VR. 117, at 120.
argument and found BHP guilty of contempt. However, this ruling was overturned by the Court of Appeal on appeal on the issue of standing.

On appeal, the whole issue turned on whether contempt proceedings could only be brought by the Attorney-General for the State of Victoria. The Attorney-General had been granted leave to intervene in the contempt proceedings and, along with BHP, appealed the original finding of contempt. Ultimately, the plaintiffs, having been worn out in the battle, submitted to a settlement which was woefully little. This case demonstrates that, as solely an investor protection regime, FDI protection regime as presently designed does not take into account the plight of local communities facing environmental degradation and harm resulting from foreign investment activity.

4.3.2 Bhopal, India

In 1984 a lethal gas leak from a pesticide factory sent clouds of poisonous fumes across Bhopal, a city of one million people gave rise to the case of Union Carbide Corporation v Union of India and Others. Approximately 8,000 individuals in the week following the disaster were killed. An estimated additional 20,000 people have since died from illness and injury resulting from exposure to the toxic gas. Up to 150,000 residents of Bhopal suffered severe injuries. Union Carbide Corporation, an American MNC, operated in India through its subsidiary, Union Carbide of India Limited. This Indian company owned the pesticide factory responsible for the disaster. By early 1985, multiple proceedings had been filed in the United States against Union Carbide seeking damages in the neighbourhood of 50 billion US Dollars. At this point, the Indian government stepped in, consolidated these proceedings pursuant to the Bhopal Gas Leak Disaster

22 ibid.
23 ibid.
Union Carbide defended the proceedings. It cited the jurisdictional doctrine of *forum non conveniens* and urged the ground of separate corporate personality in its defence. It argued that the United States was an inappropriate forum for the resolution of the dispute. It also argued that it was not responsible for the activities of the Indian company and was entirely unconnected with it. It argued that there was no such thing as a "multinational corporation" and that it was an entirely separate and distinct legal entity from the entity the plaintiffs should have been pursuing. India countered with an argument it described as "multinational enterprise liability", arguing that the parent company functioned in all material respects as the same enterprise as the Indian subsidiary and that conduct specifically connected to the cause of the Bhopal incident occurred in the United States. Further, India argued that a collective group of companies operating as a single economic body under the control of one multinational corporation should be regarded as one single entity. This argument links a direct level of control between the parent company and its subsidiaries, and asserts that the parent company should be liable for the activities of its subsidiaries. The proceedings were ultimately dismissed on grounds of *forum non conveniens* and judicial comity of nations.

In 1986, proceedings were filed in the District Court of Bhopal and a settlement reached on a figure of US $470 million. Miles argues that India's apparent desire to attract new FDI was a factor in its acceptance of such a woefully inadequate compensation sum and that the government did not wish to discourage potential investors with a large settlement or continued litigation. The outcomes in this case indicate the unresponsiveness of the FDI protection regime to the impact of FDI on local communities and the environment.


Ibid.

Union of India v Union of Carbide Corporation, Bhopal Gas Claim Case No. 113 of 1986.
4.3.3 Aguinda v Texaco: The Indian Rain Forest Case

Kimerling observes that the discovery of commercial quantities of oil in the Amazon rainforest in Ecuador in 1967 by a consortium of foreign companies (Texaco and Gulf, both now part of ChevronTexaco) was heralded as the salvation of Ecuador’s economy, the product that would, at last, pull the nation out of chronic poverty and "underdevelopment." Suddenly, the discovery of oil became the centerpiece of this country’s economy to invigorate its modernisation and progress igniting a rush for oil. The commercial exploitation of this oil reserve was launched. By 1972 oil exportation commenced. The true effect of this exploitation was later to turn out to be a complete contrast with the triumphalist launch. For indigenous peoples in the Amazon rainforest, the arrival of Texaco’s work crews meant destruction rather than progress. Their homelands were invaded by outsiders with unrelenting technological, economic, and political power. The whole episode was disturbing to these peoples. The Amazonian peoples have over the years borne the costs of oil development without sharing in its benefits and without participating in a meaningful way in political and environmental decisions that affect them, and in fact constitute life itself for them.

When Texaco began its operations, Ecuador did not have a history of environmental protection, and there was little public awareness or political interest in environmental issues. But, a basic legislation was in place to manage environmental degradation arising from exploitation of oil. Since 1971, Ecuador’s Law of Hydrocarbons included boilerplate environmental directives which required oil field operators to "adopt necessary measures to protect flora, fauna and other natural resources" and prevent contamination of water, air, and soil. Similarly, Texaco’s production contract with Ecuador negotiated after the discovery of commercially valuable reserves and signed in 1973 required Texaco "to adopt suitable measures to protect the flora, fauna, and other


Ibid, at 415.

Ibid.

Ibid, at 416.

Kimerling, supra note 31 at 435.
natural resources and to prevent contamination of water, air and soil under the control of pertinent organs of the state.\textsuperscript{36} In addition, the generally applicable Law of Waters, adopted in 1972,\textsuperscript{37} and Law of Fishing and Fishing Development, adopted in 1974,\textsuperscript{38} included general provisions aimed at preventing pollution and thus protect the environment. The Law for the Prevention and Control of Environmental Contamination,\textsuperscript{39} dedicated entirely to pollution control, was promulgated in 1976. Texaco and other oil companies ignored the laws and successive governments failed to implement and enforce them.\textsuperscript{40} In effect, there was an "environmental law vacuum".

In this environmental law vacuum, Texaco set its own environmental standards, and policed itself.\textsuperscript{41} As can be reasonably expected, Texaco's own standards and practices did not include environmental protection or monitoring. Oil spills were treated exclusively as economic rather than environmental and human health concerns.\textsuperscript{42} It failed "to develop and implement contingency plans to contain and clean-up spilled oil and mitigate environmental damage, to provide affected residents with alternative water supplies when local waters were polluted, or to indemnify them when crops and natural resources were damaged."\textsuperscript{43} The government of Ecuador seemed ignorant of these goings-on which it should have known would generate large quantities of wastes with toxic constituents and presents ongoing risks of spills. Oil is very toxic and can harm aquatic life. It contaminates water with toxics. Spills from the trans-Ecuadorean pipeline and secondary pipeline systems have had "particularly devastating and far-reaching impacts, causing

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\textsuperscript{36} Decreto Supremo No. 925 [Supreme Decree No. 925], ch. IX, cl. 46.1, from General Guillermo Rodríguez Lara, President of Ecuador (Aug. 16, 1973).

\textsuperscript{37} Ley de Aguas [Law of Waters], Decreto Supremo No. 369 [Supreme Decree No. 369], R.O. No. 69, art. 22 (May 30, 1972) (Ecuador).


\textsuperscript{39} Ley para la Prevención y Control de la Contaminación Ambiental [Law for the Prevention and Control of Environmental Contamination], R.O. No. 204 (June 5, 1989) (Ecuador) [translated in Food and Agriculture Legislation, vol. 26-1 (1977)].

\textsuperscript{40} Kimerling, supra note 31, at 434.

\textsuperscript{41} Ibid. at 436.

\textsuperscript{42} Ibid.

\textsuperscript{43} Ibid.
major fish kills and destroying plant and animal life for hundreds of kilometers.\textsuperscript{44} The Coca River, a tributary of the Napo, and the Napo River were particularly hard hit.\textsuperscript{45}

The government of Ecuador only realised the enormity of the problem when it was highlighted by international environmental lawyers and commentators concerned with environmental protection in the Amazonian oil production region.\textsuperscript{46} Studies carried out in the regions were instrumental in Ecuador’s realization of its environmental protection duty.\textsuperscript{47} These revelations were a turning point for environmental protection in Ecuador’s policy. In part, it led to awakened consciousness in environmental concerns in Ecuador.\textsuperscript{48} The revelations also bolstered up the empowerment of local populations and put on the spot “their longstanding grievances to an international concern”.\textsuperscript{49}

Before Texaco’s arrival, Ecuadorian indigenous peoples lived in harmony with their rainforest environment.\textsuperscript{50} Oil exploitation violently disrupted their way of life. It created poverty among forest peoples by "damaging natural resources that provided them with secure, self-reliant, and sustainable sources of food, water, medicine, and shelter."\textsuperscript{51} Outright dispossession through exploitation of their environment diminished their lifestyle to almost nothingness. Industrial noise and chemical pollution from oil facilities degraded important natural resources, further straining the subsistence base of indigenous populations and limiting their range for hunting, fishing, gathering and gardening.\textsuperscript{52}

According to local residents, some forest species both terrestrial and aquatic have become more difficult to find; others have disappeared.\textsuperscript{53} Rainforest habitats have been reduced, fragmented, and degraded, and pollution saturates the oil fields, in addition to affecting

\textsuperscript{44} Ibid, at 459.
\textsuperscript{45} Ibid.
\textsuperscript{46} Ibid.
\textsuperscript{47} Ibid.
\textsuperscript{48} Ibid. at 464.
\textsuperscript{49} Ibid
\textsuperscript{50} Ibid, supra note 31.
\textsuperscript{51} Ibid.
\textsuperscript{52} Ibid.
\textsuperscript{53} Ibid, supra note 31.

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downstream and downwind areas. Rain is no longer clean, and residents say it now feels "slippery, like washing with soap." When Texaco began its search for oil, the area was covered with pristine humid tropical forest. An impartial and independent environmental audit by a Canadian consulting firm, HBT Agra Ltd, that was carried out on Texaco's facilities in 1992, months before Texaco's contract with Ecuador was scheduled to expire, confirmed the foregoing environmental effects as the impact of oil exploitation by Texaco.

In *Aguinda v Texaco, Inc.*, a class action lawsuit was filed against Texaco in federal court in White Plains, New York, on behalf of indigenous and settler residents of Ecuador's oil fields who had been harmed by pollution from the company's operations. White Plains is where Texaco had its headquarters. The case was an environmental tort action, based on common law claims of negligence, public and private nuisance, strict liability, trespass, civil conspiracy, and medical monitoring. The plaintiffs alleged that they and the class had suffered injuries to their persons and property and "are at a significantly increased risk of developing cancer as a result of their exposure" to toxic substances. They sought compensatory and punitive damages and unspecified equitable relief to remedy the contamination and spoliation of their properties, water supplies and environment. This case was an effort to environmentally hold a multinational corporation involved in foreign investment responsible for its environmental damage. It represented a golden opportunity for environmental justice and corporate accountability in the frontiers of FDI. The case did not see the light of day owing to the innovative transplant of legal principles and concepts by FDI protection law from other spheres of the law. In response to the lawsuit, Texaco denied any wrongdoing and vigorously fought the legal action. It applied for dismissal of the action on the grounds of international comity, failure to join indispensable parties (Petroecuador and Ecuador) and *forum non conveniens*. Texaco also argued that its operations had complied with Ecuadorian law and then prevailing industry practices. It argued that it had not operated in Ecuador since 1990, and any legal claims

54 Ibid.
55 Ibid.
6 Ibid, at 468.

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should be pursued there, instead of U.S. courts. It also argued that the parent company was not involved in oil exploitation in Ecuador, which was another way of claiming the separate entity defence.

Collusion between the foreign investor and the host government occurred in this case. The Ecuador government initially supported Texaco's efforts to have the lawsuit dismissed. It churned a diplomatic protest directed to the U.S. Department of State and subsequently in an *amicus curiae* brief, argued that the exercise of jurisdiction over the case would violate principles of international law and become a serious disincentive to U.S. companies that had invested in Ecuador, thereby harming the nation's economy. The diplomatic note stated that the lawsuit "could do severe harm to the Republic of Ecuador" and requested that the U.S. government advises the court that under international law, "jurisdiction over this case belongs exclusively to Ecuadorian courts." The U.S. government, home state of Texaco, intervened. The U.S. government through its appointed lawyer, who appeared in an *amicus* capacity, requested that the court "abstain" from accepting the case because it "may result in a substantial and unwarranted interference with Ecuador's sovereign right to develop and regulate its own natural resources and may strain the friendly relations between the United States and Ecuador." It argued that "Ecuador's sovereign right over its natural resources is paramount" and that the exercise of jurisdiction would violate the principle of international comity. The government brief stressed the importance of FDI and oil development to Ecuador's economic policies. It assured the court that the government of Ecuador "regulates its vast natural resources because it is sensitive to the threat to human and natural life presented by the development of its natural resources" and claimed that various governmental and

Embassy of Ecuador, Diplomatic Protest from Embassy of Ecuador to U.S. Dept. of State, No. 4-2-38/93 (signed by Ambassador Edgar Ter' an) (Dec. 3, 1993) (unofficial translation in Appendix to Texaco c.'s Motions to Dismiss, Aguinda v Texaco, Inc., No. 93 Civ 7527 (S.D.N.Y. Dec. 28, 1993)).

Kimerling, supra note 31.


nongovernmental organizations "monitor pollution and other environmentally harmful activity."  

In 1995, the case faced its first dismissal. In effect, the home state of the foreign investor denied the plaintiffs their day in court. The court ruled that the lawsuit belongs in Ecuador because it has "everything to do with Ecuador and nothing to do with the United States." It upheld the company and Ecuador's contention that the "Ecuadoran-centered" case did not belong in U.S. courts citing three grounds for the dismissal. The first was international comity, a doctrine of deference to the acts of a foreign state, when that recognition is neither required, as an absolute obligation, nor extended as mere courtesy. The second was *forum non conveniens*, a doctrine that allows a court to dismiss an action that could be litigated in a different court for the convenience of the parties and in the interest of justice. The third was dismissal for failure to join indispensable parties, on the ground that participation in the litigation by Ecuador and Petroecuador was necessary to afford plaintiffs the full scope of equitable relief they sought. In response, Ecuador which had a new President, Abdala Bucaram, reversed its opposition to the lawsuit and joined the plaintiffs in asking the court to reconsider the dismissal. This appeal was dismissed on the same grounds. On appeal to the Second Circuit Court of Appeals the determination based on the doctrine of *forum non conveniens* was affirmed subject to the condition that Texaco agrees to submit to the jurisdiction of Ecuador's courts and waive defenses based on any statutes of limitation that expired between the date the lawsuit was filed and one year after the dismissal. 

**4.3.5 The Maasai Case of Kenya**

This case involved the exploitation of resources of indigenous peoples for purposes of foreign investment. FDI protection law's innovation in manipulating legal doctrines and concepts, in order to advance its fist-tight FDI protection regime emerges in this case.

*Kimertling, supra note 31, at 437.*

Jbid, at 515.

*g v Texaco, Inc., 303 F.3d 470, 478-79 (2d Cir. 2002).*

Pre-colonial Masaai community was a subsistence society, trotting the Rift Valley from point to point depending on where the best pastures could be found. Gathii argues that "British colonialism in East Africa became a tragedy for the Masaai peasantry". In 1904 the ritual leader of the Maasai, known as Laibon, was cajoled by the British Protectorate government into having the Maasai vacate lush and fertile land traditionally used as their grazing grounds. They were to be moved into two Maasai reserves, the Northern Maasai Reserve and the Southern Maasai Reserve, and their land not to be expropriated again for British imperialism. In 1911, under pressure the British reached an agreement with the Maasai that the Maasai would be moved from the Northern Reserve and lumped up in the Southern Reserve to free up more land for settlers engaged in imperial investment. The Maasai alleged breach of the 1904 agreement. They brought a suit.

The suit was *Ol le Njogo v Attorney General* in which they alleged breach of the agreement, that the 1904 agreement "shall be enduring so long as the Maasai as a race shall exist, and that Europeans or other settlers shall not be allowed to take up land in the Masaai settlements." The Maasai argued that the 1904 agreement still survived as a civil contract notwithstanding the 1911 agreement. The British Protectorate government argued that the agreements were not contracts but treaties. The implication of this latter argument was that the purported confiscation of Maasailand was an Act of State, as an action under the "treaties," was not cognizable in a municipal court.

The Court of Appeal for Eastern Africa upheld the government's contentions on the basis that the Maasai were a sovereign entity with whom a treaty could be made by the Protectorate government, although they would not be governed by international law. They would, however, be governed by some rules analogous to international law, and would have the same force and effect to that held by a treaty, and must be regarded by municipal courts in a similar manner. Arguably, the court's reasoning was informed by

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*157; Also generally see James Thuo Gathii, "Imperialism, Colonialism, and International Law (2007) 54 (4) Buffalo Law Review 1013.
^[Ibid., at 72.
^[b]d. at 90 - 91.
the norms of FDI protection law in manipulating legal doctrine in order to grant maximum protection to a foreign investor. Shutting the doors to the Maasai ever reclaiming their confiscated land, the Maasai were now exposed to severe ecological changes to the much diminished land. Their lifestyle may not be sustained by the size of land left to them. Their desire to remain a distinct indigenous people may be shattered, since the land structure they were forced into has a potential of fracturing their identity as an indigenous people.

4.3.6 The Certain Phosphates in Nauru Case

The Case Concerning Certain Phosphates in Nauru (Nauru v Australia)\(^d\) (the Nauru Case) concerned grave environmental damage and sought several remedies against Australia at the forum of the International Court of Justice (ICJ). The case presented the stark plight of a people whose verdant island home, once known as "Pleasant Island," was transformed by mining into a scarred wasteland.\(^4\) The rehabilitation of the island was necessary for the survival of the Nauruans as an independent people. Nauru contained extremely rich phosphate deposits that are a very valuable source of fertilizer. Approximately a third of the island was mined out while it was administered by Australia. This extractive process was a foreign investment activity.

Anghie notes that the essence of Nauru's claim against Australia is the prejudice it continues to suffer as a consequence of Australia's failure to rehabilitate the lands damaged by phosphate mining. He notes that considerable uncertainty surrounds the applicable law in the realm of environmental damage of this type.\(^7\) He states that there are a number of complex and unresolved issues connected with causation, harm, and the status of lawful activities that cause transborder damage surrounding the question of responsibility for international environmental damage.\(^6\) This case was the first of its kind


\(^3\) Case Concerning Certain Phosphates Lands in Nauru (Nauru v Australia), ICJ (1990) Vol. 1 Memorial of the Republic of Nauru.

\(^4\) Anghie, supra note 11, at 446.

\(^5\) ibid, at 447.

\(^6\) ibid, at 481 - 482.
to be presented to the ICJ. Nauru looked to international law for a means of remedying the environmental damage. It is significant that the ICJ accepted jurisdiction. Unfortunately, the case did not proceed to hearing on merits. The unique opportunity for the ICJ to resolve the uncertainty surrounding international environmental responsibility and reparation, especially in the context of foreign investment was lost.

The case was settled by a "Compact of Settlement" between Australia and Nauru, which was signed on August 10, 1993.77 Under the terms of the Compact, Australia agreed to pay Nauru A$ 107 million.78 Australia was also to work jointly with Nauru towards rehabilitation and development activities in Nauru each year for the next twenty years.79 Anghie argues that this settlement represents, in effect, "Nauru's primary claim for the expenses associated with rehabilitating the lands mined out prior to independence."80 Nauru agreed to discontinue its ICJ action against Australia. Even though the opportunity to clarify the law was lost, this settlement speaks very positively of the rights of host states in relation to environmental responsibility for damage arising from foreign investment activity. It is at least some acknowledgement that there should be a grave concern for the environment.

4.3 Use of Legal Doctrine to Undermine Environmental Protection

The use of legal doctrine imported from general principles of law, as the foregoing caselaw indicates, is interwoven in the FDI legal regime. It is an attribute FDI law picked up as it was evolving in a context of colonialism and imperialism where manipulation of legal doctrine was heavily relied upon to further the expansionism objectives of capital exporting states. It uniquely and innovatively reaches out to, and borrows from, other fields of law such legal principles and concepts that would bolster up its principal purpose of FDI protection. Legal doctrine was innovatively manipulated and applied during the era of the Dutch East India Company to entrench the position of foreign
investors.\textsuperscript{81} Anghie points out that the innovative application of international legal doctrine in the seventeenth to the nineteenth centuries was engineered in order to support the political and economic aspirations of European expansionism. Gathii makes a similar assertion in the context of colonial Kenya. \textsuperscript{9} This expansionism desperately needed protection. European control reigned in the development of FDI law, and as such its rules that evolved did not take into account the interests of host states.

The resolution of environmental disputes arising from FDI is textured and burdened with the transplanting of general legal principles and legal concepts in order to accord maximum protection to foreign investment. As a sequel of this, the host state or its citizens are faced with an uphill task in holding multinational corporations that may be responsible for environmental damage accountable. In essence, legal doctrine is applied, as argued by Rogge, to shield multinational corporations from liability for damage resulting from their activities in host states. On these premises, we argue that the FDI protection regime facilitates multinational corporations as foreign investors to engage in transnational operations while denying the host states protection from damage they suffer in the process. The jurisdictional doctrine, otherwise expressed as \textit{forum non conveniens}\textsuperscript{*} and rules on corporate structure, separate legal personality, and limited liability, are commonly invoked to preclude the determination of a dispute by a home


\textsuperscript{9} Ibid, at 3-12, 65-114.

This is the central theme of his article: James Thuo Gathii, \textquote{imperialism, Colonialism, and International Law} (2007) 54 (4) \textit{Buffalo Law Review} 1013.

\textsuperscript{*} Ibid.

\textsuperscript{10} Malcolm J. Rogge \textquote{Towards Transnational Corporate Accountability in the Global Economy: Challenging the Doctrine of Forum Non Conveniens in Re: Union Carbide, Alfaro, Sequiuhu and Aguinda", (2001) 36 \textit{Texas International Law Journal} 299, 300 - 301; Also see Beth Stephens, \textquote{the Amorality of Profit: Transnational Corporations and Human Rights\textquoteright, (2002) 20 \textit{Berkeley Journal of International Law} 45, at 48.}

\textsuperscript{11} Rogge, supra note 85, at 156; Also see Judith Kimerling, \textit{Indigenous Peoples and the Oil Frontier in Amazon: The Case of Ecuador, ChevronTexaco, and Aguinda v Texaco", (2006) 38 \textit{New York University Journal of International Law & Policy} 413, at 661.}

state court. These are raised as defenses, and operate to defeat efforts at attributing environmental damage to the polluter. The jurisdictional doctrine of *forum non conveniens* empowers a court to decline jurisdiction to hear a case on the ground that that court is an inappropriate or inconvenient forum. This is a principle of conflict of laws whose original formulation and scope was to shield defendants from an abuse of court process packaged in the form of deliberate selection of an inconvenient forum by a plaintiff with the collateral purpose of harassing the defendant.

In the realm of foreign investment-environmental disputes, a plaintiff could be suing in the home state of the foreign investor to hold the investor responsible for environmental damage in the host state. This could be for sound reasons. Miles argues that the practical justification for filing action in the home state of the investor or its parent company included "the lack of assets and funds held by the subsidiary company, the potential for higher damages awards in the home state, and structural obstacles to plaintiff claims in their own countries, such as the lack of legal aid facilities or host state unwillingness to • •  • • regulate multinational corporations." — She further argues that there are ethical reasons for suing in home country as opposed to host country. These include the desire to close the gap between law and ethics and to ensure that corporate responsibility and accountability apply equally in transnational operations and home state activities. When this approach is invoked against foreign defendants by the defendant multinational foreign investor, such a plea defeats the efforts of protection of the environment in holding the polluter responsible. This becomes discriminatory against the foreign plaintiff


Chesterman, *supra* note 7, at 315.


\[93\text{ Ibid.}\]

\[94\text{ Ibid.}\]
who is pursuing the noble cause of promoting environmental protection. Environmental cases with merit may falter simply because of this doctrine. The disincentives to litigation to which the doctrine gives rise to are incredibly strong.

The separate entity argument is advanced on the basis that the home state parent company is a different entity from the host state investor, which is more often its subsidiary. This legal principle is founded on company law. The principle precludes a court from "piercing the corporate veil" so as to look behind the facade of separate legal personality of companies within the same "family" or group, as they are normally classified. Contesting the allegations, defendant corporations have often sought to rely on *forum non conveniens* arguments to dismiss proceedings, arguing that the country in which the alleged damage occurred would be the more appropriate forum. These multinational corporations have also argued that the claims are against the wrong defendant. As they are entirely separate legal entities from their subsidiaries and technically do not themselves have any operations in the country of the alleged damage, the proceedings should be against the subsidiary only. Arguably, multinational corporations through which foreign investment is implemented are difficult to hold liable for environmental damage in host states once one appreciates the profound effect of the separate legal entity and limited liability principles of company law. The presence of a foreign investor will normally be manifested in a host state through a branch company. This representative branch company will normally be a separate legal entity from the real investor who would be based in the capital exporting state. Because of separate legal personalities of the real investor and the entity implementing the investment it becomes impossible to attribute environmental liability the MNC as happened in the Bhopal Case in India.


In *Recherches Internationales Quebec c Cambior Inc.*, [1999] JQ No 1581 (Quebec Superior Court, 12 May 1999) a group of Guyanese plaintiffs brought a tort action in Canada against Cambior, a Canadian mining corporation, alleging that the MNC had dumped billions of liters of cyanide into two Guyanese rivers, injuring thousands. Although a Canadian court initially asserted jurisdiction over the case, it dismissed it on forum non conveniens grounds after determining that Guyana was an adequate alternative forum.

Using the above arguments which are legal formulations, the multinational corporation conveniently avoids liability for the environmental damage caused by its subsidiary. The practical solution left is for the host state to proceed against the subsidiary which may not have adequate resources to defray damages. This happens in spite of the fact that the real beneficiary of the foreign investment is the multinational corporation to whom profits of the investment are expatriated. The balance between bearing responsibility, in our case, environmental liability and the benefit derived from the cost and burden borne by the host state is greatly skewed against the host state. Miles observes that "the approach adopted in these cases has been to apply strictly the international rules on foreign investment protection, without allowing wider social and environmental objectives, policies and legal principles into the equation." She further argues that in not incorporating relevant developments from other areas of international law, FDI protection law has not yet adapted to the global socio-political shift in values that has been occurring over the years.

4.4 Collusion with Host State

This happens when a multinational investor attempts to influence the governments of home and host states. It is a common strategy employed by multinational corporations in disputes over their conduct. As evident from the Bhopal case the host state may legislate against an action brought against the multinational in its home state. Legislation could be passed by the host state to enable it take over such cases on behalf of plaintiffs. It could also happen by having the host state negotiate an amicable settlement on behalf of the plaintiffs. Such a settlement could be compromised, and more often than not may lead to much lower compensation. In this collusion process, legitimate legal processes under international law such as diplomatic relations between states may also be invoked. The propensity to compromise the host state is real, and it is based on the host state's fear of losing the investment to another country, reminiscent of the "regulatory chill". The fear could also be based on the picture likely to be painted of the host state as a destination for FDI. The foreign investor concerned may command enormous resources which dwarf a host state's resources, and thus tilt the negotiating power to its advantage.

Miles, supra note 5, at 91.
4.5 Conclusion

The manner disputes concerning environmental concerns arising from an FDI context indicate how deep the FDI protection regime is entrenched. The FDI protection regime, as presently shaped and textured, cannot be called upon to protect host states from the environmentally destructive and detrimental effects of foreign investment activity. Clearly, this state of affairs leaves a gaping hole in the regulation of foreign investment by host states. The dispute settlement mechanism under international investment law is eschewed in favour of foreign investors. It shields them from liability for environmental damage that consequentially arises from their investment activity. A vast majority of bilateral investment treaties entrench arbitration of state-investor disputes. These treaties grant foreign investors a unilateral right to institute arbitral proceedings. This practically shuts out the host state from seeking remedies through the arbitration process, if it ever desired to do so. Arbitration being a private process, it is questionable whether environmental issues which are a public interest matter should be subjected to a private process of dispute settlement.

The collusion of the foreign investor with the host state, and sometimes backed by its home state, is applied to defeat environmental damage claims brought by communities affected by environmental hazards of foreign investment activity. Legal arguments such as diplomatic relations and international comity of states can be relied upon in this manipulation process. FDI law innovatively borrows legal concepts and legal doctrines from other spheres to afford a foreign investor protection. The doctrine of *forum non conveniens* has been skillfully applied to shield multinational corporations from environmental liability arising from their FDI activity. The legal concepts of limited liability and separate legal entity are also pleaded as defences to distance a parent company of a subsidiary in its group from environmental liability arising from FDI activity. This gives impetus for advocating for a doctrine of "multinational enterprise liability" since MNCs are the principal vehicles of FDI.
CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the conclusions to the research through the application of the analytical framework to address the research questions with a view to confirming or disapproving the research hypothesis. Implications for policy in constructing an environmentally responsible FDI regime are also considered. The chapter takes note of study’s implication for further research. Overall, the study addresses the research gap in the integration of the norms of sustainable environmental management into the FDI protection legal regime.

5.2 Conclusion to Hypothesis

This thesis offers a study of the challenges FDI protection regime poses to construction of sustainable environmental management systems in host states. This study is undertaken within a sustainability and integrative framework. Through an in-depth analysis of FDI protection principles (Chapter 3), the thesis explores the extent to which the FDI protection regime undermines the norms, values and principles of sustainable environmental management.

5.3 Summary of Conclusions to Research Questions

5.3.1 What impact does FDI legal protection regime have on environmental management? How do the principles of the two legal regimes clash?

The FDI protection regime is strongly designed to protect foreign investments. The FDI-environment nexus indicates that FDI and the environment are closely
connected. FDI has serious implications on the environment. However, the FDI protection regime fails to integrate the environment into its fold. FDI principles foster the FDI protection regime and appear to muzzle the principles of sustainable environmental management. They protect foreign investment and shield it from either either regulation or accountability for environmental damage. The FDI protection regime, as presently shaped and textured, cannot be called upon to protect host states from the destructive and detrimental effects of foreign investment activity. This result leaves a gap in the regulation of foreign investment by host states.

The international minimum standard introduces an external standard of treatment of foreign investment, and negates the sovereign right of a host state in the control of foreign investment activity within its territorial jurisdiction. This stifles the regulatory function of the host state in environmental management.

The rule against uncompensated expropriation has been construed in such a way as to blur the distinction between environmental regulation and indirect expropriation. It looks at the effect of an environmental regulation as on a foreign investment establishment opposed to its purpose. It requires host states to compensate investors merely because of environmental regulation, a trend which appears to reverse the polluter pays principle. Host states are also likely to succumb to the "regulatory chill" for fear of being required to compensate affected investors.

The principle of national treatment critically plays an important role in muzzling environmental regulations. It is a significant constraint on the part of host states. Whenever a host state attempts to regulate in certain sectors whose environmental circumstances demand so it is, under the national treatment principle, exposed to claims based on the fact that such a step is discriminatory as against players in such an industry who may be foreign investors. Even when a host state is keen on extending similar treatment to all investors there is the difficulty of determining
whether the entities are in "like circumstances". In reality, it may be impossible to
determine whether entities are in like circumstances, and this becomes a loop hole
for striking down environmental regulations that could be rightly directed at a
particular industry or activity that is, for instance, more pollutive.

The most-favoured-nation treatment standard has an effect on lax environmental
protection if entry of investors is allowed based on environmental standards
applicable to already existing entities. It fails to appreciate that there may be need
to differentiate in order to avert further environmental damage.

5.3.2 Does dispute settlement under FDI legal regime promote
environmental responsibility?

The dispute settlement mechanism under international investment law has also
taken a protective angle towards foreign investment activity. A vast majority of
bilateral investment treaties entrench arbitration of state-investor disputes. These
treaties grant foreign investors a unilateral right to institute arbitral proceedings.
This practically shuts out the host state from seeking remedies through the
arbitration process, if it ever desired to use that route. Arbitration being a private
process, it is questionable whether environmental issues which are a public
interest matter should be subjected to a private process of dispute settlement.

FDI law innovatively imports legal principles and concepts from other spheres of
the law to advance the doctrine of foreign investment protection. The doctrine of
forum non conveniens has skillfully been applied to shield multinational
corporations from environmental liability arising from their foreign investment
activity. The legal concepts of limited liability and separate legal entity have
equally been applied to distance a parent company of a subsidiary in its group
from, and thus avoid, environmental liability. The principle of international
comity of nations comes into play. Intertwined with this is the unethical act of
collusion between the foreign investor and home state with the host state in order to defeat environmental lawsuits connected with foreign investment activity.

5.4 Implications for Research Theoretical Framework

This research has contributed empirical evidence showing that the notion of sustainability needs to be integrated into the FDI legal regime in order to have in place an environmentally accountable and responsible FDI. The framework is based on the theoretical foundations of sustainable development presented in Chapter 1. The framework typifies the assumption that an integrative approach is critical in the assessment of sustainable environmental management in FDI.

5.5 Implications for Policy Reforms

Sustainable development is at the centre of developmental processes. FDI is one of the components of the development process. The environment must be managed sustainably. Since FDI has a bearing on the environment, it is instructive that the norms, values and principles of sustainable environmental management be integrated into the FDI regime. This is framework upon which this thesis is premised. This framework could be of great use in designing appropriate policy for the development of an international FDI regime that integrates the requirements of sustainable environmental management.

5.6 Implications for Further Research

The implication FDI and its legal protection regime on sustainable environmental management has not received adequate attention by all actors. This situation is exacerbated by the lack of an international FDI regulatory regime. This study has an implication of further research in this area of concern within a broader perspective of sustainable development. It also creates an impetus of further legal research in the construction of an accountable and responsible FDI regime.
5.7 Recommendations

What reforms are necessary in constructing an environmentally responsible FDI legal regime?

The limits of the international minimum standard require to be redefined so as to leave room for the host state to regulate for the sake of environmental protection. This is all important since environmental management is not only a national duty, but an international one as well. There is need to realize that foreign investment should not become a means of undermining a host state's sovereignty. The principle of permanent sovereignty over natural resources should equally be taken into account when applying the international minimum standard. If the principle of permanent sovereignty over natural resources is given a strong emphasis, there will hopefully be a nice balancing of the interest of the foreign investor and those of the host state. At least, for such universally accepted principles of environmental law, there should be room to argued that the host state has an unfettered right to regulate.

We recommend a paradigm shift in the way expropriation is interpreted. Its scope should not step too much into the field of regulation. Regulation for a public purpose which is legitimate such as environmental regulation should not be construed as expropriation. BITs should provide greater accountability in the scope of indirect expropriation so as to engender a proper balancing of investor protection with effective environmental regulation.

The construction of the principle of national treatment ought to be done constructively so as not to defeat environmental regulatory measures that may be well meaning, but because of their effect may be said to be subjecting a foreign investor to a less favourable position. In the context of the standard of most-favoured-nation treatment care should also be taken to differentiate between investors. This is because investors with a lower compliance capacity, or even mention, could seek to benefit from concessions given to investors who have
already satisfied better compliance levels. The emphasis should be to apply these principles in a constructive manner, and not blindly.

The dispute settlement or resolution mechanism is in dire need of reform. It would be critical that the current decentralized structure comprising of non-accountable, temporary tribunals is replaced with a permanent two-tier forum incorporating an appeals system. Appropriate procedures should also be defined clearly in order to sufficiently benefit both the foreign investor and the host state. Such a system should provide a conducive environment for a reconsideration of the current expansive interpretation of international investment principles towards excessive protection of investors to the detriment of environmental management. The importation of legal principles, doctrines and concepts from other spheres of the law should also be reconsidered. FDI law should be developed so that it is governed properly under dispute resolution settings. The doctrine of *forum non conveniens* should be set aside to allow multinational corporations to be sued at their home state. The legal concepts of limited liability and separate legal entity should also be reconsidered. It is recommended that in lieu of the legal concepts of limited liability and separate legal entity a doctrine known as "corporate enterprise liability" be adopted in the realm of international investments given that it is implemented through a transnational corporate structure that may easily elude liability but while taking its benefits.

It should also be possible to utilise the courts of home states for civil actions relating to significant damage to the environment and others such as loss of life or for injury as a result of investment activity. Such a regime should also guard against collusion between the investor and the host state and also the host state in averting environmental accountability law suits.

Without a comprehensive international regulatory framework most of the problems bedeviling foreign investment protection in the light of the protective principles of FDI law will not simply go away. Some of the recommendations
made above will need to be consolidated under an international regulatory regime in order to achieve co-ordinated approach towards regulation. It is hoped that such a regulatory regime will provide an international avenue to pursue corporate accountability for their activities in host states. This initiative should harness the principles emerging from voluntary codes of conduct which have developed upon the backdrop of the negative effect FDI activity has on sustainable environmental management.

An international regulatory regime should define a new path for the reorientation of the substantive principles of FDI protection. It should define new approaches within international investment agreements or treaties. It should also introduce a procedural reform in investor-state dispute resolution mechanisms. It will also require a balancing of rights and obligations of the investor and the investor's home state. It should also firmly entrench and preserve the host state's sovereign right to regulate in the interest of the public including sustainable environmental management. This will ensure that FDI will not only promote development, but must also do so sustainably.
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ANNEX I

Agreement among the Governments of Brunei Darussalam, the Republic of Indonesia, Malaysia, the Republic of the Philippines, the Republic of Singapore and the Kingdom of Thailand for the Promotion and Protection of Investments (Association of Southeast Asian Nations).

Agreement Between the Caribbean Community (CARICOM), Acting on Behalf of the Governments of Antigua and Barbuda, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, St. Kitts and Nevis, Saint Lucia, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago and the Government of the Republic of Costa Rica (2004).


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37. Romanian Model Agreement on the Promotion and Reciprocal Protection of Investments.

38. South Africa Model Agreement for the Reciprocal Promotion and Protection of Investments.


40. Swedish Model Agreement on the Promotion and Reciprocal Protection of Investments.

41. Swiss Model Agreement on the Promotion and Reciprocal Protection of Investments.

42. Turkey Model Agreement Concerning the Reciprocal Promotion and Protection of Investments.

43. Ugandan Model Agreement on the Reciprocal Promotion and Protection of Investments.
ANNEX II

(a) Agreement Between the Caribbean Community (CARICOM), Acting on Behalf of the Governments of Antigua and Barbuda, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, St. Kitts and Nevis, Saint Lucia, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago and the Government of the Republic of Costa Rica (2004).

Article X.05 National and Most Favored Nation Treatment: [1]. In accordance with its laws and regulations, each Party shall accord to investments of the other Party in the former's territory, treatment no less favourable than that granted to investment of its own investors. [2]. Each Party shall accord to investments and returns of the other Party in the former's territory, treatment no less favourable than that granted to investments of investors of any non-Party. [3]. Each Party shall accord the treatment which is more favourable to the investment of the other Party, either national or most favored nation treatment.

Article X.06 Expropriation and Compensation: (1). Investments of either Party in the territory of the other Party shall not be nationalized, expropriated or subjected to measures having an equivalent effect (hereinafter referred to as "expropriation"), except in cases when any of such measures have been adopted for the public good, in accordance with the due process of law, on a non-discriminatory basis and against prompt, adequate and effective compensation.

Article X.11 Settlement of Investment Disputes Between One Party and Investors of the Other Party: [2]. If a dispute has not been settled amicably within a period of six (6) months from the date of the notification referred in paragraph 1 above, it may be submitted, at the choice of the investor concerned, either to the competent Courts or Administrative Tribunals of the Party in whose territory the investment was made, or to international arbitration.

(b) Dominican Republic-Central America-United States Free Trade Agreement.

Article 10.3: National Treatment: [1]. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances,
to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory. [2]. Each Party shall accord to covered investments treatment no less favorable 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.

**Article 10.4: Most-Favored-Nation Treatment:** [1]. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory. [2]. Each Party shall accord to covered investments treatment no less favorable than that it accords, in like circumstances, to investments in its territory of investors of any other Party or of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

**Article 10.5: Minimum Standard of Treatment:** (1], Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security. [2]. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments.

**Article 10.7: Expropriation and Compensation:** [1]. No Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization ("expropriation"), except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment of prompt, adequate, and effective compensation in accordance with paragraphs 2 through 4; and (d) in accordance with due process of law and Article 10.5.

**Article 10.17: Consent of Each Party to Arbitration:** [1]. Each Party consents to the submission of a claim to arbitration under this Section in accordance with this Agreement.
(c) **Canadian Model Promotion and Protection of Investments Agreement of 2004.**

**Article 3. National Treatment:** [1]. Each Party shall accord to investors of the other Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.

**Article 4. Most-Favoured-Nation Treatment:** [1]. Each Party shall accord to investors of the other Party treatment no less favourable than that it accords, in like circumstances, to investors of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.

**Article 5. Minimum Standard of Treatment:** [1]. Each Party shall accord to covered investments treatment in accordance with the customary international law minimum standard of treatment of aliens, including fair and equitable treatment and full protection and security.

**Article 13. Expropriation:** [1]. Neither Party shall nationalize or expropriate a covered investment either directly, or indirectly through measures having an effect equivalent to nationalization or expropriation (hereinafter referred to as "expropriation"), except for a public purpose, in accordance with due process of law, in a non-discriminatory manner and on prompt, adequate and effective compensation.

(d) **Federal Republic of Germany Model Treaty Concerning the Encouragement and Reciprocal Protection of Investments**

**Article 2: Minimum Standard of Treatment:** (1) Each Contracting Party shall in its territory promote as far as possible investments by nationals or companies of the other Contracting Party and admit such investments in accordance with its legislation. It shall in any case accord such investments fair and equitable treatment.

**Article 3: National Treatment and Most-Favoured Nation Treatment:** (1) Neither Contracting Party shall subject investments in its territory owned or controlled by nationals or companies of the other Contracting Party to treatment less
favourable than it accords to investments of its own nationals or companies or to investments of nationals or companies of any third State. (2) Neither Contracting Party shall subject nationals or companies of the other Contracting Party, as regards their activity in connection with investments in its territory, to treatment less favourable than it accords to its own nationals or companies or to nationals or companies of any third state.

Article 4: Expropriation: (1) Investments by nationals or companies of either Contracting Party shall enjoy full protection and security in the territory of the other Contracting Party. (2) Investments by nationals or companies of either Contracting Party shall not be expropriated, nationalized or subjected to any other measure the effects of which would be tantamount to expropriation or nationalization in the territory of the other Contracting Party except for the public benefit and against compensation.

Article 10: Arbitration: (1) Divergencies between the Contracting Parties concerning the interpretation or application of this Treaty should as far as possible be settled by the governments of the two Contracting Parties. (2) If a divergency cannot thus be settled, it shall upon the request of either Contracting Party be submitted to an arbitration tribunal.