Implications of International Trade and Investment Agreements for Water and Water Services: Some Responses from Other Sources of International Law

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May, 2006

This paper was prepared for the bolivian NGO “Agua Sustentable” as part of the project "Vision Social del Agua" for sustainable water management. The Economic Commission for Latin America and the Caribbean advised on the structure of the paper. The project’s overall funder is the International Development Research Centre (IDRC) in Ottawa, Canada.

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EXECUTIVE SUMMARY

This paper is divided into two parts. Part 1 describes the numerous interfaces between international trade law and international investment law on the one hand, and water management and resource allocation on the other hand. Part 2 describes how sources of international law outside trade and investment agreements can be used to rebalance the impacts of trade and investment law on water management decision-making.

Part 1 begins with the question of whether trade law can compel countries to trade freshwater resources. While the general conclusion is that it likely cannot, it is noted that the matter is not free of doubt. Indeed, some states, like Canada, have not banned freshwater exports because of advice from trade lawyers that to do so could breach WTO and NAFTA requirements.
Part 1 also considers the role of trade law in promoting privatization and access by foreign investors to water services delivery, in particular in developing countries. It notes how international investment agreements are also increasingly being used to promote liberalization and privatization in the water services sector. The reach of regional and bilateral agreements has, to date, been more penetrating in this regard, as compared to the WTO General Agreement on Trade in Services (GATS). However, ongoing WTO negotiations may expand national requirements to liberalize and privatize in the water services sector, both under the services negotiations and under separate negotiations on environmental services.

Part 1 also considers the impact of international investment agreements in non-water sectors, primarily for water-intensive sectors. Here, broader levels of investment liberalization are noted, especially through regional free trade and investment agreements. This may lead to additional pressures on pollution controls, future water allocation between foreign and domestic investors and other stakeholders, and water rights in indigenous and

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traditional communities. This is because international investment agreements create additional rights for foreign investors over those enjoyed by other domestic users. Moreover, these agreements today provide special remedies for foreign investors through what is known as investor-state arbitration under the international law rules of the agreements. This allows other domestic law issues to be avoided by foreign investors in certain circumstances.

Part 2 looks in particular at the use of these remedies and how the special rights of investors may be balanced by other sources of international law. This Part seeks to provide a way of thinking for reversing the singular touchstone of investor protection as the basis for interpreting and applying the rules under international investment agreements. In brief, Part 2 argues that the rights of the investor must be seen not in a vacuum, but in the context of a range of international law, general principles of law, international standards and domestic laws that relate to the establishment and operation of an investment. Focusing on the issue of investor-state arbitrations relating to water privatization, but setting out principles equally applicable in a range of other water-related contexts, it sets out some initial perspectives on how such additional sources can be brought to bear on investor-state cases in order to establish a more balanced legal approach to the interpretation and application of investor rights.

Part 2 concludes that there are significant opportunities within the structure of international investment agreements and investor-state arbitrations for sources of international law outside of the treaties themselves to be raised in an arbitration. These sources include other treaties, customary international law and general principles of law. These in turn allow a range of other legal principles relating to the formation and execution of contracts, and governmental regulation of such works, to be raised. These other principles include, for example, anti-corruption principles, duress or undue influence, abuse of position, unconscionability, constructive knowledge and constructive notice. The applicability of such principles as regards the formation of investment agreements, their implementation, and the subsequent application of new regulatory measures are considered.
Finally, the role of related areas of international treaty law and customary international law on sustainable development, human rights and transboundary water agreements is briefly explored.

The paper concludes that all of these areas of international law and general

principles of law may, in appropriate circumstances, be brought to bear in an investor-state arbitration. This can be done to assist in the interpretation of the rules contained in international investment agreements, and to assist in balancing the application of these rules with other sources of law heretofore neglected or downplayed in the arbitration process. These options should be further considered in water-related arbitrations.

INTRODUCTION

There are two primary goals to this paper. The first is to give a broad overview of how water management and water services issues are impacted by international trade and investment agreements. In fact, not many international economic agreements, be they trade or investment, expressly address water management and water services issues. But almost all of them can (and many now do) have direct or indirect impacts on trade in water, management of water resources and water services, and allocation of water use rights.

On a previous occasion,[2] the present author has undertaken an in depth review of the full range of potential and actual legal linkages between international trade and investment agreements and water issues. Part 1 of this paper will summarize the previous findings, and sets the context for some of the new thinking these relationships now require. With over 2300 international trade and investment agreements in existence, understanding their relationship to water management and services is becoming critical today.

Part 2 of this paper will consider various ways in which the same and other sources of international law might reduce or eliminate some of the negative impacts and concerns described in the first part of the paper. It will, in particular, begin an exploration of how other sources of international law and international standards can have an impact on the application of trade and investment agreements to water-related issues. This is an important, but often neglected question in the field of international trade and investment agreements. It is particularly germane to water-related issues, given the growing concerns globally over diminishing water quality and water quantity as medium and long term challenges. To what extent, for example, can the human right to water impact the interpretation of international investment agreements when disputes arise over water-related issues? This type of question is especially important in Latin America, where it appears that all of the water privatizations involving foreign investors undertaken in the 1990's in Argentina are now subject to arbitrations under various investment agreements, and others in Bolivia and elsewhere have been subject to actual, and are still subject to potential, challenges.

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[2] "International Economic Law: Water for Money's Sake?" I Seminario Latino-Americano de Politicas Publicas em Recursos Hidricos, Brasilia, Brazil, 22 September 2004, available at http://www.howardmann.ca/pdfs/WaterandInternationaleconomiclaw.pdf

The introduction to these various issues below cannot be understood as directly relating to any one of these arbitrations. There is insufficient information in the public domain for someone not personally involved in the proceedings to be able to comment on how any issue raised here might play out in the concrete circumstances of a specific case. However, it is hoped that an introduction to these issues may highlight which are more relevant and which less relevant for future consideration in general research terms, or for application in any specific circumstances.

PART 1: TRADE AND INVESTMENT AGREEMENTS AND WATER

Trade dates back thousands of years. The ancient Silk Roads from China, the empires of the Greeks and Romans, the cross-Mediterranean reach of the Moorish empire (which included trade in services: a Spaniard was personal physician to the ruling king of Egypt for some time in the Moorish period), the colonialist empires of the European powers, and the restructuring of nation states with the Treaty of Westphalia all had major trade and economic aspects. The protection of the means of trade also has a long history. The freedom of the seas, possibly the first of many international rules relating directly or indirectly to water, had a distinct origin in the promotion of trade, as did the outlawing of piracy on the high seas.[3] The promotion of trade under international law is not new to this era of globalization, nor is the linkage between trade and water in one way or another.

What might be termed the modern age of trade law began in 1947, with the drafting of the Havana Charter that sought to establish an International Trade Organization as part of the Breton Woods financial institutions. This effort failed to get the necessary ratifications, but its substantive instrument on trade, as an annex to the Havana Charter, did enter into force. This was the General Agreement on Tariffs and Trade, 1947, the GATT. As the organizational component of the International Trade Organization never came fully into being, the institutional apparatus took on the name of the substantive instrument, and the

[3] 3 For proper reviews of the development of international trade law see, e.g., Michael Trebilcock and Robert Howse, The Regulation of International Trade, 2nd ed., 1999, Chapter 1; John H. Jackson, The World Trading System (MIT Press, 2d ed. 1997);.range of trade and trade-related agreements, covering issues from tariffs to non-tariff measures impacting trade, to intellectual property rights and investment in service sectors.

Secretariat thus became known as the GATT as well.

On January 1, 1995, the GATT became the World Trade Organization, following the conclusion of the Uruguay Round of trade negotiations. The WTO now incorporates a Over the last two decades, international trade has also evolved through a series of bilateral and regional free trade agreements (FTA), many of which follow the WTO model of a range of agreements or chapters on a range of trade and trade-related issues. The European Union is of course one such example, though it has moved from its origins as a trade union to a much more fully integrated economic and political union. The North American Free Trade Agreement (NAFTA) was a pioneering FTA, being the first to link a developed and developing country into one regional FTA. The US-Central America Free Trade Agreement has since followed, and a multitude of other agreements are being negotiated in most regions of the world, though with varying depths of commitments.

At the same time that trade law has expanded in recent decades, so has international investment law. In many cases, investment has been addressed as part of trade agreements. NAFTA, for example, includes its Chapter Eleven on Investment. Other US and Canadian agreements, like the US-CAFTA or Canada-Chile FTA, include chapters on investment. But the major source of international investment law is found in the Bilateral Investment Treaties (BITs) and, increasingly, similar regional investment treaties. There are now some 2400 BITs that have been signed, and there are several regional investment agreements as well. Unlike trade law, this diverse universe of agreements has no institutional home such as the WTO, and lacks a comprehensive, consistent, standing dispute settlement process.[4]

1.1 Areas of interface between trade law and water

As trade law has moved over the last two decades from purely tariff and other border issues to incorporate things like trade in services and technical barriers to trade, its interface with water has grown. In the immediately following sections, this interface is summarized. The interface between international investment law and water is then considered in section 1.2. The implications for governmental decision-

[4] For some history on these see M. Sornorajah, The International Law on Foreign Investment, Second edition, 2004, pages 209-211

making are considered in relation to each specific issue.

1.1.1 Trade in Water

One of the most concerning issues in trade law today is whether trade law compels the trade in freshwater, through diversions, bulk shipment in tankers or similar bulk exports. It is well understood that bottled water, for example, is covered by trade law, and that restrictions on exports of bottled water are, therefore significantly limited.[5] In addition, rules on non-discrimination in non-tariff barriers to imports and exports also apply, precluding special limitations on the export of bottled water by a government.

What is less clear is whether trade law today can be used to compel the trade in freshwater, or water flowing in its natural state in lakes and rivers. While it is generally believed that a state cannot be compelled to export its water through canals, large tanker exports or other bulk transfers of water to neighboring or more distant states, the issue has not been formally tested and remains open to some doubt. This became a major issue in Canada prior to NAFTA's ratification in 1993. As a result, the three governments (Mexico, Canada, United States of America) issued a statement that water in its natural forms was not covered by NAFTA. However, when the Canadian government initially sought to re-enforce this view by banning the export of freshwater, government lawyers indicated this could not be done because it would be contrary to NAFTA. Thus, trade lawyers have sought to argue both sides of the coin, leaving legislators and others confused as to the proper state of the law.[6]

A second issue of relevance here is what might happen if some exports are allowed by a state. Would crossing the tripwire of allowing an export then compel a state to allow other exports? This is a very difficult question. What is clear is that an initial export unaccompanied by strict

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[5] Art. XI of the GATT, 1947, as renewed in 1994, for example, prevents quotas and other restriction on exports. Bottled water is covered by Art. XI. See General Agreement on Tariffs and Trade, in The Results of the Uruguay Round of Multilateral Trade Negotiations, The Legal Texts, World Trade Organization, 1995.

[6] 1993 Statement by the Governments of Canada, Mexico and the United States. This statement does not appear to have a formal name or number, but is referred to on many occasions by Canada and the United States. The author has a copy of the statement. In 2001, however, Canada adopted a licencing approach to trade in water as opposed to a ban. Government lawyers cited trade law as a reason for this. Bill C-6, An Act to Amend the International Boundary Waters Treaty Act, Legislative Summary, Library of Parliament, Parliamentary Research Branch, 12 February 2001, at p. 10-11, available at http://www.parl.gc.ca/37/1/parlbus/chambus/house/bills/summaries/c6-e.pdf

environmental controls that ensure it is not damaging to water supplies, local uses and ecosystems could lead to requests for non-discriminatory treatment of future water exports, i.e. that similarly lax standards be applied to other exports. Whether the initial application of high control standards would preclude claims to lower standards for future exports is not a settled issue either, though the weight of evidence today suggests that the continued application of non-discriminatory standards (applying equally to domestic water withdrawals as for export) would be sustainable.

In short, while common sense and some history indicates trade law cannot compel the trade in freshwater resources, the matter is not without doubt, doubt created at least in part by the trade lawyers themselves. This doubt can be compounded if a first export is allowed to occur, as additional limitations or conditions on exports subsequent to a first export may become more difficult to apply due to non-discrimination requirements under trade law.

As a result, governments must be conscious of the need to protect against initial exports of freshwater on a commercial basis. Where water withdrawals are allowed for export or for domestic diversion purposes, special controls to ensure water withdrawals are in keeping with the ability to regenerate supplies should be considered. Domestic priority uses, including agriculture and water supply services, should be understood as underlying water allocation decisions, and the ability of governments through the appropriate decision-making bodies to review, adjust and terminate water withdrawals must be protected to ensure long term management capabilities are certain. A complete ban on freshwater commercial exports can and should be considered where there is any doubt as to the medium and longer term viability of water supplies. This is one area where stopping a problem before it arises is essential.

It should also be noted here that the above issues do not have any bearing on the wide range of transboundary water agreements between states all around the world. These agreements, which establish water allocations in rivers and lakes that form or cross borders, maintain the capacity of states to regulate the allocation within there territories subject to the rights of downstream and co-riparian parties. The normal flow of water is not considered to be trade in water or to create assumptions relating to trade in water. On the other hand, the allocation rights and priorities established in these agreements can lend significant legal weight to arguments that support the banning or severe restrictions on trade in

water. This is returned to below.

1.1.2 Investment rights in the water sector under trade law

A second area where trade law today impacts on water is through the liberalization of water services sectors (water supply and sewage treatment). The WTO Agreements of 1994 included the General Agreement on Trade in Services, or GATS. Trade in services is very broadly defined by the GATS, and includes what is known as mode three of trade in services, "service by a supplier of one Member, through commercial presence in the territory of another member."[7] The language of commercial presence is a euphemism for "investment", which negotiators of the GATS were precluded from using in the text for political reasons. Politics notwithstanding, this now provides the opening for investment in the water service sectors to be included in the process of progressive liberalization that the GATS encourages, as well as limitations on the scope of regulation for covered service sectors.[8]

These opening positions indicate the potential for GATS to cover water services and, indeed, to compel water services privatization and access for foreign investors. However, the GATS does not do so at present. This is because of the structure of the GATS. It works on a "list in" basis, meaning all sectors that a state agrees to have covered by the GATS requirements must be listed in a schedule by that state for the GATS to create actual obligations for it (with possible limitations on its coverage as well). To date, it appears that no state has included water supply services in its schedule, though a limited number have included water sewage services.

But while the GATS at present does no compel any water services privatizations or access for foreign investments, the current Doha Round of negotiations includes two components that could reverse this. The first is ongoing negotiations to expand the scope and rate of investment liberalization under mode three. A formal declaration of negotiators in July, 2004, stated that no sector was to be excluded from the scope of requests and

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[7] General Agreement on Trade in Services, hereinafter GATS, Article 1.2(c), in The Results of the Uruguay Round of Multilateral Trade Negotiations, The Legal Texts, World Trade Organization, 1995.

[8] This last aspect arises under Article VI of the GATS, whose scope remains unclear in several respects. Elizabeth Tuerk, Aaron Ostrovsky, Robert Speed, "GATS and Water: Retaining Policy Space to Serve the Poor", Chapter 6 in Edith Brown Weiss, Laurence Boisson DeChazournes and Nathalie Bernasconi-Osterwalder, eds., Water and International Economic Law, Oxford University Press, 2005. Negotiations to add specific content to Article VI are ongoing as part of the Doha Round of WTO negotiations.

offers in this negotiation.[9] The second negotiation is on environmental services. Here, several developed states have now called for a reversal of the normal list-in approach to services negotiations. The EU and others have argued that all environmental services should be liberalized. The definition of environmental services that has been proposed in this regard is broad and includes water services. Thus, many states who are concerned with calls for privatization and liberalization of the water sector must now be concerned with the two tracks of negotiations opened up in this area.

The push for water services liberalization through the WTO mechanisms carries on unabated. How far it will succeed is not yet clear. Ensuring that the national policy of individual states on water services is maintained will be an important factor in the Doha Round of negotiations. Pressure in this area will become intense in the next year or so. For those states who believe that foreign investment in the water sector is in their interests, and there may be several reasons for this, one may consider several issues prior to establishing legal rights of establishment for foreign investors. First, there is no legal need to enshrine foreign investor rights in an international trade agreement in order to allow foreign investment in the sector. This can easily be done solely through unilateral domestic measures tailored for specific needs. Signing on to international commitments, however, may prevent any changes being made later, or require significant economic penalties to be paid to other treaty partners to make those changes. Second, states thinking of opening the sector to foreign investors should consider whether they have both the regulatory infrastructure needed to support such foreign private investment and the economic capacity to afford their costs in a sustainable manner.[10] Indeed, the experience in water supply management over the past decade indicates clearly that the successful inclusion of private enterprise requires more, not less, regulation. Water regulatory mechanisms must be able to foresee the needs of all users, provide mechanisms for adjustments over time, establish transparent decision-making processes, ensure the economic viability of the service and so on.

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[9] World Trade Organization, Doha Work Programme, decision Adopted by the General Council on August 1, 2004, WT/L/579, 2 August 2004, Annex C, para d.

[10] There is significant evidence, for example, that the failures of water privatizations in Argentina and Bolivia, and likely elsewhere, are due, as leading factors, to a combination of lack of proper legal and administrative structures, and improper calculations on the ability of rate payers to afford the rates necessary to maintain a privatized water system. (We turn to some other probable factors below as well.) See, e.g. Miguel Solanes, Efficiency, equity and liberalization of water services in Buenos Aires, Argentina, Presented at Service Expert Meeting-Joint OECD and World Bank, Paris, 3-4 February 2005. See also Andrei S. Jouravlev, Water Utility Regulation: Issues and Options for Latin America and the Caribbean, Economic Commission for Latin America and the Caribbean, LC/R.2032 11 October 2000.

Although there is a scarcity of literature on why privatizations and foreign investments in the water sector have failed, it is clear that in many cases the sequencing has been wrong: regulatory systems must be built before any privatization or foreign investment, not afterwards. Only then will the pre-conditions for a possible success, based on a proper assessment of the socio-economic factors as well, exist. A failure to sequence things in this way increases the opportunities for investors who have rights under bilateral or regional investment agreements, as described below, to exercise their rights and remedies under those agreements.

1.1.3 Water Trade and Water Services in Other Trade Agreements

While the WTO, through the GATT and the GATS, creates the best known trade linkages to water, they are not the only trade agreements that do so. Indeed, any bilateral or regional trade agreements with provisions similar to those found in the GATS and GATT will have similar impacts. This includes the most recently signed one between the United States and Latin American countries, the US-CAFTA. It is a useful example here, as there is no specific exclusion anywhere for freshwater from potential coverage of the trade-related rules. In the services sector, many regional agreements, especially those with the USA, reverse the GATS list-in approach and require full liberalization except for those sectors listed out. Of the CAFTA countries, only Costa Rica has listed out water services, meaning that all other Central American countries are now committed to allow for foreign investment in the water services sector if any privatization of ownership or service provision is allowed (i.e. as soon as it is not a fully public sector utility). The United States, however, has undertaken no such liberalization commitment, as it has excluded those areas subject to state jurisdiction from mandatory coverage, and water is a state-regulated service sector.[11]

The implications of this situation are exactly the same as described above, except of course that the Rubicon of services liberalization commitments has been crossed for most of the Central American countries. A failure to allow US based investors in the water sector to enter the markets where rights have

[11] United States-Central America Free Trade Agreement, available at http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/CAFTA-DR_Final_Texts/Section_Index.html, The list of exclusions is found in Annexes to the US-CAFTA FTA. The Central American states include Costa Rica, Guatemala, El Salvador, Honduras, Nicaragua, and the Dominican Republic as an additional partner.

been given can be the basis for complaints under the investment provisions of CAFTA. However, changes in water services regulatory regimes that have a significant impact on the investors may also be actionable and are likely to yield higher levels of awards due to the sunken time and costs of the investor in actually making and operating a facility or service. On balance, therefore, it remains preferable to ensure a proper regulatory and administrative infrastructure is in place before any new investments from foreign investors are permitted or contracted. An important component of these structures must ensure that the putative rate payers, who will carry the costs of the system, will have the means to do so.

1.2 Areas of Interface of International Investment Law and Water

International investment law can have several direct and indirect impacts on water management issues for governments at all levels. Three categories of issues are described here:

those pertaining to investment in the water sector,
those concerning investment in non-water sectors, and
the impact of investor-protection provisions after an investment is made.

1.2.1 Investment rights in the water sector

Like the GATS, investment agreements often have investment liberalization provisions. In investment agreements, these may also be called pre-establishment rights or rights of establishment. Where such pre-establishment rights are provided for, the agreement will stipulate whether this includes all sectors unless they are listed out (US-CAFTA) or only those sectors that are expressly listed in (GATS model).

To date, most BITs do not include investment liberalization provisions. However, the demand for them to do so is growing. In addition, many regional and bilateral free trade agreements do include investment chapters, and several have services chapters as well. Either of these can be avenues for including investment liberalization in the water sector, as we have already seen as regards the services chapter of the US-CAFTA FTA. Where an agreement has a services chapter, this will usually be the location for such commitments. Where it does not, the investment provisions must be carefully read to see if service sectors are included or not in the investment liberalization provisions.

1.2.2 Investment rights in non-water sectors

An increasing number of international investment agreements include pre-establishment rights in non-services areas. The most common context for such rights is bilateral or regional FTA's that include investment chapters. However, other bilateral or regional investment negotiations now also may include investment liberalization provisions in a range of sectors.

The scope of investment liberalization today in the non-service sectors is rapidly increasing. These sectors can include agriculture, heavy industry, forestry, energy sectors, chemicals and many others where water is an important factor in production processes. Again, the NAFTA and US-CAFTA provide good examples of this in the Americas, and long term commitments in ASEAN reflect a similar trend, though it is only prospective in nature in Asia so far.[12] When this liberalization occurs, foreign investors that come from a country that has secured such pre-establishment rights for its investors may enter that market under the same terms and conditions as its domestic investors "in like circumstances". "In like circumstances", or a similar phrase in almost all IIA's, sets the parameters for which foreign and domestic investors to compare. However, the meaning of this phrase is itself unclear, with some arbitration tribunals interpreting it very widely, and some very narrowly.[13] Thus, while social programs in the water sector that distinguish small producers and consumers from large ones, and poor consumers from wealthier ones, should normally be safe from concern, one cannot guarantee this will be so under all IIA's.

To some extent, this raises almost the same potential concerns as foreign investment in the water services sector. In many developing countries, for example, the host states or local communities do not have sufficiently developed water allocation or pollution prevention legislation. While lower standards may have been acceptable for smaller scale domestic investments, they often are not adequate for larger scale foreign investments, or to balance the rights and interests of foreign and domestic investors and water users. Yet, the absence of a properly structured set of rules for them does not

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[12] See, e.g, Framework Agreement on the ASEAN Investment Area, 1998, available at http://www.aseansec.org/6466.htm.

[13] See, eg. MDT Equity v. Chile, ICSID Case No. ARB/01/7, Final Award 25 May 2004 for a very broad interpretation comparing exporters in the oil sector to exporters in the flower sector, and Methanex v. United States, Methanex Corporation v. United States of America, Final Award of the Tribunal, August 7, 2005, where the most direct comparison available was called for.

act as a barrier to such investments being made. Indeed, this may even be a factor that supports an investment being made in some cases.

Once a host government agrees to accept an investment in a sector that is heavily water dependent, this will either expressly or by implication create the right of that investor to access the water needed for its investment to function properly. Unless the legal environment is clear that such rights must be balanced against the rights of others, and are subject to pollution controls and other related regulatory requirements, foreign investors can obtain significantly enhanced water allocation and use rights compared to domestic users. This is because the international investment rules for protection of an investment after it is made (discussed below) have a potential capacity to solidify the rights of the foreign investor over a longer period where no adequate indication of possible change in access rights and use rights is made clear. For example, a water use permit that does not clearly specify any time limits can be understood under the investment agreement as a guarantee of perpetual access, even if local custom operates in a different manner. While domestic users have no international law claims of this sort, those of foreign investors can be heard in international arbitration tribunals. No international arbitrations on water allocations in this context have arisen as yet. However, in other sectors where, for example, royalties have been increased in a significant way or tax regimes have been changed, large awards against these measures have been obtained by foreign investors.[14]

The legal grounds behind this situation, and the remedies included in the agreements, are described in more depth below. What is critical to understand here is that the rights of access and use of foreign investors can take precedence over domestic rights of access and over later measures to control water pollution. This becomes especially serious where the rights of other users, such as subsistence farmers and indigenous peoples, are often found in unwritten or customary practices rather than what international arbitrators would, in many cases, consider to be hard legal rights. As a result, the right to make an investment in sectors that have a significant relationship with water rights and with water quality concerns has important implications for the management of both water quality and water allocation where the investment takes place.[15] This puts a very high premium on the

[14] E.g., Occidental Petroleum v. Ecuador, Final Award, UNCITRAL, July 2004.

[15] The relationship between investments in water intensive sectors and trade law also manifests itself through the notion of trade in virtual water. This occurs when products that either contain large amounts of water (bottled water, soft drinks, beer) or products that take lost of water to produce (maize and other crops,

original investment permits, contracts or other forms of investor-government agreement that supports the initial investment. Ensuring sensitivity to all water users is critical in this regard.

1.2.3 Investor rights after an investment is made: a summary

Trade law applies to protect and promote trade in products and services. These can be understood as specific acts: the trade is consummated when the good or service (or service supplier) crosses the border and enters into the commercial realm of the importing country. Investment, by contrast, is an ongoing activity. Once an investment is made, there is usually an intention for it to operate for a significant period of time. As an operating business (using this term in a generic sense), an investment has multiple interfaces with national, local and potential state or provincial levels of government, as well as with the local communities in which they are based. Legal relationships can include areas of labour, health and safety, environmental, human rights, consumer rights, commercial activities within the state, and many more. Investment agreements apply not just to the making of an investment, but to this full panoply of governmental relationships during the life of the investment. Thus, where trade law applies to the entry into commerce of a foreign good or service, investment law applies to a much wider and ongoing set of relationships.[16]

The preceding section has discussed the implications of investment liberalization commitments in the water services sector and in non-water sectors with an important relationship to water use. Below, the rights available to an investor after the investment is made are described, along with their implications for government decision-making.

There are five key protections for investors that are relevant to the impacts of investment agreements to water services and water management, in

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livestock, chemicals, farmed wood, minerals) are traded. When they are traded to countries with water scarcity, it is assumed that the trade levels reflect, in part, the relative abundance or scarcity of water in the trading countries. The full dynamics and impacts of trade in virtual water are not known. However, there are both potential benefits for countries with abundant resources, and potential costs where foreign investors move in to harness water resources where it is less abundant or where rights of access are not well defined. A full discussion of this issue is beyond the scope of this paper, but its relationship to the issue of investment in water intensive sectors is worth noting.

[16] In fact, the primary role of investment agreements has always been to provide post-establishment protections for investors. The inclusion of investment liberalization provisions in such agreements began only in the 1990s and is still far from a universal component of new investment agreements.

particular in developing countries. In summary form, these key protections are:

- **National treatment:** This requires the host government to treat the foreign investor no less favourably than it treats its own domestic investors. Thus, higher labour, environmental, health or other standards, or taxes, cannot be imposed on a foreign investor unless the government has specifically excluded any specific standard or tax from the scope of the agreement. In water-related terms, a foreign investor could not, for example, have higher rates of water charges imposed upon it, or tougher environmental standards applied when compared to other investors in similar circumstances.
- **Most favoured nation treatment (MFN):** This requires a foreign investor to be treated no less favourably than the better of a domestic investor or any investor from a third country. It therefore extends the comparative net of the national treatment requirement to cover all other foreign investors as well.

  Both the national treatment and MFN provisions of agreements can be expressly excluded from application to certain sectors or certain laws and regulations through annexes that usually accompany investment agreements. However, this must be expressly done, usually when the treaty is developed.
- **Minimum international standards of treatment, fair and equitable treatment:**

  Unlike the national treatment and MFN provisions, this is an absolute standard defined by international law, not on a comparative basis with the treatment of domestic or other foreign investors. However, while it is not a comparative standard, it is intended to be a contextualized standard requiring fair and equitable treatment to be determined in the light of all the facts and circumstances. What this paper argues, in effect, is that the fair and equitable standard must also be seen in a relational manner, requiring treatment that is fair and equitable as between the different rights, obligations and interests of all the stakeholders, not just the foreign investor.[17]

  The precise nature of this standard is far from clear. Increasingly, it is emerging as a form of administrative law standard, invoking elements of transparency in decision-making, due process and the right to be heard, access to administrative or judicial review of decisions, plus

[17] A broader review of this issue is found in Howard Mann, "Is Fair and Equitable Fair, Equitable, Just, or Under Law?" 100 American Society of International Law Proceedings (2006), forthcoming.

liberal doses of fairness and equity in treatment. Patent abuses of administrative decision-making functions will fail this test, but lesser types of abuses, such as a failure to allow an appeal of a decision to be heard, may also fail the test. There is some evidence today that the test will be "scaled" by arbitrators to the level of development of the government in question, but there is no conclusive legal view on this question.

The minimum international standards/fair and equitable treatment tests may also be applied to decisions taken without any abuse of process. In particular, decisions that run counter to explicit or even implicit assurances given by a government official may also fail to meet the standard. An increasingly applied test in this regard is whether the government action or decision is consistent with the "legitimate expectation of the investor", a subjective standard that provides considerable scope for the investor to determine.[18]

In water terms, some examples of the potential breach of this standard could include an increase in water tariffs if none is foreseen in a license or the legislation underpinning a license, increased pollution controls that impact the profitability of a business and that are not clearly provided for in legislation underpinning an investment, reductions in water allocation levels for a water-intensive investment not foreseen in the initial operating decisions, or changes in water service provision contracts that impose increased service requirements, such as universal service. Where express assurances have been given that operating conditions will be maintained for a given number of years, changes to those conditions will found a basis for a claim. The absence of an express assurance will not, however, preclude a claim on this basis if there is no pre-existing regulatory base that foretells the right of government decision-makers to make later changes. In all cases, the presence or absence of a transparent decision-making process, founded in sound administrative practice, will be a very significant factor. Thus, following a pre-designed decision-making process will reduce chances for investor challenges of the result, while ignoring pre-designed procedures or not having any transparent procedures in place will increase them.

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[18] Recent decisions on this include Occidental v. Ecuador, Final Award, UNCITRAL, July 2004; CMS Gas v. Argentina, ICSID Case No ARB/01/8, May 12, 2005, and Thunderbird Gaming Corp v. Mexico, Final Award, UNCITRAL, January 26, 2006, with an accompanying dissenting opinion as well. This has direct parallels to the domestic law notion applied in several jurisdictions of "investment-backed expectations", in particular in the United States in relation to regulatory takings and other administrative conduct. See Michael Hantke-Domas, Common Legal Principles of Advanced Regulatory Systems, September 2005.

- **Protection from expropriation without compensation:** The protection against expropriation is also an absolute standard, not based on treatment of domestic investors. This protection is not a barrier to an expropriation taking place for a public purpose, but it does require fair market value compensation to be promptly paid for any expropriation. This is not a new concept from international law, and is widely applied in almost all domestic legal systems.

  What is new, however, is the potential extension of the notion of expropriation to government regulations that have an impact on foreign investors. It has been argued, with some success to date, that a normal regulatory measure that has a significant financial impact on an investor qualifies as an indirect or "regulatory expropriation." While this is alleged by some observers to come from US legal principles on regulatory takings, it is worth noting that no compensation to US investors appears to have ever been paid following the adoption of measures under the US Clean Air Act, Clean Water Act and similar pieces of classic environmental protection at the federal or state levels.

  At the international level, investor-state arbitrations and the literature on this question go in divergent, irreconcilable directions, often based on predisposed ideological views on property rights and governmental regulations in general as often unnecessary interferences with private activity.[19] This in itself has left many governments in confusion as to the state of the law and how much of the traditional state right to regulate is removed by the broader claims for the definition of expropriation. For example, it is not clear whether an increase in pollution control levels that might cause an investment that is not capable of adapting to close would amount to an expropriation of that investment. Or, if a product is banned from sale and consumption due to its potential toxic characteristics, is that an expropriation? Then, if one adds as a twist on this example a commitment by a previous government not to change the environmental controls for a long period of time, and that commitment is rejected by a subsequent democratically elected government, would that alter the equation? Many arbitration decisions suggest it should, including the *Methanex*

[19] For example, the recent final award in Methanex Corporation v. United States of America, Final Award of the Tribunal, August 7, 2005, ICSID case No. ARB (AF)/97/1, 2000, under NAFTA cannot be reconciled with the first NAFTA decision on expropriation in Metalclad v. Mexico. For a discussion on this point see Howard Mann, The Final Decision in Methanex v. United States: Some New Wine in Some New Bottles, IISD, 2005 at http://www.iisd.org/publications/pub.aspx?id=719.

v. United States decision, arguably the most favourable decision from a state right to regulate perspective to date under NAFTA.[20]

Uncertainty as to the scope of the expropriation rules has potentially serious consequences for regulators in developing countries. In part this is due to a lower level of regulatory standards to begin with, which may put a higher premium on the need to raise standards during the life of an investment. But one must also anticipate in the life of any investment the need for the regulatory environment to change over time, as community needs and knowledge change. For all countries, there is a concern that the potential for a foreign investor to initiate a claim under the expropriation rules may create a chill over new regulations being initiated. For developing countries this risk is even greater as the potential damages awards if a measure is found to be an expropriation may create higher budget stresses on developing countries. If investments are made in the absence of an appropriate regulatory framework, the effort to introduce one may, therefore, be made more difficult or even impossible due to the uncertainties in the scope of the expropriation provisions in the investment agreements.[21]

- **Freedom from the imposition of performance requirements:** Finally, there is a provision that is becoming increasingly popular in investment agreements. This is the prohibition on the imposition of so-called performance requirements on foreign investors. Such requirements may include minimum levels of domestic purchasing to supply an investment, tying export levels to foreign exchange levels, imposing specific technical standards on business operations, setting minimum numbers of home state managers or directors, and more.

  The major characteristic of performance requirements is that they reduce the independent business decision-making capacity of the investment and may reduce its efficiency from the perspective of the investor. The goal of the performance requirements for the government imposing them is to increase the benefits of the foreign investment for the host state or community. The imposition of such requirements is increasingly being proscribed by investment agreements. In a water context, this could include requiring specific

[20] Methanex Corporation v. United States of America, Final Award of the Tribunal, August 7, 2005. Part IV-Chapter D-Para. 7.

[21] One of the great premises of trade and investment liberalization is that the higher living standards that this will bring will lead to calls for higher levels of environmental and human health protection as incomes levels rise and governments can afford more. The risk is significant that the expropriation provisions in investment agreements will reduce or in some cases even eliminate the application of this premise in practice.

technologies to be purchased locally to control water pollution, requiring local suppliers to have a given percentage of supplier payments, or forcing a water services company to have high numbers of local citizens on its management team.

Each of the above, which are simultaneously rights of foreign investors and obligations of their host states, applies to the full life of an investment, not just its initial establishment phase. Further, they apply to all actual foreign investments subject to an agreement, whether made before or after the agreement enters into force, and whether the investment is made pursuant to specific rights of establishment or the simple application of domestic laws on establishing a foreign investment. Thus, investor rights can be very broad, and should be understood as applying to the full lifespan of the investment. The breadth of the rights has also been expanded in some interpretive constructs due to the absence of express obligations on investors or rights of states in relation to the investments, issues returned to later below.

The implications noted of each type of investor right for governments thus extend not just to the immediate decision on allowing an investment, but throughout its lifespan. This imposes a large burden on setting the right domestic law framework for the initial decisions on foreign investments, as well as ensuring that the host state has the economic capacity to support the potential success of the foreign investment.

1.2.4 Investor remedies under investment agreements

The rights of foreign investors are backed today by special remedies in most of the IIAs. Indeed, it is widely recognized that one of the major features of post 1980s international investment agreements is the articulation of special dispute settlement procedures for foreign investors. The so-called investor-state dispute settlement process was developed from international commercial arbitration models between private sector firms. Recent estimates indicate it has been invoked over 220 times since it was first used in 1984, with about 150 such arbitrations commenced since the year 2000.[22]

The investor-state arbitration process allows foreign investors to initiate an

[22] UNCTAD, IIA Monitor No. 4 (2005), Latest Developments in Investor-State Dispute Settlement, 2005, indicates that there were 219 known arbitrations by November, 2005. More have been initiated since then.

international arbitration process composed of three arbitrators. A notice of arbitration is sent by the investor to the responsible government official to begin the process. Each "side" chooses one arbitrator and a "neutral" is then jointly chosen or appointed by a third party. Most of these arbitrations take place behind closed doors today, with only those under the investment rules of Chapter 11 of NAFTA and a few recent US agreements in public.[23] In most cases the final decisions are made public, but not in all cases. There is no appeal from the arbitral decision, only more limited forms of review that apply to correct what can loosely be described as egregious errors by a tribunal.

In looking at a claim by an investor, the Tribunals apply first and foremost the provisions of the treaty on which the claim is based, and other sources of international law that may be relevant. However, they may also review domestic legal issues and review breach of contract claims in the place of domestic courts if the investors phrase the legal issue as a breach of the treaty as well as of domestic law. Thus, the tribunals can have a very broad mandate in regards to a complaint by an investor, and can usurp the role of local courts in contract disputes or other circumstances. At the same time, this is usually done from the perspective of applying the investor rights to such other legal rules, rather than a perspective of balancing rights and obligations of different stakeholders.

The transposition of the commercial arbitration model to the investor-state arena has led to a number of problems arising. These include a systemic conflict of interest in that many active arbitrators also serve as lawyers in other cases or have partners that do so;[24] inconsistent decisions exacerbated due to a lack of an effective appeals process; the usurpation of domestic court roles in contracts and other disputes; secrecy through much of the process; and more.

As already noted, there are over 220 arbitrations known to have been commenced under this process. While certainly not all are won, several recent awards have reached over $100 million in damages against host states, including two recent decisions in South America. This is, therefore, a very significant feature of the investment agreements. Not all BITS or other

[23] For Latin America, this includes the US-Chile FTA and the US-CAFTA-DR FTA.

[24] When only the financial dealings of private companies are involved, how they resolve their disputes may be less important than when a balance of public and private interests is involved, as it is in the investor-state cases.

investment agreements include investor-state dispute settlement. However, it is sufficiently widespread to assume for present purposes that most if not all of the agreements that one will encounter in practice today in relation to water issues will have such a process.

In addition to the need for care in appointing arbitrators for an investor-state arbitration, and the costs of preparing a defence, the investor-state process carries other risks for developing countries in particular. For example, they may not have sufficiently well trained lawyers for the highly specialized process that is involved. Awards, as already noted, can be very high, with several cases now reaching over $100M US in damages against host states. When large investments are involved, the ability of investors to directly initiate the arbitration, as opposed to state to state dispute settlement, can also provide foreign investors with a privileged status in negotiations with other stakeholders. This status can also be enhanced by the fact of the litigation taking place under international law rules with a narrow focus on investor rights as opposed to a broad set of interacting rights of different stakeholders. In contexts where water-sensitive issues are raised, these advantages can have a significant influence on the final outcome of water management decisions and water allocation rights.

2. TRADE AND INVESTMENT LAW IN THE CONTEXT OF OTHER SOURCES OF INTERNATIONAL LAW, WITH A SPECIAL EMPHAISIS ON WATER

Based on this review of the relationships of trade and investment agreements to water management issues, and their implications for government decision-makers, Part 2 of this paper now turns to consider how other sources of international law may reduce, offset or mitigate these potential impacts. The issue is especially important in the water area, in particular in the area of water services: all of Argentina's water privatizations of the 1990s are currently under investor-state arbitration processes,[25] one of Bolivia's two major privatizations was subject to suit but has recently been settled for the

[25] (1) Aguas de Aconquija S.A. and Vivendi Universal v. Argentina, ICSID Arb. No. ARB/97/03; (2) Azurix corp. v. Argentina, ICSID Arb. No. ARB/01/12; (3) Aguas Provinciales de Santa Fe S.A., Sociedad General de Aguas de Barcelona S.A. and Interagua Servicios Integrales de Agua S.A. v. Argentina, ICSID Arb No. ARB/03/07; (4) Aguas Cordobesas S.A., Suez, y Sociedad General de Aguas de Barcelona v. Argentina, ICSID Arb No. ARB/03/18; (5) Aguas Argentina S.A., Suez, Sociedad General de Aguas de Barcelona and Vivendi Universal v. Argentina, ICSID Arb No. ARB/03/19; (6) Azurix Corp v. Argentina, ICSID Arb No ARB/03/30; (7) SAUR International v. Argentina, ICSID Arb No ARB/04/4.

sum of $1.00;[26] and arbitrations in this sector impacting other countries are either thought to be underway or are being considered.[27]

A brief comparison is useful here. Over the course of the 1970's and 1980's, trade law panels sitting under the GATT became increasingly isolationist in how they viewed the law. By the early 1990's, a major GATT panel with significant environmental implications held that the GATT panels should rule fully from within the GATT, and without taking into account other external sources of international law.[28] Several years later, however, the WTO Appellate Body completely reversed this approach and ruled that the WTO existed as part of a broader body of international law that might have to be considered when it appeared relevant to the issues a Panel or Appellate Body was facing.[29] Arbitrators sitting on investor-state panels have often taken a similar approach to the GATT cases, focusing on the rights of the investor as expressed in the text of the agreement, and limiting their recourse to other sources of international law that may be relevant to a particular case.[30] This has been based in part at least on a reference to the stated object and purpose of IIAs, to protect the investor. And, it has tended to lead to an expansive interpretation of investor rights and a commensurate reduction of policy space for host states. This approach has often led to a shrinking of the sources of, and hence the scope of, the substantive law being considered in any given arbitration compared to what would likely be considered in a balancing of public and private welfare in a domestic court case. Indeed, in many instances, the goal of the investor-state process for an investor is to challenge the application and applicability of the breadth of domestic law that seeks to balance public and private welfare interests by subordinating them to the singular purpose of investor protection under international investment agreements. This is important, as the use of the investor-state process usually displaces recourse to the domestic courts by the investor in question.

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[26] Aguas del Tunari v Republic of Bolivia, ICSID Arbitration ARB/02/03. This involved the Cochibamba water privatization, and was settled in early 2006. There are persistent rumors concerning the likelihood of an arbitration concerning the privatization of a second system in Bolivia.

[27] Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania, ICSID Case No. ARB/05/22, registered on November 2, 2005. There are also reports of likely arbitration in relation to a Philippines water system, at a minimum.

[28] The case is widely known as the Tuna Dolphin case, UNITED STATES - RESTRICTIONS ON IMPORTS OF TUNA, Report of the Panel, (DS21/R - 39S/155)1991.

[29] United States - Standards for Reformulated and Conventional Gasoline, report of the Appellate Body, AB-1996-1.

[30] This has not been as consistently isolationist as the GATT had become, and some instances of direct reference to other sources of international law are found in some decisions.

This Part seeks to provide a range of initial perspectives for reversing this approach. In its briefest form, it suggests that the rights of the investor must not be seen in a vacuum, but in the context of a range of international law sources that can legitimately impact on the interpretation and application of an investment treaty and the rights of investors articulated within them. This is a critical starting point, but one that is often bolstered by references in the treaties themselves to international law as part of the interpretational matrix of the treaty text, as noted below.

One must always recall in this context that the point of bringing in non-investment treaty sources of law is not to have a tribunal rule on a dispute under that source, but to rule in a more informed and holistic way on the dispute relating to the investment agreement under whose jurisdiction the tribunal sits. The sources must therefore be strictly relevant to the legal issues confronting the tribunal, and be set out in a manner that the tribunal can apply them to the specific decisions it faces.

Several options are considered below. These are based on an initial assessment of where reasonable opportunities to broaden the legal inputs may be available in different contexts, rather than a more definitive argument that every case must allow for one specific approach or another. Indeed, the relevance of any option to any given investor-state case will depend on the specific factual and legal issues raised by that case. The options considered below include:

Customary international law (CIL);
General principles of law;
International law on sustainable development;
Human rights law; and
Transboundary water agreements specifically in relation to water issues

The first two categories, customary international law and general principles of law are widely recognized as legitimate sources of international law. This derives from their historical role in the development of international law, as confirmed in Article 38 of the Statute of the International Court of Justice:

1 *The Court, whose function it is to decide in accordance wit*h

international law such disputes as are submitted to it, shall apply: *international conventions…*
2 *international custom, as evidence of a general practice accepted as law;*
3 *the general principles of law recognized by civilized nations…*

The primary difference between customary international law and general principles of law is their source. Customary international law is found directly at the international level through the conduct of states. General principles of law are found in the major legal systems of the world and transposed to the international level due to their broad acceptance across a range of such systems. Both of these sources of international law have some applicability for our present purposes. Some specific examples are considered below.

The remaining three categories reflect areas of international law that have emerged through a combination of treaties and customary international law over recent decades. How they can be made relevant to specific arbitrations will be explored below.

2.1 Customary International Law

2.1.1 Customary Law as an Interpretive Aid

Customary international law is one of the most widely recognized sources of international law. In the context of investment arbitration, at least two functions can be identified for its use. The first is as a source of interpretation of treaty obligations. The use of customary law for this purpose is not new to international economic law. The World Trade Organization, in the first decision of its Appellate Body, recognized the need for its rules to be interpreted and applied in the light of both customary international law and other treaties that might have a bearing on its own rules.[31]

The use of customary international law to help define the scope of an investor right or host state obligation has already been seen in a very large number of international arbitral decisions on issues ranging from national

[31] United States - Standards for Reformulated and Conventional Gasoline, report of the Appellate Body, AB-1996-1

treatment to fair and equitable treatment and the scope of expropriation rules. Indeed, it is now so widespread in investor-state arbitrations as to defy exemplary citations of any value: almost every recent decision has examples of this.

The most common use of customary international law in treaty interpretation is through the application of the rules of the Vienna Convention on the Law of Treaties itself. Although the treaty is now in force, its rules are considered to be part of CIL as well, and thus binding on all states, including those not party to it. In the investment agreement context, this has both negative (constraining) and positive (expanding) elements.

The most important negative element has been the focus on the object and purpose of investment agreements as a basis for their interpretation. This focus is derived from one view of the Vienna Convention, which stipulates that the provisions of a treaty are to be interpreted in the light of its object and purpose.[32] Because the stated object or purpose of most IIAs has been to provide foreign investors with rights and protections, this has allowed investor-state tribunals to read such agreements in a manner that deliberately provides an expansive reading of such provisions, while downplaying potential negative implications of such readings on state decision-making and other public welfare issues.[33]

A recent article has queried, however, the appropriateness of this identification of the object and purpose of IIAs, noting that there is a second set of objectives that lies behind such agreements that is rarely stated. [34] This is seen in the rationale provided to developing countries for entering into such agreements: that the provision of rights to foreign investors will lead to additional levels of foreign investment and thus to enhanced domestic development opportunities, economic growth and socio-economic development. Although this is rarely expressed in the actual text of the treaties,[35] there may be greater opportunities through a CIL analysis to bring it back into the mainstream of legal analysis as part of the cognizable, and

[32] Vienna Convention of the Law of Treaties, Article 31.1

[33] As recent examples see Occidental Petroleum v. Ecuador, Final Award, UNCITRAL, July 2004; MDT Equity v. Chile, ICSID Case No. ARB/01/7, Final Award 25 May 2004.

[34] Omar E. Garcia-Bolivar, "The Teleology of International Investment Law: The Role of Purpose in the Interpretation of International Investment Agreements", Journal of World Investment and Trade, Vol. 5, 2005, pages 751-772

[35] Luke Peterson, Bilateral Investment Treaties and Development Policy-Making, IISD, 2004, at http://www.iisd.org/publications/pub.aspx?id=658

hence justiciable, object and purpose of IIAs. For example, this is consistent with basic customary international law recognitions of the right of states to development, and to achieve this through the rights to regulate, to control their own development policy, and to establish rules of access to domestic natural resources and markets, each of which is a core aspect of national development policy making.[36] A CIL analysis can draw these strands together to highlight the development aspects of the purposes of investment agreements. In doing so, one might take note of critical underlying policy documents produced by some of the biggest institutional "boosters" of investment agreements as development aids, for example, UNCTAD's work promoting BITs as an aid to development. While this could not replace the stated purpose of an agreement, it may add to it and thus generate a more balanced set of purposes that limit a uni-dimensional approach to this issue.

Other examples where CIL can be of direct relevance is in the interpretation of key provisions common to IIAs. To date, major investor-state arbitrations have involved references to the role of CIL in interpreting, in particular, the scope of the fair and equitable treatment (minimum standard of treatment) and expropriation provisions of IIAs, in each case arguing that the scope of customary international law in this regard is evolving. The experience with fair and equitable has been, at best, mixed. While it is generally thought that the notion of fair and equitable treatment was originally linked to the standard first identified in the Neer case in the 1930's, "that the treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency",[37] investor-state panels deciding cases on the basis of the minimum international standards have, from the beginning, not limited themselves to this approach. Rather, the tribunals have with specific purpose set out to expand the coverage under the NAFTA decisions and an array of BITs arbitrations. While this evolution is far from complete, its direction is now visible: the fair and equitable treatment standard is evolving under CIL into an international administrative law standard that includes elements such as the right to transparent decisions, for an affected party to be heard, for a review of initial decisions, a requirement to honor any initial commitments

[36] Howard Mann, "The Right of States to Regulate and International Investment Law", in The Development Dimensions of FDI: Policy and Rule-Making Perspectives, United Nations Conference on Trade and Development, 2003, pp. 211-224.

[37] 37 Neer Claim, General Claims Commission, United States and Mexico, (1926) 4 R.I.A.A. p. 138.

regarding the legal operating environment of the investment, issues relating to governmental guarantees prior to an investment being made, and more.[38] In the process of developing the fair and equitable treatment standard, some arbitrations have reflected upon the need to differentiate between states that are at different levels of development in their domestic institutions, while others have not done so.[39] This can be understood as an example of how different tribunals have responded, and not responded, to the contextual and relational requirements for assessing the application of the fair and equitable treatment standard. The growing trend of the international law system to differentiate the level of obligations among parties to an agreement based on their level of development may be argued now as part of customary international law, such that it supports this differentiation by the tribunals. This emerges from such fields as trade law (special and differential treatment) and international environmental law (common but differentiated responsibilities [40]). This approach can provide some potential support to the extant decisions that have argued that one single standard cannot realistically apply to all states today, given disparities in practices and capacities, by anchoring differentiated levels of responsibility in a broader range of similar public international law experiences. There is an important difference in that in most of the relevant treaties, differentiated treatment is set out in the text, whereas in most IIAs it is not. However, the ongoing development of differentiated responsibilities does remain a relevant concept to be considered as a counterweight to the notion of a single global standard. This would not negate the obligation, but may help contextualize its application as regards a specific investment in a specific host state. (The discussion below on the notion of the reasonable expectation of the investor as it relates to fair and equitable treatment, picks up related issues.)

The second major issue where customary international law has become very

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[38] Some of the more expansive cases include Occidental Petroleum v. Ecuador, Final Award, UNCITRAL, July 2004; CMS Gas v. Argentina, ICSID Case No ARB/01/8, May 12, 2005; Tecnivas Medioambientales TECMED v. Mexico, ICSID Case No. ARB(AF)/00/2, May 29, 2003; Metalclad v. Mexico, ICSID case No. ARB (AF)/97/1, 2000; and Pope & Talbot v. Canada, Award on the Merits of Phase 2, April 10, 2001. For a most recent review of the very rapidly evolving scope of the fair and equitable treatment requirement see Matthew C. Porterfield, "An International Common Law of Investor Rights?", forthcoming, University of Pa. Journal of Int'l Econ. Law, March 2006. The author cites and reviews numerous recent articles that provide an excellent window into the substantive evolution and process behind the evolution of this concept. See also Catherine Yanaca-Small, Fair and Equitable Treatment Standard in International Investment Law, OECD, 2005.

[39] The clearest of these is probably Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil Genin v. Republic of Estonia, ICSID Case No ARB/99/2 (Award) (June 25, 2001)

[40] Philippe Sands, Principles of International Environmental Law, 2nd ed., 2003, for an expanded view on the evolution of customary international law in this regard.

relevant to interpreting treaty provisions is in relation to the concept of expropriation under IIAs. There are two critical issues here: one is the standard for when an expropriation is to be found, in particular in relation to a regulatory measure. The second is the quantum to be paid after a finding of an expropriation. Only the first issue is addressed here, as the latter issue is largely determined by treaty language in the agreements, and an array of formulas that have taken the evaluation of damages into highly technical domains that are beyond the scope of this paper to properly analyze.[41]

Four categories of measures by governments can be identified today as being subject to expropriation claims:

The actual taking of property by direct or indirect means, including the loss of all or almost all useful control of property;

A measure tantamount to expropriation, where a measure that does not directly take property has the same impact by depriving the owner of all or almost all the benefits of the property;

Creeping expropriation, or the use of a series of measures in order to achieve an indirect expropriation. In this case, no individual measure in itself would amount to an expropriation; and

A claim of regulatory expropriation, where a measure is taken for regulatory purposes such as the protection of human health, the environment or consumers, but has an impact on a foreign investor sufficient to be claimed as an indirect expropriation.

Of these four types of expropriation claims, the first three are widely accepted as within a customary law definition of expropriation. What is much more controversial is the potential claim of a regulatory expropriation. Here, the literature and case law now varies widely. The latest arbitration decision on this issue, *Methanex v. United States*, held that normal regulatory measures would not constitute an expropriation under international law:

> *But as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or*

[41] See, for example, the complex evaluation of damages in the CMS Gas v. Argentina, ICSID Case No ARB/01/8, May 12, 2005.

investment is not deemed expropriatory and compensable…[42]

This is consistent with the present author's understanding of the exclusion of police powers measures from the scope of the definition of expropriation under customary international law.[43] However, it must be recognized that a number of arbitration decisions have taken a different view of the state of the law, led by the decision in *Metalclad v. United States*, the first NAFTA case to address this issue directly. It held differently on two points: first that the test was one of the economic impact of a measure on the investor;[44] and second that it was not necessary for the tribunal to understand or even look at the motivation for a measure to determine whether or not it was an expropriation.[45] The combination of these two aspects of the decision would effectively eviscerate any exclusion of police powers measures from the scope of the definition of expropriation.

The Methanex ruling has become quite controversial due to the clarity of its position. However, a review of the arguments made by the United States in this case, and by the two amicus curiae briefs,[46] show it is well supported in customary international law. This emphasizes the need to bring the sources of this law fully to bear in an arbitration.

The importance of how customary international law can impact on the interpretation of key provisions of an IIA can be seen in the limitations of other efforts to impact on treaty interpretation. In particular, the United States has set as a negotiating objective that the recent IIAs it is party to should be consistent with US domestic law, including on the issue of expropriation in particular.[47] However, such legislative measures do not actually bind treaty negotiators at international law, and can only be relied upon as authoritative if both parties have agreed that this was the intention as part of the negotiation of the agreement in question. In such a case, the

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[42] Methanex Corporation v. United States of America, Final Award of the Tribunal, August 7, 2005, Part IV-Chapter D-Para. 7. The final lines of the passage are important, but not for present purposes. They read: …unless specific commitments had been given by the regulating government to the then putative investor contemplating investment that the government would refrain from such regulation." This has already been discussed above. For a critical comment on this element, see Howard Mann, 2005, note 17.

[43] See also Howard Mann and Konrad Von Moltke, NAFTA's Chapter 11 and the Environment: Addressing the Impacts of the Investor-State Process on the Environment, International Institute for Sustainable Development, Working Paper, 1999

[44] Metalclad v. United States, Final Award, Case No. ARB (AF)97/1, August 30, 2000, para. 103.

[45] Ibid, para. 111.

[46] All the written arguments can be found at www.naftalaw.org.

[47] US Trade Promotion Authority Act, 2002, Sec. 2102(3).

Vienna Convention on the Law of Treaties ensures such a joint view can be a factor in the interpretation of a treaty's provisions. By comparison, showing a broadly based customary international law use of a term or concept will not face such requirements.

2.1.2 Customary Law as Additional Applicable Law

A different potential use of customary international law is as an additional element in adjudicating investor-state cases. Many investment agreements include broad language as to the law to be applied (or "applicable law") by a tribunal in the event of a dispute. NAFTA's Chapter 11 provides an example of this:

> *Article 1131: Governing Law*
> 1. *A Tribunal established under this Section shall decide the issues i*n *dispute in accordance with this Agreement* ***and*** *applicable rules o*f *international law.* (emphasis added)

This type of broadly phrased clause allows sources of international law other than the specific treaty that enables an arbitration to commence to be raised, as long as one can show they have a legitimate relationship to the issues to be decided, i.e. that they are applicable rules of international law. While such a provision is not needed to consider the role of CIL as an interpretive aid to the provisions of a treaty, it is quite useful to assess whether additional sources of international law may be applicable as well.

The questions that must then be addressed in each individual case are:

- whether such a provision is included in the IIA on which a claim is based, and if so
- what additional areas of international law, with its rights and obligations of states, may be applicable.

In this context, customary international law can be used not just to help interpret a BIT or regional IIA, but to help identify other rules outside its scope that might act as a further source of rights and obligations as between an investor and host state so as to alter the impact of an assessment of fault and liability based solely on the text of an agreement. What might be argued under CIL is difficult to establish in the abstract. Each case differs, and the nature and scope of the applicable law will differ accordingly. However, the

first step, of identifying an approach that supports the inclusion of other sources of law in the analysis, is important and should be fairly common to most arbitral contexts.

Even where the type of language seen in Article 1131.1 of NAFTA is not present, additional sources of customary international law may be relevant to some situations. For example, the notion of a legitimate expectation of the investor has become a central part of some approaches to analyzing the fair and equitable treatment standard. Here, it is certainly arguable that an investor could not have a legitimate expectation that is contrary to customary international law, as all states are bound by such law. Thus, in the context of water quality issues, it is certainly arguable that a company operating on one side of a transboundary river could not have a legitimate expectation of being able to pollute the river to the injury of the state or residents on the other side of the border, as there are clear customary international law rules on not allowing activities in one state to harm those in another state.[48] In this example, customary international law can be understood as contextualizing and thus setting certain parameters around the legitimate expectations of an individual investor or its investment.

Other examples where CIL might be relevant in the water context could include the identification of water allocation priorities in a large number of transboundary water agreements and the International Law Commission work on state rights and obligations over transboundary waterways, the quickly growing notion of access to clean water as a basic human right, and the notion of indigenous peoples' rights in international law as a balance against otherwise unsecured or unwritten water rights. Having set out the legal basis on which they may be used or be seen as relevant here, the substance of these areas of customary international law is explored in more depth in section 3 of this paper.

2.2 General Principles of Law

It has already been noted that general principles of law are to be found in the legal systems applicable at the domestic legal level. When such principles are sufficiently widespread across legal systems, they may be identified as general principles of law and applied as such in international

[48] The duty of states not to allow transboundary pollution was established in 1936 in the Trail Smelter Arbitration between Canada and the United States. See a broader discussion in Patricia Birnie and Allan Boyle, International Law and The Environment, 2nd edition, 2002, pp. 104 et seq.; 267 et seq.

law.

General principles of law are also recognized, as noted previously, as a legitimate source of international law. It is generally used to help fill gaps in treaty and customary international law applicable to a specific situation, but can also be used to advance new principles of international law derived from their widespread application in domestic law.

Like customary international law, general principles of law may fulfill two purposes in relation to IIAs: as an aid to interpretation and as an external source of law that can be called upon to contextualize and balance the rights and obligations of an investor and host state under an investment agreement.

Several specific principles may be relevant here, going to the formation of investor contracts, their execution, and governmental measures that alter such contracts. The applicability of any given principle will, of course, be determinable based only on the facts and legal issues flowing from that case, as well as the capacity to show it is indeed a generally accepted principle of law so as to be recognized as such in international law.

2.2.1 Possible general principles relating to the formation of contracts

Corruption

The concept of "*ordre publique*" comes from a civil law tradition but has expanded to many legal systems today. Without seeking an absolute definition, it carries with it the presumption that acts contrary to the "*ordre publique*" are not acceptable and cannot be the basis of a legal action. This has been recognized as applicable in the case of acts contrary to the *ordre publique internationale in recent writings on international arbitration.*[49]

Corruption is probably the most critical issue relating to the formation of investment agreements, contracts and permits that one finds under the broader legal context of *ordre publique internationale*. It is widely accepted that the initial run of water privatizations in Latin America and elsewhere was accompanied by significant levels of corruption, although no governmental memoranda appear, as can best be seen to date, to raise this

[49] Richard Kreindler, "Aspects of Illegality in the Formation and Performance of Contracts"; and Karen Mills, "Corruption and Other Illegality in the Formation and Performance of Contracts and in the Conduct of Arbitration Relating Thereto", in International Commercial Arbitration : Important Contemporary Questions (ICCCA Congress Series, No. 11), Kluwer International, 2003

issue.

The barring of corruption in all legal systems is now widespread, and consequences can include jail time in most legal processes. In international law itself, at least two major treaty processes are seeking to ban corruption by foreign persons of domestic government decision-makers, one at the UN and one through the OECD.[50] Both processes call for corporate officers engaged in corrupting acts to be punished, as well as those who solicit or receive them.

The issue for international arbitrations is not the punishment of individual corporate officials, but the implications of corruption for the formation of contracts and for the rights of the investor or investment relating to its execution and subsequent governmental measures. The achievement of an investment through corruption of the government decision-makers goes to the very status of the investment contract, agreement, permit or other instrument that defines the primary context for the investment: Can such a contract or other instrument be used as the foundation of an investor-state arbitration?

Increasingly, leading authors are suggesting that it cannot.[51] One major reason for this is that it goes against the *ordre publique internationale*, borrowing the concept as a general principle from domestic legal systems. Thus, it is argued, allowing an investment gained through corruption to be the basis for an arbitration allows corruption to be recognized as a legitimate cost of doing business. As the *ordre publique internationale* now rejects this premise, it also requires that arbitration tribunals reject jurisdiction over a claim based on such a history. Of course, the tribunal must be satisfied that corruption played a role in the achievement of the investment, and a tribunal must take jurisdiction to assess this. But a finding of corruption, it is argued, would then vitiate the jurisdiction of the tribunal to proceed further.

This approach appears to be supported in at least one important investor-state case where the question of corruption arose in the context of the formation of the contract. In *Wena v Egypt*, the Tribunal stated in relation to allegations of corruption by the defending state that, "…If true, these

[50] OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, 1997; United Nations Convention Against Corruption, 2003
[51] Note 49, supra.

allegations are disturbing and grounds for dismissal."[52] The Tribunal, however, went on to avoid an investigation of whether the allegations were true at least in part on the basis that the state had taken no investigative or corrective steps itself on the corruption issue.

The more recent case of *Methanex v. United States*, which concerned allegations of corruption of government decision-makers by a third party to the detriment of Methanex, suggests that such deference to domestic investigation is not needed. In its broad analysis of the methodology to use and the importance of a Tribunal investigating such claims of corruption seriously is, it may be argued, equally applicable to allegations of corruption in the formation of a contract that lies at the root of the dispute the tribunal is addressing.[53] Indeed, the methodology set out, one of considering circumstantial evidence in the absence of direct evidence, is clearly a precedent that can be relied upon in terms of the issues of proof of corruption in any context.

Given the transition of the international legal order from seeing corruption as a cost of business to corruption as a breach of the *ordre publique internationale*, the shift to seeing corruption as a basis for vitiating the jurisdiction of an investor-state tribunal is a conceptually easy one to make. Although one may anticipate significant resistance from investors in this regard, it is worth noting here that in one recent high profile instance, the company alleged to have achieved its investment through corruption of high ranking government officials actually admitted the corruption following a prosecution in its home state, withdrew its claim, and paid a significant amount of the legal costs of the defending state.[54] In addition to being a jurisdictional issue, the question of corruption also goes to the more substantive issue of the legitimate expectations of the investor as part of the analysis of future government measures pertaining to an investment. Here, the argument is very clear and straightforward: expectations achieved by illegitimate means cannot, by definition, be legitimate expectations. On this basis, and beyond the jurisdictional issues, it would seem that most if not all claims by an investor would also fail.

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[52] Wena v. Egypt (Proceedings on the Merits), 41 ILM 2002, at para. 111, p. 917

[53] A brief commentary on this part of the decision appears in Howard Mann, 2005, supra. 19.

[54] SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan (Case No. ARB/01/13), Settlement agreed by the parties and proceeding discontinued at their request (Order taking note of the discontinuance issued by the Tribunal on May 23, 2004 pursuant to Arbitration Rule 43(1)).

Other potential principles relating to the formation of an investment

While corruption is perhaps the most salient and easily identified general principle relating to the formation of an investment, other principles may also be relevant. These include:

- Duress in the formation of a contract
- Undue influence in the formulation of an agreed investment
- Misrepresentation and non-disclosure of material information
- Abuse of right
- Mistake,
- Constructive knowledge; and
- Unconscionability.

Consideration of the applicability of these principles is in an early stage of development in international investment law. That they are in an early stage should not be surprising: it is a response to an ever deepening intrusion into what had formerly been domestic law issues, not international law. As a result, the need for the balancing requirements that these principles represent has only become apparent in the past few years. It is likely that these principles can be established as broadly accepted general principles of law, and hence there is a basis for their identification as a general principle of law under international law. However, the ability to deploy these principles in the context of negotiations between investors and states where it is the state that would claim them as a defense may be questioned in practice as they paint a picture of the state as the less able partner in the negotiation. However, some cases, not in the water sector, have in fact already noted that some developing countries, and some states with economies in transition, do not have the same level of expertise as private companies with extensive experience in their area of operations.[55] This, combined with a deeper look at the actual practices of major corporations in, specifically, the public utility sectors, should provide a base from which to begin to make more specific and focused legal arguments.

Under what type of circumstances might a defendant state raise any of the above noted principles as a defense? Specifically in relation to water

[55] Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil Genin v. Republic of Estonia, ICSID Case No ARB/99/2 (Award) (June 25, 2001) is perhaps the leading example of this view being a key part of a decision against an investor.

privatizations in Latin America, several issues could arise.[56] For example, there is information that several banks, major companies in the water sector and other potential beneficiaries of water privatization actively promoted and encouraged the privatizations within the World Bank and other key places prior to the World Bank making this part of the conditions for financing. Subsequently, these same actors are understood to have sought the active support of the Bank in seeking refinancing of the contracts and full contract renegotiations on terms more favourable to the foreign investors. Whether the lobbying of the World Bank did in fact lead to policy changes that would favour those in the privatization business is not clear, but a factual assessment could help determine this, and a legal analysis could determine whether this rose to the level of undue influence, abuse of position, etc.. It could also determine if this activity prejudiced the interests of the developing states, such as Argentina, by restricting their access to foreign capital and loans if they did not do what the companies, and critically, the World Bank was promoting. At the more extreme end, if there were evidence that the financing banks or water companies bribed World Bank officials involved in any given privatization project to promote that result; this could lead to very serious allegations. No duress or other failure on the part of the investor could be made out simply by virtue of its having made the investment once the decision to privatize was made; it could only be made out if the investor had been involved in precluding other options to the state through the kind of lobbying suggested above.

There have also been suggestions circulating in some quarters that legal support for governments negotiating privatization contracts was provided through the World Bank by law firms that otherwise represent investors in the water sector. If this is true, this could raise a question of the complicity those firms in organizing contracts that may have turned out to be imbalanced or inappropriate for the circumstances of the government in question, or of undue influence in the negotiation of the contracts. Non-disclosure of any possible conflicts of interest may also be involved.

A further question is whether the companies would have known, due to their experience, that the contracts were inadequate to ensure the actual

[56] A large number of the issues that are raised here are set out in a series of investigative reports called "The Water Barons", by the Center for Public Integrity, published in 2003 and collated as a book in 2005. The issues are raised here as illustrative, not as an endorsement of any findings or as proven facts. http://www.publicintegrity.org/water/

fulfillment of the underlying terms of the contract and objectives of the governments involved. This could include issues relating to rates, water losses and other problems within the system, emergency management, inadequate auditing and oversight mechanisms, absence of needed regulations, lack of a sound economic base to run a privatized water system, etc, all of which suggest possible abuses of roles or failures to disclose critical information they had knowledge of or the expertise to gain knowledge of. Indeed, there are credible suggestions today that the water companies were knowingly game-playing the process by negotiating initial contracts on conditions they did not believe were viable in order to gain the advantage in already anticipated contract renegotiations.[57]

Here, the doctrine of constructive knowledge, defined in Black's Law Dictionary simply as: "If one by exercise of reasonable care would have known a fact, he is deemed to have had constructive knowledge of such fact", may be relevant in assigning knowledge of the conditions for impending failure to an investor due to its expertise. If there is sufficient proof, transferring the same information to impose knowledge of certain facts on an investor may be a sound component of a defense strategy. As one example, they may have been aware or there may be conditions to suggest they should have been aware, that users within the about to be privatized system lacked the ability to pay at levels needed to support it effectively, thereby creating conditions for failure or mandatory renegotiation on terms more favorable to the investor. If this issue were to relate to the issues in dispute in an investor-state process, grounds for constructive knowledge may exist, and this would potentially alter the legitimate expectations of an investor.

One would have to assess the nature of each contract or agreement carefully here, and the nature of the knowledge one might presume the private party to have in relation to it. Knowledge of the type suggested here could raise an issue of misrepresentation, abuse of position or abuse of right. In an extreme case, where the investor may have been in a position to know that the contract would lead to implementation problems and loss of service for some users, and an impossibility of fulfilling its terms, a case for unconscionability may also lie. In this regard, misleading statements by an investor as to its capacity to fulfill all of the operational obligations it has

[57] "The Water Barons," ibid; and J. Luis Guasch, Jean-Jacques Laffont, Stepane Straub, "Renegotiation of Concession Contracts in Latin America", November 2003, at http://www.publicintegrity.org/water/

taken on in a waste management privatization in Mexico was held to be one important factor in the dismissal of a claim by an investor in an early NAFTA case.[58] Finally, if there were to be evidence of a "carving" up of the investment market so as to constrain competition among the handful of real potential investors in the privatizations, that could raise additional issues of undue influence, abuse of right, or unconscionability.

It is worth noting that in a recent arbitral decision, careless business practices of the investor led to a 50% reduction in the award of damages in favor of the investor.[59] It is arguable that a willful set of poor practices, which could be characterized as willful blindness and be developed through concepts like constructive knowledge, could also alter the very merits of a claim. Indeed, more than one case has made the point that the investor-state arbitrations are not intended as an insurance resource for bad business decisions.[60]

Mistake as a defense may be a much more precarious one. One would have to show that the government had so manifestly erred in its negotiations as to vitiate its consent to the contract. Absent some of the other factors noted above that might be argued to induce the mistake, achieving this level of proof in the face of the public debates on privatization, the long processes involved and more may be a hurdle of some significance.

All of the above requires very fact specific argument and careful analysis of the status of the potentially applicable principles as a general principle of law applicable in international law. Current information points to possible directions of arguments and raises the possibility that further development of the facts and law maybe useful in some cases.

An additional factor that would be relevant in this last regard is to determine

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[58] Robert Azinian et al. v. United Mexican States, Award, International Centre for Settlement of Investment Disputes, Additional facility, case No. ARB(AF)/97/2

[59] 59 MDT Equity v. Chile, ICSID Case No. ARB/01/7, Final Award 25 May 2004.

[60] 60 See, for example, Olguin v. Paraguay, ICSID Case No. ARB/98/5, 26 July, 2001, at para. 65(b): It seems obvious to this Tribunal that there are serious shortcomings in the Paraguayan legal system and in the functioning of various State agencies. This Tribunal is not seeking to determine whether this situation is more severe in Paraguay than in other nations. What is evident is that Mr. Olguín, an accomplished businessman, with a track record as an entrepreneur going back many years and experience acquired in the business world in various countries, was not unaware of the situation in Paraguay. He had his reasons (which this Tribunal makes no attempt to judge) for investing in that country, but it is not reasonable for him to seek compensation for the losses he suffered on making a speculative, or at best, a not very prudent, investment. See also, e.g., Robert Azinian et al. v. United Mexican States, Award, International Centre for Settlement of Investment Disputes, Additional facility, case No. ARB(AF)/97/2.

the pattern of remedies for any breaches of the kinds of principles described here. For example, does mistake by one part automatically lead to a repudiation of the contract, or some other, lesser remedy, perhaps an adjustment to damages? Does duress or undue influence similarly lead to nullity of the underlying contract or permit? This would need to be part of a research agenda looking forward. Included in this agenda would be recent development in private international commercial arbitrations as well.

Prior to turning to the next section, it is worth noting that the idea that investor conduct can be a significant factor in an international arbitration is not set out for the first time in this paper. Indeed, it was raised as a part of a debate at the British Institute for International and Comparative Law on the fair and equitable treatment standard in September, 2005.[61]

2.2.2 Possible general principles relating to the execution of contracts

A separate set of potential principles may arise in relation to the execution of a contract after its implementation has been initiated. Again, each must be seen as fact specific, and hence a strong factual base would have to be laid to make any such claim viable. Perhaps the critical potential principles that may apply here are abuse of right, or principles related to specific performance as a prerequisite for initiating a claim based on breach of contract by the state.

The monopoly context of most water services creates a potentially unique environment for claims relating to abuse of rights in the execution of contracts, including potentially based on abuse of position in a contract renegotiation. (Renegotiation is an almost endemic occurrence in the 1990s public utility privatizations, often with the renegotiating company having a significant upper hand due to a variety of factors that are magnified in a monopoly context.[62]) The monopoly context makes it difficult for governments to shift contract holders. In addition, where the monopoly operator is covered by an IIA, this creates the added risk of very expensive investor-state arbitrations which can weigh disproportionately on governments faced with a monopoly foreign

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[61] Peter Muchlinski, "The Relevance of the Conduct of the Investor", paper presented at The Fifth Public Conference of the British Institute of International and Comparative Law's Investment Treaty Forum, FAIR AND EQUITABLE TREATMENT IN INVESTMENT TREATY LAW, London, September, 2005, http://www.biicl.org/index.asp?contentid=995

[62] See, supra, n. 57.

investor. There can also be substantial knowledge advantages for an investor already operating a water distribution or other public utility system.

All of these factors may lead to a shift in balance of rights and obligations between an investor and a host government such that it advantages the investor seeking new operating terms, and may even allow investors to accept less favourable terms initially in the expectation of better renegotiating conditions later when other players have fully left the scene. For example, if an investor finds that the original terms were not sufficient to allow for the levels of new investments called for under the agreement, it may seek to use its operating powers to force higher levels of tariffs in order to meet the new investment targets while maintaining the same level of profitability. Similarly, an investor can use its operating capacities to alter service delivery to areas or persons with limited ability to pay, even if service levels had been guaranteed. By avoiding full performance of its obligations, investors may create multiple additional issues for renegotiation in a crisis context. If an investor can be shown to have known of the likelihood of such results, or have failed to make due diligent efforts to ensure the planned results were reasonably based, this can amount to an abuse of rights or position.[63] This would, of course, have to be shown through factual evidence in any specific case, and a legal assessment of what standard of conduct is required to show an abuse of right as a general principle of law. In addition, if such planning could be shown to have occurred, issues such as abuse of position or misrepresentation as part of the original conclusion of the contract would gain additional support.

Another form of abuse of rights could be the use of transfer pricing practices to inflate the costs of purchased goods and services and thus distort profit and loss margins. This kind of practice is especially open to investors that have related companies that provide goods and services to sister corporations in a corporate family. Many of the large water multinational companies have such structures. The use of transfer pricing practices is well documented in the public utilities sectors,[64] and has also spread to other

[63] Again, parallels to Robert Azinian et al. v. United Mexican States, Award, International Centre for Settlement of Investment Disputes, Additional facility, case No. ARB(AF)/97/2; Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil Genin v. Republic of Estonia, ICSID Case No ARB/99/2 (Award) (June 25, 2001) are useful here.

[64] Regulations against transfer pricing practices have been in place in the United States, for example, since the 1940's, when the Public Utilities Holding Act was passed. It is widely recognized as fraudulent practice in that it artificially inflates prices of goods and services consumed in one jurisdiction to reduce profits

sectors where integrated companies exist. Should such practices be detected, these could also be raised in arbitrations as a basis for reducing any damages awarded or even to review the legitimacy of the basis on which a renegotiated contract may have taken place.

The consequences of conduct such as described above, if shown, could be that renegotiated or initial contracts be deemed insufficient to support investor claims against the state that was so manipulated or abused. This could vitiate certain rights of an investor, or at least impact on the reasonable expectations of the investor arising from the contract. Both of these results could impact on the investor-state process.

The corollary of an abuse of right, but one which may be less legally demanding because it focuses less on motivation and bad faith, is the question of whether an investor has met its own obligations. By focusing on the requirement for specific performance and good faith of the investor, a host government can try to turn the tables on the investor. This can be argued as providing the rationale for not fulfilling specific governmental obligations in some cases, especially when they are set out as commitment precedents for certain government actions. This can also potentially be done by way of a counterclaim or as an offset to any finding of liability or damages, though not all arbitral systems may be open to this.[65]

A different type of issue that may arise concerns a fundamental change in circumstance. In international law terms, this invokes the customary international law concept of *rebus sic stantibus* as it applies between states in their treaty relations. The notion is however, also reflected in many domestic legal systems between contracting parties. This concept requires a true change in circumstances that would not have been generally foreseen during the negotiation. It is usually a high test, whose application may be most relevant in response to unexpected crises of some type. By contrast, it does not apply to justify changes in government policy due to changes in political leadership, for example.

It has often been suggested that the Argentine Peso/dollar crisis of 2001-2002 provides sufficient factual grounds to argue the principle of a

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there. In practice, this has been used to reduce profits in privatized utilities while increasing profits for the parent companies and their shareholders. See, eg. "The Water Barons", n. 56 supra

[65] MDT Equity v. Chile, ICSID Case No. ARB/01/7, Final Award 25 May 2004, provides a good example of an award of damages being reduced by 50% due to the contributory conduct of the investor.

fundamental change in circumstance, at least as it relates to the fiscal changes that were brought in by government decree to de-link the fees and related calculations from the failed dollarization policies. The first case where this was argued on the merits did not succeed on the merits, due in part at least to a view of the tribunal that the initial privatization process had also been in response to a crisis as well, and that the investors who responded positively to Argentina's requests for foreign investment should not bear the brunt of the costs for its response to the second crisis. There was also a serious question as to whether the de-linking had in fact not been foreseen in the negotiation and accounted for in the original contract.[66] Still, it is noteworthy that the Tribunal did acknowledge that a national economic crisis was a legitimate factor for a tribunal to consider in an investor-state arbitration.

2.2.3 Possible general principles relating to government regulatory measures that alter contracts

Perhaps the most important element in the context of general principles may be the right of states to regulate within their territory. It is important to state clearly that investment agreements do not grant the right to regulate: they restrict or constrain it only in so far as the language in the agreements demonstrably does so. There is no presumption in the agreements or in the field of international investment law that the right to regulate has been generally curtailed by them.[67]

The key limits or constraints imposed by investment agreements have been noted above: national treatment and most-favored nation treatment; no expropriation without compensation, fair and equitable treatment, and in some cases prohibitions on performance requirements. None of these, unless specific undertakings have been given to the contrary, preclude regulations that are non-discriminatory and non-expropriatory being made.[68]

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[66] CMS Gas v. Argentina, ICSID Case No ARB/01/8, May 12, 2005. It is somewhat difficult to assess the proof that was required for this view, as opposed to reliance on general knowledge. In any event, this is a factor that underlies important aspects of the decision. This first decision is now subject to an annulment process at the International Centre for the Settlement of Investment Disputes (ICSID), and may thus be overturned.

[67] Howard Mann, "The Right of States to Regulate and International Investment Law", in The Development Dimensions of FDI: Policy and Rule-Making Perspectives, United Nations Conference on Trade and Development, 2003, pp. 211-224.

[68] One might note here that this is consistent with national legal systems. Despite all the talk of regulatory expropriation principles in the United States, for example, there is no evidence of any compensation ever

The question then becomes how to account for normal regulatory practice in the context of IIAs. One way is, as already noted, to consider the police powers exclusion of regulations from the concept of expropriation. A second way is to consider more specifically how to accept good regulatory practice as a positive element of the rights and obligations within an IIA. This is akin to a concept of constructive notice, whereby investors are deemed to be on notice that regulatory measures affecting their business may change in the normal course of events, and thus the expectation of regulatory change is deemed part of the legitimate expectations of the investor, rather than an eventuality that creates a cause of action.

Two examples where this has been applied in a regulatory context are available in recent cases. In Maffezini v. Spain, it was noted by the Tribunal that domestic legislation to ensure that sound environmental assessments were made of new projects was not contrary to any obligations under the Spain-Argentina BIT, but was rather an example of good practice that an investor should expect to address in the course of an investment into Europe.[69] In Methanex v. United States, it was similarly noted that the investor had invested into a market area well known for changes in environmental standards as new information was brought forward and analyzed by government decision-makers. This culture of forward-looking environmental protection was, therefore, to be understood as part of the environment the investor chose to enter into, and thus was seen as conditioning his expectations of future government conduct.[70] A slightly different context may raise similar issues in relation to investment in monopoly infrastructures. This is especially so when the investment is made into states that do not have highly developed regulatory or administrative systems, as many states undergoing new privatization processes have shown. Here, the relevant legal principles may be better understood as a combination of the basic right to regulate, constructive notice, constructive knowledge, and an understanding by the investors themselves of the requirements of good practices in the specific sector involved. In water distribution, for example, it would seem entirely reasonable to argue that

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having been paid for measures under the US Clean Air Act, Clean Water Act or any other similar kinds of regulatory measures at the federal or state levels. Yet these are the kinds of measures that have now infiltrated the debate on regulatory expropriation at the international level.

[69] Emilio Agustin Maffezini v. The Kingdom of Spain (Case No. ARB/97/7), Award, November 13, 2000, para. 67.

[70] Methanex Corporation v. United States of America, Final Award of the Tribunal, August 7, 2005. Available at http://www.naftaclaims.com/disputes_us_6.htm, .

common regulatory practices in the sector should condition the expectation of a foreign investor, even if the host state has not yet itself developed its regulatory environment at the time the investment had been made. This argument would then be strengthened if certain practices can be shown to have risen to a level of general principles in the field of water law.[71]

Specifically within the water context, a variety of issues that need regulation may be reviewed from the perspective of good practice and as a general principle of water regulation and public utilities law These include practices concerning:

- service to the poor;
- water tariff levels in relation to economic needs of consumers and of system operators;
- sharing of water access;
- maintaining potable water quality;
- re-investment levels in the public utility systems;
- appropriate levels of indebtedness; and
- rates adjustments in times of crisis,
- transfer price restrictions

A broad review of each of these from a comparative law perspective would be critical to making a legal case. The adoption of a sector wide approach, informed where useful by approaches in other public utility sectors, with a view to establishing benchmarks for good practice and hence for conditioning the legitimate expectations of the investor and of other stakeholders is given added credence in the water sector due to the multinational nature of the limited number of players involved in the privatization process. They have a unique level of expertise in water management systems and the expected standards for a successful operation. It is reasonable to argue that they should anticipate that best practices be applied to all of their operations, wherever situated.

This brings us back to a point raised a couple of times above: what happens if specific undertakings not to change the regulatory environment of an investment have been made by the host government? Existing investor-state cases posit such undertakings as critical elements in determining not just the

[71] Further detail on comparative water law practices and principles is found in Michael Hantke-Domas, Common Principles of Advanced Regulatory Systems, 2005.

content of the expectations of an investor, but the level such expectations may rise to as a matter of law. Indeed, this is a critical element, as already noted, in the first decided case of the privatization arbitrations against Argentina, *CMS v. Argentina*. It has also been seen as critical in other recent decisions on fair and equitable treatment [72] and has emerged as a salient issue in the most recent decision on expropriation.[73] This raises numerous issues in a democratic society, in particular the constitutional pre-emption against one government binding the decisions of future governments.

In addition to inherent limits to a doctrine that one government can permanently bind other governments not to regulate, what, it may be asked, happens if the undertaking purports to freeze the regulatory environment at levels that are below best practice or below definable principles or best practices of water management? Here, one can arguably go back to the issues raised above of undue influence, abuse of position, misrepresentation and non-disclosure of material facts, or even unconscionability specifically as it may relate to such undertakings. In other words, the same principles that apply to the negotiation of a contract as a whole may also be applied to any specific clauses that limit the regulatory responsibilities of governments.

This is a more targeted approach, as opposed to arguing the entire investment contract or permit is null. It can be argued in such circumstances that a major participant in the global water industry cannot use its business cunning or its special expertise in such a way as to unduly distort present or future regulatory needs of the host government, or to constrain future efforts by a government to attain a state of the art regulatory system. Indeed, the very fact that the regulatory system is below what is needed to properly regulate a public service utility can be argued as generating the constructive notice that it will have to change to meet proper standards in due course. The failure globally of the "privatize and deregulate" model employed by the World Bank in the 1990s provides further evidence for applying such constructive notice to an investor in a highly specialized sector.

The more evidence one can show of commonly accepted best practices and state of the art rules in the regulation of public utilities, or of general principles of water law applying across different legal systems, the stronger

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[72] See, for example, Occidental v. Ecuador, Final Award, UNCITRAL, July 2004; and Tecnivas Medioambientales TECMED v. Mexico, ICSID Case No. ARB(AF)/00/2, May 29, 2003.

[73] Methanex Corporation v. United States of America, Final Award of the Tribunal, August 7, 2005.

the case to show that achieving those standards should be understood within the notion of legitimate expectations of the investor, and that a contract precluding achieving those standards or principles should be carefully reviewed based on principles relating to contract formation as described above. All of this gives additional context, depth and specificity to the recognition of the right of states to regulate within the context that this right might be challenged under investment agreements.

3. SOME POTENTIAL APPLICATIONS FOR NON-INVESTMENT AREAS OF INTERNATIONAL LAW

So far the potential role of other sources of law in the context of investment treaty arbitrations has been considered primarily from the strategic or legal logistics perspective of how they may fit into an investor-state arbitration. In this section, a preliminary discussion of the potential role of certain other areas of international law from a substantive perspective is considered. This is not intended to be an exhaustive discussion, but rather one that helps sow the seeds of the possibilities for additional sources of international law to be seen as relevant.

Some of the areas of law discussed have a combination of treaty and customary international law as their sources. This should not be a significant barrier if the substance of the law has properly crystallized under customary law on the one hand, or if the treaty practice includes the host state in particular on the other hand. In this regard, the basic legal principle of *pacta sunt servanda*, treaties must be implemented and complied with in good faith, will assist states in both justifying specific acts in relation to treaties they are a party to, and in setting out the full legal environment into which an investor has entered. Again, this second element is important in setting the appropriate parameters of the legitimate expectations of the investors.

One principle underlying this section has already been stated, but may be reiterated here. It is the one identified in the first WTO Appellate Body decision, that the WTO legal system lives within the broader body of international law, and not in isolation from it. The point is as important as it is simple to make. Yet, how far any given tribunal will allow exterior sources to be called upon is a largely unknown factor. Contextualizing its role, as described in several different manners previously, will thus be important to show why and how it is relevant for a decision on the

respective rights and obligations under the IIA in question.[74]

Three areas of international law are considered below:

- International sustainable development law;
- International human rights law; and
- Transboundary water agreements.

3.1 International Sustainable Development Law

Sustainable development is often understood as an environmental concept. This is incomplete. In addition to bringing environmental sustainability into the economic debate, sustainable development also requires the consideration of equitable development from its social and economic aspects. Respect for basic human rights is also often considered as a specific element of sustainable development, but this element will be considered separately below.

The environmental dimensions of sustainable development are fairly well understood. They require that economic decisions be taken in the light of their environmental consequences. They also require that preventive, remedial and mitigative measures be taken to prevent or address environmental damage from human activity. Towards this end, a web of international agreements and principles has been constructed, and thousands of domestic laws and regulations have been adopted around the world.

It has already been noted that at least two investor-state arbitrations have positively noted the need for investors to consider the ongoing right of states to protect the environment, including new measures as knowledge evolves, as part of the reasonable expectation that any investor should have. This goes to support the carve out of regulatory protection for the environment through the concept of police powers, as well as the limitations that must be understood on the legitimate expectations of the investor when analyzing investor rights under the fair and equitable treatment standard.

A key element that specific references to international sustainable

[74] One must always recall that the point of bringing in extrinsic sources of law is not to have a tribunal rule on a dispute under that source, but to rule in a more informed and holistic way on the dispute under IIA under whose jurisdiction it sits.

development law may bring into the debate is the recognition of the precautionary principle as a foundation of the role of states in protecting environmental and human health. The precautionary principle is not an open-ended approach to environmental regulation, but a principle based on science and evaluation that ensures appropriate room for action in the face of uncertainty.[75] It may at times be useful to refer to the broad acceptance of the precautionary principle in international sustainable development law in an investor-state arbitration.

In addition, it would seem clear that complying with international environmental obligations would be full justification for enacting environmental measures. This presumption has taking root in practice if not in a formal legal manner at the WTO,[76] and it should fit perfectly within the scope of the customary international law on police powers measures on the one hand, and as a conditioning factor on the legitimate expectations of the investor on the other hand. The customary international law rule of not causing transboundary harm has already been mentioned. Eliminating pollutants in waterways pursuant to international treaties would thus be relevant if foreign investors are emitting such controlled pollutants.

The development component of sustainable development is usually understood in terms of the concepts of equity in social and economic development that often require government intervention to protect and promote the broad public welfare. Thus, the inherent right to set national development policies that reflect domestic needs would be recognized, as well as distributional equity, in particular in relation to historically mistreated populations.[77]

While these may now be generally recognized as legitimate exercises of the right to development, specific actions may conflict with the provisions of IIAs. It is understood, for example, that a number of foreign investors in South Africa have threatened to sue under BITs in response to the Black Empowerment Program, though no such suit has actually materialized. How a tribunal would treat such a potential situation is unclear. The first

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[75] Patricia Birnie and Allan Boyle, International Law and the Environment, 2nd Edition, 2002, p. 115 et seq.

[76] Howard Mann and Stephen Porter, The State of Trade and Environment Law 2003: Implications for Doha and Beyond, IISD and CIEL, 2003, at pp. 19-26.

[77] In relation to historically mistreated populations, South Africa, for example, has a black empowerment program and Malaysia a program to promote the economic growth of its ethnic bumiputras (native Malay) populations.

step would be a detailed analysis of the IIA itself, and in particular whether any such measures were expressly precluded by it. After that, one can suggest that a careful balancing of the rights and obligations would be needed, including the potential for claims based on fundamental changes in circumstances in some cases.

The extent to which crisis management and the legitimate need to preserve social peace and equity between domestic and foreign investors, such as in the aftermath of the Argentine fiscal crisis, can fit within the right to development is unclear. It has already been noted that a serious economic crisis may be reasonably considered by a tribunal. However, the question is complicated in that the only decision so far on the substance in relation to the Argentinean financial crisis makes it clear, as already noted, that the consideration of this issue was distorted by the inclusion in many of the foreign investment contracts of specific guarantees and remedies in the event that the specific recovery policies employed in the 1990's crisis were to be reversed.

It is true that in earlier decisions relating to damages to a foreign investor following a period of internal social strife and violence, maintaining identical treatment between domestic and foreign investors was not considered a valid response to the loss of property of the foreign investor under an investment agreement that did not specify equal treatment would be sufficient to meet the applicable obligation on the host state.[78] However, when issues of maintaining and promoting social equity reflect not just immediate periods of civil strife but long term, widely known issues of discrimination and commensurate re-adjustments, it is not clear that the provisions on compensation for civil strife are the most apt analogy.

3.2 Human Rights

Specific applications for human rights law may be more difficult to find in practice, but the water sector may indeed be one where human rights law can find application. This possibility has, in fact, been expressly recognized in a water services case in Argentina:

> *[water and sewage] systems provide basic public services to millions*

[78] Asian Agricultural Products Ltd. (AAPL) v. Republic of Sri Lanka, International Legal Materials, 30 (1991), pp. 580-655; American Manufacturing & Trading, Inc. (AMT) (US) v. Republic of Zaire, ICSID case No. ARB/93/1 Award, 21 February, 1997.

of people and as a result may raise a variety of complex public and international law questions, including human rights considerations."[79]

What might these considerations be? First, of course, is the human right to clean and safe water. This right, now emerging more clearly as a human right,[80] can be understood as setting a basic requirement for water service providers to comply with. In essence, by taking on the right to deliver water, they also take upon themselves the obligations to meet basic human rights in relation to the right that they exercise. The growing recognition in a number of international standards that consider multinational corporations to be obligated to comply with basic human rights standards adds weight to this approach.[81] At a minimum, they spell out a clear link of business responsibilities, and hence go directly to the question of balancing the legitimate expectations *of* investors with the legitimate expectations *from* investors.

Unlike other areas of law where it may be easier to contract out of certain obligations, or to limit state acts to levels below international obligations, it is also arguable in the water context that this obligation cannot be contracted out of. The concept of an international obligation *erga omnes* or an obligation that has risen to the level of *jus cogens,* obligations owed to all humankind that cannot be derogated from, would be relevant here.[82] As water is a basic necessity of life, the consequences of allowing a contract or IIA to be read as a contracting out of such a right are significant and obvious.

A second area where human rights laws may be relevant is in the protection of indigenous peoples. The special situations of indigenous peoples in many cases has been recognized in international human rights documents. This can be relevant, for example, in assessing rights to access water as between a

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[79] Aguas Argentinas v. Argentina, Amicus Curia Decisión, ICSID Case No. ARB/03/19; Order in Response to a petition for Transparency and participation as Amicus Curiae, May 19, 2005, para. 19.

[80] See, e.g., Salman M. A. Salman , Siobhan McInerney-Lankford, The Human Right to Water: Legal and Policy Dimensions, World Bank Publications, 2004.

[81] E.g., OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, 1997; United Nations Convention Against Corruption, 2003.

[82] 82 An obligation erga omnes is one that is owed by a state to all other subjects of international law, irrespective of whether they have signed a formal treaty with all or the status of individuals as citizens or not of that state. An obligation that has risen to the level of jus cogens is one that, in accordance with Article 53 the Vienna Convention on the Law Of Treaties, cannot be contracted out of by states in a treaty. Any such contracting out is deemed invalid under international law.

foreign investor and an indigenous community. Often, the water rights of the latter may not have been codified in any way. Drawing on the special recognition of indigenous peoples status in international law may add weight to the argument that their rights are nonetheless cognizable in law and cannot be diminished by the needs of foreign investors, or at least not without their consent. Similarly, the right to receive clean and safe water may be heightened by historical or traditional claims of indigenous peoples.

3.3 Transboundary Water Agreements

The third area of international law to briefly consider is that of transboundary water agreements. Transboundary water law has a long history in both treaties and customary international law. The customary obligation not to allow transboundary pollution is a well known rule already noted above. Another critical element of this field is the setting of water allocation priorities based on equitable usage and ensuring, today, that basic human needs have priority usage. Where these obligations are present as between states in an agreement, and the host state is a party to such an agreement in relation to a water allocation that may be subject to an investor-state dispute, the treaty may well be drawn upon to support governmental allocation decisions. The existence of a treaty could do two things: show compliance by the states with international norms and hence the absence of any unreasonable behavior, and condition the expectations of the investor from the beginning as treaties are part of the legal environment into which they would have entered.[83]

In addition, many transboundary water agreements contain institutionalized decision-making processes for water allocations and water diversions. These may also be relevant factors for host governments to consider if water allocation decisions in a covered waterway become subject to challenge.

4. CONCLUSIONS: HELPING THE EXTRINSIC SOURCES OF INTERNATIONAL LAW WORK

One must be careful in not ascribing to international investment agreements

[83] The legal status of treaties as part of, or not part of, domestic law may be a technical factor to address here. This varies form state to state and would have to be dealt with specifically in relation to the host state involved.

powers or ills they do not possess. Investment agreements, for example, have not been the cause of the water privatizations in Argentina, elsewhere in Latin America, in the Philippines, Africa or anywhere else, or the cause of their failures. At the same time, it is true that investment agreements, in particular those with investment liberalization provisions (including in services sectors), can contribute to failed projects if liberalization is promoted in environments that lack the appropriate regulatory and administrative infrastructures to help them succeed and the economic capacity to sustain infrastructure privatizations. Perhaps the leading proponent of such premature liberalization to date has probably been the World Bank Group, but they have not been alone. It may also be noted that the World Bank has more recently moved to rethink a number of privatization related issues in relation to developing countries, including the need for more rather than less regulatory structure and capacity for privatized systems.

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t is also true that investment agreements do play a significant role in how disputes involving water privatizations are approached today. They will continue to play a significant role in how water allocation and water quality issues are approached in the future. This paper tries to address this linkage primarily in the dispute settlement context, based on the kinds of relationships between investment agreements and water described in Part 1 of the paper.

Some additional issues have not been addressed in the body of this paper. For example, transparency in the investor-state arbitration process has not been addressed here but is arguably an essential element for accountability that promotes a greater opening for inclusive arguments. This is because tribunals that know they are being watched will not want to appear to be limiting potentially relevant arguments from being made. Similarly, the different roles of states as defendants and civil society groups as potential *amicus curiae* have not been addressed. These kinds of issues, which go to the heart of a democratic and accountable dispute settlement process, do have a potentially significant impact on how an arbitration is heard and how it may be decided.

The arguments put forward above can be summarized as follows. There are significant opportunities within the structure of international investment agreements and investor-state arbitrations for sources of international law outside of the treaties themselves to be raised in an arbitration. These

sources include other treaties, customary international law and general principles of law. The uses for such extrinsic elements of international law can be as a supplementary means of interpretation of investment treaty provisions, as sources of international law directly applicable where treaties allow for these to be raised, as indicators of the scope of police powers measures as understood in customary international law and of the scope of the inherent right of states to regulate, and as legally conditioning elements that help define the legitimate expectations of an investor.

Any combination of source of law and uses may be relevant in a given arbitration. Only the facts and legal issues raised in a specific case can determine what will or will not be relevant. None are certain to make a difference in the outcome of a case, but equally any of them, used in the right combination and in the proper legal context, can have a significant impact on a decision. To achieve this type of impact, strategic choices must be made. Lawyers and their clients, whether in government or in civil society, must act pragmatically and strategically. Arguments must be cogent, complete and well set out in the context of the dispute before the tribunal, which is about the application of the rights and obligations under an IIA to a specific situation. Polemics and broad generalizations will not likely be well received and are unlikely to have an impact.

Government lawyers can help the process through a more carefully weighed choice of arbitrator than has often been seen to date. All lawyers must consider the arbitrators involved in a case and see if their writings or prior decisions give indications of how to approach the broadening of the law being presented to them: what concerns have they shown in the past in related areas of law? Can you respond to them with outside sources?

In short, it is submitted that there are significant opportunities to inform the deliberations of an investor-state tribunal with extrinsic sources of law through cogent, well directed arguments. This does not replace the need to alter agreements to reduce some of the inequities and fix the democratic deficits they present. But it does suggest that states and civil society groups should not give up when an arbitration is announced against them, and that they should not play only by the presumed rules set by an investor. The scope for argument is potentially broad and leaves much room for creativity when it can be properly harnessed.