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Stabilization Clauses in International Investment Law: Beyond Balancing and Fair and Equitable Treatment

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Stabilization Clauses in International Investment Law: Beyond Balancing and Fair and Equitable Treatment

by

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A. Introduction

Stabilization clauses are provisions in investment contracts that accommodate the risk of regulatory changes for investors.[1] Given their nature of safeguarding individual interests of investors, stabilization clauses may cause tensions with interfering states' regulation in the public interest, including to protect human rights or more generally to work towards sustainable development.[2] The debate on stabilization clauses closely relates to the more general call for coherence between investors' rights and legitimate public interest in international investment law.[3] There is increasing public criticism regarding the one-sidedness of investment law, protecting investors' rights without at the same time anchoring investors' responsibilities for human rights and sustainable development.[4] Some start to question the contribution of international investment law to sustainable development[5] and its positive effect on the rule of law, some call for taking into account the whole picture of sustainable development when dealing with international investment law.[6] The purpose of investment law is, in the first place, the protection of economic (human) rights,[7] such as the freedom to trade or to conduct a business, non-discrimination, or property rights related to business activities. Other human rights issues touching upon social and environmental issues, highly relevant for development and long term sustainable economy as well, are not subject to international investment law in the first place as these belong to other domains of international law, such as international social or environmental law. Such delimitation is, however, somehow artificial, as these domains overlap with investment protection standards and may significantly influence trade and investment (e.g. investment climate, business risks, and competition). Today, most parties to international investment agreements (IIAs) or the WTO belong to one of the core human rights treaties,[8]

1 See below A, I.

2 *Cotula*, Regulatory Takings, Stabilization Clauses and Sustainable Development, OECD VII Global Forum on International Investment, 1 et seq, available at: <http://www.oecd.org/dataoecd/45/8/40311122.pdf> (visited 11 February 2017); *Amnesty International UK*, Human Rights on the Line: The Baku-Tblisi-Ceyhan Pipeline Project, May 2003, 16, available at: <https://www.amnesty.org.uk/files/baku_line_0.pdf> (visited 18 March 2017).

3 *OECD*, Indirect Expropriation" and the 'Right to Regulate' in International Investment Law, Working Papers in International Investment (No 4, 2004), available at: <https://www.oecd.org/daf/inv/investment-policy/WP-2004_4.pdf> (visited 11 February 2017); *Kriebaum*, Journal of World Investment and Trade 8 (2008), 717 et seq; *Markert*, in: Bungenberg/Griebel/Hindelang (eds), European Yearbook of International Economic Law (2011), 145 et seq.

4 *Newcombe*, Journal of World Investment and Trade 8 (2007), 357 (359).

5 Public Statement on the International Investment Law Regime, 31 August 2010, available at: <http://www.osgoode.yorku.ca/public-statement-international-investment-regime-31-august-2010/> (visited 11 February 2017).

6 *Cottier/Gehne/Schultheiss*, in: König/Matz-Lück/Röben/Seibert-Fohr/Stoll/Vönekey (eds), Coexistence, Cooperation and Solidarity – Liber Amicorum Rüdiger Wolfrum, 367 (369); *Gehne*, in: International Land Coalition (ed), International Instruments Influencing the Rights of People facing Investments in Agricultural Land, 88-131.

7 *Petersmann*, European Journal of International Law 13 (No 3, 2008), 621 (629).

8 *Choudhury/Gehne/Heri/Humbert/Kaufmann/Nadakavukaren Schefer,* in: Cottier/Delimatsis (eds), The Prospects of International Trade, 323 (328).

and are thus at the same time bound to investment and other human rights legal regimes. The same is true for environmental regulation and related state obligations on the basis of international environmental law. Thus, "hard cases" may occur, when legal principles of different legal regimes collide with no clear rule determining the case.[9] In such cases, how the case is resolved very much depends on the "pre-analytic vision of law".[10] In general, investment protection standards remain relatively broad and will leave a margin of interpretation that allows for reconciling overlapping obligations of states in the social, environmental and investment fields. The tension underlying investment protection and other fields of human rights and environmental standards, therefore, seems mostly to arise from the scope of due legal interpretation.

This changes when stabilization clauses come to play. They create a tighter legal regime for host states, and demand specific legal answers when it comes to balancing overlapping fields of investment protection and public interest regulation. This paper intends to give an insight in the context and debate of stabilization clauses (B.) and arbitral decisions which have directly or indirectly dealt with stabilization clauses (C.). Against this backdrop, the paper explores possible interpretative leeway to reconcile conflicts with socially or environmentally related public interest regulation of host states (D). As a conclusion, stabilization clauses, at least in their most general form – i.e. providing for freezing or compensating any change in law (general stabilization clauses) – fail to fulfil their original purpose of investment protection and security today as they may provoke rather than remedy legal uncertainty and business risk. Strict application of general stabilisation clauses may damage and not protect business interests, and furthermore, delegitimize international investment law as such. Lawyers and arbitrators should be aware of these effects when dealing with stabilization clauses in international investment law, and investors and states should use general stabilization commitments with caution. Carefully tailored provisions that better respond to actual interests in investment incentives and protection and security may better suit the overall interests of all concerned parties (E.).

B. Stabilization clauses: background and debate

I. Current features of stabilization clauses in investor-state contracts

General information about stabilization clauses in contractual practice is difficult to find, as investor-state agreements are not easily publicly accessible. In 2008, a study under the auspices of the Special Representative of the Secretary-General for business and human rights (SRSG) and the International Finance Corporation (IFC) explored the role of stabilization clauses in practice, particularly regarding their potential to negatively influence host states' and companies' human rights compliance record

9 See for the "rights thesis" that is based on a "principle and rights" approach in so called "hard cases" when no settled rule dictates a decision either way, *Dworkin*, Harvard Law Review 88 (No 6, 1975), 1057 (1060).

10 *Gehne*, Nachhaltige Entwicklung als Rechtsprinzip, 278 et seq.

(SRSG study).[11] The study defines stabilization clauses as "contractual clauses in private contracts between investors and host states that address the issue of changes in law in the host state during the life of the project".[12] It identifies three main types of modern stabilization practice. First, "freezing clauses" that exempt an investment from the application of new laws, "freezing" the law of the host state, either in its entirety or limited to certain regulatory fields (e.g. fiscal issues); second, "equilibrium clauses" that cover the financial loss that relates to changes in law; and third, "hybrid clauses" that are combinations of freezing and economic equilibrium clauses, providing in complementing each other "an additional layer of protection for stability of the contract".[13] Hybrid clauses leave it to the parties to determine whether economic equilibrium is to be achieved through exemption from regulatory change or other forms of "alleviation of the unfavourable impact of changes"[14] such as contract adaptation or compensation. This classification proposed by the study is a rough analytical description of the characteristics of stabilization clauses; it is not necessarily congruent with the terminology in practice.[15] In the following sections, we adhere to this terminology to discuss the general features and effects of these clauses. We are well aware that the level of complexity in stabilization practice is high, and can hardly be generalized.

Freezing clauses have been the "classic approach" to contract stability for investors. They "freeze" the law "as in force of" the date of the conclusion of the contract"[16] or determine that "laws and decrees which may in the future impose higher rates or more progressive rates of tax or would otherwise impose a greater […] tax liability […] shall not apply to the Company".[17] Freezing clauses may also embrace court decisions subsequently in force.[18] Some forms of freezing commitments stipulate that the contract shall apply as *lex specialis* over current or subsequent legislative enactments", or only if "consistent with the investment contract". Other clauses may "insulate the contractual relationship from any material adverse effect" (MAE).[19] Even though freezing clauses seem to "freeze" the right of the host state to regulate with respect to the investment contract between the parties and by this turn any adverse state action illegal, these clauses are still "no guarantee against the state's exercise of sovereign authority in the public interest".[20] They can, however, "entitle the aggrieved party to a higher

[11] See for a later analysis and overview *Titi*, Journal du Droit International 141 (No 2, 2014), 97 (99 et seq).

[12] *Shemberg*, Stabilization Clauses and Human Rights, IFC/SRSG Research Paper, 27 May 2009, 4, available at: <http://www.ifc.org/wps/wcm/connect/9feb5b00488555eab8c4fa6a6515bb18/Stabilization%2BPaper.pdf?MOD=AJPERES> (visited 11 February 2017).

[13] *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (127).

[14] See hybrid clause example, *Shemberg*, Stabilization Clauses and Human Rights, IFC/SRSG Research Paper, 27 May 2009, 8, available at: <http://www.ifc.org/wps/wcm/connect/9feb5b004 88555eab8c4fa6a6515bb18/ Stabilization%2BPaper.pdf?MOD=AJPERES>, 4 (visited 13 July 2016).

[15] See for example, *Alexander*, Journal of World Energy Law & Business 2 (No 3, 2009), 243 (244).

[16] *Dolzer/Schreuer*, Principles of International Investment Law, 75.

[17] *Ibid.*

[18] *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (123).

[19] *Ibid*, 122.

[20] *Ibid*, 126.

amount of compensation for its violation than in the case where such a clause is absent".[21]

The modern alternative to freezing clauses is economic equilibrium clauses. They often include negotiation provisions, sometimes vested with recourse to a third party (arbitration) to determine adaptation when negotiations fail.[22] Some clauses also leave room for flexibility, such as threshold financial losses, restriction to discriminatory measures, the obligation of the investor to mitigate compliance costs, or the operation of the clause in the investors' and the host states' favour, e.g. with host states sharing benefits in cases of unforeseen raises in profits.[23] From a legal point of view, "economic equilibrium clauses do not seem to pose significant problems, as they do not prevent host state regulation so long as the economic equilibrium is restored",[24] while freezing clauses limit state sovereignty and turn any adverse state action illegal. However, from a political point of view, although they provide greater flexibility and are at first glance less intrusive with respect to the state's sovereignty, economic equilibrium clauses may prove costly for the state. Restoring the economic equilibrium could lead to a more comprehensive claim for damages and a larger coverage of claims than compensation for the breach of freezing commitments.[25] However, other than freezing clauses, "economic equilibrium clauses are generally only triggered where a minimum threshold is met – namely where the economic equilibrium of the contract is affected".[26] An often cited advantage of economic equilibrium clauses is their contribution to the stability of the investor-state relationship. It is argued that re-adjusting the economic equilibrium and negotiation tool could maintain a negotiation atmosphere when otherwise the tension between host states' regulatory interests and investors' expectations would have amounted to conflict and contractual breach.[27] This is why some attribute to negotiation clauses the general advantage of leaving the "state's sovereignty more intact" and of "protect[ing] the investor against changes in the law".[28] Others see the alleged positive influence of economic balancing provisions and re-negotiation clauses more critically, pointing to the fact that they leave an unsettled legal situation open and that re-negotiation may not be as conflict-preventing as it seems.[29] Negotiation and recourse to a third party may put agreed legal obligations in question. According to

[21] *Ibid.*

[22] *Ibid*, 128; *Gotanda*, Vanderbilt Journal of Transnational Law 36 (2003), 1461 (1462 et seq), *Shemberg*, Stabilization Clauses and Human Rights, IFC/SRSG Research Paper, 27 May 2009, 7, 28, available at: <http://www.ifc.org/wps/wcm/connect/9feb5b00488555eab8c4fa6a6515bb18/Stabilization%2BPaper.pdf?MOD=AJPERES> (visited 11 February 2017). The authors observed that most equilibrium clauses are vested with negotiation tools.

[23] *Shemberg*, Stabilization Clauses and Human Rights, IFC/SRSG Research Paper, 27 May 2009, 8, available at: <http://www.ifc.org/wps/wcm/connect/9feb5b00488555eab8c4fa6a6515bb18/Stabilization%2B Paper.pdfMOD=AJPERES> (visited 11 February 2017).

[24] *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158-179.

[25] *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (126).

[26] *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158 (166).

[27] *Gotanda*, Vanderbilt Journal of Transnational Law 36 (2003), 1461 (1469); *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158 (176).

[28] *Berger*, Vanderbilt Journal of Transnational Law 36 (2003), 1347 (1364).

[29] *Gotanda*, Vanderbilt Journal of Transnational Law 36 (2003), 1461 (1469); *Alexander*, Journal of World Energy Law & Business 2 (No 3, 2009), 243 (252).

some commentators, this rather hampers than promotes the contract's stability,[30] the more so as the scope of stabilization clauses is often very little specified and leaves room for interpretation.[31]

II. Stabilization clauses rationale and practice

The rationale of stabilization clauses is risk management for foreign investments. Stabilization clauses are mostly included in contracts that relate to capital-intensive projects in foreign countries, such as extractive industry, infrastructure or public services' projects (e.g. mining, oil, electricity, water and sewage, telecommunications, transport) and involve concession agreements (CA), production sharing agreements (PSA), and build-operate and transfer agreements (BOT).[32] These projects typically require large initial capital investments and become profitable over time. According to the SRSG study, credit grantors view stabilization clauses as vital in order to mitigate the financial risk of such investments, particularly for "nonrecourse financing" when the repayment is exclusively linked to the project's performance.[33] Large projects with longer periods to recover the costs and generate profits, such as infrastructure investments, seek guarantees so that changing investment conditions do not harm the cost-benefit equilibrium of the investment. Pre-investment cost-benefit calculations may be significantly distorted by later environmental and social legislation, e.g. related to new technology standards or employment and healthcare regulation.[34] Host states generally grant stabilization clauses to accommodate investors' interests and attract future investment by providing a high level of warranty.[35] Their use is fostered by their inclusion in model agreements that set a certain standard of protection for specific sectors or industries, such as, for example, the Energy Charter Model Host Government Agreement (HGA) on Cross-Border Pipelines.[36]

As to their frequency in practice, the SRSG study has analysed a wide range of industries, such as infrastructure, extractive industries, telecommunication, and health care services, on the basis of 76 contracts and 12 contract models from different re-

[30] *Gotanda*, Vanderbilt Journal of Transnational Law 36 (2003), 1461 (1463 et seq).

[31] Maniruzzaman, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (129).

[32] *Cotula*, Foreign Investment Contracts, International Institute for Environment and Development (IIED), Sustainable Markets Investment Briefings (No 4, 2007), 1, available at: <http://pubs.iied.org/pdfs/17015IIED.pdf> (visited 18 March 2017).

[33] *Ibid*, 2, *Shemberg*, Stabilization Clauses and Human Rights, IFC/SRSG Research Paper, 27 May 2009, 5, available at: <http://www.ifc.org/wps/wcm/connect/9feb5b00488555eab8c4fa6a6515bb18/Stabilization%2BPaper.pdf?MOD=AJPERES> (visited 11 February 2017).

[34] See *Wälde*, Centre for Energy, Petroleum and Mineral Law and Policy, Professional Papers 13 (1994), 1 (5).

[35] *Shemberg*, Stabilization Clauses and Human Rights, IFC/SRSG Research Paper, 27 May 2009, 5, available at: <http://www.ifc.org/wps/wcm/connect/9feb5b00488555eab8c4fa6a6515bb18/Stabilization%2BPaper.pdf?MOD=AJPERES> (visited 11 February 2017).

[36] *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (135); the Energy Charter Host Government Agreement (HGA) model stabilization clause was at the basis of the civil society protest against the Baku-Tblisi-Ceyhan (BTC) pipeline project and the West African Gas Pipeline (WAGP) projects. Since, the HGA model has changed, see Energy Charter Model HGA, available at: <http:/www.encharter.org/index.php? id=182> (visited 11 February 2017).

gions of the world, including Sub-Saharan Africa, East Asia and Pacific, Middle East and North Africa, Eastern Europe, Southern Europe and Central Asia, South Asia, Latin America, the Caribbean and OECD countries.[37] According to the study's findings, freezing clauses still belong to modern investment contract practice with respect to Sub-Saharan Africa, Eastern and Southern Europe, Central Asia, the Middle East and North Africa, and especially in the extractive industry.[38] In the 1970s and 1980s, in the aftermath of colonialization, the use of freezing commitments came under pressure as the freezing effect considerably reduces the sovereign power of the host state. The UN-General Assembly issued resolutions that emphasized the sovereignty of states, stressing the need for fairness in the share of benefits, solidarity and technology transfer in international investment relations.[39] The study shows that even though freezing clauses are designated "to be outdated",[40] they are still commonly used. Some still consider them to be the best and most secure form of contractual stability.[41] Today, they usually come along in rather modern forms of "*lex specialis*", "intangibility" or "consistency" clauses.[42] Frequent use of freezing clauses by a host state with respect to different investors over time may cause significant administrative complexity: to each investment another law is applicable, creating legal enclaves of which the administration has to keep track.[43] This may cause frictions, distortion in domestic competition, inequalities and tensions within the country, and constitute a challenge for de-

37 *Shemberg*, Stabilization Clauses and Human Rights, IFC/SRSG Research Paper, 27 May 2009, 11, available at: <http://www.ifc.org/wps/wcm/connect/9feb5b00488555eab8c4fa6a6515bb18/Stabilization%2BPaper.pdf?MOD=AJPERES> (visited 11 February 2017).

38 *Ibid*, 19, *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (123).

39 United Nations General Assembly (UNGA) Resolution 1803 (XVII), on the Permanent Sovereignty over Natural Resources; UNGA Resolution 3281 (XXIX), Charter of Economic Rights and Duties of States; UNGA Resolution 3201 (S-VI), Declaration on the Establishment of a New International Economic Order.

40 *Shemberg*, Stabilization Clauses and Human Rights, IFC/SRSG Research Paper, 27 May 2009, 7, available at: <http://www.ifc.org/wps/wcm/connect/9feb5b00488555eab8c4fa6a6515bb18/Stabilization%2BPaper.pdf?MOD=AJPERES> (visited 11 February 2017).

41 *Gotanda*, Vanderbilt Journal of Transnational Law 36 (2003), 1461 (1468).

42 *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (125). An example of a clause in the BTC context that was subject to civil society campaigning reads as follows quoted from *Titi*, Journal du Droit International 141 (No 2, 2014), 97 (113). Article 7.2(x) of the contractual agreement with Azerbaijan: "[T]he State Authorities shall take all actions available to them to restore the Economic Equilibrium established under the Project Agreements if and to the extent the Economic Equilibrium is disrupted or negatively affected, directly or indirectly, as a result of any change (whether the change is specific to the Project or of general application) in Azerbaijan Law (including any Azerbaijan Laws regarding Taxes, health, safety and the environment)[...], including changes resulting from the amendment, repeal, withdrawal, termination or expiration of Azerbaijan Law, the enactment, promulgation or issuance of Azerbaijan Law, the interpretation or application of Azerbaijan Law (whether by the courts, the executive or legislative authorities, or administrative or regulatory bodies), the decisions, policies or other similar actions of judicial bodies, tribunals and courts, the State Authorities, jurisdictional alterations, and the failure or refusal of judicial bodies, tribunals and courts, and/or the State Authorities to take action, exercise authority or enforce Azerbaijan Law (a « Change in Law »). The foregoing obligation to take all actions available to restore the Economic Equilibrium shall include the obligation to take all appropriate measures [...], including by way of exemption, legislation, decree and/or other authoritative acts, any conflict or anomaly between any Project Agreement and such Azerbaijan Law".

43 *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (124).

veloping countries where administration often suffers from scarcity of resources and electronic equipment, problems of governance, and related difficulty in inspection and documentation. In developing countries, fundamental standards of environmental protection or human rights (e.g. health and safety, labour standards) may also be insufficiently regulated or enforced. Thus, situations of considerable environmental or social impact may persist against the backdrop of "legal freezing shields", the more so, as investment contracts usually stay in force over a long period of time.[44]

Freezing clauses usually do not feature in contracts with OECD countries. Here, limited economic equilibrium clauses addressing specific regulatory risks prevail. In OECD-contracts, their scope is generally restricted to discriminatory regulation and they may exclude regulation on safety, security and other public concerns, such as environmental or social legislation. Conversely, full economic equilibrium clauses covering any regulatory change regardless of its discriminatory effect or *bona fide* motivation, are predominant in contracts with non-OECD countries, e.g. related to the power, water, transportation, infrastructure, and the extractive industry. The difference between the practices of developing and OECD states is explained with the assumption that in OECD countries risks related to change in law are lower than in developing countries, and therefore need less extensive stabilization protection.[45] The standard of social and environmental protection may also be significantly lower, so raising standards, if not taken into account in the original economic equilibrium, could be more costly and pose more risks (e.g. in terms of licenses).

III. Business' commitment to social responsibility and public-private soft law frameworks

In response to civil society pressure, investors took initiatives to publish[46] and limit stabilization commitments, including change in law or law application regarding national courts' decisions, human rights and environmental protection. An often cited example is the Baku-Tbilisi-Ceyhan (BTC) pipeline consortium's "Human Rights Undertaking" to prevent eventual impacts of the contract's stabilization clause on measures of public concern, reacting to strong civil society campaigning.[47] Paragraph 2(d) of the Undertaking stipulates that the BTC consortium "shall not seek compensation under the 'economic equilibrium' clause or other similar provisions [...] in such a manner as to preclude any action or inaction by the relevant Host Government that

44 See Human Righs Council (HRC), Business and human rights: Towards operationalizing the "protect, respect and remedy" framework, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, para. 30, available at: <http://www2.ohchr.org/english/bodies/hrcouncil/docs/11session/A.HRC.11.13.pdf> (visited: 18 March 2017).

45 See *Faruque*, Journal of International Arbitration 23 (No 4, 2006), 317 (334); *Shemberg*, Stabilization Clauses and Human Rights, IFC/SRSG Research Paper, 27 May 2009, 33, available at: <http://www.ifc.org/wps/wcm/connect/9feb5b00488555eab8c4fa6a6515bb18/Stabilization%2BPaper.pdf?MOD=AJPERES> (visited 11 February 2017).

46 See for example BP, available at: <http://www.bp.com/en_az/caspian/aboutus/legalagreements.html> (visited 11 February 2017).

47 See e.g. *Cernic,* German Law Journal 11 (No 2, 2010), 210 (222).

is reasonably required to fulfil the obligations of that Host Government under any international treaty on human rights (including the ECHR), labour or HSE (health, safety, environment) in force in the relevant Project State from time to time to which such Project State is then a party". Paragraph 2(a) excludes more generally claims against host state measures that are based on human rights, health, safety and environmental aspects, provided that domestic regulation is "reasonably required by international labor or human rights treaties to which the Host Government is a party" and that "domestic law is no more stringent than the highest of European Union standards as referred to in the Project Agreements, including relevant EU directives ('EU Standards'), those World Bank Group standards referred to in the Project Agreements, and standards under applicable international labor and human rights treaties"[48]. This constitutes a formal declaration to exempt from the stabilization commitment measures that reflect the host states' public concerns related to the environment, human rights, and safety.[49] Although the Human Rights Undertaking is a unilateral declaration, it is formally binding as it cannot be revoked without the host states' consent.[50]

More generally, a large number of investors and companies have committed to conduct their business in a way that respects human rights and environmental protection, health and safety. Major global business players engage in standard setting activities, such as the Global Business Initiative on Human Rights (GBI).[51] Self-regulatory or multi-stakeholder initiatives, such as the Extractive Industry Transparency Initiative (EITI) and the Kimberly Process Certification Scheme (KPCS) in the extractive industry or the Roundtable on Sustainable Palm Oil (RSPO) in the agricultural field develop procedures and standards to foster responsible business conduct. Likewise, the financial services sector has developed guidelines to foster respect of sustainable development criteria, including human rights and environmental standards (Equator Principles).

In parallel, companies support international frameworks fostering good business conduct, such as the Global Compact, a UN-framework which issued 10 guiding principles for good business practices, and provides a forum for stakeholders. Members have the right to use an UN-label, provided that they comply with reporting requirements on good business practices. In the financial sector, the UNEP Finance Initiative (UNEP FI) has created a platform for good business practices, and the International Finance Corporation (IFC) established a Sustainability Framework with respect to financial support, following a long stakeholder revision process that culmi-

48 The Baku-Tbilisi-Ceyhan Pipeline Company, BTC Human Rights Undertaking, 22 September 2003, para. 2 (a), available at: <http://subsites.bp.com/caspian/Human%20Rights%20Undertaking.pdf> (visited 11 February 2017).

49 *Cotula*, Regulatory Takings, Stabilization Clauses and Sustainable Development, OECD VII Global Forum on International Investment, 1 (14), available at: <http://www.oecd.org/dataoecd/45/8/40311122.pdf> (visited 11 February 2017).

50 The Baku-Tbilisi-Ceyhan Pipeline Company, BTC Human Rights Undertaking, 22 September 2003, para. 6, available at: <http://subsites.bp.com/caspian/Human%20Rights%20Undertaking.pdf>, (visited 11 February 2017).

51 See for more information: <http://www.global-business-initiative.org/members/> (visited February 2017).

nated in its adoption in May 2011. The framework comprises the previously existing Performance Standards, which form the basis of investors' duty to assess social and environmental risks of an investment project.

Another prominent international initiative has been the mandate of the UN Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises (SRSG), John Ruggie, which was conducted under the Human Rights Council's special procedures. The aim was to facilitate further development of a business and human rights international framework after the United Nations Sub-Commission on the Promotion and Protection of Human Rights' attempt to "[d]raft norms on the responsibility of trans-national corporations and other business enterprises with regard to human rights" (UN-norms) failed. The result of the mandate was the adoption by the Human Rights Council of the UN Guiding Principles on Business and Human Rights, endorsing and guiding the implementation of the now very popular three prong framework (i) "states' duty to protect human rights, (ii) business' responsibility to respect human rights, and (iii) remedy to "investigate, punish and seek redress for abuses"[52]. This framework was the result of a comprehensive stakeholder process that facilitated its recognition and allowed for widespread acceptance. The business' responsibility to respect human rights includes a "human rights due-diligence process to identify, prevent, mitigate and account for how [business enterprises] address their impacts on human rights".[53]

Confronted with customer inquiries and investment funds that are increasingly focusing on compliance with and promotion of human rights and sustainable development, companies are more and more under pressure to respond to these principles. Key reporting standards such as the Global Reporting Initiatives' (GRI) wide spread benchmark for companies' sustainability reporting (non-financial reporting)[54] or the Dow Jones Sustainability Index (DJSI) RobecoSam questionnaire,[55] implicitly or explicitly refer to the UN Guiding Principles. In 2011 the revised OECD Guidelines for Multinational Enterprises (OECD MNE Guidelines), a soft law framework for responsible business conduct initially put in place in 1976, have endorsed the UN Guiding Principles, including the due diligence standard, by inserting a new chapter on human rights. Within the OECD framework, according to the OECD MNE Guidelines, non-compliance may result in complaints before National Contact Points. Although this is a non-legal, mediation-like instrument, there is considerable so-felt pressure for reputational harm. From a business perspective, adverse effects on human rights, public health or environmental concerns constitute business risks (reputational harm, legal insecurity and political instability). Investors may need to pull out of fi-

52 *Harrison*, Human Rights and Transnational Corporations: Can More Meaningful International Obligations Be Established?, Warwick School of Law Research Paper, 23 October 2009, 1 (16), available at: <http://ssrn.com/abstract=1493305> (visited 11 February 2017).

53 Office of the High Commissioner for Human Rights (OHCHR), Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework, available at: <http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf> (visited 11 February 2017).

54 See https://www.globalreporting.org/Pages/default.aspx (visited 11 February 2017).

55 See for more information: <https://www.globalreporting.org/Pages/default.aspx> (visited 11 February 2017)

nancing a project if they cannot afford in risk management terms to resist public pressure of the home state (e.g. in the context of Hermes guarantees[56]) or civil society. Even though business commitments and initiatives are often broad in scope,[57] and generally not directly legally binding, their soft-binding effect, mainly in terms of law interpretation, is non-negligible. Public declaration and positioning of a company regarding respect for human rights and environmental standards is – with regard to the principle of good faith – hardly reconcilable with claims on the basis of general stabilization clauses interfering with these standards.

IV. The political concern regarding stabilization practice

As described above, stabilization clauses in their far-reaching forms may guarantee recompense for *bona fide* state activities that interfere with the investment. States need, however, to adapt their regulation to keep pace with the needs and challenges they face, including participation in international standard setting, and compliance with or adaptation to international standards. As the arbitral tribunal in *AES v. Hungary* states "[a] legal framework is by definition subject to change as it adapts to new circumstances day by day." For the tribunal in *Feldman v. Mexico* this aspect is crucial for a state's affairs:

> "Governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this".[58]

Stabilization clauses do not actually prevent governments from regulating in the public interest;[59] even freezing clauses do not exclude a host government's right to exercise its sovereign power.[60] Even if governments violate freezing commitments, this does not hinder change in law but triggers compensation for unlawful acts.[61] The key consequence of stabilization clauses is thus that changes in law come with a price to

56 See for more information: <http://www.bmwi.de/DE/Themen/Aussenwirtschaft/Aussenwirtschaftsfoerderung/finanzierung-und-absicherung-von-auslandsgeschaeften,did=190888.html> (visited 11 February 2017).

57 See *Leader*, Journal of International Economic Law 9 (2006), 657 (670).

58 *Marvin Feldman v. Mexico* (hereinafter *Feldman v. Mexico*), ICSID Case No ARB(AF)/99/1, Award and Separate Opinion, 16 December 2002, para. 103, available at: <http://www.italaw.com/sites/default/files/case-documents/ita0319.pdf> (visited 11 February 2017).

59 As the diverging decisions *Texaco v. Libya* and *Liamco v. Libya* show, there is legal uncertainty as to the actual "freezing" effect of these clauses. While in the Texaco case the tribunal hold "the sovereign ability of a state to bind itself" valuable, the Liamco decision presumes that freezing clauses do not affect the sovereign right of the state, but trigger compensation, see B. I. below.

60 *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (126), see below B. I.

61 *Wälde*, Centre for Energy, Petroleum and Mineral Law and Policy, Professional Papers 13 (1994), 1 (38), see B, I below.

pay, including reasonable *bona fide* regulation that does not discriminate or unreasonably, unnecessarily or unfairly affect the investor.

In particular, with respect to long term large-scale investments (e.g. infrastructural or power projects) and the usual far-reaching extent of the stabilization guarantee under which they operate, changes in law could trigger high amounts of compensation that may come close to significant budget percentages in developing countries. As described above, even if left with the possibility of escaping compensation payments by not applying subsequent legislation to an investment (like in the case of freezing clauses), the effectiveness of that legislation may suffer as frictions and inequalities in competition may occur. Although economic balancing clauses leave more space for flexibility and negotiation and may be conducive to good practices, they nevertheless provide for systematic compensation or restoration of an estimated equilibrium through adaptation of the contract, including changes for non-discriminatory *bona fide* activities in the public interest.

Moreover, independent of their actual enforcement, scope or interpretation, stabilization clauses establish legally protected expectations that could result in compensation claims. Voices from civil society and academia have expressed the concern that this could cause a "regulatory chill effect"[62] that could impair human rights protection and the implementation of environmental standards, and more generally disincentivize states to progress and cooperate with a view toward achieving sustainable development. The presumption of the "regulatory chill effect" is based on the effect of pre-enforcement compliance which is actually part of the purpose of law and has an effect that is independent of the enforcement of contract rights by the investor.[63] Binding law creates pre-obedience, at least until there is certainty that the enforcement "stick" will not apply.[64] To avoid costs, the state may not enforce or even chose to exempt the investor from the application of new laws and regulation, with the potential negative impact that may come with it (distortion of market-efficiency and competition, inequalities and resulting tensions, frictions in law and administration, impact on human rights and the environment). Absent data and studies it is difficult to judge the actual impact on the host states' motivation to regulate in the public interest. The question would need closer examination. Experienced practitioners point out that the "chill effect" may be a chimera. States may not even be aware of the far reaching effect of stabilization or not care about contractual obligations in the face of public interest regulation.[65] However, one can hardly deny that there is a "dissuasive element"[66] in the conditions underlying state regulation under possible effects of stabilization clauses. It is a matter of fact of modern investment law and arbitration that states that potentially

62 *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158 (168 et seq).

63 See regarding the importance of this aspect with respect to stabilization clauses, *Faruque*, Journal of International Arbitration 23 (No 4, 2006), 317 (334 et seq).

64 See for an analysis touching upon the question why states comply with international law, here at the example of WTO law which may allow for drawing parallels: *Chaisse*, Fordham International Law Journal 38 (2015), 57 (59 et seq).

65 We are indebted to *Roberto Echandi* and *Christian Häberli* for practitioners' insights. See *Crockett*, in: Brown/Miles (eds), Evolution in Investment Treaty Law and Arbitration, 516 (527).

66 *Titi*, Journal du Droit International 141 (No 2, 2014), 97 (105).

breach the law are likely to face very costly arbitration and compensation claims, and many have already made this experience.

The situation is specifically delicate where poor developing countries' are the host states. According to the IFC-SRSG-study they are – as countries with high business risks – typically involved in the most far reaching freezing or equilibrium stabilization practice. Developing countries seek investment for development, and they need foreign investment in particular for cost intensive infrastructure projects. Due to lack of control mechanisms, nepotism and power accumulation, government officials may profit from investments and accept conditions with not much regard to the public good, or lack experience and know-how when it comes to investment contract or treaty negotiations. Consequently, one cannot necessarily presume that an investment contract or treaty reflects a thorough balance between investors' rights and the public interest. Moreover, law in developing countries may not amount to the state of the art industry practice. Even if most developing states are bound to human rights instruments and international environmental standards, and often have a high level of legislation, the state of implementation may be embryonic and require progressive implementation and awareness over time to become fully effective. Poor states are particularly vulnerable to high compensation costs that could be triggered by social and environmental legislation, and finally, due to weak or lacking institutions or non-existing or non-effective participatory processes, individual citizens of these countries barely have access to remedy when adversely affected by investment projects.[67]

C. Stabilization clauses in international arbitration

Investment decisions that directly or indirectly dealt with stabilization clauses[68] can be divided into three main categories. The first category, more abundant, concerns early cases addressing the question of whether stabilization clauses could indeed bind sovereign power to a commitment not to expropriate or whether they constitute specific protection against arbitrary unilateral state action. The second category refers to cases in which stabilization clauses were indirectly referred to *in arguendo* to dismiss claims against alleged regulatory action on the basis that in those cases there was no specific commitment to stabilization. Finally, the third category addresses disputes where stabilization clauses were directly at issue. In all cases, the validity of stabilization clauses as *lex specialis* commitment was not put into question by arbitrators. To the contrary, ICSID tribunals, for instance, seem to have adopted a favourable attitude to such clauses.[69] For example, the tribunal in *AGIP v. Congo* sought to place

67 *Cottier/Gehne/Schultheiss*, in: König/Matz-Lück/Röben/Seibert-Fohr/Stoll/Vönekey (eds), Coexistence, Cooperation and Solidarity – Liber Amicorum Rüdiger Wolfrum, 367 (375).

68 The scarcity of reported investment disputes that involve stabilization clauses poses a challenge when attempting to identify trends in their interpretation by arbitrators. The picture that will be presented in the following paragraphs may thus not be complete, see *Shemberg*, Stabilization Clauses and Human Rights, IFC/SRSG Research Paper, 27 May 2009, xi, available at: <http://www.ifc.org/wps/wcm/connect/9feb5b00488555eab8c4fa6a6515bb18/Stabilization%2BPaper.pdf?MOD=AJPERES> (visited 11 February 2017).

69 *Schreuer/Malintoppi/Reinisch/Sinclair*, The ICSID Convention, a Commentary, 589.

stabilization clauses as part of international law,[70] and the tribunal in *LETCO v. Liberia* observed that such clauses must be respected.[71] More recently, in *CMS v. Argentina*, the tribunal, after noting that the discussion concerning stabilization clauses was well known in international law, asserted that these clauses ensure a right that can be properly invoked by investors.[72]

I. Legality of stabilization clauses

The first category of cases dealing with stabilization clauses is to be examined in the context of nationalizations and expropriations in the 1970s and 1980s. These involve the legality and binding nature of stabilization clauses.[73] Legal arguments revolve around the sovereignty of the host state and the extent to which stabilization clauses would "contract out" its sovereign power. The arbitral practice is divided in this regard. The question has never been fully settled.[74] In the *Texaco v. Libya* case, the tribunal held that stabilization clauses limit the host state's sovereignty as the host state in exercising its sovereignty committed to its waiving.[75] The tribunal referred to the UN General Assembly Resolution 1803 on the Permanent Sovereignty of States over Natural Resources as expressing customary international law and to the principle *pacta sunt servanda*.[76] In contrast to this reasoning, the tribunal in the *Liamco v. Libya* upheld the state's sovereign right to nationalize as being lawful, however, provided that it is accompanied by adequate compensation.[77] The arbitral decision in the *Aminoil v. Kuwait* case goes in a similar direction. The tribunal presumed that the limitation of a state's sovereignty was a "particularly serious undertaking", at least if for a long period of time, and thus could only be presumed if explicitly provided for.[78]

70 *AGIP v. The Popular Republic of Congo* (hereinafter *AGIP v. Congo*), ICSID Case No. ARB/77/1, Award, 30 November 1979, ILM 21 (1982), 726 (735 et seq).

71 *Liberian Eastern Timber Corporation (LETCO) v. Republic of Liberia* (hereinafter *Letco vs Liberia*), ICSID Case No. ARB/83/2, Final Award, 31 Mar 1986, ICSID Reports 2 (1994), 343 (368).

72 *CMS Gas Transmission Company v. Argentina* (hereinafter *CMS v. Argentina*), ICSID Case No ARB/01/8, Award, 12 May 2005, IIC 65 (2005), para. 151. Although the validity of stabilization clauses was not questioned by arbitrators, it has been noted by commentators that such clauses would not be generally enforceable under the domestic laws of common law countries and might also be difficult to enforce in civil law jurisdictions. See *Wälde*, Centre for Energy, Petroleum and Mineral Law and Policy, Professional Papers 13 (1994), 1 (37 et seq); *Cotula*, Regulatory Takings, Stabilization Clauses and Sustainable Development, OECD VII Global Forum on International Investment, 1 (8), available at: <http://www.oecd.org/investment/globalforum/40311122.pdf> (visited 18 March 2017).

73 *Cotula*, Regulatory Takings, Stabilization Clauses and Sustainable Development, OECD VII Global Forum on International Investment, 1 (7), available at: <http://www.oecd.org/investment/globalforum/40311122.pdf> (visited 18 March 2017).

74 *Dolzer/Schreuer*, Principles of International Investment Law, 75.

75 *Texaco Overseas Petroleum Company v. The Government of the Libyan Arab Republic* (hereinafter *Texaco vs Libya*), Award, 19 January 1977, ILM 17 (1978), para 80.

76 *Ibid*, para. 88, *Dolzer/Schreuer*, Principles of International Investment Law, 76.

77 *Dolzer/Schreuer*, Principles of International Investment Law, 76.

78 *Kuwait v. The American Independent Oil Company* (hereinafter *Kuwait vs Aminoil*), Award, 24 March 1982, ILM 21 (1982), 1023, paras. 88 et seq.

Similarly, arbitrators in the *AGIP v. Congo* case held that stabilization clauses that have been liberally signed by governments do not affect the sovereign regulatory power of a state as the state could still regulate vis-à-vis investors, nationals or foreigners that are not subject to such stabilization commitments.[79] Both decisions pointed, however, to the limitation of the "freezing" effect of stabilization clauses, in time or in extent, which could lead, hypothetically, to the argument *a contrario* that if there is no such limitation, stabilization clauses could be judged as affecting the sovereignty of a host state.[80] In the *LETCO v. Liberia* case (ICSID), the arbitration panel stated that the main purpose of stabilization clauses was to protect against arbitrary actions of the contracting government and could not totally impair the sovereign power of states.[81] Some commentators draw the conclusion that:

> "stabilization clauses are not thus a guarantee against lawful nationalization and for that matter lawful expropriation. They impose on the state an obligation to act in good faith and give rise to an obligation to compensate in case of their breach. "[82]

Regarding the outcome, there is not much difference among the divergent tribunal approaches to the matter. In all cases, the obligation to pay compensation is the result of states breaching stabilization clauses. Even though the *Texaco* case stated a wrongful act that requires *restitution in integrum* this did not prove enforceable in practice.[83] The difference of the two approaches can, however, play a role regarding the amount of compensation that varies for lawful or unlawful acts.[84]

Another branch of jurisprudence has been dealing with the legality of stabilization clauses under domestic law. National constitutional principles may stand in the way of stabilization clauses, depending on which law is applicable to the investor-state contract.[85] The choice of domestic law can secure sovereign power of the state to change the law, at least "in so far as a due diligence effort by the investor would have indicated serious doubts over the government's ability to grant such a guarantee effectively under national law".[86] However, given the international character of arbitration and the international rules applicable to aliens, tribunals may nevertheless rely on international law when adjudicating the case.[87] An illustrative case is the *Revere Copper v.*

79 *AGIP v. Congo*, ICSID Case No ARB/77/1, Award, 30 November 1979, ILM 21 (1982), 726 (737); *Titi*, Journal du Droit International 141 (No 2, 2014), 97 (105).

80 See *Titi*, Journal du Droit International 141 (No 2, 2014), 97 (107).

81 *Letco vs Liberia*, ICSID Case No. ARB/83/2, Final Award, 31 Mar 1986, ICSID Reports 2 (1994), 343 (368); *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (140); other similar arbitral reasoning is to be found in the *AGIP v. Congo*, ICSID Case No. ARB/77/1, Award, 30 November 1979, ILM 21 (1982), 726 (735 et seq); *Wälde*, Centre for Energy, Petroleum and Mineral Law and Policy, Professional Papers 13 (1994), 1 (36 et seq).

82 *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (141).

83 *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158 (165).

84 *Faruque*, Journal of International Arbitration 23 (No 4, 2006), 317 (230).

85 *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158 (164).

86 *Wälde*, Centre for Energy, Petroleum and Mineral Law and Policy, Professional Papers 13 (1994), 1 (31).

87 *Dolzer/Schreuer*, Principles of International Investment Law, 74; *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (124).

OPIC case. The case concerns a stabilization clause that prohibited increase in tax and levies and stipulated that no derogation from its right to operate would occur.[88] The government of Jamaica nevertheless issued a "bauxite levy" and an increase in the royalties to be paid by Revere. The Jamaican Supreme Court had declared the contractual stabilization clause "*void ab initio*". The arbitral tribunal held that application of domestic law does not "preclude the application of principles of public international law which govern the responsibility of States for injuries to aliens", particularly if the question is "whether actions taken by a government contrary to and damaging to the economic interests of aliens are in conflict with undertakings and assurances given in good faith to such aliens as an inducement to their making the investment affected by the action."

Moreover, the tribunal argued that the international character of the contract arose from the fact that the contract was "part of a contemporary international process of economic development, particularly in the less developed countries", that required "contractual guarantees" for the security of private parties, and that "governments of developing countries in turn are willing to provide such guarantees in order to promote much needed economic development." This was, in the eyes of the tribunal, confirmed by the fact that the home government of the private parties "are very much interested in such agreements and in promoting their conclusion", and in this case, even "provided its own guarantees for the investment". On this basis, the tribunal upheld the legality and binding nature of the clause and emphasized that "under international law the commitments made in favour of foreign national share are binding notwithstanding the power of parliament and other governmental organs under the domestic constitution to override or nullify such commitments".[89]

II. Indirect reference to stabilization clauses

In contemporary investment arbitration the possibility of having claims of expropriation based on stabilization clauses is increasingly remote as expropriation standards are now well established at the international level, especially considering the ever-spreading network of IIAs. Nonetheless, as some commentators have observed, the application by host states of new legislation to an investment covered by a stabilization clause could be seen as an expropriation of the contractual right not to be subject to such new legislation without compensation.[90] As it has been argued, it is well established in investment law practice that rights arising from contracts may amount to

88 *Revere Copper & Brass, Inc. v. OPIC*, Award, 24 August 1978, ILM 17 (1978), 784 (802 et seq), partly available at: <http://www.trans-lex.org/261500/pdf> (visited 11 February 2017), 1321 et seq; see *Delaume*, American Journal of International Law 75 (No 4, 1981).

89 *Revere Copper & Brass, Inc. v. OPIC*, Award, 24 August 1978, ILM 17 (1978), 1321 (1343), partly available at: <http://www.trans-lex.org/261500/pdf> (visited 11 February 2017).

90 *Marshall*, Climate Change and International Investment Agreements: Obstacles or Opportunities? International Institute for Sustainable Development (IISD), March 2010, 1 (50), available at: <http://www. iisd.org/pdf/2009/ bali_2_copenhagen_iias.pdf> (visited 11 February 2017); *Shemberg*, Stabilization Clauses and Human Rights, IFC/SRSG Research Paper, 27 May 2009, 38, available at: <http://www.ifc.org/wps/wcm/connect/9feb5b00488555eab8c4fa6a6515bb18/Stabilization%2BPaper.pdf?MOD=AJPERES> (visited 11 February 2017).

investments,[91] and thus be subject to the protection against expropriation envisaged by IIAs. The potential legal value of stabilization clauses with regard to investment treaty arbitration involving expropriation is reflected in the case *Methanex v. United States*. In this case, a commitment such as a stabilization clause was linked to the notion of a measure tantamount to expropriation.[92] The tribunal in that case held that a

> "non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects a foreign investor or investment is not deemed expropriatory and compensable *unless specific commitments had been given by the regulating government (…) that the government would refrain from such regulation*."[93] (emphasis added)

The latter part, although not using the expression "stabilization clause", virtually summarizes its underlying design. The tribunal relied on the lack of any such commitment as one of the grounds on which to dismiss the expropriation claim. Other indirect mentioning has been made with respect to the fair and equitable treatment standard, more precisely to delimit the extent of the "legitimate expectations" of the investor. In *AES v. Hungary*, an Energy Charter Treaty case, the ICSID tribunal saw the lack of a stabilization clause as an element to help it determine that there could be no legitimate expectations that the applicable regulation would not be changed by the government. The claim that the investor's legitimate expectations were frustrated was inserted into a broader claim of failure by Hungary to accord fair and equitable treatment to the investor. In that case, considering the facts, the tribunal found that there could be no legitimate expectations that administrative pricing would not be reintroduced.[94] The tribunal went on to say that the duty to provide a stable environment for investment is not to be confused with a stabilization clause, noting that:

> "It is also common ground that the 2001 Settlement Agreement does not contain a so-called "stabilization clause" - i.e. a covenant not to change the relevant law […][95]. In these circumstances, the Tribunal concludes that Claimants cannot legitimately have been led by Hungary to expect that a regime of administrative pricing would not be reintroduced.[96] […] A legal framework is by definition subject to change as it adapts to new circum-

[91] *Dolzer/Schreuer*, Principles of International Investment Law, 126.

[92] *Methanex Corporation v. United States* (hereinafter *Methanex v. United States*), Final Award on Jurisdiction and Merits, UNCITRAL Arbitration Rules, 3 August 2005, part IV, Chapter D, para. 7; see *Marshall*, Climate Change and International Investment Agreements: Obstacles or Opportunities? In-ternational Institute for Sustainable Development (IISD), March 2010, 1 (50), available at: <http://www. iisd.org/pdf/2009/ bali_2_copenhagen_iias.pdf> (visited 11 February 2017); *Cotula*, Regulatory Takings, Stabilization Clauses and Sustainable Development, OECD VII Global Forum on International Investment, 1 (7), available at: <http://www.oecd.org/investment/globalforum/40311122.pdf> (visited 18 March 2017).

[93] *Methanex v. United States*, Final Award on Jurisdiction and Merits, UNCITRAL Arbitration Rules, 3 August 2005, part IV, Chapter D, para. 7.

[94] *AES Summit Generation Limited and AES-Tisza Erömü Kft v. Hungary* (hereinafter *AES v. Hungary*), ICSID Case No ARB/07/22; Award, 23 September 2010, paras. 9.3.25 et seq, available at: <http://www.italaw.com/cases/193> (visited 18 March 2017).

[95] *Ibid*, para. 9.3.25.

[96] *Ibid,* para. 9.3.26.

stances day by day and a state has the sovereign right to exercise its powers which include legislative acts."[97]

A similar approach was followed in *Parkerings v. Lithuania*. The ICSID tribunal first acknowledged that the investor's expectations are legitimate if the host state has made an explicit promise or an implicit promise which was taken into account by the investor when making the investment.[98] The tribunal then dismissed the claim that Lithuania had failed to accord fair and equitable treatment to the investor, asserting that:

> "It is each State's undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion. *Save for the existence of an agreement, in the form of a stabilisation clause or otherwise*, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. As a matter of fact, any businessman or investor knows that laws will evolve over time. What is prohibited however is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power."[99] (emphasis added)

III. Direct application of stabilization clauses

The third category of cases refers to those in which stabilization clauses were at the core of the dispute. The case *CMS Gas Transmissions v. Argentina*, an example involving the conjunction between stabilization and umbrella clauses suggests that violations of investor-state contractual stabilization obligations constitute a breach of the inter-state investment agreement.[100] The Claimant relied on a specific undertaking that the tariff structure would not be frozen or subject to further regulation or price control, as well as on the commitment that the basic rules governing the license would not be changed without the licensee's consent.[101] The tribunal found that such undertakings were valid[102] and enforceable based on the umbrella clause in the relevant IIA:

> "[…] there are in particular two stabilization clauses contained in the License that have significant effect when it comes to the protection extended

[97] *Ibid*, para. 9.3.29.

[98] *Parkerings-Compagniet AS v. Lithuania* (hereinafter *Parkerings v. Lithunia*), ICSID Case No ARB/05/8; Award on jurisdiction and merits, 11 September 2007, para. 331, available at: <http://www.italaw. com/sites/default/files/case-documents/ita0619.pdf> (visited 11 February 2017).

[99] *Ibid*, para. 332; see other similar arbitral decisions: *Total v. Argentina*, ICSID Case No. ARB/04/01 Decision on Liability of 27 December 2010, para. 119; *Paushok v. Mongolia*, UNCITRAL, Award on Jurisdiction and Liability, 28 April 2011, para. 305; *Impregilo v. Argentina*, ICSID Case No. ARB/07/17, Award, 21 June 2011, para. 290; *EDF v. Romania*, ICSID Case No. ARB/05/13, Award, 8 October 2009, para. 216.

[100] *CMS v. Argentina*, ICSID Case No ARB/01/8, Award, 12 May 2005, paras. 296 et seq.; see for an analysis on that matter, *Titi*, Journal du Droit International 141 (No 2, 2014), 97 (108 et seq).

[101] *CMS v. Argentina*, paras. ICSID Case No ARB/01/8, Award, 12 May 2005, para. 145 et seq.

[102] *Ibid.*, para. 151.

> to them under the umbrella clause. The first is the obligation undertaken not to freeze the tariff regime or subject it to price controls. The second is the obligation not to alter the basic rules governing the License without [the licensee]'s written consent."[103]

It should be noted, however, that the part of the *CMS* award addressing the tribunal's finding concerning the umbrella clause was later annulled by the ad hoc Committee, on the grounds that the tribunal failed to make it clear how it got to the conclusion that CMS, as a minority shareholder of the licensee, could claim based on obligations undertaken toward the licensee (and not CMS itself). Nonetheless, the validity of a stabilisation clause as such was never put into question or even challenged by Argentina in the annulment proceeding. The *ad hoc* Committee ruled that:

> "[i]n the end it is quite unclear how the tribunal arrived at its conclusion that CMS could enforce the obligations of Argentina to TGN [the licensee]. (…) In these circumstances there is a significant lacuna in the Award, which makes it impossible for the reader to follow the reasoning on this point. It is not the case that answers to the question raised 'can be reasonably inferred from the terms used in the decision'; they cannot. Accordingly, the tribunal's finding on Article II(2)(c) [the umbrella clause] must be annulled for failure to state reasons."[104]

In another case, the tribunal in *LG&E v. Argentina*, after noting that there was no contractual stabilization clause in that case,[105] found that failure by Argentina to observe statutory stabilization provisions would give rise to liability under the umbrella clause:

> "As such, Argentina's abrogation of the guarantees under the statutory framework – calculation of the tariffs in dollars before conversion to pesos, semi-annual tariff adjustments by the PPI and no price controls without indemnification – violated its obligations to Claimants' investments. Argentina made these specific obligations to foreign investors, such as LG&E, by enacting the Gas Law and other regulations, and then advertising these guarantees in the Offering Memorandum to induce the entry of foreign capital to fund the privatization program in its public service sector. These laws and regulations became obligations within the meaning of Article II (2) (c), by virtue of targeting foreign investors and applying spe-

[103] *Ibid.*, para. 302.

[104] *CMS v. Argentina*, ICSID Case No ARB/01/8, Decision on Application for Annulment, IIC 303 (2007), signed 21 August 2007, para. 96 et seq.

[105] "In short, one must also recall that between Argentina and LG&E there is no binding contractual agreement. The existence of such relationship would have allowed the parties to agree on stabilization clauses in the event of changes in certain circumstances. But, in the absence of such agreement, one is bound to resort to a legal system regulating those events", *LG&E Energy Corp and others v. Argentina* (hereinafter *LG&E v. Argentina*), ICSID Case No ARB 02/1; Decision on Liability, 3 October 2006, para. 98.

cifically to their investments that gave rise to liability under the umbrella clause".[106]

The cases show that enforcement of contractual stabilization clauses may be based on umbrella clauses in international investment treaties. The purpose of such clauses is to put contractual commitments entered into by the state with foreign investors under the protective "umbrella" of the international investment agreement.[107] Commentators have observed the great diversity both in the interpretation given by arbitral tribunals to such clauses as well as in the wording they present themselves in.[108] There seems to be no single concept of umbrella clauses but rather multiple umbrella clauses[109] and with this more or less extensive reading of their scope.[110] It therefore very much depends on the wording and context of an umbrella clause to which degree its reach can be generally understood to elevate contractual commitments to the level of the international treaty protection.[111] An example of the role that stabilization clauses could play in this context is the *El Paso v. Argentina* case. The ICSID tribunal, when faced with the task of drawing the boundaries of umbrella clause coverage, found it useful to make reference to stabilization clauses as an illustration:

> "[i]nterpreted in this way, the umbrella clause (…) will not extend the Treaty protection to breaches of an ordinary commercial contract entered into by the State or a State-owned entity, but will cover additional investment protections contractually agreed by the State as a sovereign – such as a stabilization clause – inserted in an investment agreement."[112]

In the tribunal's view, a stabilization clause thus represents an additional protection undertaken by the state as a sovereign. In this way, failure by the host state to observe such a commitment would give rise to a claim under the relevant IIA for which the tribunal would consequently have jurisdiction. This interpretation has been criticized for not being far reaching enough. For example, commenting on this decision, *Campbell McLachlan et al.* criticized the narrow interpretation given to the umbrella clause as an instrument to secure jurisdiction under IIAs, advocating that purely contractual claims, undertaken by the state as a merchant, would also follow under the scope of the clause. In this sense, the authors argue that:

[106] *LG&E v. Argentina*, ICSID Case No ARB 02/1; Decision on Liability, 3 October 2006, para. 175.

[107] *Dolzer/Schreuer*, Principles of International Investment Law, 153.

[108] *Wackernagel*, Beiträge zum Transnationalen Wirtschaftsrecht 32 (2009), 1 (17).

[109] *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (152).

[110] See for an overview *Crawford*, Treaty and Contracts in Investment Arbitration, 22nd Freshfields Lecture on International Arbiration, 29 November 2007, cited after *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (152).

[111] *Salini Costruttori SpA and Italstrade SpA v. Jordan* (hereinafter *Salini v. Jordan*), ICSID Case No ARB/02/13; Decision on Jurisdiction, 9 November 2004, paras 62 et seq; *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158 (163); *Dolzer/Schreuer*, Principles of International Investment Law, 153 et seq.

[112] *El Paso Energy International Co v. Argentina*, ICSID Case No ARB/03/15, Decision on Jurisdiction, 27 April 2006, para. 81.

"[the tribunal's] conclusion does not appear to be warranted by the language of the treaties or by any necessary restriction on the jurisdiction of an investment arbitral tribunal. This is particularly so of the notion that, in order to gain the benefit of the clause, an investor would have to have persuaded the host State to grant a contractual stabilization clause. Investment treaties are designed to provide a predictable framework for all investors as a result of mutual guarantees exchanged between the contracting States. The operation of those guarantees should not be dependent upon individual contractual bargaining for a type of clause which was never popular with States, and was in any event a blunt, and at times unpredictable, instrument for stability of contract. However, the underlying concept that the clause might protect from the abuse of State power is a valuable one. If, then, there were a clear basis for contending that the State had made subsequent changes in its law which undermined its undertakings to the investor, that would constitute an exercise of sovereign authority, and would found a basis for a treaty claim, irrespective of any contractual jurisdiction clause."[113]

Another case that involved stabilization clauses addressed the nature and extent of the scope of protection of stabilization clauses. In *Duke Energy v. Peru*, the ICSID tribunal determined that the stability envisaged by stabilization clauses goes beyond the mere protection against future changes in legal texts and also applies to changes in legal interpretation:

"[…] The Tribunal must now determine whether legal stability covers not only the formal text of the laws and regulations that were in place at the time the Egenor LSA [the Legal Stability Agreement entered into between Peru and Claimant] was executed, but also their specific interpretation and application at that time.
[…][I]f, at the time when the guarantee was granted, the application of the existing rules resulted in a consistent interpretation, such interpretation must be deemed to be incorporated into the guaranteed stability. In a broad sense, stability is the standard by which the legal order prevailing on the date on which the guarantee is granted is perpetuated, including the consistent and stable interpretation in force at the time the LSA is concluded. The Tribunal is convinced that the maintenance of such stable interpretations of the law, existing at the time the LSA was executed, is part of the continuity of the existing rules."[114]

113 *McLachlan/Shore/Weiniger*, International Investment Arbitration: Substantive Principles, 116 et seq.

114 *Duke Energy International Peru Investments No 1, Ltd v. Peru* (hereinafter *Duke v. Peru*), ICSID Case No ARB/03/28, Award and Partial Dissenting Opinions, paras. 210-219, cited after *Cotula*, Pushing the Boundaries vs. Striking a Balance: Some Reflections on the Stabilization Issue in Light of Duke Energy International Investments v. Republic of Peru, Transnational Dispute Management 1 (2010), available at: <http://www.transnational-dispute-management.com/article.asp?key=1571> (visited 11 February 2017).

The tribunal further held that even in the absence of a stable pre-existing interpretation of the relevant legal provision, against which it could judge subsequent developments, the stabilization clause would still allow it to make an assessment of the allegedly new interpretation in the light of the standard of reasonableness.[115] That is to say that, in the tribunal's view, even when a consistent and stable interpretation cannot be established by the contending parties as a matter of proof, although arbitrators may not determine what would be the "correct" interpretation of the domestic legal provision, they may nonetheless put the allegedly new interpretation given to it by the domestic authorities through a reasonableness test.[116]

In another case, *Burlington v. Ecuador*, the ICSID tribunal was faced with a tax stabilization clause in several oil and gas Production Sharing Contracts that read as follows:

> "Modification to the tax system: In the event of a modification to the tax system or the creation or elimination of new taxes not foreseen in this Contract, which have an impact on the economics of this Contract, a correction factor will be included in the production sharing percentages to absorb the impact of the increase or decrease in the tax."[117]

Commentators have referred to such a contractual undertaking as a stabilization clause, more specifically as a species of the economic equilibrium genre or "stipulated economic balancing provision".[118] The tribunal, nonetheless, chose to refer to this provision as a "tax indemnification clause".[119] This designating distinction seemed to suit the tribunal's will to regard the clause as something that could be agreed upon by two private parties in similar circumstances and not as a guarantee afforded by the state as such, in view of its taxation power. This categorization of the clause by the tribunal would also suit its decision to consider that invoking the clause did not raise "matters of taxation", which would fall outside the scope of the tribunal's jurisdiction by virtue of a US-Ecuador BIT express provision.[120] The Claimant had raised the non-observance of the stabilization clause as a violation of the treaty umbrella clause, which was accepted by the tribunal for the purpose of determining its jurisdiction:

115 *Ibid*, para 223.

116 Arbitrator *Tawil* goes even further in his Partial Dissenting Opinion, asserting that in such a case – where proof of a prior consistent and stable interpretation is absent – it would fall under the jurisdiction of the tribunal to determine the appropriate interpretation of the relevant domestic legal provision, *ibid*, Dissenting Opinion, paras. 7-9.

117 *Burlington v. Ecuador*, ICSID Case No ARB/08/5, Decision on Jurisdiction, 2 June 2010, para. 24.

118 Such clauses would provide for automatic amendment of the contract in a stipulated fashion in case of changes to the previous terms. In this case, the amendment would operate through the automatic readjustment of the oil split between the parties to the Production Sharing Contract, see *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (127, 131).

119 *Burlington v. Ecuador*, ICSID Case No ARB/08/5, Decision on Jurisdiction, 2 June 2010, para. 24.

120 As observed by the tribunal, "[u]nder Article X of the Treaty, 'matters of taxation' are as a rule excluded from the scope of the Treaty". *Burlington v. Ecuador*, ICSID Case No ARB/08/5, Decision on Jurisdiction, 2 June 2010, para. 168.

> "Indeed, Respondent's indemnification obligation under the PSCs is unrelated to its taxing power as a sovereign state. The contract indemnification clauses bind the investor just as much as they bind Respondent[121]. […]
> Thus, two private parties who have no power whatsoever over taxes could enter into an indemnification clause identical to those contained in the PSCs, i.e. if there is a tax increase, the contract price is reduced, and vice versa. And if one of the parties were to seek enforcement of the indemnification clause, it would not mean that that party is challenging the tax that prompted the application of the clause; rather, it would simply invoke the tax to substantiate its claim for indemnification. This logic does not change when the State is one of the parties subject to the clause. Hence, the Tribunal is of the view that this claim does not raise 'matters of taxation'."[122]

The view of the clause as a "banal" contractual provision rather than a tax stabilization clause may well have brought legal consequences in the *Burlington* case. But what is of more relevance to this study is that the state's role in terms of the stability clause is reduced to that of a private party with no public functions or constraints.

IV. Conclusion

As a conclusion, all reviewed decisions that directly or indirectly involved stabilization clauses, have implicitly or explicitly recognized the validity of such clauses, giving rise to, at least, the right to compensation, including the case of legitimate public purpose and *bona fide* regulation. However, it is worth noting that so far the decisions that dealt directly with stabilization clauses (third category) revolved around taxation issues and tariff readjustment. Arbitrators were not faced with the more troublesome cases touching upon stabilization clauses in the context of human rights or environmental regulation. Nonetheless, as we have seen, arbitration decisions suggest that stabilization clauses may well fix the investors' position to no flexibility and zero risk in those cases. This goes beyond the extent and nature of investment law protection as it is anchored in average IIAs today.

In general IIA practice, the sovereign role of the state is usually the starting point of reasoning. In recent arbitration, this has led to a limited principle and balancing approach when conflicting public interests were involved. Arbitral tribunals have referred to the jurisprudence of the European Court of Human Rights (ECHR), e.g. in *Tecmed*, *Azurix* and *LG&E* to interpret the expropriation standard.[123] If "there is a reasonable relationship of proportionality between the charge or weight imposed on the

121 *Burlington v. Ecuador*, ICSID Case No ARB/08/5, Decision on Jurisdiction, 2 June 2010, para. 182.
122 *Ibid.*, paras. 181-183.
123 See regarding the proportionality requirement *Tecmed v. Mexico*, ICSID Case No. ARB(AF)/00/2, Award of 29 May 2003, para. 121.

foreign investor and the aim sought to be realized by any expropriating measure",[124] the state's measure is not to be considered expropriatory and thus would not prompt compensation.[125] Even if arbitrators depending on their interpretive approaches may apply a very narrow concept of "legitimate expectations", at large, the standards as they are applied within the framework of IIA today leave room for balanced interpretation. When discussing "frustration of the investor's legitimate expectations", the tribunal in *Saluka v. Czech Republic* held, for example, that if "taken too literally", a narrow reading "would impose upon host States' obligations which would be inappropriate and unrealistic". The tribunal deployed a proportionality test, weighing "the Claimant's legitimate and reasonable expectations on the one hand and the Respondent's legitimate regulatory interests on the other".[126] Other tribunals introduced a counter-balance by conditioning legitimate expectations guarantees upon "due diligence" on the side of the investor. The arbitrators in *Parkerings v. Lithuania* state:

> "The investor will have a right of protection of its legitimate expectations provided it exercised due diligence and that its legitimate expectations were reasonable in light of the circumstances. Consequently, an investor must anticipate that the circumstances could change, and thus structure its investment in order to adapt it to the potential changes of legal environment."[127]

Similarly, the tribunal in *MTD v. Chile* held that the host state's liability for frustrating the investor's legitimate expectations should be partially offset by the investor's own lack of diligence. The tribunal found that, although the host state was responsible for breaches of the fair and equitable treatment standard, MTD had contributed to the damages suffered as a result of its negligent conduct.[128] After making these assertions, the tribunal went on to say that "BITs are not an insurance against business risk".[129] Therefore, the more expansive notion of the protection of legitimate expectations "may be circumscribed by the notion of the 'investor conduct', reflected in various investor duties such as (i) the duty to refrain from unconscionable conduct, (ii) the duty to invest with adequate knowledge of risk and (iii) the duty to conduct business in a reasonable manner."[130]

Against this backdrop, and given the broad scope of international investment protection standards, there is room for an interpretative approach that takes into account

124 The tribunal cites the European Court of Human Rights (ECHR) cases *Mellacher and Others v. Austria* from 19 December 1989, *Pressos Compañía Naviera and Others v. Belgium* from 20 November 1995, available at: <http://hudoc.echr.coe.int> (visited 11 February 2017).

125 The critical issue here is deference of the tribunal to the states' determined level of protection.

126 *Saluka v. Czech Republic*, Partial Award, PCA—UNCITRAL Arbitration Rules, 17 March 2006, para. 306, available at: <http://www.italaw.com/sites/default/files/case-documents/ita0740.pdf> (visited 11 February 2017).

127 *Parkerings v. Lithunia*, ICSID Case No ARB/05/8; Award on jurisdiction and merits, 11 September 2007, para. 333, available at: <http://www.italaw.com/sites/default/files/case-documents/ita0619.pdf> (visited 11 February 2017).

128 *MTD Equity Sdn. Bhd. and MTD Chile S A. v. Republic of Chile* (hereinafter *MTD v. Chile*), ICSID Case No. ARB/01/7, Award, 25 May 2004, para. 178.

129 *Ibid.*

130 *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (149).

public interests and individual rights in “hard cases” when principles are colliding and no clear rule determines the case. However, stabilization clauses provide a clear rule that determines the case, e.g. that changes in law are not applicable to a foreign investor and/or trigger negotiation and/or compensation. Cases like *Methanex* or *Parkerings* suggest that stabilization clauses turn the nature of contemporary investment protection practice, as it has been developing over the last decades, upside down. While arbitrators have made clear that investors bear the risks of “non-discriminatory regulation for a public purpose” (*Methanex*), or have underlined the fact that “laws will evolve over time” (*Parkerings*), they have explicitly stated that host state commitments such as stabilization clauses put the financial burden of *ex post* investment regulation entirely on the state. Thereby, the general presumption of a right to regulate at no price under the general standard of international investment law turns into a general obligation to compensate for regulation under stabilization commitments.[131] The public law character that is reflected in arbitral practice concerning expropriation and *fair and equitable treatment* (FET) is thus turned into the nature of a private *inter-se* relationship ignoring the state’s role as a public entity (see *Burlington v. Ecuador*).

With this, the investor is let off the hook of the balancing game between private rights and the public interest of which he would be part in a public state relationship. Moreover, this investor-state private law relationship may be “elevated to the international level”[132] of IIA protection through umbrella clauses in investment treaties or on the basis of the internationalizing effect of stabilization clauses, as expressed in the *Revere Copper v. OPIC* case.[133] In this context, non-observance of contractual stabilization commitments could be interpreted as expropriation of contractual rights within the broader context of an applicable international investment agreement[134] or violate “legitimate expectations” with respect to the FET standard.[135] Another legal effect of contractual stabilization clauses at the international level may occur through the most favored nation principle, e.g. if contractual model agreements are applied between states.

D. Dealing with conflicts – exploring interpretative avenues

Arbitral tribunals have not, to our knowledge, dealt with cases that juxtaposed investor’s rights based on stabilization clauses on the one hand and public regulation implementing international environmental or social standards on the other. As an introduction to this potentiality, we would like to explore the nature of these “conflicts”. Each individual case will very much depend on the specificities of the facts and the content of the stabilization clause in question. As described above, stabilization

[131] See a detailed analysis *Johnson/Volkov*, The American Review of International Arbitration 24 (No 3, 2013), 361 (369 et seq); *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (146).

[132] *Hirsch*, in: Dupuy/Petersmann/Francioni (eds), Human Rights in International Investment Law and Arbitration, 97 (109).

[133] *Faruque*, Journal of International Arbitration 23 (No 4, 2006), 317 (326).

[134] See *Titi*, Journal du Droit International 141 (No 2, 2014), 97 (109).

[135] See above, B. II.

clauses exist in very different forms and features. They are often tailored to a sector or project, vested with specific terms and conditions.[136] Our intent is to shed light on general possible interpretative leeway that allows for introducing an element of balancing into a strict stabilization commitment that interferes with human rights or environmental international standards.

As an introductory remark, in the case of stabilization clauses, these are no legal conflicts *strictu sensu*, and not necessarily "hard cases" in the sense of *Ronald Dworkin*[137] that call for a balancing interpretative approach on the basis of principles, as the stabilization clause typically constitutes "the rule that decides the case" when legitimate state governance interests and investors rights collide (the rule is that the state compensates for changes in law). As the ILC study group on fragmentation of international law puts it:

> "A strict notion [of conflict] would presume that conflict exists if it is possible for a party to two treaties to comply with one rule only by thereby failing to comply with another rule. This is the basic situation of incompatibility. An obligation may be fulfilled only by thereby failing to fulfil another obligation."[138]

Applied to the stabilization clauses case, mainly in terms of equilibrium clauses, regulation as such does not violate the stabilization commitment. The obligation is to compensate for changing the equilibrium. Following the decisions *Aminoil v. Kuwait* and *Liamco v. Libya*, this is also true for freezing clauses: the obligation is to pay for breaching the freezing clause. There is thus no "surrendering" of human rights or environmental standards or "contracting out" of international law obligations via stabilization clauses. The potential conflict is rather about the legitimacy of the compensation claim when regulation is based on internationally recognized standards to which the host state is committed.

According to the ILC study group on fragmentation of international law, there may nevertheless be a conflict of law that calls for a specific interpretative approach. In its report, the group observes a category of so-called "policy-conflicts", equally relevant for the problems involved in the fragmentation of international law.[139] As the ILC study group puts it:

> "A treaty may sometimes frustrate the goals of another treaty without there being any strict incompatibility between their provisions".[140]

Stabilization clauses seem to be a perfect example of this. Interpretative approaches to create leeway in the strict application of stabilization commitments have been

136 See for example, *Alexander*, Journal of World Energy Law & Business 2 (No 3, 2009), 243 (249), who points at the fact that most investor-state-agreements in the oil extractive industry contain exceptions regarding an evolving international environmental protection standard.

137 *Dworkin*, Harvard Law Review 88 (No 6, 1975), 1057 (1060).

138 Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law, Report of the Study Group of the International Law Commission, finalized by Martti Koskenniemi, A/CN.4/L.682, 13 April 2006, para. 24.

139 *Ibid.*

140 *Ibid.*

subject to lawyers' analysis, and international arbitration has developed approaches that could guide legal reasoning here. In the following, we discuss some of these approaches, and add some thoughts.

I. The argument of implicit "compliance with international law exceptions"

One interpretative way that some suggest to resolve conflicts between stabilization commitments and legitimate policy goals is to exclude social and environmental public interest regulation from the scope of stabilization clauses. The argument goes that stabilization clauses are implicitly limited by "compliance with international law exceptions".[141] As "state sovereignty is limited by the international obligation to realize fundamental human rights […] the host state cannot impair the human rights held by individuals and groups that may be affected by the investment project".[142] Stabilization clauses could thus not "prevent genuine host state action to progressively realize human rights".[143] "States may not contract out of compliance with their obligations under international law."[144]

It is true that there is a clear case for human rights as almost all states are bound to at least one of the eight core human rights treaties.[145] This equally applies to principles and standards with respect to environmental protection. Principle 2 of the Rio Declaration, which has been widely recognized in international law, underlines the duty of the sovereign authority of states not to harm the environment. In the arbitration regarding the *Iron Rhine Railway (Belgium v. Netherlands)*, the tribunal stated the state's "duty to prevent, or at least mitigate" environmental harm,[146] referring to respective developments in international environmental law.[147]

Does this, however, allow for the argument "that states may [in case of stabilization clauses] not contract out of compliance with their obligations under international law"? As we have argued above, from a legal point of view *strictu sensu*, stabilization clauses do not hinder states to adopt public interest measures. They provide in the first place for compensation, for loss due to changes in regulation. There is thus no "contracting out" of international law obligations. Host states do not "commit themselves to rights they do not have – such as a right to exercise sovereignty in a way that does not take account of international obligations".[148] They commit themselves to pay for that regulation. Against this backdrop, an implicit "compliance with international law" clause is from a legal point of view *strictu sensu* difficult to make. The underlying conflict that is at the basis here is not about states being obliged to act against their

141 *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158 (172).
142 *Ibid.*
143 *Ibid.*
144 *Ibid*, 173.
145 See above, Introduction.
146 Arbitration Regarding the *Iron Rhine ('Ijzeren Rijn') Railway (Belgium/Netherlands)*, Permanent Court of Arbitration, 24 May 2005, para. 59, available at: <http://legal.un.org/riaa/cases/vol_XXVII/35-125.pdf> (visited 11 February 2017).
147 *Birnie/Boyle/Redgwell*, International Law & the Environment, 131.
148 *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158 (173).

international obligations. The problem is rather the far reaching compensation commitments that may frustrate regulation fostering public interest that is protected or required by international law.

One could think about an implicit “compliance with other international law at no price” clause to resolve the policy-conflict involved here. Such an approach implies, however, *prima facie* primacy over applicable investment law, and may thereby create interpretational inflexibility to capture all dimensions of the policy-conflict between the different international legal regimes at stake. Any balancing may – depending on the law in question – be excluded from the outset. Moreover, “international law” is a very vague legal concept, raising a lot of questions, and thereby carrying a great deal of legal uncertainty.

II. The argument referring to general law

Another entry door to more flexible interpretation of stabilization commitments could be a broad reading of the “changes in law” language. Stabilization clauses may, for example, stipulate compensation for “any changes in the applicable laws”.[149] But what is meant by “applicable law”? Does this automatically include any measure that changes regulation? What about international obligations, existing at the time of the contract or national constitutional principles being the motivation for the change? One could, for example, argue that measures based on international obligations or constitutional principles that did exist at the time the investment contract was concluded but have not yet been fully implemented by the host state, do not constitute a “change in applicable law”. These measures could be seen as mere implementation of law that existed at that time. Independently of the school that classifies international law as part of national law (monism) or as part of external obligations that are to be implemented or observed on the national level (dualism),[150] international obligations belong to the law in force which binds the host state and determines its legal order. If the host state takes measures to implement these international or national constitutional obligations, it applies these norms but does not *change* the existing general law. Such reading could foster coherence in law, as this allows for taking into account the different hierarchical levels of international obligations and constitutional law.

The typical counterargument would be that law is only applicable if sufficiently concrete to form a behavioural norm. After all, change in behavioural norms or *lex specialis* automatically falls under the usually intended scope of stabilization clauses. This is precisely the risk against which the investor seeks protection. Moreover, the majority of state measures could be interpreted as somehow fulfilling general obligations, given their wide scope, so that stabilization clauses – if read against the backdrop of general law – would nearly become void.[151]

149 *Shemberg*, Stabilization Clauses and Human Rights, IFC/SRSG Research Paper, 27 May 2009, 8, available at: <http://www.ifc.org/wps/wcm/connect/9feb5b00488555eab8c4fa6a6515bb18/Stabilization%2BPaper.pdf?MOD=AJPERES> (visited 11 February 2017).

150 *Schweitzer*, Staatsrecht III, paras. 24 et seq.

151 *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158 (174).

As a middle-way, one could argue that the benchmark of "change in law" should refer to the minimum requirement that is necessary to not violate the core of the general norm so that changes in the level of protection or way of implementation would still be covered by stabilization clauses. General norms of international or constitutional law generally set a core normative baseline as a "purposive system of law" and leave it up to the state how the norm is implemented through *lex specialis* (e.g. in the case of fulfilling or protecting fundamental human rights). State measures implementing the minimum requirements of constitutional law or international obligations of the state that existed at the time when the contract was concluded would then not be covered by the clause and thus not be subject to compensation.

Such interpretation may work for some cases, but in other cases would still "frustrate" the goals that are inherent in broad and aspirational general rights and objectives, typical of modern constitutions and international standards: the progressive state of law – the latter being precisely and typically the risk against which stabilization clauses seek protection. There is not much of a "balancing" solution to this underlying "policy-conflict" of law.

As the ILC study group notes:

> "As an interpretative guideline, *lex specialis* does articulate important concerns: the need to ensure the practical relevancy and effectiveness of the standard as well as to preserve what is often a useful guide to party intentions. These need, of course, to be balanced against countervailing ones: the hierarchical position of the relevant standard and other evidences of State intent. But however the "balance" is conceived, all of this takes place within an argumentative practice that seeks to justify its outcomes less in terms of technical applications than as contributions to a purposive system of law."[152]

III. The argument referring to national law of "fundamental importance"

The investor-state contractual relationship is often "elevated" to international law "as the governing law in the contract", mainly given the many international investment agreements (IIA) globally existent.[153] Accordingly, the Vienna Convention on the Law of Treaties (VCLT)[154] becomes a likely reference for interpretation. Article 27 VCLT stipulates that a party to an international treaty may not invoke the provisions of its internal law as justification for its failure to perform its obligations under a treaty. Article 46 VCLT provides an exception to this, for cases when "violation was man-

152 Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law, Report of the Study Group of the International Law Commission, finalized by Martti Koskenniemi, A/CN.4/L.682, 13 April 2006, para. 40.

153 See above, B, III; *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (124), *Revere Copper & Brass, Inc. v. OPIC*, Award, 24 August 1978, ILM 17 (1978), 1321 (1343), partly available at: <http://www.trans-lex.org/261500/pdf> (visited 11 February 2017).

154 Vienna Convention on the Law of Treaties, opened for signature 23 May 1969, available at: <http://crossborder.ie/site2015/wp-content/uploads/2015/11/1969-Vienna-Convention-on-the-Law-of-Treaties.pdf> (visited 11 February 2017).

ifest and concerned a rule of the state's internal law of fundamental importance". Thereby, a "manifest violation" is to be presumed if "it would be objectively evident to any State conducting itself in the matter in accordance with normal practice and good faith".

Applied to the investor-state relationship one could think of the argument that there are internal rules of fundamental importance which "a diligent investor should be aware of before concluding contracts with the host state".[155] In cases involving constitutional principles, such as fundamental rights, or widely recognized and well established standards of international law to which the state has committed or is bound, this could be a "way around" the international law obligation inherent in stabilization clauses.[156] If fundamental constitutional principles are affected, one could invoke the violation of the principle of separation of powers, if, for example, the government had signed an investor-state contract with far-reaching stabilization commitments without the constitutionally required consent of the Parliament.[157] However, it is argued that "(as under most, if not all, developed systems of law) the binding force of contracts is recognized, so long as the contracts in question are validly made and do not offend public policy (*l'ordre publique*)".[158] In the *Revere Copper v. OPIC*, the arbitral tribunal underlined that the commitments in favour of foreign nationals are binding, independent of the power of Parliament or the Government.[159]

IV. The argument referring to evolutionary "new norms and standards"

Another approach that could soften the interpretative rigidity of stabilization clauses is the "issue of evolutionary interpretation", a specific form of *rebus sic stantibus* in the field of policy conflicts related to sustainable development.[160] This mainly refers to the ruling of the International Court of Justice (ICJ) in the *Gabcikovo-Nagymaros* case.[161] The ICJ stated that in the field of sustainable development "new norms and standards have been developed, set forth in a great number of instruments during the last two decades. Such new norms have to be taken into consideration, and such new standards given proper weight, not only when States contemplate new activities but also when continuing with activities begun in the past".[162] Other tribunals, such as the WTO Appellate Body in *US Shrimp* and the arbitral tribunal in the *Iron Rhine* case, took similar approaches of evolutionary interpretation with respect to sus-

155 *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158 (165).

156 *Cotula*, Foreign Investment Contracts, International Institute for Environment and Development (IIED), Sustainable Markets Investment Briefings (No 4, 2007), available at: <http://pubs.iied.org/pdfs/17015IIED.pdf> (visited 18 March 2017), 3.

157 *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158 (165).

158 *Letco v. Liberia*, ICSID Case No. ARB/83/2, Final Award, 31 Mar 1986, ICSID Reports 2 (1994), 343 (368).

159 See above, *Revere Copper & Brass, Inc. v. OPIC*, Award, 24 August 1978, ILM 17 (1978), partly available at: <http://www.trans-lex.org/261500/pdf> (visited 11 February 2017), 1321 (1343).

160 *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158 (176).

161 ICJ, *Gabcikovo-Nagymaros* (*Hungary v Slovakia*). Judgment of 25 September 1997, ICJ Rep 1997, 7–84, available at: <http://www.icj-cij.org/docket/files/92/7375.pdf> (visited 11 February 2017).

162 *Ibid*, para. 140.

tainable development.[163] In the *Gabcikovo-Nagymaros* case, the ICJ stated that the conflicting parties have the obligation to renegotiate the contract to find a "satisfactory solution" to the environmental concerns at stake, even though these were originally not the subject of the treaty.[164] The "evolutionary interpretation" thus softens the *pacta sunt servanda* principle.

This approach could be translated into contractual obligations between the investor and the state.[165] With respect to stabilization clauses, the question is to what extent changes in law on the basis of "new standards and norms" could fall out of the scope of the stabilization commitment. On the one hand, these norms could be considered to belong to well-known standards of international law, so that the investor cannot legitimately presume that the host state would refrain from implementing them. On the other, it is not very clear which kinds of norms fall under the scope of "new standards and norms" and could thus be subject to "evolutionary" interpretation. This lack of legal certainty goes against the investor's need for stability. After all, stabilization clauses precisely protect against this evolutionary risk. In the *Gabcikovo-Nagymaros* case the ICJ imposed a consensual approach as a way out of the dilemma of *pacta sunt servanda* versus the normative power of newly established and widely recognized standards in the field of public interest. The ICJ recognized the claim on the basis of the international agreement but still ruled that new norms that are relevant to the context are to be respected at the same time. The court concluded that the parties to the contract need to negotiate a "satisfactory solution" against the backdrop of the concept of sustainable development.

Sustainable development is a well-known legal concept today and has been recognized by various international decision making bodies.[166] The normative responsibility inherent in the concept of sustainable development is addressed to states and businesses alike.[167] One of the salient features of the concept of sustainable development is that economic interests are to be reconciled with needs in the social and developmental domains.[168] These "domains" (economic, social, and environmental) are normatively

[163] WTO, *United States — Import Prohibition of Certain Shrimp and Shrimp Products*, Report of the Appelate Body, adopted 6 November 1998, WT/DS58/AB/R and WTO, *United States —Shrimp*, Report of the Panel, *Recourse to Article 21.5* by Malaysia, WT/DS58/RW, adopted 15 June 2000; Arbitration Regarding the *Iron Rhine ('Ijzeren Rijn') Railway (Belgium/Netherlands)*, Permanent Court of Arbitration, 24 May 2005, available at: <http://legal.un.org/riaa/cases/vol_XXVII/35-125.pdf> (visited 11 February 2017).

[164] ICJ, *Gabcikovo-Nagymaros* (*Hungary v Slovakia*). Judgment of 25 September 1997, ICJ Rep 1997, 7–84, available at: <http://www.icj-cij.org/docket/files/92/7375.pdf> (visited 11 February 2017), para. 140.

[165] See for this argument *Abba Kolo* and *Thomas Wälde*, cited after *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158 (176).

[166] *International Law Association*, Report of the Seventy-Second Conference, Committee on International law on Sustainable Development, 467 (472 et seq).

[167] UNGA, Resolution 42/187, 11 December 1987, Report of the World Commission on Environment and Development; United Nations, Report of the United Nations Conference on Environment and Development, A/Conf.151/26/Rev.1 (Agenda 21).

[168] See *Iron Rhine ('Ijzeren Rijn') Railway (Belgium/Netherlands)*, Permanent Court of Arbitration, 24 May 2005, available at: <http://legal.un.org/riaa/cases/vol_XXVII/35-125.pdf> (visited 11 February 2017), para. 59. See for efficiency in regulation in this respect *Gehne*, Nachhaltige Entwicklung als Rechtsprinzip, 132, 156.

expressed in international standards and principles that have been carved out over time.[169] This includes international investment law in the economic domain but imposes to strike a balance – in this case through re-negotiation – with conflicting environmental or social issues at stake. New norms and standards in the field of sustainable development could thus relativize what has been negotiated among the parties to an international contract.[170] According to the ICJ, these norms and standards are to be observed not only "when continuing with activities begun in the past" (evolutionary) but also "when States contemplate new activities. This means that the observation of these norms is also a condition to all future contractual relations".[171]

The ICJ approach recalls the renegotiation provisions that accompany modern economic equilibrium clauses.[172] The constellation is, however, different in nature: while in the case of economic equilibrium clauses the negotiations are about rebalancing the economic equilibrium and thus due compensation for public interest regulation, the case of evolutionary norms is about negotiating the balance to be struck between social, environmental and economic factors determining the legitimate public interest in the domain of sustainable development. This could be an interpretative aspect that could be taken into account from an "evolutionary" point of view when dealing with economic equilibrium clauses. The weak point of the negotiation approach is the presumption of good faith negotiations and consent. What happens if the parties do not achieve an agreement, abstain from negotiation or block negotiations in bad faith? The ICJ held that "the parties are under an obligation to conduct themselves in a way that ensures that the negotiations are meaningful, which will not be the case when either of them insists upon its own position without contemplating any modification of it".[173] The ICJ did not clarify what happens if negotiations failed. Negotiation clauses coming with equilibrium clauses may provide for arbitral decision if the parties cannot achieve an agreement.

V. The argument of good faith and the investor's due diligence

The main instrument allowing for equity and respective flexibility in law interpretation is the use of the principle of good faith.[174] Good faith has been interpreted as

169 *Ibid*, 82 et seq.

170 This is to be distinguished from *rebus sic stantibus*, see ICJ, *Gabcikovo-Nagymaros* (*Hungary v Slovakia*). Judgment of 25 September 1997, ICJ Rep 1997, 7-84, available at: <http://www.icj-cij.org/docket/files/92/7375.pdf> (visited 11 February 2017), para. 104.

171 *Ibid*, para. 140.

172 See *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158 (176) who states that the evolutionary approach of the ICJ is in line with the logic of economic equilibrium clauses.

173 ICJ, *Gabcikovo-Nagymaros* (*Hungary v Slovakia*). Judgment of 25 September 1997, ICJ Rep 1997, 7–84, available at: <http://www.icj-cij.org/docket/files/92/7375.pdf> (visited 11 February 2017), para. 141.

174 "Good faith is the principle which is most often invoked in international law", *Brownlie*, The Rule of Law in International Affairs, International Law at the Fiftieth Anniversary of the United Nations, 15 et seq.

being “at once a general principle of law and a general principle of international law”:[175]

> “A reasonable and bona fide exercise of a right in such a case is one which is appropriate and necessary for the purpose of the right (i.e., in furtherance of the interests which the right is intended to protect). It should at the same time be fair and equitable as between the parties and not one which is calculated to procure for one of them an unfair advantage in the light of the obligation assumed. A reasonable exercise of the right is regarded as compatible with the obligation. But the exercise of the right in such a manner as to prejudice the interests of the other contracting party arising out of the treaty is unreasonable and is considered as inconsistent with the bona fide execution of the treaty obligation, and a breach of the treaty.” (emphasis added).[176]

Given its public-private hybrid character, there are two conceptually different entry points for the good faith principle to gain effect in international investment law: within the realm of public (international) law as a principle applying to the state, and from a private law perspective applying to the investor. The private law perspective was for example put forward by the tribunal in the above mentioned *MTD v. Chile* case. The tribunal developed a due diligence restriction of the investor’s legitimate expectations under the FET standard.[177] It held that the notion of “legitimate expectations” was limited on the basis of various (good-faith) duties. These can be framed as “(i) the duty to refrain from unconscionable conduct, (ii) the duty to invest with adequate knowledge of risk and (iii) the duty to conduct business in a reasonable manner”.[178] While the normative origin and content of the FET standard are difficult to trace, it can hardly be denied that FET is an expression of equity.[179] The FET standard plays a similar role in international investment law than the complemen-tation of specific rules in a civil law system with a “general clause of good faith as an overarching principle that fills gaps and informs the understanding of specific clauses”.[180] One can thus conclude that “the substance of the standard of fair and equitable treatment will in part overlap with the meaning of a good faith clause in its broader setting”.[181] From an international public law perspective, the principle of good faith could also be invoked independently of the FET standard, as a principle of international law and interpretative tool to allow for examination of the investor’s legitimate expectations from a broader perspective. As such, it may also influence the application of the FET standard.

175 WTO, *United States — Import Prohibition of Certain Shrimp and Shrimp Products*, Report of the Appelate Body, WT/DS58/AB/R, adopted 6 November 1998, para. 158.

176 *Ibid.*, at Fn. 156 citing Bin Cheng, General Principles of Law as applied by International Courts and Tribunals (Stevens and Sons, Ltd. 1953), Chapter 4, in particular, p. 125.

177 *MTD v. Chile*, ICSID Case No. ARB/01/7, Award, 25 May 2004, para. 178.

178 *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (149).

179 See for a more general due diligence approach, *Wälde*, Centre for Energy, Petroleum and Mineral Law and Policy, Professional Papers 13 (1994), 1 (31).

180 *Dolzer/Schreuer*, Principles of International Investment Law, 122.

181 *Ibid.*

Although tied to a *lex specialis* commitment, one could nevertheless think about invoking the investor's diligence with respect to human rights obligations or international environmental standards, at least in the context of the FET standard. This is mainly true if the state has been bound to respective international agreements at the time the contract was concluded. If a state adheres to international obligations widely recognized in the international community or forming part of fundamental standards of international law, there is space to invoke lack of good faith[182] on the part of the investor if the latter expects the state not to observe these standards. One could even go as far as applying this reasoning to ex-post adherence of a host state to international obligations which are widely recognized,[183] and is also true for progressive improvement of social and environmental regulation on the basis of widely recognized international standards. Investors cannot expect states to compensate for regulation that implements widely recognized international standards in the public interest – and thus reflect an international standard of "good governance".

Moreover, new developments in international law point to investors' responsibility to not harm human rights when conducting their business. It is true that private actors are not bound by human rights under international law.[184] However, on the basis of the framework which was elaborated by the former UN Special Representative for Business and Human Rights, *John Ruggie*, and the ongoing work of the UN-Working Group building up on his work, a new standard of businesses' responsibility to respect human rights seems to be emerging in international law.[185] Additionally, as mentioned above, an increasing number of companies, mostly large transnational enterprises, have committed themselves to this standard. In this regard, an investor's claim challenging a host state's measure which aims to fulfil human rights obligations, such as core labour rights, early ILO standards on limited working hours, health and safety, etc., could thus be deemed a case of *venire contra factum proprium* and "illegitimate" in the broader context of good faith. The same holds true for international standards in other fields of public interest that are widely recognized, for example as part of standard setting international bodies (e.g. FAO).

This does not, however, mean that every public measure that is related to human rights or environmental public interest is automatically exempt from compensation.

182 See below, C. V.

183 *Cotula*, Journal of World Energy Law & Business 1 (No 2, 2008), 158 (175).

184 *Schaub*, Die Regulierung multinationaler Unternehmen. Rechtliche, politische und wirtschaftliche Grundlagen, 149 et seq.

185 The so-called "Protect, Respect and Remedy" framework as it has been developed by the SRSG on business and human rights, John Ruggie (see See Human Righs Council (HRC), Business and human rights: Towards operationalizing the "protect, respect and remedy" framework, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, available at: <http://www2.ohchr.org/english/bodies/hrcouncil/docs/11session/A.HRC.11.13.pdf> (visited 18 March 2017), has been widely recognized, including the human rights due diligence requirements for transnational enterprises. The concept has been integrated in the revised OECD Guidelines for Multinational Enterprises which have been adopted on the occasion of the OECD ministerial meeting in May 2011, see OECD Guidelines for Multinational Enterprises, Recommendations for Responsible Business Conduct in a Global Context, 25 May 2011, available at: <http://www.oecd. org/corporate/mne/> (visited 11 February 2017), Chapter IV.

Good faith works for both sites, generating the often cited necessity of balancing different rights and obligations in law interpretation when a principled conflict of law needs to be resolved,[186] as it is typically the case for policy-conflicts. This is where the public law perspective of good faith steps in, reviewing the legitimacy of public authority action encroaching upon a private person's legally protected rights and related interests. In the case of investors, these rights may derive from contractual relations, international investment law or other international obligations of the state. Consequently, different rights of different levels of law (private, national, regional, international) could be invoked.

One of the common interpretive principles in the context of good faith that steps in when two opposing rights collide – such as investors' rights and rights' of others that are protected by the host state measure – is the principle of proportionality. This principle has mainly been employed in the German and European law traditions, but it is also applied in international law. It could serve as a legal reasoning instrument to reviewing the efficiency of reconciliation of conflicting norms so that both interrelated (legitimate) positions may attain their best effectiveness in the given context.[187] The criteria of suitability, necessity and reasonableness of a measure in relation to its aim pursued[188] legally capture the balancing requirement involved in the task to reconcile or optimize different equally important and legally binding colliding principles. This may include political objectives as well as legal obligations (e.g. environmental protection and investment protection). In this sense, the proportionality principle can serve as an interpretive instrument to achieve coherence regarding the "policy-conflict"-fragmentation of international law as it has been described by the ILC.[189] It can also be a conflict-preventing decision-making tool for governments to design policy measures in a balanced way, including in the domain of sustainable development.[190] In international investment law, the proportionality principle has been applied with a view to balancing rights and obligations, for example in the context of FET or expropriation.[191] This has raised considerable concerns with a view to arbitral tribunals' jurisdic-

186 *Dworkin*, Harvard Law Review 88 (No 6, 1975), 1057 (1060).

187 *Alexy*, Theorie der Grundrechte, 101; in the context of sustainable development *Gehne*, Nachhaltige Entwicklung als Rechtsprinzip, 225.

188 Free translation of the German terminology "Verhältnismäßigkeit im engeren Sinne".

189 See above, Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law, Report of the Study Group of the International Law Commission, finalized by Martti Koskenniemi, A/CN.4/L.682, 13 April 2006, para. 24; *van Aaken*, Indiana Journal of Global Legal Studies 16 (No 2, 2009), 483 (502); *Schill/Kingsbury*, International Law and Justice Working Papers 6 (2009), 1 (24 et seq).

190 *Gehne*, in: Bungenberg/Griebel/Hindelang (eds), European Yearbook of International Economic Law (2011), 271 (285).

191 *Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12, Award, 14 July 2006, para. 311; *LG&E Energy Corp., LG&E v.* Argentina, para. 195; see however *Schill/Kingsbury*, International Law and Justice Working Papers 6 (2009), 1 (6): "While many international human rights courts, and indeed many national courts, often conduct a proportionality analysis in order to balance rights and rights-limiting policy choices, in investor-State arbitration only a few tribunals have taken such an approach. Instead, the complexity and polyvalent nature of the issues involved is analyzed and weighed only weakly in a range of cases where a stronger methodology seems called for, including some cases dealing with legislative measures of general application that affect existing foreign investors along with domestic actors, and others dealing with discretionary functions as-

tion when reviewing host state measures, arbitrators' governance power that encroaches upon public administrative principles of states' sovereignty and democracy.[192]

While these concerns should not lead to generally questioning the proportionality principle in investor-state arbitration, as the principle could serve as a strong tool to raise predictability in weighing-and-balancing investors' rights and states' governance measures that are with or without proportionality test necessarily occurring in international investment law,[193] the question of arbitrators' governance power is a critical one. The key question is the legitimacy of arbitration panels' discretionary power. In national law contexts, where the proportionality principle is well established, weighing and balancing of conflicting, legitimate policy goals or rights normally gives rise to courts' judicial self-restraint. Judicial self-restraint means deference to the state's prerogative to choose policies or the level of protection, unless there is an evident problem of good faith, e.g. when a measure is obviously not suitable, not necessary or not proportionate with respect to its aim pursued.[194]

Finally, as another expression of good faith, the FET standard itself applies in international investment law when determining the legitimacy of the state's measure in the field of environmental and social public interest regulation under international investment law. Here, issues like transparency, stability, and the investor's legitimate expectations – and, proportionality – step in.[195] Other aspects of good faith under the FET standard have concerned due process, predictability or de jure changes in law. Good faith may also include the responsibility of states to conduct consultations or negotiations with investors before enforcing legislation.[196]

VI. The argument of systemic integration and harmonized law interpretation

The interpretative objective to seek a balance between legitimate rights of host states and investors in the field of environmental and human rights regulation is expressed in the principle of harmonized law interpretation as it was developed by the ILC study group on fragmentation of international law. For the study group "treaty interpretation is diplomacy, and it is the business of diplomacy to avoid or mitigate

signed to administrative agencies under local law, but exercised in ways that impose regulatory constraints and thus result in particular harm to foreign investors."

192 See Brownlie, *Principles of Public International Law*, 289.

193 *Schill/Kingsbury*, International Law and Justice Working Papers 6 (2009), 1 (39).

194 In the context of the WTO deference to member states' choice of the level of protection has been stated by the WTO Appellate Body, see for example WTO, *Korea — Various Measures on Beef*, Report of the Appelate Body from 11 December 2000, WT/DS161/AB/R, WT/DS169/AB/R, para. 176; WTO, *EC — Asbetos*, Report of the Appelate Body from 12 March 2001, WT/DS135/AB/R, para. 168, see with respect to the issue of judicial self-restraint, approaches to law interpretation, and proportionality *Gehne*, Nachhaltige Entwicklung als Rechtsprinzip, 223 et seq, 250 et seq.

195 *Dolzer/Schreuer*, Principles of International Investment Law, 133; *Schill/Kingsbury*, International Law and Justice Working Papers 6 (2009), 1 (16 et seq, 21 et seq, 37 et seq).

196 See in the context of WTO arbitration: WTO, *United States — Import Prohibition of Certain Shrimp and Shrimp Products*, Report from the Appelate Body from 6 November 1998, WT/DS58/AB/R, para. 166.

conflict".[197] The group underlines that: Whether there is a conflict and what can be done with prima facie conflicts depends on the way the relevant rules are interpreted. This cannot be stressed too much. […]."Rules appear to be compatible or in conflict as a result of interpretation". Sometimes it may be useful to stress the conflicting nature of two rules or sets of rules so as to point to the need for legislative intervention. Often, however, it seems more appropriate to play down that sense of conflict and to read the relevant materials from the perspective of their contribution to some generally shared - "systemic" – objective.[198] In terms of stabilization clauses and potential conflicts with other host state's obligations, one should thus either clarify the scope of these clauses by "legislative intervention" or seek to "play down" the conflict through systemic law interpretation. The ILC study group refers to the technique of "mutual supportiveness" and "harmonized law interpretation" which starts out from a "thumb-rule" involving the "presumption that the parties intend something not inconsistent with generally recognized principles of international law or with previous treaty obligations towards third States".[199] "Well-worn legal pathways" of law interpretation should be applied to seek a maximum of harmonized law interpretation and mutual supportiveness of conflicting norms.[200] These involve "references to normal meaning, party will, legitimate expectations, good faith, and subsequent practice, as well as the 'object and purpose' and the 'principle of effectiveness" or "if a definite priority must be established, this may […] be achieved through three criteria: (a) specificity (*lex specialis*); (b) temporality (*lex posterior*), and (c) status (*ius cogens*, obligations *erga omnes* and Article 103 United Nations Charter)".[201] An important source for harmonized law interpretation is the provisions of the VCLT, such as, for example, the preamble (reference to human rights and the UN Charta), or Article 31 VCLT (international law coherence).[202] The above explored interpretative avenues may be read as specific entry points for harmonized law interpretation in cases of policy-conflicts related to stabilization clauses in international investment law.

The application of the principle of harmonized law interpretation in cases of policy-conflicts is, however, not a given fact in investor-state-arbitration.[203] It depends on the approach to legal reasoning if or if not a stabilization clause is taken as simple *lex specialis* overriding other interpretation in the face of policy-conflicts related to public interest regulation, or as a right to be balanced against the background of conflicting

[197] Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law, Report of the Study Group of the International Law Commission, finalized by Martti Koskenniemi, A/CN.4/L.682, 13 April 2006, para. 37.

[198] *Ibid.*, para. 412.

[199] *Ibid.*, para. 38.

[200] *Ibid.*, para. 412.

[201] *Ibid.*

[202] See regarding a case for "global administrative law" reasoning in the context of investor-state arbitration, *Schill/Kingsbury*, International Law and Justice Working Papers 6 (2009), 1 (40 et seq, 50 et seq).

[203] See with respect to tendencies in international investment arbitration in terms of balancing investors' rights and states' regulatory space in the public interest, *Johnson/Volkov*, The American Review of International Arbitration 24 (No 3, 2013), 361 (369 et seq); with respect to global administrative governance and proportionality reasoning, *Schill/Kingsbury*, International Law and Justice Working Papers 6 (2009), 1 (6, 24).

underlying rights and principles.[204] Currently, law interpretation and legal reasoning are very much influenced by the composition of the investment tribunal, not least due to arbitrators' interpretative approach to investment law.[205] For harmonized law interpretation to be effective in international investment law there seems to be a need for anchoring respective guiding interpretative principles and methodologies in IIAs or interpretative rules, e.g. in the context of UNCITRAL or ICSID, not least to enhance legal certainty and predictability.[206]

E. Conclusion

Recent arbitration decisions that directly or indirectly involved stabilization clauses are mixed in their tendencies. Older as well as recent investment tribunals' awards suggest that this practice is considered a widely recognized investment protection tool to which host states chose to commit in their effort to attract investment. One can detect two main tendencies in international investment arbitration: on the one hand, seemingly unconditional recognition of stabilization commitments even with regard to cases in which a balancing approach to smooth underlying conflicts with environmental and social standards has been explicitly adopted (e.g. *Methanex v. U.S.*, *AES v. Hungary*, *CMS Gas Transmissions v. Argentina*, etc.).[207] On the other hand, independent of the specific case of stabilization clauses but equally concerning the underlying "policy-conflict" regarding legitimate public purpose regulation and investors' rights, arbitrators have expressed concerns with respect to host states' constitutional principles and right to regulate in the public interest (*Duke Energy v. Peru*, *Burlington v. Ecuador*), and have taken into account the investor's due diligence as a benchmark, including with respect to the public interest (*Saluka v. Czech Republic*, *Parkerings v. Lithuania*, *MTD v. Chile*). To our knowledge, none of the publicly available and discussed arbitration cases have yet involved a "policy-conflict" between a strict general stabilization clause and a host state's public interest regulation related to the respect of international social or environmental standards. Such a case could provoke different legal arguments.

As we have discussed above, there are different interpretative ways to address this case of stabilization clauses in the face of interfering social/environmental international law. It very much depends on the "pre-analytic vision" of law or legal reasoning of the arbitrators in charge to what extent these approaches may play a role in a given case. As the study group of the ILC Report on Fragmentation noted: "conflict-resolution and interpretation cannot be distinguished from each other. Whether there

[204] See for the different effects of „positivist“ or „principled“ approach to legal reasoning in the context of sustainable development and law, *Gehne*, Nachhaltige Entwicklung als Rechtsprinzip, 278.

[205] *Van Harten*, in: Balchin/Chung/Kaushal/Waibel (eds), The Backlash against Investment Arbitration, 433 (441).

[206] See suggestions related to a global administrative law approach *Schill/Kingsbury*, International Law and Justice Working Papers 6 (2009), 1 (50 et seq).

[207] *Johnson/Volkov*, The American Review of International Arbitration 24 (No 3, 2013), 361 (369 et seq).

is a conflict and what can be done with *prima facie* conflicts depends on the way the relevant rules are interpreted".[208]

Apart from law interpretation, in our view, stabilization clauses "freezing" a certain legal or favourable business context (compensation clauses) over a longer period of time without regard of investors' responsibilities and reasonableness with regard to public needs (general stabilization clauses), are generally questionable for various reasons. First of all, from an investment protection perspective, due to unsettled interpretative practice, such stabilization clauses carry the risk of not living up to their original purpose concerning legal certainty and stability. Today, general stabilization clauses or other forms of stabilization clauses that potentially interfere with environmental or social public interest fields do not necessarily guarantee legal security. On the one hand, it will depend on the arbitrators' interpretative approaches to what extent stabilization clauses will keep their stability promise when confronted with "hard" policy-conflict cases. This drills loopholes in the rigid legal guarantee that is sought with these clauses, the more so as stabilization clauses are often characterized by broad scope and wording (e.g. "adversely affected", material adverse change or effect, MAC or MAE).[209] Even though these provisions may come in handy as "escape hatch" for renegotiation or ending deals in times of uncertain economic developments, their open terms generally leave a lot of room for interpretation.[210]

On the other hand, an isolated interpretation or application of stabilization commitments entails the risk of "deficit in legitimacy" and with that civil society protests and local uproar. For companies, this can grow into a costly problem when confronted with local protests, related litigation, and bad terms with local government. Investment security, reputation and brand may suffer considerably, mainly given globalized media and social networks. Smart companies rather consider the factor of social capital that consists, for example, in good terms with local communities, government and other relevant stakeholders; seek to resolve problems via alternative dispute resolution and renegotiation instead of insisting on far-reaching commitments. Thereby, as another win, they earn the positive effects that come with good reputation, brand trust, and the market match for the growing body of companies, customers and investors that make social responsibility a differentiating factor or even a condition for business. Sustainable development, of which responsible business conduct in the social and environmental sphere is part, has become a differentiating factor on various markets, influencing the business strategies of a wide range of big transnational companies today. Additionally, non-observance of widely recognized international standards harms companies' brands. This is why today companies increasingly take into account risks related to internationally recognized standards when investing abroad. For an investor, counting on general stabilization commitments, could thus mean to camouflage risks and to neglect due diligence with respect to these standards. Against this

208 Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of Inernational Law, Report of the Study Group of the International Law Commission, finalized by Martti Koskenniemi, A/CN.4/L.682, 13 April 2006, para. 412.

209 *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (130).

210 *Ibid.*, 131.

backdrop, investment security rather implies than excludes observation of widely recognized international human rights and environmental standards.

As a conclusion, stabilization clauses "freezing" legislation and hindering legal development and law application in the social and environmental domain do not necessarily match the interests of investors anymore. Additionally, as described above, they imply risks of legal uncertainty and lacking legitimacy that rather impair than foster investment security. Moreover, "hard" policy-conflict cases may harm the rule of law and legal protection in international investment law when decided along the lines of freezing clauses.[211] Civil society protests and lacking acceptance of investment law delegitimizes international investment law, arbitration, and the rule of law that comes with it. Enforcing ways of law interpretation that are publicly felt to represent one-sided business rent seeking carries a strong risk to fuel anti-investment law campaigning, mainly when not considering international human rights and environmental standards.

Another question is if general stabilization clauses are still a necessary instrument of investment protection today. Their historical foundations root in the 19^{th} / early 20^{th} century when investment protection in international law was practically nonexistent. Today, a solid ground of international investment protection standards is in place through customary international law and the widespread growing network of IIAs. Most IIAs typically share the same features of investment protection standards (for example non-discrimination, expropriation, most-favored nation treatment, and fair and equitable treatment). So normally, there is already quite a good basis of investment protection in place. As the above case studies and exploration of interpretive avenues have shown, the widespread net of investment protection law generally allows for flexibility and good faith harmonized law interpretation when it comes to balancing investors' and public interest through arbitration decisions. Arbitral decisions even suggest that the FET standard already implies a certain degree of stability as legitimate expectation of the investor.[212] Some treaties explicitly stipulate investment stability as a goal of the FET standard.[213]

The main difference between stabilization commitments as *lex specialis* and the FET standard of international investment law is that under the latter "simple non-discriminatory bona fide regulation does not trigger compensation"[214] while "the presence of a stabilization clause can make such action compensable".[215] Compensation for unfair and arbitrary treatment thus may, on the basis of a stabilization clause as *lex*

211 *Echandi*, in: Alvarez/Sauvant/Ahmed/Vizcaíno (eds), The Evolving International Investment Regime, 3 (11).

212 *Schill/Kingsbury*, International Law and Justice Working Papers 6 (2009), 1 (10); *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (147); see for the FET standard as instrument to „balance the competing interests of regulatory flexibility and legal predictability" in the sense of due stability or "equilibrium" *Hirsch*, International Law Forum, The Hebrew University of Jerusalem, Research Paper (No 7, 2013), 1 (7), available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2272952> (visited 18 March 2017).

213 *Dolzer/Schreuer*, Principles of International Investment Law, 122.

214 *Maniruzzaman*, Journal of World Energy Law & Business 1 (No 2, 2008), 121 (131)

215 *Ibid*, 131; see with respect to the FET standard, *Hirsch*, International Law Forum, The Hebrew University of Jerusalem, Research Paper (No 7, 2013), 1 (2), available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2272952> (visited 18 March 2017).

specialis, turn into general compensation for regulation, even beyond *rebus sic stantibus*.[216] Additionally, arbitration panels may consider non-observance of contractual stabilization commitments as expropriation of contractual rights against the backdrop of an applicable international investment agreement.[217]

Consequently, stabilization clauses in investor-state contracts imply a much broader protection of the investors' business interest – mainly if elevated to the protection of the international investment law regime through umbrella clauses or respective law interpretation. This protection standard goes beyond the original function of stabilization clauses which was about shielding against nationalization and arbitrary treatment of an investor that is exposed to the sovereignty of a foreign state.[218] General protection of the investors' business interest also goes beyond the idea of due risk management between states and investors. The risk of changing conditions is borne by the host state alone. This is clearly expressed through the observations of the arbitrators in the *EDF v. Romania* case who state:

> "The idea that legitimate expectations, and therefore FET, imply the stability of the legal and business framework, may not be correct if stated in an overly-broad and unqualified formulation. The FET might then mean the virtual freezing of the legal regulation of economic activities, in contrast with the State's normal regulatory power and the evolutionary character of economic life. Except where specific promises or representations are made by the State to the investor, the latter may not rely on a bilateral investment treaty as a kind of insurance policy against the risk of any changes in the host State's legal and economic framework. Such expectation would be neither legitimate nor reasonable."[219]

Investors cannot duly expect to be totally let off the hook from their societal position as corporate citizens subject to "the evolutionary character of economic life"[220] simply because they invest abroad. As cited above, arbitrators have stated that on the basis of customary international law "governments must be free to act in the broader public interest".[221] Economic conditions for business are naturally contingent to the regulatory progressive state reacting to evolving conditions of life and governance. After all, investment protection is about risk management in the public sphere, about adjusting the imbalance that exists between contracting parties, if one party has administrative or legislative power. It is not about generally shielding firms against any

216 See *Titi*, Journal du Droit International 141 (No 2, 2014), 97 (111).
217 *Ibid*, 109.
218 *Ibid.*, 97 (106 et seq).
219 *EDF v. Romania*, ICSID Case No. ARB/05/13, Award, 8 October 2009, para. 216, available at: <http://www.italaw.com/sites/default/files/case-documents/ita0267.pdf> (visited 11 February 2017).
220 *Ibid*, para. 217
221 *Feldman v. Mexico*, ICSID Case No ARB(AF)/99/1, Award and Separate Opinion, 16 December 2002, para. 103, available at: <http://www.italaw.com/sites/default/files/case-documents/ita0319.pdf> (visited 11 February 2017).

business risks.[222] An investor that expects this kind of protection is thus not duly managing risks from the outset.

This does not mean that unfair treatment and arbitrary host state action to the detriment of foreign investors is to be neglected. After all, this has been the core good reason for the actual investment law in place. One should, however, avoid to go beyond a due balance of reasonable interests between host states and investors,[223] throwing the baby out with the bathwater, and ignoring core principles of good governance, such as sustainable development and fair competition. As *Robert Howse* puts it: "Business at no risk" distorts market-efficiency, has the potential to disincentivize progressive regulation, and fosters "moral hazard on the part of the firm".[224] *Moshe Hirsh* formulated in the context of FET: "Facing the [above] competing interests, and being aware that full acceptance of either need will be neither efficient nor fair, investment tribunals and policy-makers strive to strike an adequate balance between the interest of host government in regulatory flexibility and foreign investors' interest in legal predictability". "The equilibrium point may be anchored in several alternative legal concepts and doctrines: administrative contracts, stabilization clause and the FET principle."[225] Consequently, if via contractual general stabilization clauses the "equilibrium point" is set at "full protection" of the investor's business interest with respect to any reasonable, fair and equitable change in regulation, the deal will hardly be "efficient or fair". If there was an imbalance to the detriment of the investor before due to the state's public function, there can hardly be an equilibrium if the investor enjoys full *lex specialis* stabilization against all regulatory change. Explicit risks and specific interests in incentivizing foreign investment should rather be the factors that inform fair and equitable contractual equilibrium. Against this backdrop, it seems at least questionable if general stabilization clauses can constitute a "fair and equitable means" of investor-state contract regulation.

Given the above reflections, and safe specific circumstances, we think that the best way to deal with general stabilization clauses today is to make them history by interpreting them in a harmonizing way when applicable and by not deploying them anymore in investor-state contracts or other forms of international investment agree-

222 *MTD v. Chile*, ICSID Case No. ARB/01/7, Award, 25 May 2004, para. 178, available at: <http://www.italaw.com/sites/default/files/case-documents/ita0544.pdf> (visited 11 February 2017).

223 See with respect to the challenge of that balance ("equilibrium point") in international investment law *Moshe Hirsch* who states "that full acceptance of either need will be neither efficient nor fair". This is why "policy-makers and arbitrators strive to strike an adequate balance between the interest of host governments in regulatory flexibility and foreign investors' interest in legal predictability", *Hirsch*, International Law Forum, The Hebrew University of Jerusalem, Research Paper (No 7, 2013), 1 (3), available at: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2272952> (visited 11 February 2017).

224 *Howse*, Freezing Government Policy: Stabilization Clauses in Investment Contracts, International Institute for Sustainable Development (IISD), Investment Treaty News, 4 April, 2011, available at: <http://www.iisd.org/itn/2011/04/04/freezing-government-policy-stabilization-clauses-in-investment-contracts-2/> (visited 11 February 2017).

225 *Hirsch*, International Law Forum, The Hebrew University of Jerusalem, Research Paper (No 7, 2013), 1 (3 et seq), available at: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2272952 (visited 11 February 2017).

ments.[226] Investors' legitimate interests in business stability should start with the FET standard with a focus on compensation for unfair or arbitrary treatment, subject to good faith on the side of the state and due diligence on the side of the investor. As *Anthony Crockett* puts it: "Stability is, after all, a synonym for balance."[227] Against this backdrop, the remaining challenge for investor-state contracts is to complement the investment picture where individual contracts "allow for greater care to be taken and greater certainty to be achieved in the framing of the parties' legal rights and obligations".[228] Part of this should be to strive for a high degree of legal certainty with a view to the individual investment project in a complex field of tension that includes investment security, legitimacy in the public sphere, and investment incentives.[229] There will be no one-size-fits-all solution similar to general stabilization commitments but the challenge to achieve a carefully tailored, balanced and predictable solution for each individual investment, vested with conflict prevention instruments such as transparency and/or mediation or renegotiation clauses to prevent and resolve conflicts between the parties.[230] Investment incentives, including commitments to compensate for significant regulatory change in certain fields of law (e.g. tax law), should be legitimate only if no other fundamental rights, principles and goals in the public interest are violated or significantly frustrated (systemic coherence), that they are transparent for the public, limited in time, and agreed upon on a clearly defined basis regarding content, extent and expiration. Generally, the legitimate interest of the host state in the positive social and/or developmental impact of the investment should be as much a criterion of legitimate expectations on the side of the host state as business stability on the side

226 Similar *Howse*, Freezing Government Policy: Stabilization Clauses in Investment Contracts, International Institute for Sustainable Development (IISD), Investment Treaty News, 4 April, 2011, available at: <http://www.iisd.org/itn/2011/04/04/freezing-government-policy-stabilization-clauses-in-investment-contracts-2/> (visited 11 February 2017); different view: *Hirsch*, International Law Forum, The Hebrew University of Jerusalem, Research Paper (No 7, 2013), 1 (20), available at: <http://papers.ssrn.com/sol3/papers. cfm?abstract_id=2272952> (visited 11 February 2017). "Stabilization clauses […] constitute one technique for the allocation of such risks and the parties may adopt diverse allocation formulas regarding the risk of regulatory change. Investment tribunals have consistently ruled that FET clauses are not equivalent to stabilization clauses. Thus, it is highly desirable that the parties to investment relations negotiate adequate risk allocation formulas that will significantly reduce the uncertainties involved in future modifications for the regulatory framework applicable to investors. "

227 *Crockett*, in: Brown/Miles (eds), Evolution in Investment Treaty Law and Arbitration, 516 (530).

228 Public Statement on the International Investment Law Regime, 31 August 2010, para. 10, available at: <http://www.osgoode.yorku.ca/public-statement-international-investment-regime-31-august-2010/> (visited 11 February 2017).

229 See with respect to the vital role of legal "calculability" for foreign investment, *Hirsch*, International Law Forum, The Hebrew University of Jerusalem, Research Paper (No 7, 2013), 1 (3), available at: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2272952> (visited 11 February 2017).

230 See *Howse*, Freezing Government Policy: Stabilization Clauses in Investment Contracts, International Institute for Sustainable Development (IISD), Investment Treaty News, 4 April, 2011, available at: <http://www.iisd.org/itn/2011/04/04/freezing-government-policy-stabilization-clauses-in-investment-contracts-2/> (visited 11 February 2017), who mentions the cost-factor of due diligence and general principles of investor-contract negotiations favoring stabilization clauses, see *Hirsch*, International Law Forum, The Hebrew University of Jerusalem, Research Paper (No 7, 2013), 1 (20), available at: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2272952> (visited 11 February 2017), with different conclusion regarding stabilization clauses as appropriate means of contractual risk management.

of the investor. Share-in-deals should be based on transparency and clearly defined criteria, including adaptation clauses. Interpretative principles or rules should support vague MAE or MAC clauses and should underline the state's right to regulate subject to fair and equitable treatment as well as the investor's due diligence regarding public interest needs. Thereby, the definition of concretizing criteria as to what constitutes "fair and reasonable"[231] treatment could help to foster legal certainty (e.g. timely information of the investor, exchange on possible solutions to achieve the regulatory goal with the least impact on the investor, etc.). As risk management tools, parties may agree upon *de minimis* thresholds or recognized legal standards as reference frame for regulatory change, as it was the case in the BTC's pipeline consortium's Human Rights Undertaking that referred to "relevant EU directives (EU Standards), those World Bank Group standards referred to in the Project Agreements, and standards under applicable international labour and human rights treaties". The more specific a benchmark gets (e.g. EU Standards) the more it may, however, restrict the flexibility of the state to adopt different and better-adapted solutions in a given situation.

An instrument that could foster risk management of investments is dispute prevention mechanisms, such as well-defined mediation and negotiation instruments as a procedural tool to achieve well-tailored solutions to upcoming issues.[232] Another tool that could support thorough risk analysis is sustainability impact assessments (SIAs), e.g. as an *ex ante* due diligence requirement of an investment opportunity/risk analysis. SIAs could contribute information as to due investors' responsibilities and risks against the backdrop of the state of governance of the host state. They normally integrate human rights' impact assessments, and ideally also screen (on the side of the state), conditions for development opportunities. SIAs require evaluations with respect to social and environmental risks and effects of an investment, and seek to assess from the outset which risks and opportunities are at stake in relation to the investment when it comes to social and environmental standards. SIAs could thus provide transparency and information to tailor benchmarks of investor-state negotiations and individual contract clauses.

For the investor, SIAs allow for a more comprehensive approach to business risks with respect to upcoming state measures and civil society pressure. This is particularly true as SIAs normally include stakeholder dialogue, which is a clear asset for detecting investment risks, and manage them accordingly, and for achieving investment stability with respect to civil society acceptance. From the state's perspective, such a tool could at the same time allow for assessing and monitoring positive impacts, development opportunities and good practices which could help channel development technical

[231] As the arbitrators in *Parkerings vs Lithunia* note: what is prohibited however is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power", *Parkerings v. Lithunia*, ICSID Case No ARB/05/8; Award on jurisdiction and merits, 11 September 2007, para. 332, available at: <http://www.italaw.com/sites/default/files/case-documents/ita0619.pdf> (visited 11 February 2017).

[232] *Echandi*, A novel approach towards addressing investor–state conflicts: development of investor–state dispute prevention mechanisms, NCCR Trade Regulation, Swiss National Centre of Competence in Research, Working Paper (No 46, 2011), 1 et seq, available at: <http://www.nccr-trade.org/fileadmin/user_upload/nccr-trade.ch/wp2/publications/wp%202011%2046_Echandi.pdf> (visited 18 March 2017).

assistance and policies. Many, mainly developing countries within the foreign aid frame (e.g. World Bank) have already established *ex ante* assessment tools with respect to social and environmental impacts of investment projects. The challenge is to fill them with life to make them effectively working investment risk management tools. For example, for SIAs to be effective and less cost-intensive for each individual investment, standardized sector-by-sector risk-assessments as well as systematic data collection and transparency in terms of economic, environmental, and societal/political conditions are of great importance.[233]

[233] See for example the UN Global Pulse initiative, available at: <http://www.unglobalpulse.org/about-new> (visited 11 February 2017), and Verisk Maplecroft, a private risk management service provider, available at: <http://maplecroft.com> (visited 11 February 2017).

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