

**‘PARADISE REGAINED’: CAN SUSTAINABLE DEVELOPMENT BE  
ACHIEVED WHEN THE PROTECTION OF FOREIGN DIRECT INVESTMENT  
IS AT STAKE? EXAMINING THE CASE STUDY OF VATTENFALL V  
GERMANY I<sup>1</sup>**

***“PARAÍSO RECONQUISTADO” - É POSSÍVEL ALCANÇAR O  
DESENVOLVIMENTO SUSTENTÁVEL QUANDO A PROTEÇÃO DOS  
INVESTIMENTOS EXTERNOS DIRETOS ESTÁ EM JOGO? - UM EXAME DO  
CASO VATTENFALL VS. ALEMANHA I***

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**ABSTRACT:** Reconciliation between development and environmental protection is one of the greatest pressing issues of our times and should happen under a full integration model. In reality, however, political and ‘diplomatic tricks’ left the concept of SD open to interpretation not to bind policy decisions. Some have argued that SD is already inherent to the policy of most developed States. This study will demonstrate, however, that even in developed economies, the implementation of SD still faces difficulties because of the vagueness of the concept, which enables policy choices that prioritise the protection of FDI at the expense of environmental protection. The issues generated by these conceptual flaws are often aggravated by the actual filing or even by the threat of private expensive arbitration procedures, which generate a “chilling effect” on environmental regulation. The case of Vattenfall v Germany I will demonstrate that even a State with a strong governance system faced a foreign intrusion in its environmental policy choices as a result of being sued for EUR 1.4 billion in ICSID. The study concludes by suggesting that the achievement of SD can coexist with FDI as long as host States do not waive their policy space to regulate.

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**KEY WORDS:** Sustainable development, foreign direct investment, environment, arbitration, chilling effect.

**RESUMO:** A conciliação entre desenvolvimento e proteção do meio ambiente é uma das questões mais prementes do nosso tempo, devendo fundar-se em um modelo de integração total. Na realidade, no entanto, “artifícios” diplomáticos e políticos deixaram o conceito de DS aberto a interpretação de modo a não vincular decisões regulatórias. Há argumentos de que o DS já é inerente à política da maior parte dos Estados desenvolvidos. Este estudo demonstrará, entretanto, que, mesmo em economias desenvolvidas, a implementação do DS ainda enfrenta dificuldades por se tratar de um conceito vago, o que propicia escolhas políticas que priorizam a proteção do IED às custas da proteção do meio ambiente. As questões geradas por essas falhas conceituais são frequentemente agravadas pela efetiva instauração ou mesmo pela ameaça de instauração de procedimentos arbitrais privados de alto custo, o que gera um “efeito inibidor” da regulamentação da proteção ambiental. O caso *Vattenfall vs. Alemanha I* demonstrará que mesmo um Estado com um forte sistema de governança submeteu-se a uma intromissão estrangeira nas suas escolhas de política ambiental como resultado de um processo de 1,4 bilhão de euros instaurado perante o ICSID. Este estudo conclui sugerindo que o alcance do DS pode coexistir com o IED, desde que os Estados recebedores do investimento não renunciem à sua autonomia de regulamentação.

**PALAVRAS-CHAVE:** Desenvolvimento sustentável, investimento externo direto, meio ambiente, arbitragem, efeito inibidor

## INTRODUCTION

‘Paradise Regained’ is the title of a poem by Milton, which emphasizes the idea of reversals. A paradise that is lost is eventually recovered after the endurance of an epic journey. The reconciliation between development and environmental protection is one of the most important pressing issues of our times. Widespread ecological degradation has already taken place and, for that reason, the achievement of SD is one of the central objectives of

IEL.<sup>2</sup> Nevertheless, the implementation of SD is a hard task, despite the efforts undertaken towards this goal. The explanation for such difficulty is that the concept of SD was ‘vague enough’ to gather consensus around its formulation, but it remains too vague to be effectively implemented.<sup>3</sup>

Chapter One shall elaborate on the idea of SD, elucidating why the vagueness of the concept brings difficulties for its practical applicability. The chapter shall further include arguments for the reason why SD is a rule of international customary law,<sup>4</sup> mentioning the ICJ’s jurisprudence on the issue. Chapter One finally concludes with an explanation on how States’ duties towards the environment function under IL through the lens of SD, clarifying that SD rather than a rule to constrain States’ behaviour implies the right to develop sustainably.

The second chapter is also divided into three sections. Firstly, it will contrast FDI protection under IL with foreign investors’ duties towards the environment, highlighting that while States bear hard law obligations to protect FDI, foreign investors have no similar commitments towards the environment. Secondly, it will expose the role of FDI in undermining the environmental sovereignty of peoples, which consequently reflects on States’ lack of policy space to regulate on environmental issues. Thirdly, and in order to contextualise this key concern, this study will reveal ICSID’s pitfalls with regards to addressing environmentally related arbitration disputes, further exploring the regulatory chill that arises out of either the filing of a costly arbitration case or even out of the mere threat of arbitration.

Chapter Three starts by briefly providing some background information about the international arbitration case *Vattenfall v Germany I*,<sup>5</sup> settled in ICSID, critically analysing the chilling effect that resulted from such a settlement in terms of Germany’s environmental policy. Moreover, the chapter shall also critically reflect on relevant primary sources of

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<sup>2</sup> SANDS, Philippe *et al.* Principles of International Environmental Law. New York: Cambridge University Press, Third Edition, p.15, 2014.

<sup>3</sup> VINUALES, Jorge E. ‘The Rise and Fall of Sustainable Development’, 22/1 *Rev. Eur. Community & Int’l Envtl. L.* 3, p.5, 2013.

<sup>4</sup> SANDS, Philippe *et al.* Principles of International Environmental Law. New York: Cambridge University Press, Third Edition, p.208, 2014.

<sup>5</sup> *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany*, ICSID Case No. ARB/09/6, Award of the Arbitral Tribunal [2011], available at <<http://www.energycharter.org/fileadmin/DocumentsMedia/Disputes/ISDSC-024a.pdf>> Accessed 01 November 2019.

research about the German energy policy, from the point of view of SD. The purpose of Chapter Three is to shed light on why the existing framework that could have sheltered Moorburg's environment and the river Elbe's ecology from degradation have arguably failed both on a domestic and international level. As argued, the international framework that protects FDI is legally binding, surpassing public interest and domestic laws. Furthermore, this study will reveal a paradigm shift in international investment arbitration, characterised by the surrender of the strong German State, who is not used to being in a respondent position, nor to change regulations as a result of lawsuits. The chapter concludes by exploring reforms that shall be undertaken in both the international framework of FDI and arbitration. In order to investigate if a coexistence between the achievement of SD and FDI is possible, the chapter will elaborate on the new generation of IIAs, which contain a sustainability impact assessment clause, revealing that greater transparency, reliability and continuous monitoring are necessary for reaching this goal. The study will conclude by summarising all the substantial issues raised in the paper, and shall afterwards highlight the key concerns pertaining to the achievement of SD in contrast to the protection of FDI. Finally, in a quest to tackle the referred issue, the study shall explore a feasible reconciliation between both values in order to reach the much desired worldwide implementation for the principle of sustainable development in a broader perspective.

## **CHAPTER ONE**

### **Examining sustainable development**

#### **The concept of sustainable development**

Sustainable development lacks a universal and precise definition, as this study will help to demonstrate, which brings consequences not only for the enforceability of the principle itself, but to individual policy choices associated with it. In terms of the historical background of the concept of SD itself, the concern surrounding reconciliation between economic development and environmental protection captured global awareness at the 1972 UN Conference on the Human Environment. The 1972 Stockholm Conference followed Club of Rome's 'comprehensive report' regarding the *status quo* of the natural environment,

after years of exploitation by an industrial planetary community.<sup>6</sup> As human beings, our relationship with the environment is one of inherence, as we belong to the planet, we are not detached from it. The same line of thinking applies to all other creatures that form the interconnected web of life that links all the living species.<sup>7</sup> In the words of Mebratu, the environment is our ‘field of meanings and significance’, from which we can infer a sense of ‘cohesion’ and ‘a certain wholeness’.<sup>8</sup>

Secondly, despite the wide variety of theories about what constitutes development amongst mainstream scholars, this study highlights the view of Sen, who defines it as ‘an expansion of freedoms’, offering a ‘comprehensive, inclusive and humanistic approach’ of development.<sup>9</sup> This notion provides a more realistic possibility for the above mentioned reconciliation to occur. On the other hand, the idea that development ‘equated with economic growth’<sup>10</sup> could not coexist harmonically with the natural environment has been increasing in awareness amongst researchers and environmentalists around the globe. Therefore, it has been argued that SD would be a contradiction in terms since increasing levels of economic growth would not be possible without generating the corresponding ecological degradation.<sup>11</sup>

There are several variations in academia and politics for what defines SD, depending on the preponderance of economic, social or environmental viewpoints.<sup>12</sup> The vagueness of the concept may be justified, nevertheless, by a desire to leave the definition open to debate, which can be an interesting opportunity in the ‘world of politics and policies of sustainable

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<sup>6</sup> MEBRATU, Desta. ‘Sustainability and Sustainable Development: Historical and Conceptual Review’, 18 *Environmental Impact Assessment Review* 493, p.501, 1998.

<sup>7</sup> SHIVA, Vandana. *Earth Democracy - Justice, Sustainability and Peace*. London: Zed Books, p.vii-11, 2016.

<sup>8</sup> n 5 above, p.514-515.

<sup>9</sup> CARVALHO, Viviane Cruz Alves de. ‘Sustainable development: understanding the relationship between poverty alleviation, environmental protection and a ‘new era of economic growth’ in light of the case studies of India and Bhutan’. Unpublished essay submitted as coursework for Law and Natural Resources. SOAS, University of London, p.6, 2015.

<sup>10</sup> ROBINSON, John. ‘Squaring the Circle? Some thoughts on the idea of Sustainable Development’, 48 *Ecological Economics* 369, p.373, 2004. See also n 6 above, p.xi about the theme when the author mentions that “Yet the economic paradigm is based on crude reductionism, to the extent that one measure, gross domestic product (GDP), has displaced the assessment of true wealth as well-being for all species, including humans.’

<sup>11</sup> ROBINSON, John. ‘Squaring the Circle? Some thoughts on the idea of Sustainable Development’, 48 *Ecological Economics* 369, p.369-370 and 377, 2004.

<sup>12</sup> ALAM, S.; KARIM, M.S., ‘Linkages of Development and Environment: In Search of an Integrated Approach through Sustainable Development’, 23 *Georgetown International Environmental Law Review* 345, p.357, 2011. See also n 8 above, p.503-504.

development.’<sup>13</sup> However, the most distinguished of all these definitions is the one coined in the 1987 Brundtland Report. As declared therein:

Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs. It contains within it two key concepts: the concept of needs, in particular the essential needs of the world's poor, to which overriding priority should be given; and the idea of limitations imposed by the state of technology and social organisation on the environment's ability to meet present and future needs.<sup>14</sup>

First of all, priority shall be given to the alleviation of poverty, which needs to be understood as an ‘an indispensable requisite for sustainable development to be effectively achieved’.<sup>15</sup> This was clearly enunciated not only in the Brundtland Commission outcome document, but also in other UN relevant documents, where the vital commitment to free ‘peoples from want’ was ratified.<sup>16</sup> The idea of sustainability does not infer an assumption that there should be an equal distribution of resources, but instead it contains an equity goal, which shall be achieved through what the Brundtland Report calls a ‘new era of economic growth’. In this ‘new era’, a fair division of assets between and within countries shall be guaranteed.

To assure the realisation of such a goal, the widespread reinforcement of the rule of law is of paramount importance, ‘and sound policies that can guarantee participatory rights for all citizens’, as well as ‘a more democratic system regarding international affairs’ shall be implemented.<sup>17</sup> Finally, it was understood that because the Earth’s limited resources are unable to fulfil the needs of ‘a fast growing population divided by political borders’, a paradigm shift regarding the evolving responses to these difficult scarcity issues is of

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<sup>13</sup> n 10 above, p.374.

<sup>14</sup> Report of the World Commission on Environment and Development, UN General Assembly, UN Doc. A/RES/42/187, p.41, 1987.

<sup>15</sup> n 8 above, p.8.

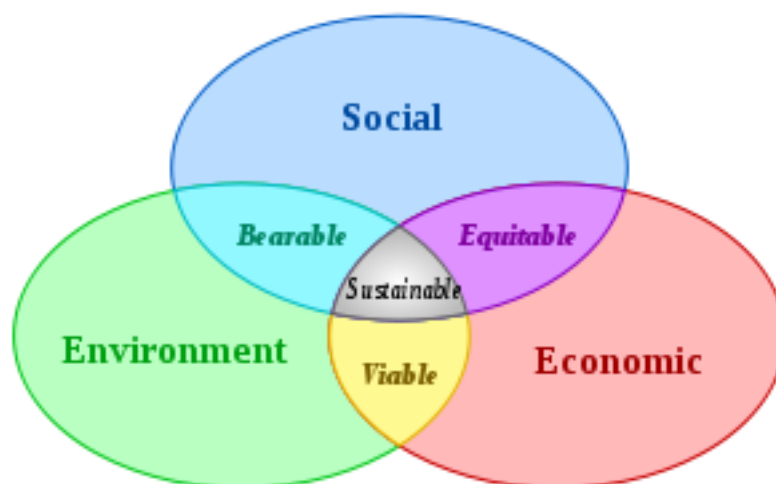
<sup>16</sup> *ibid* and Report of the Open Working Group of the UN General Assembly on Sustainable Development Goals, UN General Assembly, UN Doc. A/68/970, p.6, 2014.

<sup>17</sup> n 11 above, n 13 above, and Report of the World Commission on Environment and Development, UN General Assembly, UN Doc. A/RES/42/187, p.16, 1987.

supreme importance. Henceforth, the well being of present and future generations relies upon ‘a deep transformation in consuming patterns, resources exploitation and energy use, driven by a strong political will, which can integrate society’s participation and environmental concerns into the economic’ arena.<sup>18</sup>

This notion of SD was first mentioned in a treaty, in the preamble of the 1992 European Economic Area Agreement, but really gained momentum when the referred integration principle was affirmed in Principle 4 of the 1992 Rio Declaration.<sup>19</sup> Additionally, UNCED (1992) did not strengthen the domination paradigm of mankind over nature, but instead held both as ‘equal, mutually interdependent partners.’<sup>20</sup> Ten years after the UNCED, the UN held, in Johannesburg, another World Summit on SD, where the idea of interdependency of what was, from then on, called the ‘three pillars of sustainable development’ was reinforced.<sup>21</sup> These three pillars can be visualised in the figure below:

Figure 1: The Three Pillars of Sustainable Development



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<sup>18</sup> n 13 above, n 14 above and Report of the World Commission on Environment and Development, UN General Assembly, UN Doc. A/RES/42/187, p.16-17, 1987. See also FRENCH, Duncan. ‘Sustainable Development’, in FITZMAURICE, Malgosia et al. eds, *Research Handbook on International Environmental Law* 51. Cheltenham: Edward Elgar, p.59, 2010.

<sup>19</sup> n 3 above, p.206 and 210.

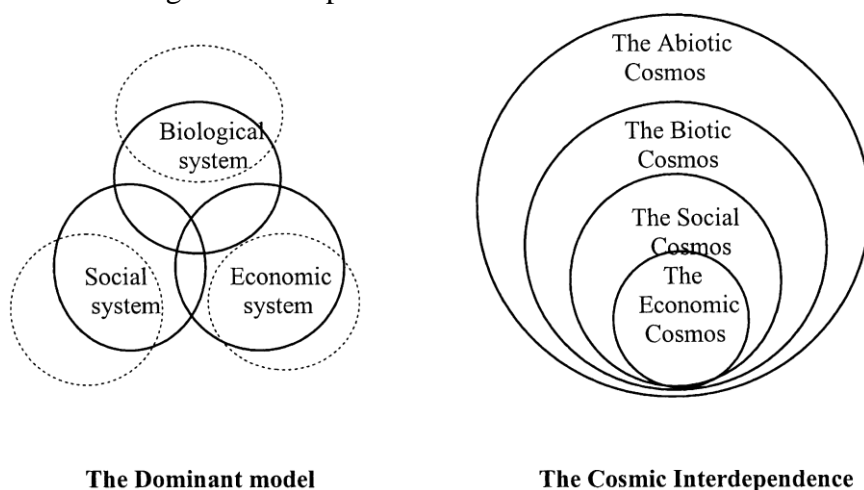
<sup>20</sup> GALIZZI, Paolo; HERKLOTZ, Alena. ‘Environment and Development: Friends or Foes in the 21st Century?’, in FITZMAURICE, Malgosia et al. eds, *Research Handbook on International Environmental Law*. Cheltenham: Edward Elgar, p.87, 2010.

<sup>21</sup> ALAM, S.; KARIM, M.S., ‘Linkages of Development and Environment: In Search of an Integrated Approach through Sustainable Development’, *23 Georgetown International Environmental Law Review* 345, p.350-351, 2011.

Source: Energythic. Available at <<http://energythic.com/view.php?node=35>> Accessed 01 November 2019.

Nonetheless, Mebratu interprets this allegedly ‘separate existence of the natural, economic and social systems’ as reductionist. In his opinion, ‘the ultimate objective of sustainability is the full integration’ of such systems.<sup>22</sup> The figures below reproduce the contradiction between the dominant model and Mebratu’s linear thinking:

Figure 2: Comparison between the dominant model and Mebratu’s view



Source: n 5 above, p.513.

Along similar lines, Vandana Shiva claims that science ‘has moved beyond mechanistic reductionism’ and that ‘the ecological paradigm recognises interconnectedness’.<sup>23</sup> Despite these voices amongst scholars, the principle of integration was conceived under the three pillars model, requiring that ‘development decisions do not disregard environmental considerations.’ One argument put forward in academia about this principle is that it was an ‘intrinsic feature of international environmental regulation, and of most developed economies’, being still a concern to be considered in developing economies and in the practice of the World Bank.<sup>24</sup> This study will demonstrate, however, that even in

<sup>22</sup> n 5 above, p.513-514 and n 10 above, p.378.

<sup>23</sup> n 7 above, p.xi.

<sup>24</sup> BOYLE, Alan; FREESTONE, David eds, *International Law and Sustainable Development - Past Achievements and Future Challenges*. Oxford: Oxford University Press, p.11, 1999.



developed countries, the applicability of the principle of SD in practice still faces difficulties because of the vagueness of the concept, which enables policy choices that prioritise the protection of FDI at the expense of environmental protection.<sup>25</sup>

### **Sustainable development in practice**

The notion that the present generation is the trustee of the Earth's resources and should sustainably manage them, for the sake of future generations, figures in State practice since 1893. That was the US understanding in the 'Pacific Fur Seal' arbitration.<sup>26</sup> More recently, the ICJ recognised the vested rights of future generations to a healthy environment in its Advisory Opinion on 'The Legality of the Threat or Use of Nuclear Weapons' and regarding the conservation of biodiversity in the 'Whaling in the Antarctic' judgment (Australia v Japan: New Zealand intervening).<sup>27</sup> In that sense, it has been argued that the rights of the unborn can strengthen the claims of the present generation's members.<sup>28</sup> On the other hand, Boyle highlights that international legal doctrine and jurisprudence lack a theory that can justify the representation of the unborn before international tribunals independently of state actors. He sees no reason, howbeit, for this representation not to be allowed by national courts, citing the 'Minors Oposa' case filed before the Philippines Supreme Court.<sup>29</sup> It is not the purpose of this study to deepen this procedural issue, however it is important to stress that 'rights are meaningless unless practical mechanisms exist to ensure they are recognised'<sup>30</sup>.

Also concerned with inter-generational equity, amongst other values, is the separate opinion regarding the Gabčíkovo-Nagymaros Project written by ICJ's judge Weeramantry, where he cites an ancient wisdom that emanates from Sri Lanka's heritage, about the notions of 'development and environmental protection'. He mentions that 'anyone interested in the

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<sup>25</sup> Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany, ICSID Case No. ARB/09/6, Claimant's Request for Arbitration [2009], p.14-15, available at <<http://www.italaw.com/sites/default/files/case-documents/ita0889.pdf>> Accessed 01 November 2019.

<sup>26</sup> n 3 above, p.209.

<sup>27</sup> Whaling in the Antarctic (Australia v Japan: New Zealand intervening), Separate Opinion Judge Cancado Trindade, [2014] Reports 348 ICJ, p.365.

<sup>28</sup> n 3 above, p.155 and 210. See also FRANCIONI, Francesco. 'International Human Rights in an Environmental Horizon', 21/1 European Journal of International Law, p.55, 2010.

<sup>29</sup> n 23 above, p.14.

<sup>30</sup> MOENCH, M. et al, 'Water, human rights and governance. Issues, debates and perspectives.' in MOLLINGA, Peter, 'Water Rights in Farmer Managed Irrigation Systems in India: Equity, Rule Making, Hydraulic Property and the Ecology', 1/1 South Asian Water Studies, p.4, 2009.

human future would perceive the connection between the two concepts and the manner of their reconciliation’ and that the principle of reconciliation is ‘the principle of sustainable development.’<sup>31</sup> The ancient Sri Lankan society adopted the ‘concept of development *par excellence*’, which showed respect for the natural environment, human beings and animals.<sup>32</sup> It went beyond the reductionist model, criticised by Mebratu, embracing, centuries ago, a full integration model of SD.<sup>33</sup> Sri Lanka was then based on a principle that is key to IEL, which is notably ‘the principle of trusteeship of earth resources’, which led the king to protect both fauna and flora, based on Buddhist teachings.<sup>34</sup> As the king was told three centuries before the birth of Christ, we are the ‘guardians’ of the Earth, not its ‘owners’.<sup>35</sup> Judge Weeramantry finally emphasised that he considers SD to be a rule of customary international law, when he stressed that there is a "general recognition among states of a certain practice as obligatory", hence the nature of customary law can be assigned to the principle of sustainable development<sup>36</sup>

It is further remarked in the referred opinion that development should not mean environmental degradation and exploitation of peoples, but instead its objective should be the ‘betterment’ of people’s standards of living, which subsequently also goes hand in hand with ecological conservation policies.<sup>37</sup>

### **States’ duties towards the environment under International Law through the lens of sustainable development**

Henceforth, if SD is a rule of international customary law, as asserted by Judge Weeramantry, then the logical assumption is that States are legally bound by this norm. But what exactly does that mean in practice? Can SD be a rule to constrain States’ behaviour or

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<sup>31</sup> Gabčíkovo-Nagymaros Project (Hungary/Slovakia), Separate Opinion of Judge Vice-President Weeramantry, [1997] Reports 88 ICJ, p.90 and 103.

<sup>32</sup> *ibid*, p.101-102.

<sup>33</sup> n 21 above.

<sup>34</sup> n 30 above. About modern public trust doctrine, derived from English Law, see TAKACS, David. ‘The Public Trust Doctrine, Environmental Human Rights, and the Future of Private Property’, 16 NYU Environmental Law Journal, p.737, 2008.

<sup>35</sup> n 30 above, p.103.

<sup>36</sup> *ibid*, p.104.

<sup>37</sup> *ibid*, p.110.

is it more accurate to claim that States have the right to develop sustainably?<sup>38</sup> If there is an assumption that States are accountable for accomplishing sustainability goals, then an international authority must exist to guarantee compliance. It is true that since the 1992 Rio Conference, SD has been voluntarily embraced by several countries and reflected in their national policies. Nevertheless, despite the fact that individual States' implementation of Agenda 21 - UNCED's action plan for SD - is monitored by the CSD, it is not within the mandate of this commission to assess 'whether any particular policy or development is or is not sustainable.'<sup>39</sup>

Seemingly, it has been affirmed that hardly any international court will rule that an individual State did not achieve a certain facet of SD, while reviewing its national policy. In the *Case Concerning the Gabčíkovo-Nagymaros Dam*, the ICJ instead asked the parties to 'look afresh at the environmental consequences and to carry out monitoring and abatement measures to contemporary standards set by international law.' Boyle argues, therefore, that such an argument is based 'on the components of' SD, 'rather than on the concept itself.' Hence, it is accurate to stress that this normative inconclusiveness about what constitutes SD leaves the final call about it within individual States.<sup>40</sup> On the other hand, it has been also put forward in academia that SD can assume a 'normative status as an element of the process of judicial reasoning', and more than that, can be characterised as a 'meta-principle', which means that when in conflict with other norms or principles, SD shall prevail. Furthermore, when a tribunal rules about a given concept, 'it becomes part of the conceptual apparatus of that tribunal, a kind of prism through which disputes brought before the tribunal are viewed', and that is how the law advances in practice. The concept of SD could, henceforth, develop through judicial decisions, rather than just being at the mercy of policy makers.<sup>41</sup>

When it comes to policy, the implementation path of SD is still a major challenge facing the world community. When governments achieved a consensus at the 1992 Rio Conference, there was political will to do so. In contrast, at the Rio+20 Summit, the 'centre of gravity' completely shifted 'from environment to development and growth', in the aftermath of the 2008 economic crisis. Therefore, according to Vinuales, it would not be

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<sup>38</sup> LOWE, Vaughan, in BOYLE, Alan; FREESTONE, David eds, *International Law and Sustainable Development - Past Achievements and Future Challenges*. Oxford: Oxford University Press, p.23-25, 1999.

<sup>39</sup> n 23 above, p.5-7.

<sup>40</sup> *ibid*, p.16-17.

<sup>41</sup> n 37 above, p.31-37.

considered realistic to despise the pronounced ‘tradeoffs’ that need to be dealt with when it comes to the binary choice of environmental protection versus economic priorities, with the tendency of most industrialised countries to give privileges to development and growth over the environment.<sup>42</sup> In this context, it is of key importance to highlight that States have the legal obligation to protect the environment arising out of binding MEAs,<sup>43</sup> through which individual governments could regulate MNEs activities by imposing hard law obligations on them.<sup>44</sup>

## CHAPTER TWO

### Examining foreign direct investment

#### Foreign direct investment protection under International Law v foreign investors’ duties towards the environment

The above mentioned States’ duties regarding the protection of the environment as a result of their binding commitments under MEAs can, on the other hand, potentially collide with their equally binding obligations to protect investment emerging from IIAs.<sup>45</sup> International investment law is a field where the theory of the ‘sanctity of contract’ or *pasta sunt servanda* prevails, i.e., the terms of the contract are law between the signatories and should be respected and enforced.<sup>46</sup> Henceforth, IIAs, which are enacted between multiple States if the agreement holds a multilateral nature, or between two States, in which case they are classified as a BIT, bear protective provisions. In both cases, the IIAs are signed between States, with the objective to protect and foster investment beyond their borders. The referred protective clauses repose essentially on: ‘non-discrimination; fair and equitable treatment, that overlaps with the international minimum standard; full protection and security; and

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<sup>42</sup> VINUALES, Jorge E., ‘The Rise and Fall of Sustainable Development’, 22/1 Rev. Eur. Community & Int’l Envtl. L. 3, p.4-6, 2013.

<sup>43</sup> UN Committee on Economic, Social and Cultural Rights, General Comment 14, The Right to the Highest Attainable Standard of Health (Art. 12 of the International Covenant on Economical, Social and Cultural Rights), UN Doc. E/C.12/2000/4, 2000.

<sup>44</sup> CARVALHO, Viviane Cruz Alves de. ‘The clash between the public interest to protect the environment and international investors’ self-interests: Evidence from the Nigerian oil spills’, 8 Queen Mary Law Journal, p.4, 2017.

<sup>45</sup> *ibid* and UNCTAD paper series on issues in international investment agreements - Environment, UNCTAD/ITE/IIT/23, p.26, 2001.

<sup>46</sup> MUCHLINSKI, Peter T. *Multinational Enterprises & the Law*. Oxford: Oxford University Press, Second Edition, p.578-579, 2010.

protection against expropriation without due compensation.<sup>47</sup> This study will focus on the latter protective provision since this is the main clause related to the case *Vattenfall v Germany I*, contemplated herein.<sup>48</sup>

It has been claimed that the regulatory action of ‘taking of property’ encompasses both the ‘creeping expropriation’, that causes the devaluation of the investment, and the ‘regulatory taking’, which is outlined by UNCTAD as a expropriation of property that arises out of the police powers of an individual State, or otherwise results ‘from State measures like those pertaining to the regulation of the environment, health, morals, culture or economy of a host country.’<sup>49</sup> Despite the fact that this specific IIAs’ protective clause demands compensation whenever an expropriation takes place, ‘international courts have been generally ruling that a state regulatory taking in pursuit of a true public interest does not usually give grounds for compensation.’<sup>50</sup> On the other hand, as this author has already stressed on a previous essay:

when the regulatory taking can not exactly be justified by public interest or the state measures lack proportionality, the courts tend to favour the investors because of their ‘legitimate expectations’ in regards to the investments’ length. In other words, the state cannot cause harm to the private sphere of the investor without a relevant public purpose and legitimate motifs.<sup>51</sup>

In contrast, when it comes to the foreign investor’s duties towards the environment of the host country, it has been argued in relation to the 1994 EECT, that it contains non-mandatory language in terms of environmental protection. As a result, the foreign investor bears the duty of environmental care and is liable for environmental damages only under the applicable national laws of the host State.<sup>52</sup> The EECT is particularly important for this study as it is the IIA that regulates the investment contemplated in the case study *Vattenfall v*

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<sup>47</sup> n 43 above, p.5.

<sup>48</sup> n 24 above.

<sup>49</sup> n 43 above, p.5 and n 45 above, p.588.

<sup>50</sup> *ibid.*

<sup>51</sup> n 43 above, p.5.

<sup>52</sup> EMSEH, Engobo, ‘Globalisation and resource development in Africa: assessing the facilitator - protector roles of international law and international institutions’, 25/5 Development Southern Africa, p.568-569, 2008. See also EECT, Lisbon, 1994, art.10 (1), art. 13, art. 18 (3) and art.19.

Germany I, where Vattenfall is a Swedish MNE, while Germany stands as the host State of the investment *in casu*.<sup>53</sup> Moreover, the EECT was ‘the first binding multilateral investment protection agreement’ and also the first to include ‘binding international dispute settlement as the general rule’.<sup>54</sup> It has been observed more recently that like the US, the EU is fostering an ongoing negotiation agenda that includes a ‘new generation’ of FTAs, which contain chapters pertaining to sustainable trade, hence searching for an integration between MEAs and FTAs. However, the minimum standards again contain flexible language, leaving space for several interpretations and still unknown consequences.<sup>55</sup>

### **The clash between environmental sovereignty and foreign direct investment**

It has been claimed that negotiating parties of prevailing international agreements related to FDI disregard that a necessary enhancement in international regulations needs to happen as a compensation for the limitations on national sovereignty that arise out of IIAs. As a result, regulatory decisions with regards to the foreign investment at stake get subsequently compromised, especially in host economies ‘with weak governance’.<sup>56</sup> The strengthening of such systems of governance would help to achieve the proper equilibrium between a ‘stable business environment on the one hand’ and SD on the other.<sup>57</sup> This study will reveal, nevertheless, that a strong State such as Germany, which is internationally well ranked in terms of good governance,<sup>58</sup> also suffered a limitation in its environmental regulatory policy powers, when bound by an IIA, namely the EECT.

If there isn't enough policy space left for sovereign governments to protect their nation's environment, then the foreign investor can hypothetically claim a ‘breach’ of that State's binding commitments under the applicable IIA.<sup>59</sup> In the absence of a binding international framework that could compel the foreign investor to protect the environment

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<sup>53</sup> n 24 above.

<sup>54</sup> EECT, Lisbon, 1994, p.8.

<sup>55</sup> JINNAH, Sikina; MORGERA, Elisa, ‘Environmental Provisions in American and EU Free Trade Agreements: A Preliminary Comparison and Research Agenda’, 22 (3) *RECIEL* 324, p.337-338, 2013.

<sup>56</sup> *ibid*, p.55.

<sup>57</sup> The United Nations World Water Development Report 2015 - Water for a Sustainable World, UNESCO on behalf of UN WATER, p.83, 2015, available at <<https://unesdoc.unesco.org/ark:/48223/pf0000231823>> Accessed 01 November 2019.

<sup>58</sup>The Worldwide Governance Indicators (WGI) project, The World Bank Group, available at <<https://info.worldbank.org/governance/wgi/>> Accessed 01 November 2019.

<sup>59</sup> UNCTAD paper series on issues in international investment agreements - Environment, UNCTAD/ITE/IIT/23, p.8, 2001.

or fulfil environmental obligations<sup>60</sup>, a potential solution would be to bind them through the IIAs or FTAs themselves. Regarding the EECT, there is the use of affirmative language about the regulation of ‘the environmental and safety aspects’ surrounding energy resources’ sovereignty.<sup>61</sup> This provision does not concern investment specifically, but the sovereignty over the energy resources themselves, deriving from the permanent sovereignty over natural resources, as authorised by UNGA Resolution 1803. As the case of *Vattenfall v Germany I*<sup>62</sup> ended up in settlement, it remains to be seen if this provision could have been used as an effective line of defence against an expropriation claim. For that reason, it has been proposed by UNCTAD that a possible way of addressing environmental protection in IIAs is to make sure that governments have enough domestic policy space to regulate the issue.<sup>63</sup>

Additionally, it is paramount importance to stress that a regulatory change might be needed not only because of ‘actual environmental damage’, but also because there are reasonable grounds to believe in ‘serious threats’ or that ‘irreversible damage’ is going to happen to the environment, under the ‘precautionary principle’.<sup>64</sup>

The SDGs, which replaced the Millennium Development Goals, in 2015, after a long period of consultation amongst multiple stakeholders, were set by the UN as goals and targets that should be achieved in the quest for SD. In this context, SDG target 17.15 expressly stresses the need for every country’s policy space to be respected in order for SD to be obtained and SDG target 17.14 asserts the necessity for States to ‘enhance policy coherence for’ SD.<sup>65</sup> Henceforth, the environmental sovereignty restriction referred in this section, is understood to be a lack of freedom to establish sound policies that can effectively protect the environment of a given nation, derived from the lack of policy space to regulate as a consequence of the binding obligations under IIAs. Such a constraint severely undermines the pursuit of SD.

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<sup>60</sup> MORGERA, Elisa, ‘The UN and Corporate Environmental Responsibility: Between International Regulation and Partnerships’, 15 (1) *RECIEL* 93, p.97, 2006.

<sup>61</sup> UNCTAD paper series on issues in international investment agreements - Environment, UNCTAD/ITE/IIT/23, p.22-23, 2001.

<sup>62</sup> n 24 above.

<sup>63</sup> n 58 above.

<sup>64</sup> *ibid.*

<sup>65</sup> Trade Justice Movement, ‘TTIPing Away the Ladder: How the EU-US trade deal could undermine the Sustainable Development Goals’ (hard copy - September 2015), p.7, 17 and 43.

### **The ICSID arbitration procedures and the “chilling effect”**

The matter concerning ‘the right to regulate for environmental protection’ deserves special attention as the constraints imposed on these regulatory powers by the protective provisions of IIAs ‘coupled with investor-State dispute settlement (ISDS) procedures provided for therein’, can potentially be and have been used by foreign investors to challenge environmental protection measures announced or enforced by host States.<sup>66</sup> The cases *Metalclad vs Mexico* (1997), *Ethyl vs. Canada* (1997), *S. D. Myers vs. Canada* (1998) and *Methanex vs. United States* (1999) are examples of disputes brought upon international arbitration under allegations that the host States had breached their obligations inserted in NAFTA.<sup>67</sup>

As already pointed out, the EECT is an IIA of multilateral nature, bearing also the characteristics of a FTA in the energy sector and indicating ICSID as the centre for the resolution of disputes in case the investor decides to bring upon a claim against the host State. ICSID was set up by the World Bank in Washington D.C. as a centre for international investment arbitration. According to information provided on its website, since its creation, most international investment cases were handled by ICSID, with States having consented on it as a forum for ISDS in several IIAs.<sup>68</sup> It is important to highlight that once both signatory States to the relevant IIA are members of the ICSID Convention, only the investor can sue the State in ICSID, not the other way around, with the award being final and binding.<sup>69</sup> The foreign investor does not have to comply with the requirement to exhaust local remedies ‘before proceeding to international arbitration’ either, like it is customary in ICJ jurisprudence.<sup>70</sup> So, if the host government changes its policy to protect the environment or towards fulfilling a sustainability goal, and the foreign investor subsequently judges that policy to be negatively impacting its investment or profits, then this investor can sue the host government directly through international arbitration. This case can be directly decided by a centre of arbitration such as ICSID, where a panel of arbitrators formed by three private

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<sup>66</sup> n 58 above, p.32-33.

<sup>67</sup> *ibid*, p.33-35.

<sup>68</sup> ICSID, About ICSID, available at <<https://icsid.worldbank.org/en/Pages/about/default.aspx>> Accessed 01 November 2019.

<sup>69</sup> EECT, Lisbon, 1994, art. 26 (4)(a) and (8).

<sup>70</sup> TIENHAARA, Kyla. *The Expropriation of Environmental Governance - Protecting Foreign Investors at the Expense of Public Policy*. New York: Cambridge University Press, p.123-124, 2009.



lawyers are going to rule on a conflict between private and public interests.<sup>71</sup>

A large number of these aforementioned IIAs have a bilateral nature, meaning that they are enacted between just two States and do not refer specifically to only one sector in the economy, such as the EECT did with the energy sector.<sup>72</sup> The prevailing viewpoint is ‘divide and conquer’,<sup>73</sup> especially when it comes to the field of international trade and investment, as negotiating bilaterally with individual States or even amongst small groups of States is strategically wiser than a multilateral negotiation with multiple stakeholders. The OECD MAI Draft can be cited as an example of a proposed multilateral agreement that failed to leave the negotiating table.<sup>74</sup> In contrast, the history of IEL is one marked by a struggle to reach consensus on a multilateral level, in a quest to protect the interconnected web of life in this planet and secure the well being of future generations, through the achievement of SD.<sup>75</sup>

The first BIT ever signed dates from 1959, between Germany and Pakistan. This was the predecessor of the actual more than 2,800 IIAs concluded globally. Germany is on the top of the list of States which have signed the most BITs, with 139 signed agreements.<sup>76</sup> Concurrently, the number of investor-State arbitration cases have grown a lot in recent years ‘from a total of three known treaty cases in 1995 to a record high of over 50 new claims led annually in the past five years. 2015 saw the absolute record high of 70 new ISDS cases.’ Worldwide, known numbers point to 696 ISDS cases filed as of 1st of January 2016, against 107 host governments. However, as the system is not transparent and some procedures are held in secrecy, this increases the likelihood that these figures are under-reporting the actual number of cases. Data also indicates that a paradigm has been broken, since there is an

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<sup>71</sup> EBERHARDT, Pia, ‘The Zombie ISDS - Rebranded as ICS, rights for corporations to sue states refuse to die’, Corporate Europe Observatory (hard copy - p.5, February 2016), available at <<https://corporateeurope.org/en/international-trade/2016/02/zombie-isds>> Accessed 01 November 2019.

<sup>72</sup> BERNASCONI-OSTERWALDER, Nathalie; HOFFMANN, Rhea Tamara. Briefing Note June 2012, ‘The German Nuclear Phase-Out Put to the Test in International Investment Arbitration? Background to the new dispute Vattenfall v. Germany (II)’, p.4, 2012. International Institute for Sustainable Development, available at <[https://www.iisd.org/pdf/2012/german\\_nuclear\\_phase\\_out.pdf](https://www.iisd.org/pdf/2012/german_nuclear_phase_out.pdf)> Accessed 01 November 2019.

<sup>73</sup> QUILICONI, Cintia; WISE, Carol, ‘The US as a Bilateral Player: The Impetus for Asymmetric Free Trade Agreements’ in Solís, Mireya, Stallings, Barbara & Katada, Saori N. eds, *Competitive Regionalism*. London: Palgrave Macmillan UK, p.97, 2009.

<sup>74</sup> OECD MAI Negotiating Text, OECD official website, available at <<http://www.oecd.org/investment/internationalinvestmentagreements/multilateralagreementoninvestment.htm>> Accessed 01 November 2019 and n 69 above, p.50-53.

<sup>75</sup> n 1 above.

<sup>76</sup> n 71 above.

increasing number of lawsuits against developed countries,<sup>77</sup> with Western Europe being ‘the world’s most sued region’ in 2015. When it comes to awards, foreign investors have won in 60 per cent of the cases where the merits were actually judged by the arbitrators, whereas in the other 40 per cent, the States just did not lose. Even in this case, they still have to bear the brunt of the very expensive costs of arbitration, including legal fees, as the ‘loser pays’ approach is not mandatory. Feeling threatened that a potentially expensive award can end up being granted to the foreign investors, the host States settle in a quarter of initiated ISDS procedures. The settlement can involve either a payment or a change in law or regulation concerning the investment at stake. In certain cases, the *status quo* can be preserved to cater for the investor’s interests.<sup>78</sup> Another contemplated possibility is that many conflicts will not even reach the stage of arbitration, considering the risks and costs involved. Both in the referred cases of settlement and in the threat of arbitration, a regulatory chill is characterised. It has been pointed out, however, that some governments use the existence of international commitments under IIAs ‘as an excuse for the maintenance of the *status quo* in environmental policy.’<sup>79</sup>

Other examples of regulatory chill have been put forward in academia pertaining to the systemic interpretation of law principles, rights and obligations. In *Suez v Argentina*, a potential conflict between the human right to water and the protection of investment was observed. In its decision, however, ICISID ‘found no conflict’ and held both investment and human rights obligations as equal. Interpretations like this could reduce States’ capacity ‘to fulfil their human rights obligations, including their duty to regulate’, hence generating a chilling effect.<sup>80</sup> In *CDSE v Costa Rica*, the dispute arose when a biodiversity-rich land was expropriated for the creation of a natural reserve. ICSID found that international investment law was the prevailing law over the domestic laws of Costa Rica, which granted protection for the environment.<sup>81</sup> It is striking how no international principle of environmental law was applied, such as precaution or no State obligation under any relevant MEA was even considered, like the CBD, in this case for example. As already argued in section 3 of Chapter

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<sup>77</sup> n 69 above, p.54.

<sup>78</sup> n 70 above, p.14.

<sup>79</sup> n 69 above, p.217, 262-263.

<sup>80</sup> VINALES, Jorge E. *Foreign Investment and the Environment in International Law*. New York: Cambridge University Press, p.155, 2012.

<sup>81</sup> *ibid*, p.289.

1 of this study, SD is a meta-principle that shall develop through judicial decisions and which shall prevail in case of conflict with other norms or principles. The key concern about conflicts between SD and investment protection is that arbitrators are not bound by precedent, nor does the ICSID have a permanent panel of independent arbitrators. Instead they are appointed on a case by case basis and tend to have a pro-investor bias, since only investors can bring claims.<sup>82</sup> The logical consequence is that the pursuit of SD is undermined by the ISDS system.

In the next chapter, this study will explore in depth the case study of *Vattenfall v Germany I*, where a regulatory chill also took effect after a EUR 1.4 billion ISDS arbitration procedure was filed in ICSID.<sup>83</sup> If the dispute was held between States, the applicable forum would be the ICJ,<sup>84</sup> but because *Vattenfall AB* is a corporation, regardless of the fact that it is wholly owned by the Swedish State, it can enjoy the privilege of being treated as a foreign investor.<sup>85</sup> The case, which was based on an alleged breach of the EECT, ‘was settled after Germany agreed to weaken the environmental standards’.<sup>86</sup>

## **CHAPTER THREE**

### **Examining the clash between the achievement of sustainable development and the protection of foreign direct investment**

#### **Critical analysis of the case study *Vattenfall v Germany I***

In 2009, the *Vattenfall Group* filed its first case against the German State before the ICSID, with a second case coming later in 2012 following Germany’s decision to phase out nuclear energy in the aftermath of the Fukushima disaster.<sup>87</sup> Because of the secrecy that is

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<sup>82</sup> n 69 above, p.125, 130, 285-286 and n 71 above, p.11 and 25-26.

<sup>83</sup> *Vattenfall Group*, Ownership of *Vattenfall*, available at <<https://corporate.vattenfall.com/investors/key-facts/ownership/>> Accessed 01 November 2019.

<sup>84</sup> International Court of Justice, The Court, available at <<http://www.icj-cij.org/court/index.php?p1=1>> Accessed 01 November 2019.

<sup>85</sup> ICSID, Case Details - *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany* (ICSID Case No. ARB/09/6), available at <<https://www.italaw.com/cases/1148>> Accessed 01 November 2019.

<sup>86</sup> n 70 above, p.12.

<sup>87</sup> Spiegel Online International, ‘*Vattenfall vs. Germany: Nuclear Phase-Out Faces Billion-Euro Lawsuit*’, 2011, available at <<http://www.spiegel.de/international/germany/vattenfall-vs-germany-nuclear-phase-out-faces-billion-euro-lawsuit-a-795466.html>> Accessed 01 November 2019.

often involved in arbitration procedures,<sup>88</sup> it is paramount to emphasise that ‘this was the first known investor-state arbitration procedure against Germany’, but there could have been more. The dispute concerned the construction of a coal-fired power plant in Moorburg, in the vicinity of Hamburg, also located on the River Elbe.<sup>89</sup> It was claimed that the local Moorburg authorities had a political motive to delay the authorisation for the construction ‘of the Moorburg power plant by approximately 9 months’ and that this would have represented a breach of Germany's commitments under Article 10 (1) of the EECT. The Vattenfall Group argued further that the restrictions imposed by Germany ‘under the water use permit’ of the river Elbe were incompatible with the same article. In relation to this item, the claimants put forward that the Moorburg authorities restricted the amount of ‘cooling water’ that they could extract from the river Elbe so that the power plant could ‘run at full capacity’. According to their argument, such a restriction would lead the plant to ‘be shut down for days or weeks during summertime’, what would reduce the electricity generation capacity and hence would make the plant ‘uneconomical’.

They also argued that the water use permit contained a lot more rigid requirements concerning ‘the temperature of the cooling water permitted to be returned into the Elbe and the oxygen level of water of the Elbe than the Vattenfall Group had reason to expect’. According to the German authorities, the elevation of the river’s temperature and the change of its oxygen level have an impact on the river’s ecology and that is why the water permits needed to be restricted. Furthermore, the claimants asserted that the above mentioned Article 10 (1) of the EECT was again breached by the German State because the monitoring period of the fish-ladder, due to be installed in the river in order to reduce the project’s impact more specifically on the fish’s reproduction patterns,<sup>90</sup> was extended from one to two years. They claim that such an extension ‘was a politically motivated, unreasonable measure, impairing the enjoyment of’ their investments. The final argument maintained by the Vattenfall Group was that the joined ‘effects of the delay of the administrative procedure and the restrictions imposed on the use of cooling water amount to an indirect expropriation of Claimants’

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<sup>88</sup> In the case concerning the German nuclear phase out, the relevant documents remain secret. See *Vattenfall AB and others v. Federal Republic of Germany*, ICSID Case No. ARB/12/12 [2012], available at <<http://www.italaw.com/cases/1654>> Accessed 01 November 2019.

<sup>89</sup> n 71 above.

<sup>90</sup> *Vattenfall Group, Environmental responsibility*, available at <<https://group.vattenfall.com/who-we-are/sustainability/environmental-responsibility/biodiversity>> Accessed 01 November 2019.

investments in violation of Article 13 (1)' of the EECT. Preliminary loss and damages were accessed at EUR 1.4 billion, with the claimants also pursuing to receive interest and arbitration costs.<sup>91</sup> On March 11, 2011, exactly on the day of the Fukushima nuclear disaster,<sup>92</sup> both parties reached a settlement, with the water permits being issued to the claimants and the respondent freeing the claimants from the obligation to build a cooling discharger at the Moorburg power plant. By agreement also, the arbitration costs were split by both parties.<sup>93</sup>

As already argued in the previous section, a regulatory chill was thus characterised by the restriction of Germany's environmental sovereignty. *In casu*, the tension between the rights of Vattenfall as an investor, and the 'public welfare interests' of the German nation 'was resolved to the detriment of the public interest'. As stressed, the environment, as well as people's rights are severely jeopardised by the imbalance in the ISDS system.<sup>94</sup> The pitfalls of this system have initiated a broad 'international reform debate'. Nonetheless, while other developed host States such as Australia, Canada and the US have decided to review 'their approach' towards IIAs, Germany 'continues to insist on secrecy in relation to treaty negotiations and dispute settlement procedures'. It has been argued, nonetheless, that the Vattenfall II arbitration case (nuclear phase out) should be used as an opportunity to promote an ample and transparent debate on this issue.<sup>95</sup> In this context, 'Germany's largest association of judges and public prosecutors' has lately manifested similar worries about the rights that foreign investors enjoy in Germany, urging law makers to 'significantly curb recourse to arbitration in the context of the protection of international investors'.<sup>96</sup>

### **Critical analysis of the German energy policy**

Considering SD, Germany has been announcing a transformation in its energy policy

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<sup>91</sup> n 24 above, p.11-15 and 24.

<sup>92</sup> World Nuclear Association, Fukushima Accident, July 2016, available at <<http://www.world-nuclear.org/information-library/safety-and-security/safety-of-plants/fukushima-accident.aspx>> Accessed 01 November 2019.

<sup>93</sup> Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany, ICSID Case No. ARB/09/6, Award of the Arbitral Tribunal [2011], p.6-7, available at <<http://www.energycharter.org/fileadmin/DocumentsMedia/Disputes/ISDSC-024a.pdf>> Accessed 01 November 2019.

<sup>94</sup> n 71 above, p.5.

<sup>95</sup> n 71 above, p.12.

<sup>96</sup> n 70 above, p.13.

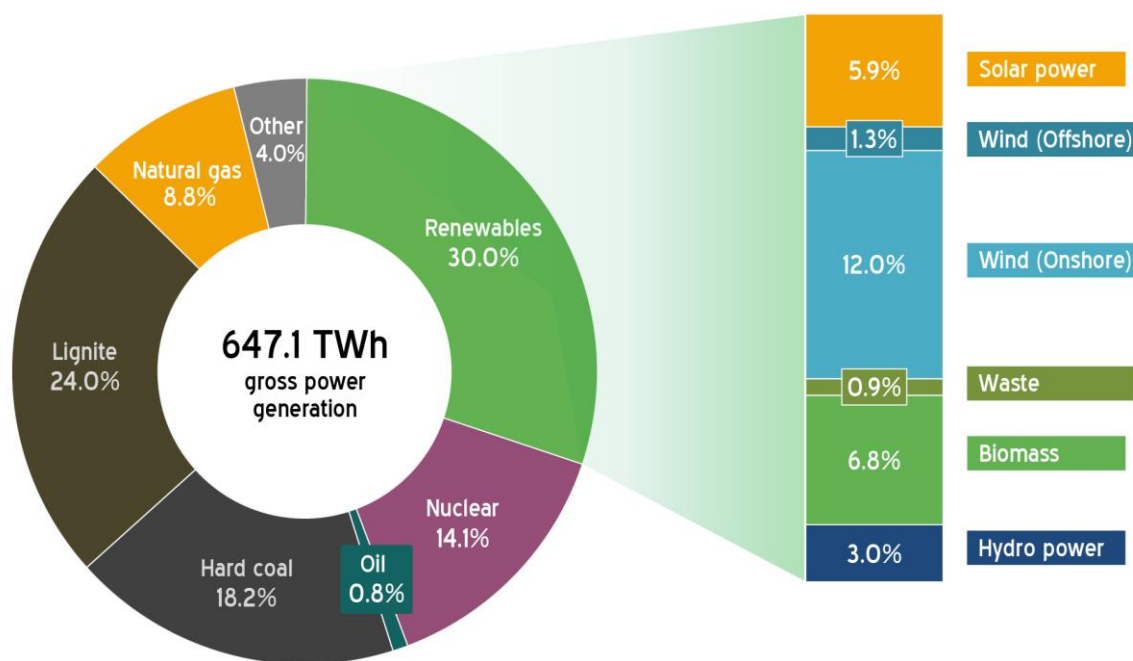
in line with its commitments under the Kyoto Protocol and towards fulfilling SDGs 7 and 13.<sup>97</sup> The *Energiewende* (energy transition in German) is a policy that aims to transition to green power and renewable energy. As of 2015, the share of green power reached a total of 30 per cent in the total generated supply of energy, as the figure below demonstrates.<sup>98</sup>

Figure 3: Germany’s energy mix as of 2015

### Germany reaches 30 percent renewable power in 2015

Gross power generation mix

Source: AGEB



German Energy Transition

energytransition.de



Source: MORRIS, Craig, ‘Germany is 20 years away from 100 percent renewable power – not!’, Energy Transition – The German Energiewende, 2016, available at <https://energytransition.org/2016/01/germany-is-20-years-away-from-100-percent-renewable-power-not/>> Accessed 01 November 2019.

<sup>97</sup> n 64 above, p.24 and 38.

<sup>98</sup> MORRIS, Craig, ‘Germany is 20 years away from 100 percent renewable power – not!’, Energy Transition – The German Energiewende, 2016, available at <https://energytransition.org/2016/01/germany-is-20-years-away-from-100-percent-renewable-power-not/>> Accessed 01 November 2019.

A telegram sent by a Hamburg government official to other German authorities and to the US Environmental Protection Agency reveals concerns not only about the electrical grid shortcomings, but also towards public opposition regarding the construction of new coal power plants and wind farms. The telegram exposes the delay in the construction of many power plants, specially the coal fired facilities, due to public disapproval. It further outlines that the construction of the Moorburg plant by Vattenfall faced a number of controversies, exemplifying the current challenge of generating enough energy in an environmental friendly way.<sup>99</sup>

An earlier telegram, dated December 7, 2006, reported a meeting between James L. Connaughton, who was then the Bush administration's Chairman of the US Council on Environmental Quality and German officials, ahead of Germany's G-8 and EU presidencies. In the referred document, it was mentioned that 'Germany's goals for the EU and G-8 presidencies' would contain 'a focus on energy efficiency' and on fostering clean coal and renewables, in accordance with commitments under the 'Kyoto Protocol, and to the post-2012 framework discussion'. The US would soon declare close to 'USD 1 billion in tax credits' in order to foster the clean coal industry. Germany was encouraged to follow the same path.<sup>100</sup> Just 7 days earlier, German officials had communicated with the White House in relation to the same issues. In this document, Vattenfall's role in promoting clean coal was highlighted, but Germany was concerned about costs,<sup>101</sup> safety and public opinion.

Initially, an investment was made via Schwarze Pumpe, Vattenfall's pilot clean coal power plant.<sup>102</sup> However, in 2014, Vattenfall decided to 'discontinue its R&D (research and

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<sup>99</sup> Public Library of US Diplomacy, Telegram title: NORTHERN GERMAN POWER - BRIDGING THE GAP WITH WIND, COAL, AND GAS, June 12 2009, available at <[https://wikileaks.org/plusd/cables/09HAMBURG15\\_a.html](https://wikileaks.org/plusd/cables/09HAMBURG15_a.html)> Accessed 01 November 2019.

<sup>100</sup> Public Library of US Diplomacy, Telegram title: ENGAGING GERMANY ON ENERGY AND CLIMATE: CEQ CHAIRMAN'S MEETINGS WITH GERMAN OFFICIALS AND GERMAN PRIORITIES FOR ITS G-8 AND EU PRESIDENCIES, December 7, 2006, available at <[https://wikileaks.org/plusd/cables/06BERLIN3442\\_a.html](https://wikileaks.org/plusd/cables/06BERLIN3442_a.html)> Accessed 01 November 2019.

<sup>101</sup> Public Library of US Diplomacy, Telegram title: EB/ESC DAS PAUL SIMONS MEETINGS WITH GERMAN OFFICIALS ON ENERGY AND GERMANY'S PRIORITIES FOR ITS G-8 AND EU PRESIDENCIES, October 30, 2006, available at <[https://wikileaks.org/plusd/cables/06BERLIN3151\\_a.html](https://wikileaks.org/plusd/cables/06BERLIN3151_a.html)> Accessed 01 November 2019.

<sup>102</sup> Public Library of US Diplomacy, Telegram title: ENERGY AND GERMANY'S EU PRESIDENCY, November 30, 2006, available at <[https://wikileaks.org/plusd/cables/06BERLIN3399\\_a.html](https://wikileaks.org/plusd/cables/06BERLIN3399_a.html)> Accessed 01 November 2019.

development) activities regarding coal power with CCS (carbon capture and storage)’ due to cost effective reasons. It was further explained by the MNE that ‘capturing and liquifying CO<sub>2</sub> coming from carbon combustion to later store it underground was meant to curb greenhouse effect gas emissions, but its costs and the energy it requires make the technology unviable’. Based on the CCS phase out, the EU is seeking ‘the reimbursement of funding worth €45 million euros, but neither Vattenfall nor the EU ever said whether the group complied with the request’.<sup>103</sup> Moreover, as already observed, because IL does not extend to States the same privileges it grants to foreign investors, no EU country can sue Vattenfall in ICSID or any other international arbitration centre. It is also unknown whether Germany followed the US advice and gave Vattenfall substantial tax credits to pursue the CCS technology.

Following the CCS discontinuance, Schwarze Pumpe was occupied by eco-activists, while at the same time Vattenfall announced that the pilot plant would be part of its sales ‘to the Czech company, Energetická Průmyslový.’ It is striking that the corporation phased out a green technology such as CCS and now claims to be selling some of its assets to this Czech company as an ‘strategy to convert to renewable and other low-carbon energy production’.<sup>104</sup> <sup>105</sup> Regarding the Moorburg power plant, while it is still in operation, along with other hard coal plants in Germany, ‘planning has largely come to a halt as most utilities consider market conditions under the *Energiewende* unfavourable to investment in fossil-fuelled power stations’. As mentioned in the diplomatic documents, the German public does not see such investments with good eyes. Furthermore, it remains to be seen if Vattenfall will keep the Moorburg power plant or sell it, as the plant might not be cost effective.<sup>106</sup>

All in all, it has been proven that the Elbe river’s ecology was jeopardised and possibly

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<sup>103</sup> Carbon Capture and Sequestration Technologies @ MIT, Schwarze Pumpe Fact Sheet: Carbon Dioxide Capture and Storage Project, <[https://sequestration.mit.edu/tools/projects/vattenfall\\_oxfuel.html](https://sequestration.mit.edu/tools/projects/vattenfall_oxfuel.html)> Accessed 01 November 2019. See also The Local Se, ‘Vattenfall abandons research on CO<sub>2</sub> storage’, 07 May 2014, available at <<http://www.thelocal.se/20140507/vattenfall-abandons-research-on-co2-storage>> Accessed 01 November 2019.

<sup>104</sup> World Coal, ‘Environmental activists shut down lignite mine’, 16 May 2016, available at <<http://www.worldcoal.com/mining/16052016/Environmental-activists-shut-down-German-lignite-mine-2016-787/>> Accessed 01 November 2019.

<sup>105</sup> Reuters, ‘Swedish government to approve Vattenfall sale of German lignite assets’, 2 July 2016, available at <<http://www.reuters.com/article/vattenfall-germany-lignite-idUSL8N19O05Z>> Accessed 01 November 2019.

<sup>106</sup> Clean Energy Wire, ‘Moorburg power plant – Last of a dying breed, or the future of coal in Germany?’, 17 March 2015, available at <<https://www.cleanenergywire.org/news/moorburg-power-plant-last-dying-breed-or-future-coal-germany>> Accessed 01 November 2019.



damaged because of a project that is not in line with Germany's energy policy, which might also not even be cost effective. Vattenfall already sold the pilot plant Schwarze Pumpe under this argument, phasing out CCS technology and, hence, showing no commitment concerning green power generation. Germany, on the other hand, is the trustee of its people's resources and should act accordingly. As for Vattenfall or any other MNE, because they have no binding international environmental obligations, they will always act in accordance with what is most profitable for them. It has been further claimed, nevertheless, that 'decarbonization' might not be such an easy task considering the large amount 'of resources invested in the last ten years on the exploration and extraction of fossil energy resources.' Naturally, the corporations and States that made those initial investments will be committed to recovering them, which makes it subsequently hard to estimate 'the implications of this phenomenon'.<sup>107</sup>

#### **Possible solutions for a better coexistence between sustainable development and foreign direct investment**

As already stated in chapter two of this study, there are currently a number of FTAs being negotiated and signed, which contain a synergy with environmental provisions. Some of them have been linking FTAs to MEAs in order to guarantee compliance to relevant provisions. However, as pointed out, further research is needed in order to identify how these interactions are going to work in practice.<sup>108</sup> Due to increasing public awareness, a new generation of IIAs has been debated in Canada and in the US, with the inclusion of an environmental impact assessment clause being the main result. These agreements contain very similar provisions to the Model International Investment Agreement for SD, which has been pointed out as not perfect, but 'the best alternative currently available.'<sup>109</sup> Muchlinski argues that the new generation of IIAs' draft models include provisions pertaining to SD, as well as clauses concerning investor's liability. He further mentions the sustainability assessment provision as perhaps the most visionary one, as that would 'require the investor to determine the impact of their investment on sustainable development goals.' This assessment would need to happen ahead of the investment, and that would determine

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<sup>107</sup> n 41 above, p.10.

<sup>108</sup> n 54 above, p.335-340.

<sup>109</sup> n 69 above, p.85 and 287.

whether or not that particular investment would take place.<sup>110</sup> This study claims, however, that an independent, transparent and reliable assessment process is mandatory in order for the reconciliation between the purposes of SD and investment to be effectively reached. Additionally, the environmental impact assessment should not take place only prior to the commencement of the investment at stake, but there should be a continuous monitoring process. If the investor fails to comply with the set standards, then the investment could be expropriated without compensation, which could subsequently promote a race to the top. Judge Weeramantry explains this necessity of permanent monitoring in his separate opinion, calling it the ‘principle of continuing environmental impact assessment’:

I wish in this opinion to clarify further the scope and extent of the environmental impact principle in the sense that environmental impact assessment means not merely an assessment prior to the commencement of the project, but a continuing assessment and evaluation as long as the project is in operation. This follows from the fact that EIA is a dynamic principle and is not confined to a pre-project evaluation of possible environmental consequences. As long as a project of some magnitude is in operation, EIA must continue, for every such project can have unexpected consequences.<sup>111</sup>

Furthermore, FDI can effectively contribute to development, as long as the host State does not waive its regulatory powers, jeopardising precious values such as the environmental sovereignty of the nation. There are existing alternatives to the ISDS system, as exemplified in both the US-Australia FTA (in force since 2005) and the Japan-Australia agreement (in force since 2015), which do not include the ISDS clause. In case a dispute arises between the foreign investor and the host State, the local courts are the appropriate forum to rule on the matter. Treaty termination has also been an option exercised by countries which were not satisfied with the imbalance created by the ISDS system. It has been further asserted that private insurance serves as an option for foreign investors against political risks in host economies. By purchasing this kind of insurance, the investors would not need to include the ISDS clause in the agreements, while the host State would keep its environmental sovereignty. South Africa, for example, updated its investment laws to make sure there is

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<sup>110</sup> MUCHLINSKI, Peter T. ‘Negotiating new generation international investment agreements. New sustainable development oriented alternatives.’ in HINDELANG, Steffen; KRAJEWISKI, Markus, eds., *Shifting Paradigms in International Investment Law. More Balanced, Less Isolated, Increasingly Diversified*. Oxford: Oxford University Press, p.56-60, 2015.

<sup>111</sup> n 30 above, p.111.

enough policy space to regulate on public issues, such as environmental protection. The country further requested that local remedies are exhausted prior to the submission of a dispute to international arbitration.<sup>112</sup> Finally, it was suggested that IIAs should include in their texts that their purpose is ‘to promote and protect investment that contributes to’ SD. However, given the conceptual flaws arising from the latter concept, as already mentioned, it was pointed out that the relevant principles of IEL should be included in IIAs, such as the precautionary principle, polluter pays principle, and finally, the common but differentiated responsibilities principle. The inclusion of such principles would support host States actions in favour of environmental protection.<sup>113</sup>

## CONCLUSION

This study has argued that the concept of SD suffers from conceptual flaws, possibly because of the existence of a political will to leave the definition open to debate for policy purposes. Such vagueness generates practical difficulties for the implementation of SD and for the much desired reconciliation between environmental protection and development to occur. It has been claimed that SD should be understood from the full integration perspective, which would allow for ‘institutional and group interest’ influences to be overcome.<sup>114</sup> Present times call for a reboot of this system, where expertise to define and implement key concepts such as SD is captured by interest groups who ultimately help to override public interest. As a rule of customary international law, SD could theoretically constrain States’ behaviour, but this rule cannot be applied to reality as there is no practical way or universal formula to define what is sustainable. It has been claimed instead that States have the right to develop sustainably, with the policy choice to define sustainability practices held within their hands. The only way to guide these choices or exercise any external control over them would be through judicial reasoning, as SD is a meta-principle, that prevails over other norms. Following this line of thinking, whenever a clash of States’ duties happened under relevant binding provisions of IIAs and MEAs, an international court could technically

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<sup>112</sup> n 70 above, p.27. See also Promotion and Protection of Investment Bill, Republic of South Africa, 2015, items 11 (g) and 12 (5).

<sup>113</sup> n 69 above, p.290.

<sup>114</sup> n 5 above, p.518.

rule the dispute based on the meta-principle of SD, finding therefore that environmental protection should have overriding priority over investors' rights. Nevertheless, international courts are not the applicable forum that rule disputes between foreign investors and host States. These disputes are governed instead by relevant arbitration conventions, that indicate private forums to settle the cases, mostly the ICSID, set by World Bank in Washington D.C. The main difference in this case is that arbitrators are not bound by precedent, nor is the panel permanent or the procedures transparent. As a consequence, there is no obligation to respect SD as a meta-principle, especially because international arbitration is a forum to settle investment disputes, with a highly pro-investor bias, since only investors can bring claims. Additionally, there is no imposition to first exhaust local remedies, the awards are final and binding, with no right to appeal, and the procedures are extremely expensive, with a 'loser pays' approach that is not mandatory. In this context, foreign investors, who have no binding duties towards the environment, can sue host States in ICSID whenever they feel their profits have been jeopardised by local regulatory powers. These potentially expensive arbitration procedures or even the threat of filing a procedure can cause a constraint in the policy space of the host State to regulate on environmental protection, generating a 'chilling effect', that severely undermines the pursuit of SD. Further along the study, the case of *Vattenfall v Germany I* demonstrated that even a strong State like Germany with a good governance system, suffered a foreign intrusion in its policy powers to regulate on environmental protection due to an expensive arbitration procedure. As a consequence, the relevant environmental standards were weakened so that the dispute could end up in settlement, in a clear example of the protection of FDI trumping the protection of the environment. Furthermore, relevant primary research sources revealed that *Vattenfall* had no real commitments towards the clean coal technology and ended up selling a non cost effective power plant. Research indicated further that investments in coal might not have been wise because of the energy market prices generated by the *Energiewende*. As a result, the river Elbe's ecology might have been harmed for no relevant developmental interest, but instead for the sole purpose of satisfying the foreign investor. This study concludes by claiming that FDI can coexist in harmony with the achievement of SD as long as States adopt measures to guarantee the preservation of their policy space to regulate. This guarantee can be obtained, for example, with the demand for the exhaustion of local remedies and the exclusion of the ISDS clause from IIAs. The so called new generation of IIAs could

potentially contribute to this goal as well, as they bring with them an important tool, namely the sustainability impact assessment, that would need to be transparent, independent and continuous in order to be truly effective. After years of ecological degradation, humankind may find its way through a much longed implementation of SD and regain its paradise. It will not be a pristine one, but it will be a possible paradise, still worth saving.

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