

**TRANSFORMING FOREIGN INVESTMENT:
GLOBALISATION, THE ENVIRONMENT, AND A CLIMATE OF
CONTROVERSY**

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I INTRODUCTION

Foreign investment is a politically charged subject. Inevitably, this has meant that as socio-political conditions have changed, so perspectives on the value and motives of foreign investment and its protection have also shifted over time. International law on expropriation has not been immune to this remoulding of perspectives. It has developed over the last century or so in fits and starts, changing shape as different issues, concepts, policies and political environments have come to the fore. As a process of legal evolution, this shape-changing has often manifested in politico-legal controversy, early examples being the crumbling of the 19th century stranglehold that capital-exporting states had on the international rules governing foreign investment and the demise of gun-boat diplomacy as a legitimate means of preserving foreign trade and investment interests. Controversy surrounded the emergence of the term ‘nationalisation’ following widespread social reform measures, such as that adopted by the Soviet Union in 1917, and a politico-legal reappraisal of foreign investment protection law was required in the 1950s and 1960s by the post-colonial emergence of newly independent or newly formed states. The development of the principle of permanent sovereignty over natural resources and the adoption of the *Charter of Economic Rights and Duties*¹ indicated a further shift in emphasis for foreign investment law and policy in the 1970s. To a certain extent, all of these events and controversies have contributed to the development of international investment law. And recently, it has become clear that the law on foreign investment protection is again in a state of flux.

Controversy currently surrounds all manner of foreign investment issues: the making of arbitral awards that appear to have no precedent for the approach

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¹ UN GA Res 3281, UN Doc A/Res/3281 (XXIX) (1974).

adopted,² the expansion or restriction of the definition and scope of the term ‘expropriation’,³ determining what the appropriate considerations are in compensation calculation methods,⁴ deciding whether principles from other areas of international law should be applied in foreign investment disputes,⁵ and even questions about the very nature and structure of fora for hearing such disputes are not settled.⁶ What is responsible for this apparent state of uncertainty or transition? What are the implications of this for the future direction of international investment law?

When an historical evaluation of the development of foreign investment protection law is conducted, it becomes clear that change and controversy in the law mirrors shifts in socio-political conditions. In considering the circumstances that could be generating controversy now, this observation of historical patterns directs attention to global socio-political shifts that have either occurred recently or are still in the process of unfolding. This article asserts that globalisation, transformations in international law-making, and the rise of a global environmental consciousness are the three main forces behind current controversies in international investment law.

The underlying premise of this article is that the transformation of perception inherent in globalisation, a global environmental consciousness and the modern development of international environmental principles has had a profound effect on the way in which international politico-legal issues are perceived and solutions sought. It asserts that this is a paradigm shift that has taken the substance and structure of international law-making away from the traditional, state-centred, isolated-issue approach, and into a new direction generating a re-evaluation of international political and legal constructs and institutions. It suggests that international law has been remoulded to address the challenges posed by the global environmental crisis and puts forward the idea that the next phase in this new direction will adapt the concept of ‘sustainable development’ to form the basis for an overall ecological framework by which society’s international and national social, economic, political and legal systems will be referenced.

² *Metalclad Corporation v The United States of Mexico*, Award, ICSID Case No ARB (AF)/97/1, 30 August 2000 (‘*Metalclad*’); (2001) 16 *International Centre for the Settlement of Investment Disputes Review – Foreign Investment Law Journal* 168.

³ See, eg, Vicki Been & Joel C Beauvais, ‘The Global Fifth Amendment? NAFTA’s Investment Protections and the Misguided Quest for an International “Regulatory Takings” Doctrine’ (2003) 78 *New York University Law Review* 30, 33-37; see also Konrad von Moltke, ‘International Investment and Sustainability: Options for Regime Formation’ in Kevin P Gallagher & Jacob Werksman (eds) *International Trade and Sustainable Development* (2002) 347, 351.

⁴ *Compania del Desarrollo de Santa Elena, S A v The Republic of Costa Rica*, Award (ICSID) Case No. ARB/96/1, 17 February 2000 (‘*Santa Elena*’); also cited at (2000) 15 *International Centre for the Settlement of Investment Disputes Review – Foreign Investment Law Journal* 169.

⁵ Philippe Sands, ‘Searching for Balance: Concluding Remarks; Colloquium on Regulatory Expropriations in International Law’ (2002) 11 *New York University School of Law Environmental Law Journal* 198, 204-5.

⁶ von Moltke, above n 3, 349-51.

This article explores how foreign investment is responding to the current culture of international environmentalism. Part II examines the polarisation of positions in the foreign investment and environment debate. Part III examines the emergence of a less hostile relationship between these two sectors. From the analysis conducted below, it is clear that foreign investment law-makers and policy developers and investors themselves have not yet found an entirely satisfactory way in which to reconcile the competing objectives involved in investment and environmental protection issues. The article concludes that it will be essential for actors in the foreign investment field to provide a response to such matters that better reflects the new global socio-political era if the foreign investment/environment relationship is to proceed harmoniously in the future.

II FOREIGN INVESTMENT AND THE ENVIRONMENT: CLIMATE OF CONTROVERSY

Highly politicised and complex, the association between foreign investment and the environment is multi-layered, encompassing both the apparent clash of objectives as well as more subtle attempts at alignment of interests. Their inter-linking has arisen in a variety of contexts, including the provision of foreign investment privileges in exchange for raised environmental standards,⁷ and recent arbitral awards where there have been allegations that environmental regulation has operated as a form of indirect expropriation of foreign-owned investments.⁸ There have been assertions that foreign investment creates pollution havens⁹ and that its protection laws allow multinational corporations to influence the domestic environmental, worker protection, and health and safety regulation of the states in which they invest.¹⁰ Attention has also been turned to more subtle causes of corporate environmental degradation – to those who provide the finance for environmentally-harmful projects – resulting in pressure to reform lending practices in both the public and private sectors.¹¹ There is, of course, the converse position, advocating the need for

⁷ See, eg, *United Nations Framework Convention on Climate Change*, 9 May 1992, New York, art 4(3) & 7, 31 ILM 849 (1992).

⁸ *Metalclad*, above n 2.

⁹ See, eg, Greenpeace, 'Position Paper', 5th Ministerial Conference at the WTO (Mexico, 2003) <http://www.greenpeace.org/international_en/multimedia/download/1/308757/0/positionpaper-FINAL.pdf> at 18 March 2007. See generally Eric Neumayer, *Greening Trade and Investment: Environmental Protection Without Protectionism* (2001) 41-67; see also a discussion of this issue and other environmental concerns as applied to specific sectors of investment in Neil Gunningham & Darren Sinclair, 'Voluntary Approaches to Environmental Protection: Lessons from the Mining and Forestry Sectors', OECD Global Forum on International Investment, OECD Conference on Foreign Direct Investment and the Environment: Lessons to be Learned from the Mining Sector (Paris, 2002) <<http://www.oecd.org/dataoecd/46/1/1819792.pdf>> at 18 March 2007.

¹⁰ See, eg, 'Joint NGO Statement on the Multilateral Agreement on Investment', NGO/OECD Consultation on the MAI, Paris, 27 October 1997. See also for a discussion of this issue Julie A Soloway, 'The North American Free Trade Agreement: Alternative Models of Managing Trade and the Environment' in Richard Steinberg (ed), *The Greening of Trade: International Trade Organizations and Environmental Issues* (2002) 155, 171-2.

¹¹ Michael M Cernea, 'The "Ripple Effect" in Social Policy and its Political Content: A Debate on Social Standards in Public and Private Development Projects' in Michael B Likosky (ed) *Transnational Law, Infrastructure and Human Rights* (2005) 65; Malcolm Forster,

safeguards against domestic protectionism disguised as environmental regulation and supporting the viewpoint that multinational corporations encourage the introduction of higher environmental standards through technology transfer, by example in their environmental practices and through the initiation of voluntary codes of corporate environmental conduct.¹² This section of the article, however, examines the climate of controversy that surrounds the interrelationship between foreign investment and the environment.

A Hostility and Polarisation of Positions

‘Foreign investment’ encompasses both foreign direct investment and foreign portfolio investment. Foreign direct investment is defined by the United Nations Conference on Trade and Development (‘UNCTAD’) in the following way:

Foreign direct investment (FDI) is defined as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate). FDI implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other economy. Such investment involves both the initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates, both incorporated and unincorporated.¹³

Foreign Portfolio Investment (‘FPI’) is described as including:

a variety of instruments which are traded (or tradeable) in organized and other financial markets: bonds, equities and money market instruments. The International Monetary Fund even includes derivatives or secondary instruments, such as options, in the category of FPI. The channels of cross-border investments are also varied: securities are acquired and sold by retail investors, commercial banks, investment trusts (mutual funds, country and regional funds, pension funds and hedge funds).¹⁴

¹² ‘Environmental Responsibilities of Transnational Companies’ in Lye Lin Heng et al (eds), *Current Legal Issues in the Internationalization of Business Enterprises* (1996) 68.

See, eg, OECD Directorate for Financial, Fiscal and Enterprise Affairs, ‘New Horizons for Foreign Direct Investment: Conclusions from Conference’ (OECD Global Forum on International Investment: New Horizons and Policy Challenges for Foreign Direct Investment in the 21st Century’, Mexico City, 26-27 November 2001) 2002; Business and Industry Advisory Committee to the OECD, ‘BIAC Background Paper’ (OECD Conference on Foreign Direct Investment and the Environment: Lessons to be Learned from the Mining Sector, 2002) <<http://www.oecd.org/dataoecd/63/62/2066204.pdf>> at 18 March 2007.

¹³ United Nations Conference on Trade and Development (‘UNCTAD’), *Foreign Direct Investment: Statistics*, <<http://www.unctad.org/Templates/WebFlyer.asp?intItemID=2190&lang=1>> at 16 March 2007.

¹⁴ UNCTAD, ‘Foreign Portfolio Investment (FPI) and Foreign Direct Investment (FDI): Characteristics, Similarities, Complementarities and Differences, Policy Implications and Development Impact’, Commission on Investment, Technology and Related Financial Issues: Expert Meeting on Portfolio Investment Flows and Foreign Direct Investment (Geneva, 1999) [6] <<http://www.unctad.org/en/docs/c2em6d2&c1.en.pdf>> at 17 March 2007.

Global flows of foreign capital continue to increase. UNCTAD reports indicate that global foreign direct investment reached an estimated US\$897 billion in 2005, a 29 per cent increase on 2004 figures.¹⁵ Developed states attracted the greater share of global foreign capital, amounting to US\$573 billion.¹⁶ While developing states drew in a lesser volume of foreign direct investment, US\$274 billion, the trend remains upwards with a 13 per cent increase overall on 2004 and with all regional groupings of developing economies, such as Africa, Latin America and Asia, recording increases in FDI inflows.¹⁷ As such, if current foreign investment practices, law and policy do contribute significantly to environmental degradation, directly through pollution generation and environmental malpractice and indirectly through their impact on international and national environmental law and policy, it will be of continued concern that this level of foreign investment activity is conducted without reference to a multinational environmental framework.

1 Corporations, Environmental Damage and Unsustainable Growth

Arguments directly linking foreign direct investment to environmental degradation have multiple dimensions. The first level of debate relates to the environmental practices of individual foreign-owned companies. This approach points to specific examples where the negative social and environmental impacts of a particular foreign-owned project are easily discernible and then argues from this that although foreign investment may generate economic wealth at the national level in host countries, it does not generally benefit the local communities or indigenous peoples in the vicinity of the project site. These arguments draw attention to localised environmental degradation, and argue that foreign investment does not necessarily promote sustainable development. This approach also argues that laws governing international investment are designed to protect investors not the interests of local communities, and that proposals to promote further global liberalisation of foreign investment would exacerbate these problems.¹⁸

¹⁵ UNCTAD, 'Sharp Rise in FDI Driven by M&As in 2005' (2006) 2006:1 *UNCTAD Investment Brief* <http://www.unctad.org/en/docs/webiteiia20061_en.pdf> at 17 March 2007; UNCTAD, 'Data Show Foreign Direct Investment Climbed Sharply in 2005' (UNCTAD Press Release, UNCTAD/PRESS/PR/2006/002, January 2006).

¹⁶ Ibid.

¹⁷ Ibid. These figures, of course, do not mean that FDI *distribution* amongst developing states is at all equal, and many countries remain well short of the finance necessary to promote the desired levels of development. Addressing inequalities in the funding of development is a key component of the United Nations Millennium Development Goals as set out in the Millennium Declaration, GA Res. 55/2, UN Doc A/55/L.2 (2000). This was also a key issue for the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002, which produced the Monterrey Consensus, a document which sought to address financing for development through a comprehensive, cross-institutional, and partnership-emphasising approach.

¹⁸ For a discussion of negative localised social and environmental effects from foreign investment, see David Hunter et al, *International Environmental Law and Policy* (2nd ed, 2002) 1268-9; on liberalising global investment, see, Greenpeace & Center for International Environmental Law, *Safe Trade in the 21st Century: A Greenpeace Briefing Kit* (1999) 33-5.

There are numerous examples of environmental malpractice by foreign-owned entities, particularly in developing countries,¹⁹ and it is unsurprising that there has been a negative linking of foreign investment and the environment on this level. The intensification of antagonism towards foreign direct investment has been closely tied to the activities of environmental non-governmental organisations ('NGOs') and their role as watch-dog of corporate and governmental practices, and with a rise in the levels of environmental awareness amongst the general public. Together with globalisation, and its symptomatic rapid-advancement of communications technology, NGO focus on multinational corporations has meant that any polluting activities of foreign-owned entities, or lax enforcement of environmental regulations as against corporations, can be almost instantaneously publicised across the globe.²⁰

The second layer of this concern linking foreign investment to environmental damage takes a regional and global perspective. It argues that the rapidly increasing levels of foreign direct investment activity contribute to a global-scale increase in resource depletion and pollution generation.²¹

The third line of argument links foreign investment into the broader debate on sustainable development, arguing that the global intensification of foreign investment activity levels, together with commercial practices divorced from social and environmental considerations, perpetuates unsustainable growth.²²

The next section of this article examines in some detail the actions of individual multinational corporations to illustrate a key source of hostility in the foreign investment and environment relationship.

(a) *Micro-Level Corporate Damage*

¹⁹ See, eg, the following articles and non-governmental commentary: on Bhopal, see, Jamie Cassels, 'Outlaws: Multinational Corporations and Catastrophic Law' (2000) 31 *Cumberland Law Review* 311; see also, NGO commentary of Bhopal.net: International Campaign for Justice in Bhopal <<http://www.bhopal.net/index1.html>> at 18 March 2007; on environmentally-damaging oil industry and mining practices, see, Richard L Herz, 'Litigating Environmental Abuses Under the Alien Tort Act: A Practical Assessment' (2000) 40 *Virginia Journal of International Law*, 545, 547-549; Jane Perlez & Kirk Johnson, 'Behind Gold's Glitter: Torn Lands and Pointed Questions', *New York Times* (New York, USA), 24 October 2005 <<http://www.globalpolicy.org/socecon/tncs/2005/1024ring.htm>> at 18 March 2007; on pollution outputs, the distribution of cadmium-laden sludge as fertilizer, and contamination of water-wells by a Coca-Cola plant in India, see, D Rajeev, 'India: Everything Gets Worse with Coca-Cola', *International Press Service*, 22 August 2005 <<http://www.globalpolicy.org/socecon/tncs/2005/0822cocacola.htm>> at 18 March 2007.

²⁰ Tony Brenton, *The Greening of Machiavelli: The Evolution of International Environmental Politics* (1994) 20-4.

²¹ Lyuba Zarsky, 'Havens, Halos and Spaghetti: Untangling the Evidence about Foreign Direct Investment and the Environment', OECD Conference on Foreign Direct Investment and the Environment (1999) 9-10; Nick Mabey & Richard McNally, *Foreign Direct Investment and the Environment: From Pollution Havens to Sustainable Development* (1999) 16-7

²² *Ibid.*

The interaction between foreign investment and the environment is particularly volatile at the micro-level where the focus is on individual examples of environmental degradation resulting from the activities of foreign-owned companies. This correlates with the high visibility of negative impacts that corporate practices and operations can have on local environments and communities. For instance, where forced resettlements, pollution of waterways and land, increased illness or mortality rates in humans, and disease or death in livestock have occurred. This form of contact has often resulted in entrenched, polarised positions between foreign-owned corporations, governments and environmental and human rights activists. Notable conflicts include the controversy surrounding the operations of the Shell Oil Company in Nigeria,²³ Freeport and Rio Tinto in Indonesia,²⁴ ChevronTexaco Corporation in Ecuador,²⁵ Broken Hill Proprietary Co ('BHP') in Ok Tedi, Papua New Guinea,²⁶ and Union Carbide in Bhopal, India.²⁷

The disputes have involved allegations of environmental devastation, contaminated land and rivers, ravaged rainforest, damage to human health, death and birth defects, the fracturing of communities, human rights abuses and collaboration with repressive state regimes. The flooding of forests downstream from the Ok Tedi copper and gold mine in Papua New Guinea is one such example.²⁸ The mining operation, of which BHP was the majority shareholder,²⁹ released 70 million tons of mine tailings and waste rock residue into the Ok Tedi and Fly Rivers every year from 1984 onwards.³⁰ This toxic sediment raised the riverbeds, causing the

²³ See, eg, the discussion in Edna Eguh Udobong, 'Multinational Corporations Facing the Long Arm of American Jurisdiction for Human Rights and Environmental Abuses: The Case of *Wiwa v Royal Dutch Petroleum, Co*' (2005) 14 *Southeastern Environmental Law Journal* 89.

²⁴ Ibid. See also NGO commentary of WALHI-Indonesian Forum for Environment, *Conflict and Militarism* (2004) <http://www.eng.walhi.or.id/kampanye/psda/konflikmil/conflict_info/> at 18 March 2007.

²⁵ See, eg, the discussion in Simon Chesterman, 'Oil and Water: Regulating the Behaviour of Multinational Corporations Through Law' (2004) 36 *New York University Journal of International Law and Politics* 307; see also NGO commentary of Amazon Watch, *ChevronToxico: The International Campaign to hold ChevronTexaco Accountable for its Toxic Contamination of the Ecuadorian Amazon* (2005) <<http://www.cheverontoxico.com/>> at 18 March 2007.

²⁶ Chesterman, above n 25; see also NGO commentary on the environmental degradation from the mine tailings at Polly Ghazi, *Unearthing Controversy at the Ok Tedi Mine* (2003), World Resources Institute <http://newsroom.wri.org/wrifeatures_text.cfm?ContentID=1895> at 18 March 2007.

²⁷ Chesterman, above n 25; see also the discussion in Cassels, above n 19; see also NGO commentary of Bhopal.net, above n 19.

²⁸ Ghazi, above n 26.

²⁹ BHP transferred its 52 per cent holding in the company, Ok Tedi Mining Ltd, to the Papua New Guinea Sustainable Development Program Company in 2002. The other original shareholders were Amoco Minerals, a consortium of German companies and a 20 per cent stake held by the Papua New Guinean government.

³⁰ Ghazi, above n 26; UNEP, *Waste from Consumption and Production: The Ok Tedi Case – A Pot of Gold* (2002) <http://www.vitalgraphics.net/waste/html_file/18-19_consumption_oktedi.html> at 18 March 2007.

flooding of a 1300 kilometre area and smothering of rainforest in a process labelled by the United Nations Environment Programme ('UNEP') as 'dieback'.³¹ The heavily polluted waters poisoned vegetation, fish and animals and resulted in the loss of traditional lifestyles for the local communities.³²

A further example of massive environmental degradation can be seen in the Texaco/Ecuador conflict. In 1964, a US company, Texaco Inc, acquired rights for oil exploration and extraction in the Oriente region of Ecuador over an area of one million acres.³³ It transferred those rights to its subsidiary, Texaco de Petróleos and carried out its drilling and extraction operations through the Ecuadorian company. Texaco dug open, unlined pits, into which untreated crude oil was dumped, leaching toxic waste into water systems and through the soil of village lands. Billions of gallons of toxic waste waters and sludge were released untreated directly into the rivers. Drinking and bathing water was contaminated; food sources became contaminated. Texaco's operations inflicted terrible damage on the environment and appalling injuries and illness on the local inhabitants — villages decimated by cancer and children afflicted with birth defects.³⁴

Serious multinational corporate misconduct is also exemplified by Union Carbide. A lethal gas leak from a pesticide factory in 1984, in Bhopal, India, sent clouds of poisonous fumes across a city of one million people, killing approximately 8,000 people in the first week following the disaster. An estimated further 20,000 people have since died from illness and injury resulting from exposure to methyl isocyanate gas.³⁵ Union Carbide Corporation, an American multinational corporation, operated in India through its subsidiary, Union Carbide of India, Ltd. This Indian company owned the pesticide factory responsible for the disaster.

The immediate injuries suffered by Bhopal residents were horrific. Survivors give accounts of the burning in their eyes and mouths, suffocation, vomiting, convulsions, loss of control of bladder and bowel, spontaneous miscarriages, blindness, as well as witnessing others frothing at the mouth, writhing in agony and dying on the streets.³⁶ The long-term effects for those who survived the exposure to

³¹ UNEP, above n 30.

³² Ibid; see also Ghazi, above n 26.

³³ Amazon Watch, above n 25. *ChevronToxico, Texaco in Ecuador* <<http://www.chevrontoxico.com/article.php?list=type&type=3>> at 18 March 2007.

³⁴ Amazon Defense Coalition, *Historic Trial: Summary of Legal Case in Ecuador against ChevronTexaco* <<http://www.chevrontoxico.com/article.php?id=55>> at 18 March 2007; see also the Complaint filed in an Ecuadorian court against Texaco in 2003, an English translation of which can be found at <http://www.chevrontoxico.com/downloads/Complaint_Ecuador_English.pdf> at 18 March 2007.

³⁵ See NGO commentary at The Bhopal Medical Appeal and Sambhavna Trust, *What Happened in Bhopal?* <<http://www.bhopal.org/whathappened.html>> at 18 March 2007; see also the discussion in Cassels, above n 19.

³⁶ See, eg, the personal account of Aziza Sultan available at <<http://www.bhopal.org/aziza.html>> at 18 March 2007.

the gas include blindness, damage to lungs, kidneys, liver and reproductive systems, cancer, and birth defects in children born subsequently.³⁷

The contamination of Bhopal was not limited to the release of toxic gas in 1984. The conduct of Union Carbide following the disaster exacerbated the pollution. Although the factory was closed down, the site was not cleaned up and no decontamination programme was implemented. Chemicals still remain dumped at the site, poisoning the soil, groundwater aquifers, drinking-water wells, and the people of Bhopal.³⁸

Manifesting in local protest and international NGO publicity and condemnation, objection to the activities of these foreign-owned entities has also led to litigation seeking redress in the United States, United Kingdom and Australia from the parent company for damage caused by its subsidiary.³⁹ Practical reasons for doing so included the lack of assets and funds held by the subsidiary company, the potential for higher damages awards in the parent company states and structural obstacles to plaintiff claims in their own countries such as the lack of legal aid facilities.⁴⁰ Contesting the allegations, the defendant corporations have often sought to rely on *forum non conveniens* arguments to dismiss proceedings, arguing that the country in which the alleged damage occurred would be the more appropriate forum.⁴¹ These multinational corporations have also argued that the claims are against the wrong defendant. As they are entirely separate legal entities from their subsidiaries and technically do not themselves have any operations in the country of the alleged damage, the proceedings should be against the subsidiary only.⁴² In seeking to avoid financial responsibility for the Bhopal disaster, Union Carbide even disputed the existence of such an entity as the ‘multinational corporation’.⁴³

There are some indications that courts are beginning to counteract the misuse of corporate structure and the rules of *forum non conveniens*.⁴⁴ The United States

³⁷ Cassels, above n 19, 315.

³⁸ I Labunska et al, *The Bhopal Legacy: Toxic Contaminants at the Former Union Carbide Factory Site, Bhopal, India*, Greenpeace (1999) 2-3, 23-4
<<http://archive.greenpeace.org/toxics/toxfreeasia/bhopal.pdf>> at 18 March 2007; The International Campaign for Justice in Bhopal, *The Poisoning of Bhopal*
<<http://www.bhopal.net/poisoning.html>> at 18 March 2007.

³⁹ See, eg. on Bhopal, *In re Union Carbide Corp Gas Plant Disaster at Bhopal, India in Dec, 1984*, 634 F.Supp. 842 (S.D.N.Y. 1986); on Nigeria, *Wiwa v Royal Dutch Petroleum Co*, 226 F.3d 88 (2nd Cir. 2000); on Ecuador, *Aguinda v Texaco, Inc*, 303 F.3d 470 (2nd Cir. 2002) (‘*Aguinda*’); on Indonesia, *Beanal v Freeport-Morgan, Inc.*, 197 F.3d 161 (5th Cir. 1999); on South Africa, *Lubbe and ors v Cape Plc* [2000] 1 WLR 1545 (HL) (‘*Lubbe*’); on Ok Tedi, *Dagi v Broken Hill Proprietary Co [No 2]* (1995) 1 VR 430.

⁴⁰ Cassels, above n 19; Chesterman, above n 25; International Ban Asbestos Secretariat, *UK Victory for African Asbestos Victims*, June 2000
<http://www.btinternet.com/~ibas/lords_cape.htm> at 18 March 2007.

⁴¹ Chesterman, above n 25, 315-8, 322.

⁴² Cassels, above n 19, 322-3.

⁴³ Ibid 322.

⁴⁴ Ibid 317-8.

Court of Appeals held in *Aguinda v Texaco, Inc*⁴⁵ that the appropriate forum for the case was Ecuador, but that any judgment against the company would be enforceable in the United States. The Court of Appeals also confirmed the proviso added by the District Court that if the US company, Texaco, Inc, was not prepared to submit to the jurisdiction of the Ecuadorian courts, the US courts would not apply the rules of *forum non conveniens* in its favour.⁴⁶ In 2000, the House of Lords determined that 3000 South African asbestos victims could bring compensation claims against a British company in the United Kingdom in relation to the activities of its South African subsidiaries.⁴⁷

That said, however, reading of the terrible injuries suffered by the local residents of Bhopal, the slow deaths from cancer of the indigenous peoples in the Ecuadorian Amazon, the poisoning of the rainforest in Papua New Guinea, Indonesia and Ecuador, and the attempts of multilateral corporations to avoid responsibility for the consequences of their operations, it is difficult to imagine how foreign investment and the environment can ever be on anything other than a collision course. These examples of corporate environmental degradation illustrate the traditional relationship between foreign investment practices and the environment, being one characterised by control and use or disregard and destruction. This has been a significant source of hostility between foreign investors and environmental protection advocates. And it will continue to be so unless foreign investment practices change to reflect better the new culture of international environmentalism.

2 *Pollution Havens, Capital Flight and Regulatory Chill*

In the midst of fierce competition to attract foreign investment, there are concerns that states may lower their domestic environmental and health standards, engaging in what is called a regulatory 'race-to-the-bottom', so as to reduce the costs of doing business and to become more attractive to potential foreign investors.⁴⁸ This possibility raises the spectre of 'pollution havens' and 'regulatory chill'. The pollution haven theory is based on the premise that in order to remain competitive in the market for foreign investment, states will set unacceptably low environmental standards, or set adequate standards but not enforce them, and then attempt to outdo each other in the continued unravelling of environmental restrictions — hence the description 'race-to-the-bottom'.⁴⁹ The hypothesis is that multinational corporations that cannot continue environmentally damaging practices in developed states, as a result of increasingly restrictive environmental protection standards, will be able to export their damaging practices to developing states with low

⁴⁵ *Aguinda*, above n 39.

⁴⁶ *Ibid*; see also the discussion in Chesterman, above n 25, 317-8.

⁴⁷ *Lubbe*, above n 39.

⁴⁸ Zarsky, above n 21, 7; Neumayer, above n 9, 41-67; Daniel C Esty & Damien Geradin, 'Environmental Protection and International Competitiveness' (1998) 32 *Journal of World Trade* 5, 15-21.

⁴⁹ Neumayer, above n 9, 41-3; Zarsky, above n 21, 7-8.

environmental protection measures, hence the term ‘pollution haven’.⁵⁰ What empirical evidence there is suggests that these fears have not been borne out in practice.⁵¹ However, Eric Neumayer does suggest that there is evidence of a more subtle and troubling effect of the pollution haven theory, being that of international environmental ‘regulatory chill’.⁵²

The regulatory chill or ‘political drag’ argument puts forward the idea that the fear of a loss of competitiveness in international markets and of capital flight from states with high environmental standards has led policy-makers to refrain from raising environmental standards and tightening regulations.⁵³ The theory does not require there to be any *actual* movement of investment dollars to states offering pollution havens; only the existence of the *fear* that there might be capital flight.⁵⁴ It is difficult to ascertain whether or not the theory has translated into reality as the hypothesis is premised on the absence of activity.⁵⁵ However, commentators are beginning to conclude that there is evidence for the existence of environmental regulatory chill due to the fear of a loss of foreign investment.⁵⁶ For example, Neumayer and Esty & Geradin cite examples in the European Union and United States where arguments put forward by industry lobbyists warning of capital flight and a loss of competitiveness had a chilling effect on ecological tax reform measures designed to bring about reductions in energy use and greenhouse gas emissions.⁵⁷

3 Expropriation, Environmental Regulations and Protectionism

Foreign investment protection law and environmental protection measures have gone head-to-head in a series of arbitral decisions over the last 10 years.⁵⁸ On the whole, the approach adopted in these cases has been to apply strictly the international rules on foreign investment protection, without allowing wider social and environmental objectives, policies and legal principles into the equation.⁵⁹ I argue that in not incorporating relevant developments from other areas of international law, foreign investment protection law has not yet adapted to the global socio-political shift in values that has been occurring over the last 40 years. This article argues that although areas of international law have been responding to this shift, remoulding to encompass the consideration of values and principles that have arisen within other international legal disciplines, such as norms from

⁵⁰ Neumayer, above n 9.

⁵¹ Ibid 43; Esty & Geradin, above n 48, 7, 15; Zarsky, above n 21, 11-3.

⁵² Neumayer, above n 9, 68-71.

⁵³ Ibid; Esty & Geradin, above n 48, 19-21; Zarsky, above n 21, 19; J Martin Wagner, ‘Nature Beyond the Nation State Symposium: International Investment, Expropriation and Environmental Protection’ (1999) 29 *Golden Gate University Law Review* 465, 469-471.

⁵⁴ Neumayer, above n 9, 68-9; Esty & Geradin, above n 48, 16.

⁵⁵ Neumayer, above n 9, 69.

⁵⁶ Ibid 69-71; Zarsky, above n 21, 19; Esty & Geradin, above n 48, 19-21.

⁵⁷ Neumayer, above n 9, 69-71; Esty & Geradin, above n 48, 19-21.

⁵⁸ See, eg, *Metalclad*, above n 2; see also *Santa Elena*, above n 4.

⁵⁹ See for a discussion of this issue, Sands, above n 5.

international human rights law, international labour standards and international environmental protection measures, the interpretation and application of foreign investment protection law has resisted this kind of integration. I take the view that international investment law and foreign investment practices will need to 'catch-up' with transformations in international law in order to maintain legitimacy. This next section of the article examines these arbitral decisions, highlighting their abrasive approach to the relationship between foreign investment and environmental protection objectives.

(a) Environmental Regulation as International Expropriation

One of the most contentious issues in the foreign investment-environment discourse has surrounded the classification of domestic environmental regulation as a form of 'indirect expropriation' of foreign-owned property requiring compensation. International law allows the expropriation of foreign-owned property if the following conditions are met:

- (a) It is carried out for a public purpose;
- (b) It is not of an arbitrary or discriminatory nature; and
- (c) Compensation is paid.⁶⁰

The formula for determining the amount of compensation payable remains controversial.⁶¹ Capital-exporting states have persisted with the promotion of the 'prompt, effective and adequate compensation' standard, while capital-importing states have pursued the less exacting standard of 'appropriate compensation'.⁶² States have, however, often turned to the use of bilateral investment treaties to negotiate the terms of compensation as between themselves in an attempt to overcome the polarisation of stated positions and the uncertainty of the applicable standard in international customary law.⁶³

Under traditional international rules on expropriation, certain kinds of governmental action that merely reduce the value of an investment do not amount to a 'taking' requiring compensation.⁶⁴ This includes action such as the imposition of taxation, devaluation in currency, or changes to inheritance, health and safety, and planning regulations.⁶⁵ There is, of course, a fine line involved in the implementation of such measures and often the difficulty is in ascertaining where the legitimate exercise of state powers ends and confiscatory action has occurred.⁶⁶ It is in the context of this type of taking that environmental protection measures and foreign

⁶⁰ M Sornarajah, *The International Law on Foreign Investment* (2nd ed, 2004) 240-1, 395.

⁶¹ *Ibid.*

⁶² *Ibid.*

⁶³ *Ibid.* 241-5.

⁶⁴ *Ibid.* 238; Ian Brownlie, *Principles of Public International Law* (5th ed, 1998) 538; B A Wortley, *Expropriation in Public International Law* (1959) 50-1.

⁶⁵ Brownlie, above n 64, 538; Wortley, above n 64.

⁶⁶ Alexander Fachiri, 'Expropriation and International Law' (1925) 6 *British Year Book of International Law* 159, 170; Wortley, above n 64, 51; Been & Beauvais, above n 3, 54.

investment protection law have recently clashed — in the form of allegations that governmental environmental regulation amounts to international expropriation.

Metalclad Corporation v The United States of Mexico,⁶⁷ decided under the North American Free Trade Agreement ('NAFTA'),⁶⁸ concerned a hazardous waste treatment site in Mexico owned by an American company, Metalclad Corp. Metalclad had received the required clearances from the federal government to build and operate a hazardous waste treatment facility in the state of San Luis Potosí. Metalclad was aware that it required further local government permits to enable authorised construction at the treatment facility site. Although Metalclad did not obtain this permit, an additional construction permit was issued by the federal government. Metalclad proceeded to build up the site at a cost of US\$22 million. The municipality, however, did not consider the federal permits as having removed the need for a local government building permit and continued to refuse authorisation for the project under land use and environmental regulations. An 'ecological decree' was also issued by the Governor of San Luis Potosí declaring a large area, which encompassed Metalclad's hazardous waste facility, as an ecological preserve to protect a rare species of cacti. This regulation prevented the operation of the treatment site.⁶⁹

The Tribunal found that, in condoning the municipality's denial of a construction permit, Mexico had acquiesced in preventing Metalclad from operating its landfill and that this amounted to an act 'tantamount to expropriation'.⁷⁰ The Tribunal also found a further act 'tantamount to expropriation' in the issuing of the ecological decree which prevented the use of the site as landfill altogether.⁷¹ The Tribunal stated that:

expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as the outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.⁷²

A furore ensued. The Tribunal's determination appeared to extend the meaning of expropriation well beyond its traditional scope and seemed to expose health and environmental regulations enacted for public welfare purposes to the risk of challenge from aggrieved foreign investors.⁷³ Commentators warned that legitimate investor protection measures in NAFTA, designed to provide stability

⁶⁷ *Metalclad*, above n 2.

⁶⁸ 32 ILM 612 (1992).

⁶⁹ See the discussion of this case in Sands, *Principles in International Environmental Law* (2nd ed, 2003), 1066-9.

⁷⁰ *Metalclad*, above n 2, [104].

⁷¹ *Ibid* [109].

⁷² *Ibid* [103].

⁷³ See for discussion of this issue, Been & Beauvais, above n 3, 33-7.

and security for foreign investors, were instead being used to consolidate private economic positions at the expense of public policy development.⁷⁴ They argued that these disputes filed under NAFTA's Chapter 11 provisions⁷⁵ inherently involve important matters of public policy and environmental law, and that Chapter 11 does not have the processes or substantive provisions to address these issues fully and balance the competing interests.⁷⁶ And, as such, the public interest is losing out to private interests.⁷⁷

The enactment of health and environmental regulations has been directly challenged in this way on a number of occasions under NAFTA by foreign investors claiming the legislation amounts to an expropriation of their investments. *Ethyl Corporation v Canada*⁷⁸ provides another illustration of this scenario. The Canadian government introduced legislation banning intra-provincial and international trade in the fuel additive, methylcyclopentadienyl manganese tricarbonyl ('MMT'), citing human health and environmental protection purposes.⁷⁹ An American company, Ethyl Corp., was the sole North American operator in this business, producing MMT in the United States and exporting the substance to its wholly-owned Canadian subsidiary, Ethyl Canada Inc, which in turn distributed fuel, intermingled with MMT, throughout Canada. There was significant disagreement at the time as to the health and environmental impacts of MMT.⁸⁰ Ethyl Corp. filed a claim under NAFTA's Chapter 11 provisions alleging that the MMT ban constituted an expropriation of its investment in Canada and claimed US\$251 million in compensation.⁸¹ A little more than a year after the legislation was passed, Canada settled the matter with Ethyl Corp. Canada agreed to repeal the MMT ban, to pay approximately US\$13 million, and to issue a statement to the effect that 'there was no evidence that MMT in low amounts was harmful to human health.'⁸²

⁷⁴ Ibid; Howard Mann & Konrad von Moltke, *NAFTA's Chapter 11 and the Environment: Addressing the Impacts of the Investor-State Process on the Environment* (1999) 6 <<http://www.iisd.org/pdf/nafta.pdf>> at 18 March 2007.

⁷⁵ Chapter 11 is a dispute resolution mechanism that allows investors to file directly against NAFTA state parties.

⁷⁶ Julie A Soloway, 'Environmental Regulation as Expropriation: The Case of NAFTA's Chapter 11' (2000) 33 *Canadian Business Law Journal* 92, 107, 123-5.

⁷⁷ Ibid 107. Soloway argues that other provisions under NAFTA would be more appropriate to address competing objectives, such as Chapters 7, 9 and 20 which provide for the balancing of multiple objectives and have the institutional capacity through committees and working groups to inquire into the wider implications of the dispute.

⁷⁸ *Ethyl Corporation v Canada* (1999) Jurisdiction Phase, 38 ILM 708 ('*Ethyl Corporation*').

⁷⁹ See Soloway, above n 76, 114-9, for a full discussion of this case.

⁸⁰ See the discussion in *ibid*, 115. See also, Neumayer, above n 9, 79-81.

⁸¹ *Ethyl Corporation*, above n 78. See further documents filed in the arbitration and awards made by the Tribunal on preliminary matters, sighted at the website of Ethyl Corporation's lawyers, Appelton & Associates, <<http://www.appletonlaw.com/4b1ethyl.htm>> at 18 March 2007.

⁸² Soloway, above n 76, 116.

Amongst the concerns raised at the use of NAFTA in this way, one of the most compelling is that expressed by Julie Soloway.⁸³ The MMT legislation had been enacted as a precautionary measure in response to inconclusive scientific evidence as to the toxic effects of MMT. She argues that the ability of a government to make policy decisions such as this on the health and environment of its citizens should not be determined by investment rules alone, particularly when there is no room in those rules for the consideration of relevant factors other than investment objectives. If NAFTA Chapter 11 continues to be used in this way, governments will effectively be shackled by a one-dimensional consideration of the issues and this does not in any way promote good governance. What is required is a sophisticated balancing of private and public interests with in-depth consideration of all the issues involved in the matter.⁸⁴

(b) Calculation Methodology

International rules of foreign investment protection and environmental norms also collided in the case of *Compañía del Desarrollo de Santa Elena, SA v Costa Rica*.⁸⁵ The case involved a large area of Costa Rican coastline and rainforest thick with unique biodiversity. The land was owned by a Costa Rican company that had been formed by an American syndicate and of which the majority of shareholders were American citizens, *Compañía del Desarrollo de Santa Elena* ('CDSE'). The original aim of the company had been to develop the site as a tourist resort.⁸⁶ On the issuing of an expropriating decree for the site, there was no complaint as to the right of Costa Rica to expropriate the property. There was, however, a dispute as to the amount of compensation due to CDSE. Costa Rica referred to its international legal obligations to protect such a unique ecological site and sought to argue that the environmental purposes for which the taking was carried out should affect the methodology for valuing the property. The Tribunal held that the environmental objectives of the expropriation, and the fact that it was done in fulfilment of international environmental obligations, did not alter the application of international rules on foreign investment protection and were not relevant considerations in determining the valuation methodology to ascertain the appropriate amount of compensation due to CDSE.⁸⁷

Philippe Sands makes the comment that in this decision international investment rules took precedence over both national and international norms of environmental protection.⁸⁸ It failed to make even the slightest concession to the value system currently driving the development of international law, a component of which is that it is in the interests of all states to promote preservation of the global environment and that developing states should be assisted in their endeavours to

⁸³ Ibid, 119.

⁸⁴ Ibid.

⁸⁵ *Santa Elena*, above n 4.

⁸⁶ *Santa Elena*, above n 4, 172, 175.

⁸⁷ *Santa Elena*, above n 4, 192. See also Sands, above n 5, 203-4.

⁸⁸ Sands, above n 5, 204.

comply with those objectives. Sands points out that strict enforcement of foreign investment protection rules on compensation requirements may preclude developing states from complying with international environmental obligations, as it is unlikely they will have the funds to pay full market value for expropriated property.⁸⁹ He suggests that balance is what is called for — a balancing of the relevant interests in international law at play in the particular circumstances, without absolute exclusion of any of those interests — and that while security for foreign investors is necessary, it should not come at too high an environmental cost.⁹⁰

These investment-environment arbitral decisions have generated a great deal of controversy. Questions have been raised as to the legitimacy of international laws that can be used to quash domestic public health and environmental regulations so as to protect foreign private economic interests.⁹¹ Concerns have been expressed that foreign investment protection law affords multinational corporations an inappropriate opportunity to influence the domestic environmental, worker protection, and health and safety regulation of the states in which they invest, effectively inducing a form of regulatory chill.⁹² These cases have been held up as an undesirable result of the investor-state dispute resolution mechanism under NAFTA and as a precedent for the potential result under the MAI.⁹³

It is possible to view the *Metalclad* expansion of the definition of expropriation and the increasing challenges to environmental regulation as part of a pattern of the remoulding of perceptions on foreign investment protection in periods of socio-political shifts. My reading of the circumstances is that this may be a reaction to the uncertainty and instability created in periods of global politico-legal shift, and I submit that it is a reaction to globalisation, transformations in international law-making and a new culture of international environmentalism. Certainly, these cases seem out of step with the values held by the global community expressed in the international environmental rules and principles developed over the last 40 years. And they also seem out of step with the growing culture of interdependence amongst international legal disciplines. These cases effectively reject the consideration of environmental objectives. It may be that the Tribunals in *Metalclad* and *Santa Elena* simply did not wish to consider the circumstances in light of these new directions in international law; it may be that they wished to record a reaction *against* the progression towards the integrated consideration of international legal issues; or they may be aberrations, a product of the state of uncertainty induced by the onslaught of new ideas from advocates of environmental

⁸⁹ Ibid.

⁹⁰ Ibid 204-5.

⁹¹ See, eg, Joint NGO Statement on the Multilateral Agreement on Investment, above n 10; see further Soloway, above n 76.

⁹² Ibid.

⁹³ See, eg, NGO Commentary: Center For Public Policy, 'NAFTA Nightmare, MAI's Potential' Briefing Paper, 2 May 1997 <<http://www.hartford-hwp.com/archives/25a/016.html>> at 18 March 2007; Friends of the Earth International, 'Trade Case Study: Ethyl Corp and MMT', (Trade, Environment & Sustainability Programme, 2001).

law. Whatever the case in fact, it is important to reflect on the directional implications of these decisions and to consider whether it is truly in the interests of foreign investors and the business community as a whole to continue adopting such an abrasive approach to global concerns for the environment.

4 *Multilateral Agreement on Investment*

An examination of the polarised nature of the foreign investment-environment relationship also requires a discussion of the collapse of the OECD negotiations to conclude a multilateral framework agreement on investment. In 1997, a network of environmental NGOs, human rights groups and anti-globalisation organisations mounted a global internet campaign to publicise their concerns at the draft MAI.⁹⁴ It was an extraordinary manifestation of the clash between foreign investment protection law and environmental protection objectives and, although the campaign was not the sole reason for the demise of the negotiations, it certainly contributed to the halting of the negotiation process in October 1998 and its eventual shelving altogether in 1999.

The OECD had hoped to further the liberalisation of international investment and create a comprehensive, harmonised global framework for rules on investment liberalisation, foreign investment protection and dispute settlement mechanisms.⁹⁵ Many of the substantive provisions of the MAI were modelled on existing regional agreements, such as NAFTA, and on the obligations contained in many bilateral investment treaties. As such, the OECD negotiators had not anticipated the move to a multilateral format as particularly controversial.⁹⁶ They were, however, still following an approach that was out of step with the socio-political climate of the 1990s and its treatment of global issues as interconnected. Rather than taking an integrated approach and considering the environmental and social implications of the proposed investment rules, the OECD was working on the traditional premise that international trade and investment law and policy were discrete areas that did not involve environmental protection principles or human rights issues.⁹⁷ However, once the draft text became publicly available in 1997,⁹⁸ a global controversy erupted and it became quite clear that the OECD had miscalculated the mood of the times and the likely public response to the Agreement.

⁹⁴ See the text of the draft Multilateral Agreement on Investment ('MAI') at OECD Negotiating Group on the Multilateral Agreement on Investment, Draft Consolidated Text, 22 April 1998, <www1.oecd.org/daf/mai/pdf/ng/ng987r1e.pdf> at 18 March 2007.

⁹⁵ Report by the Committee on International Investment and Multinational Enterprises ('CIME') and the Committee on Capital Movements and Invisible Transactions ('CMIT') to the Ministerial Council of the OECD, 5 May 1995, DAF/CMIT/CMIE(95)13FINAL, <www1.oecd.org/daf/mai/htm/cmitcime95.htm> at 18 March 2007.

⁹⁶ Rainer Geiger, 'Regulatory Expropriations in International Law: Lessons from the Multilateral Agreement on Investment' (2002) 11 *New York University Environmental Law Journal* 94, 96-7.

⁹⁷ See a discussion of this issue in, Jan McDonald, 'The Multilateral Agreement on Investment: Heyday or Mai-Day for Ecologically Sustainable Development?' (1998) 22 *Melbourne University Law Review* 617, 621-2.

⁹⁸ The draft text was leaked and posted on the internet in 1997: *ibid* 622.

Many of the concerns voiced by NGOs surrounded pollution havens, regulatory chill, loss of control over domestic health and environmental regulation, and increased foreign investor influence on domestic law and policy within host states. Key issues involved the MAI's ban on performance requirements, the wide definition of 'investor' and 'investment', the implications of the ban on uncompensated expropriation, and the investor-state dispute settlement mechanism.⁹⁹ In particular, the MAI introduced similar investor-state dispute resolution procedures to those under Chapter 11 of NAFTA, through which an aggrieved individual investor can directly institute proceedings against a signatory state.¹⁰⁰ Protesters often expressed the view that these provisions in the MAI would 'elevate the rights of investors far above those of governments, local communities, citizens, workers and the environment'.¹⁰¹

NAFTA litigation fuelled these perceptions of the MAI.¹⁰² *Ethyl Corp* had been filed under the investor-state dispute resolution mechanism in NAFTA and this case was held up as an example of what we could expect on a global scale under the MAI. Ultimately, the MAI negotiations broke down. The formal negotiating process was abandoned in December 1998 following the withdrawal of France.¹⁰³

The protests of 1997 had been a bruising experience for the proponents of further liberalisation of international investment rules. Although individual incidents of environmental degradation and damage to human health resulting from the activities of multinational corporations had previously attracted the attention of NGOs, foreign investment as a whole had not been the subject of such vehement, organised, global, environmental protest. In misjudging the nature and extent of the influence of international environmentalism, those caught within a traditional construct of foreign investment law, policy and practices felt the environmental movement flexing its muscle, challenging the propriety of excluding environmental and public health issues from consideration in foreign investment matters. How did foreign investment respond? The immediate response in 1998 was the withdrawal and shelving of the MAI negotiating process. The mid-range response has been a little less accommodating as evidenced by the arbitral decisions in the investor-state litigation examined above. The enduring response in the long-term, however, may have to settle on a more balanced approach – one that reflects both the need to

⁹⁹ Ibid; see also William Crane, 'Corporations Swallowing Nations: The OECD and the Multilateral Agreement on Investment' (1998) 9 *Colorado Journal of International Environmental Law and Policy* 429.

¹⁰⁰ MAI, above n 94, Art V (D).

¹⁰¹ Joint NGO Statement on the Multilateral Agreement on Investment, above n 10, 1; see also Scott Nova and Michelle Sforza-Roderick, '*Worse than NAFTA*': *A Commentary on the Multilateral Agreement on Investment* (undated) Center for Public Policy, <<http://www.globalpolicy.org/soecon/bwi-wto/mai2.htm>> at 18 March 2007.

¹⁰² McDonald, above n 97, 636; Geiger, above n 96, 93, 97; see eg, NGO commentary to this effect: Center For Public Policy, above n 93; Friends of the Earth International, above n 93; Nova & Sforza-Roderick, above n 101.

¹⁰³ OECD website, <<http://www.oecd.org/daf/mai/intro.htm>> at 18 March 2007; Geiger, above n 96, 95-6.

protect the interests of foreign investors and the need to pursue environmental protection objectives in the public interest.

5 Concluding Remarks

Foreign investment law has certainly had to respond to an emerging culture of international environmentalism. However, what form that response will ultimately take is as yet uncertain. The attempted negotiation of the MAI to bring about a new era in international investment law was stymied because of the failure, amongst other reasons, to realise the full extent and implications of the international politico-legal shift that had been occurring over the past 40 years. The MAI negotiations were conducted on an outmoded premise, adopting an isolationist approach to the consideration of issues, law and policy. Globalisation, a global environmental consciousness, and the development of a powerful global civil society generated circumstances in which the OECD negotiators were forced to re-think their approach.

Foreign investment law has yet to find its way in reconciling the equally valid, but often competing objectives, of promotion of international investment liberalisation and environmental protection. It also has not yet found a way to reconcile concerns regarding the regulatory chill effect and the public 'bad' of categorising environmental regulation as indirect expropriation versus preventing protectionism disguised as environmentalism. It seems that, in many respects, international investment policy- and law-makers have not yet fathomed a way in which to move forward with the relationship that is compatible with the infusing culture of global environmentalism. It is clear, however, that unless foreign investment law-makers provide a response that reflects the new global socio-political era, the foreign investment-environment controversy is unlikely to progress satisfactorily, leading only to a collision course of objectives rather than harmony. The next section of this article examines possible indicators of a more harmonious way forward.

III FOREIGN INVESTMENT AND THE ENVIRONMENT: COLLABORATION AND HARMONY?

New trends in corporate behaviour have recently been emerging. As the spotlight has been turned on the wider effects of corporate practices, companies have had to respond to demands of consumers, non-governmental organisations, shareholders, and other stakeholders to improve their social and environmental performance. The business community has responded with the adoption of voluntary codes of environmental corporate conduct and the integration of corporate social responsibility programmes into their operations.¹⁰⁴ There is also a growing appreciation amongst business representatives that operating as a 'good' global

¹⁰⁴ Erik Assadourian, 'Transforming Corporations' in Worldwatch Institute, *State of the World 2006* (2006) 171; OECD, *Corporate Responsibility: Private Initiatives and Public Goals* (2001); OECD, *Foreign Direct Investment, Development and Corporate Responsibility* (2000) 14-15; Gunningham & Sinclair, above n 9, 2.

corporate citizen can in fact improve financial performance.¹⁰⁵ Voluntary schemes are now seen as an opportunity to enhance the reputation of the corporation and avoid negative publicity.¹⁰⁶ It is now acknowledged that a corporate culture of responsible environmental management can reduce commercial risks in foreign investment activities,¹⁰⁷ and that voluntary codes, initially developed to ensure environmental credibility,¹⁰⁸ are increasingly going on to form the expected standards of environmental corporate behaviour generally.¹⁰⁹ Inherently, these political developments have required the fostering of more collaborative relationships between multinational corporations and other actors, encouraging partnerships, the balancing of multiple interests in commercial enterprises, and the incorporation of a 'triple-bottom-line' approach¹¹⁰ to corporate activities. And, as such, these new trends may ultimately hold the key to a more harmonious foreign investment/environment relationship in the future.

A Voluntary Codes of Conduct

The array of voluntary schemes is vast.¹¹¹ Not only does the type and format of regime vary greatly, but also the scope and target participants.¹¹² As such, this article has selected relevant voluntary codes to provide an indication of the direction in which the foreign investment/environment relationship may be headed. It examines several influential business initiatives, which are attempting to address the social, environmental and economic issues that can arise in transnational projects, namely, the CERES Principles, the Business Charter for Sustainable Development established by the International Chamber of Commerce ('ICC'), the

¹⁰⁵ Assadourian, above n 104, 172-3; Gary S Guzy, 'Reconciling Environmentalist and Industry Differences: The New Corporate Citizenship "Race to the Top"?' (2002) 17 *Journal of Land Use and Environmental Law* 409, 414; Forster, above n 11.

¹⁰⁶ Gunningham & Sinclair, above n 9, 2-7.

¹⁰⁷ Forster, above n 11, 69-71, 73-4.

¹⁰⁸ The importance of maintaining environmental credibility and the 'social license to operate' is discussed in detail in Gunningham & Sinclair, above n 9, 2-7.

¹⁰⁹ The Equator Principles, discussed below is the most recent example. See Cernea, above n 11 for a discussion on the evolution of World Bank initiatives on socially and environmentally responsible codes of practice into expected standards or norms of corporate behaviour; see also, Michael T Rock & David P Angel, *Industrial Transformation in the Developing World* (2005) 151, 170-6 for a discussion of firm-based adoption by MCNs of global environmental standards; see also the advice given by Australian commercial law firm Allens Arthur Robinson to its clients as an example of the commercial response: 'Having now been adopted by lenders who provide the bulk of project finance around the globe, the Equator Principles are close to becoming an industry standard so it is important that borrowers and lenders understand their potential impact on project financing transactions.', Allens Arthur Robinson, 'The Equator Principles – Guidelines for Responsible Project Financing' (August 2005) *Focus Project Finance* 1.

¹¹⁰ The term 'triple-bottom-line' refers to the consideration of economic, social and environmental issues in corporate decision-making rather than the sole deciding factor being the financial 'bottom line'.

¹¹¹ Stepan Wood, 'Voluntary Environmental Codes and Sustainability' in Benjamin J Richardson & Stepan Wood (eds) *Environmental Law for Sustainability* (2006) 229, 232-3.

¹¹² *Ibid.*

Equator Principles, and the Principles for Responsible Investment launched through the UN Global Compact and UNEP Finance Initiative.

1 *The CERES Principles*

An initiative developed in the United States following the Exxon-Valdez oil spill in Alaska in 1989, the Coalition for Environmentally Responsible Economies ('CERES') has sought to bring about changes in corporate culture and practice through a two-fold approach:

- The development of a series of guiding principles to which companies commit and then implement throughout their operations on a continuing basis; and
- The promotion of environmentally, socially and financially responsible investment policies.¹¹³

CERES is a framework organisation to which financial and investment organisations, pension fund managers, environmental organisations and other public interest groups join as members.¹¹⁴ Many companies with transnational operations have adopted the CERES Principles, including General Motors, the Body Shop International, American Airlines, Aveda, Coca-Cola, Nike and Time Warner.¹¹⁵ The Principles begin with an overarching pledge on the role and responsibilities of corporations regarding their environmental conduct, before setting out a series of specific commitments on such matters as the protection of the biosphere, the sustainable use of natural resources, and the sale of products and services that minimise adverse environmental impacts.¹¹⁶

2 *The International Chamber of Commerce: Business Charter for Sustainable Development*

The ICC Business Charter for Sustainable Development calls for a global shift in corporate practices so as to achieve sustainable development.¹¹⁷ The aim of the Charter is to encourage the widest possible range of corporations, across all sectors, to commit to responsible environmental corporate governance systems and practices, to improve corporate environmental performance overall, to change management structures and practices so as to assist with achieving that

¹¹³ Forster, above n 11, 74-5; see CERES website, *CERES: Investors and Environmentalists for Sustainable Prosperity*

<<http://www.ceres.org>> at 18 March 2007.

¹¹⁴ CERES, above n 113.

¹¹⁵ See list of CERES companies at

<http://www.ceres.org/coalitionandcompanies/company_list.php> at 18 March 2007.

¹¹⁶ CERES, above n 113

<<http://www.ceres.org/coalitionandcompanies/principles.php>> at 18 March 2007.

¹¹⁷ International Chamber of Commerce, *The Business Charter for Sustainable Development* <<http://www.iccwbo.org/home/environment/charter.asp>>.

improvement, to assess progress towards these environmental goals, and to report publicly, as well as internally, on any such progress.¹¹⁸

Essentially, the Charter is a mechanism through which an internal corporate cultural shift can be implemented. Through raising the profile of environmental issues and infusing a particular approach to corporate governance and practice throughout all operations, it is intended that environmental considerations will become as much an expected factor in corporate decision-making as financial matters are. The focus for the ICC initiative is the promotion of sustainable development through 16 principles of corporate environmental management. Covering matters such as shifting corporate priorities, employee education, increased energy efficiency, the provision of products and services that have no undue environmental impacts, the adoption of a precautionary approach to corporate activities, and compliance and monitoring issues, the Charter is designed to be a framework document on which to build individual programmes of action for each corporation.¹¹⁹

3 *The Equator Principles*

The Equator Principles is a voluntary code developed by the World Bank's International Finance Corporation ('IFC') and private investment banking houses to promote an environmentally and socially responsible approach to project finance.

By 2000, investing in projects that caused or contributed to environmental degradation was attracting public scrutiny and negative publicity. The financing of environmentally detrimental projects had in itself become a target for NGO campaigns.¹²⁰ Financial institutions were beginning to feel the impact of a culture of international environmentalism and needed to respond to this shift in public expectations of corporate behaviour. The development of the Equator Principles was one such response. Forty-one financial institutions have adopted the Equator Principles to date, being banks which account for 80 per cent of global project financing.¹²¹ As such, the Principles are now close to becoming the industry standard.

The Equator Principles apply to projects with a capital cost of US\$10 million or more. It articulates criteria and procedures for assessing the environmental and

¹¹⁸ Ibid.

¹¹⁹ Ibid 2-3.

¹²⁰ Jane Monahan, 'Principles in Question', *The Banker*, March 2005 <http://www.equator-principles.com/documents/Principles_in_question.pdf> at 18 March 2007; Jon Sohn, 'NGO Spotlight Shifts to Private Sector', *Environmental Finance Magazine*, February 2004, <<http://www.foe.org/new/news18.html>> at 18 March 2007; Christopher Wright, 'For Citigroup, Greening Starts with Listening', *The Ecosystem Marketplace*, April 2006 <<http://www.equator-principles.com/City.shtml>> at 18 March 2007.

¹²¹ The Equator Principles website <<http://www.equator-principles.com>> at 18 March 2007; Allens Arthur Robinson, above n 109, 1; Sohn, above n 119, 2.

social impacts of a proposed project,¹²² and requires banks to decline to provide finance on projects where the borrower is unable to comply with the environmental and social standards set by the bank. Projects are scrutinised for their potential environmental and social risks and are classified accordingly.¹²³ The borrower must then provide to the financier a Social and Environmental Assessment addressing those issues identified.¹²⁴ Accepting finance from an Equator Bank also commits the borrower to the environmental and socially-related conditions of the loan. As non-compliance may amount to a default, exposing the project to immediate re-payment provisions of the loan,¹²⁵ the Equator Principles constitutes an interesting mechanism for assisting in achieving environmental protection objectives.

4 Principles for Responsible Investment

The Principles for Responsible Investment is a voluntary code aimed at institutional investors developed by the UN Global Compact and UNEP Finance Initiative.¹²⁶ The Global Compact was established in 2000 with the aim of uniting corporations with UN Agencies and NGOs in the implementation of environmentally and socially responsible principles. It seeks to ensure that good corporate citizenship becomes a part of mainstream business practice, and, in so doing, it hopes to assure a sustainable global economy.¹²⁷

The Principles for Responsible Investment is a sub-set of that Global Compact initiative. The code focuses specifically on the investment sector precisely because the decisions of institutional investors do influence financial markets and corporate decision-making.¹²⁸ It sets forth six principles and 35 ‘possible actions’ to assist investors with infusing environmentally and socially responsible policies and practices throughout their operations. To date, US\$4 trillion is under the control of ‘Responsible Investment’ fund managers.¹²⁹

¹²² The text of the Equator Principles can be found at the Equator Principles website, <http://www.equator-principles.com/documents/Equator_Principles.pdf> at 18 March 2007.

¹²³ Ibid Exhibit I: Categorisation of Projects.

¹²⁴ Ibid Principle 2.

¹²⁵ Allens Arthur Robinson, above n 109, 3; Monahan, above n 119, 2.

¹²⁶ United Nations Global Compact, *United Nations Secretary-General Launches “Principles for Responsible Investment”* 27 April 2006 <http://www.unglobalcompact.org/NewsAndEvents/news_archives/2006_04_27.html> at 18 March 2007.

¹²⁷ United Nations Global Compact, *What is the Global Compact?* <<http://www.unglobalcompact.org/AboutTheGC/index.html>> at 18 March 2007.

¹²⁸ The Principles for Responsible Investment can be viewed at <<http://www.unpri.org/principles/>> at 18 March 2007.

¹²⁹ United Nations Press Release, *International Funds Worth \$4 Trillion Now Endorse UN Principles for Responsible Investment*, 1 May 2006 <http://www.unpri.org/files/20060501_press/un-uneffi-gc_press_20060501.pdf> at 18 March 2007.

B Ethical Investment Funds

The emergence of 'ethical' investment funds is another indicator of the current socio-political climate, which looks to the promotion of responsible environmental corporate governance through the financier. Although there is no universal definition of what constitutes an ethical investment fund, the process tends to involve the screening of companies according to environmental and social criteria to determine whether or not to purchase its shares.¹³⁰ The environmental criteria on which to base investment decisions vary between funds, but can entail versions of the following:

- Investing in companies that actively engage in environmentally positive activities, such as research and development into renewable energy sources;
- Investing in companies that pursue policies that are beneficial for the environment, such as those that adopt energy efficiency programmes;
- Excluding companies that engage in environmentally harmful activities, such as unsustainable forestry; and
- Excluding whole sectors, such as the fossil fuel, pesticide, or mining industries.¹³¹

While the criteria may vary, the overall aim is uniform. Ethical investment funds seek to induce change in the social and environmental practices of corporations through the lure of attracting investment as a reward for good environmental management and the fear of repelling investors as a result of irresponsible social and environmental practices.¹³² Although ethical investment funds still possess only a small slice of the investment market, it is regarded as a dynamic and growing sector, with the emergence of ethical investment 'tracking' instruments, such as the Dow Jones Sustainability Group Index and the British Financial Times Stock Exchange ethical index.¹³³ Despite the growth in activity and interest, the question as to whether ethical investment funds actually achieve their stated desired outcomes in modifying corporate behaviour, of course, still remains, and is unlikely to be satisfactorily answered in the short-term.¹³⁴ However, the mere fact of the emergence of an entity such as an 'ethical investment fund' and a 'sustainability index' to track the progress of these funds are in themselves indications of a significant socio-political shift in investment policy and practices.

¹³⁰ Benjamin J Richardson, 'Sustainable Finance: Environmental Law and Financial Institutions' in Benjamin J Richardson and Stepan Wood (eds) *Environmental Law for Sustainability* (2006) 309, 311-12.

¹³¹ Forster, above n 10, 71-2.

¹³² Assadourian, above n 104, 180-1.

¹³³ Richardson, above n 129, 312.

¹³⁴ Matthew Haigh and James Hazelton, 'Financial Markets: A Tool for Social Responsibility?' (2004) 52:1 *Journal of Business Ethics* 59.

IV CONCLUDING REMARKS

This article puts forward the hypothesis that foreign investment law, policy and practices are being impacted upon by a new culture of international environmentalism, and that foreign investment will need to be remoulded if it is to move away from a relationship characterised by hostility. Underlying this idea is the more general proposition that globalisation, a global environmental consciousness, and principles from international environmental law are currently shaping the substance and structure of international law-making, and that they will continue to influence shifts in the international legal system in the future. This more general theme also suggests that the concept of sustainable development is evolving into a key component in the international community's response to the global environmental crisis and will ultimately form the basis of an over-arching ecological framework by which society's international and national social, economic, political and legal systems will be referenced. With these systemic trends in mind, this article has examined the issues surrounding international investment law and the foreign investment/environment relationship, arguing that the uncertainty and controversy is symptomatic of a system that has not yet adjusted to the demands of a new era dominated by globalisation and a global environmental consciousness.

The article examined a number of controversial aspects of the foreign investment/environment relationship. In the course of this inquiry, it considered the links between increasing levels of foreign investment activity and environmental degradation, the classification of domestic environmental regulation as international expropriation, the concerns surrounding the creation of pollution havens and regulatory chill, the demise of the MAI negotiations, as well as the moves towards developing corporate social responsibility programmes, voluntary codes of environmental conduct and ethical investment funds. From this analysis, it is clear that foreign investment law, policy and practices no longer enjoy isolation from environmental law and environmentalism and that they will remain interlinked. It is also clear that foreign investment law-makers and policy developers and investors have not yet found an entirely satisfactory way to reconcile the competing objectives involved in these issues. And it is unlikely to be resolved while the more abrasive approach of the *Metalclad* or *Santa Elena* Tribunals continues to be applied in foreign investment- and environment-related disputes. I consider that it will be essential for actors in the foreign investment field to provide a response to these issues that better reflects the new global socio-political era if the foreign investment-environment relationship is to proceed harmoniously in the future. An examination of the form an international ecological legal framework might take and the way in which foreign investment law and practice would have to adapt to exist harmoniously within that structure will need to be undertaken in due course.