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Research Article

THE EROSION OF STATES' RIGHT TO REGULATE IN ISDS

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ABSTRACT

Arbitral awards of ISDS cases have greatly contributed to the emergence of the "regulatory chill" through broad and investor-protection-oriented interpretation of investment treaty provisions. Therefore, it is essential to examine cases concerning the public-interest actions of the states, which shed light on the lessons to be learnt for drafting "balancing provisions". One of these cases is Bear Creek Mining v. Peru. It involves a dispute arising out of circumstances, where the investor seeks damages from the host state for having revoked a permit in response to protests by a local population against the investment operations. This article analyzes how arbitral award of Bear Creek Mining case has contributed to the "regulatory chill" and proposes certain mechanisms aimed at eliminating the "chilling effect" of the treaty provisions.

KEYWORDS

States' right to regulate, investment arbitration, FTAs, interpretation of treaty clauses.

INTRODUCTION

BEAR CREEK MINING CORPORATION v. REPUBLIC OF PERU

Arbitral awards of ISDS cases have greatly contributed to the emergence of the "regulatory chill" through broad and investor-protection-oriented interpretation of investment treaty provisions. Therefore, it is

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essential to examine cases concerning the public-interest actions of the states, which shed light on the lessons to be learnt for drafting "balancing provisions". One of these cases is Bear Creek Mining v. Peru. It involves a dispute arising out of circumstances, where the investor seeks damages from the host state for having revoked a permit in response to protests by a local population against the investment operations.

In this case, a Bear Creek Mining Corporation (Bear Creek), incorporated under the laws of Canada, sought to acquire silver mining rights of the Santa Ana project, located close to the Peru-Bolivia border and indigenous populations in Peru[1]. However, under the Constitution of Peru, a foreign national could not obtain mining rights in border regions without a declaration of "a public necessity" [2]. Therefore, the Bear Creek agreed with one of its Peruvian employees that she would acquire the concession rights in her own name, while Bear Creek as a foreigner obtained a declaration of public necessity[3]. In November 2007, the Bear Creek successfully obtained Supreme Decree 083-2007, which entitled it as a foreigner to own and carry out relevant mining concessions including the Santa Ana Project. [4] However, the mining project was extremely controversial among neighboring indigenous communities in the region, who made constant protests against the project during the period of 2008 and 2011. In the meantime, Bear Creek had carried out an environmental and social impact assessment (ESIA) and it was approved by governmental bodies in 2011, [5] who requested the investor to execute community engagement activities[6]. Accordingly, Bear Creek had conducted consultations with local communities as required by Peruvian law[7]. Nevertheless, the strikes against the ESIA of the Santa Ana project continued to grow requesting its revocation[8]. As a result, the central government intervened so as to deal with these concerns by meeting the representatives of the protestors, which led to the issuance of Supreme Decree 032-2011-EM that annulled Supreme Decree 083-2007 and thus, cancelled authorizations issued to Bear Creek[9]. Consequently, Bear Creek commenced ICSID arbitration against the Republic of Peru pursuant to the investment chapter of the Canada-Peru Free Trade Agreement (Canada-Peru FTA) [10] and claimed that Peru has violated its obligations under the FTA particularly, those pertaining to FET, expropriation and full protection and security[11].

Firstly, Peru made a jurisdictional objection, alleging that the claimant had breached constitutional law when it acquired the concession rights through its employee, which could not be corrected by a subsequent permission[12]. According to Peru, this action of the claimant resulted in the illegality of its investment, which could not be protected under the FTA[13]. Peru grounded its argument about the legality requirement on the "corpus of international law and

[1] *Bear Creek Mining Corporation v. Republic of Peru,* ICSID Case No. ARB/14/21. Award (30 November, 2017) para.140

[2] Ibid para.124
[3] Ibid para.126
[4] Ibid para.149
[5] Ibid paras.152-169
[6] Ibid paras.152-171
[7] Ibid paras. 156-163, 235-238?
[8] Ibid paras.172-201
[9] Ibid para.202
[10] Ibid paras.113-115
[11] Free Trade Agreement between Canada and the Republic of Peru (signed 28 May 2009, entered into force 1 August 2009)
[12] *Bear Creek Mining Corporation v. Republic of Peru* (n 145) para.306
[13] Ibid

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persuasive international arbitration jurisprudence" [14]. However, the tribunal limited its analysis to the wording of the FTA, which states that the host state is entitled to "prescribe special formalities in connection with the establishment of covered investments such as a requirement that investments be legally constituted under the laws or regulations of the Party." [15] Thus, the tribunal held that Peru did not exercise this right and the FTA did not include any jurisdictional requirement for the investment to be established in accordance with national law of Peru. [16] Therefore, it rejected Peru's jurisdictional objection. [17]

Secondly, one of the core allegations of the claimant was that Decree 032 amounted to an indirect expropriation of its investment. [18] In response to this claim, Peru invoked police powers doctrine[19] in order to justify the annulment of the mining rights by stating "the protest made it impossible to maintain the former Decree." [20] Surprisingly, the tribunal considered the police power justification as an exception to the FTA violation rather than examining the absence of an indirect expropriation. [21] In particular, the tribunal based its reasoning on the general exception provision of the FTA, which included an exhaustive list of three exemptions to violations of its investment chapter. [22] Accordingly, it mentioned that "the interpretation of the FTA must lead to the conclusion that no other exception from general international law or otherwise can be considered applicable in this case" [23], thereby excluding the application of the police powers principle of international law. [24] Consequently, the tribunal held that the revocation of the mining rights did not fall under the general exceptions clause and constituted indirect expropriation of the investment. [25]

Lastly, Peru argued that the adoption of the Decree 032 was based on the social unrest that was caused by the claimant's conducts, specifically not taking adequate steps to obtain social license as required by International Labour Organization (ILO) Convention 169. [26] Peru based this argument on Supreme Decree 028-2008-EM, which included Citizen Participation Process (CPP) and referred to ILO Convention 169. [27] The respondent claimed that the recovery should be precluded or should be considered by the Tribunal as a contributory fault and the damages should be reduced accordingly. [28] By contrast, the claimant argued that it imposed direct obligations only on the States, not

[14] Ibid. 302
[15] Canada-Peru FTA (n 155) Article 816
[16] *Bear Creek Mining Corporation v. Republic of Peru* (n 145) para.319
[17] Ibid para.323
[18] Ibid para.371
[19] " Ibid para. 460 The police powers doctrine is a principle of international law, according to which "a State is not liable for takings that may result from legitimate exercises of a State's inherent power to regulate for the protection of safety and public order"
[20] Ibid para. 561
[21] Bernasconi-Osterwalder (n 1) 8
[22] Canada-Peru FTA (n 155) Art.2201 states that "…nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures necessary:
(a) to protect human, animal or plant life or health, which the Parties understand to include environmental measures
necessary to protect human, animal or plant life or health;
(b) to ensure compliance with laws and regulations that are not inconsistent with this Agreement; or
(c) the conservation of living or non-living exhaustible natural resources."
[23] *Bear Creek Mining Corporation v. Republic of Peru* (n 145) para.473
[24] Bernasconi-Osterwalder (n 1) 9
[25] *Bear Creek Mining Corporation v. Republic of Peru* (n 145) para.478
[26] Ibid para.251
[27] Ibid para.238
[28] Ibid para.564

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private corporations. [29] The tribunal concurred with the respondent's argument by mentioning that "claimant could have gone further in its outreach activities … to obtain social licence", [30] but the relevant question was whether the respondent legally required the claimant to take these additional steps, which the tribunal eventually refused. [31]

However, co-arbitrator Professor Sands had a conflicting view on the matter of contributory fault. Specifically, in his Partial Dissenting Opinion, he asserted that the acts and omissions of Bear Creek contributed in material ways to the social unrest that gave a rise to the issuance of Decree 032. [32] He highlighted that the claimant was responsible for acquiring a social license by making an extensive reference to ILO Convention 169 relating to Indigenous and Tribal Peoples in Independent countries. [33] Thus, he concluded that the Convention may not directly impose responsibilities on foreign investors, but as such could not mean that "it is without relevance or legal effects for them" and suggested to reduce the proposed damage by half. [34] Nevertheless, the amount of damages was not reduced by the tribunal and the claimant was awarded US$18,237,592. [35]

Lessons Learned from Arbitral Award of Bear Creek Mining v. Peru

There are a number of investment arbitration cases related to states' right to regulate or not giving permit due to environmental reasons. [36] According to developments of international law if the harm of international investment is more than its benefit there won't be any impediment to cancel the Project if only the proof of harm could be seen (come in sight) after the establishment of the investment. [37] In Bear Creek Mining v. Peru case, the arbitral tribunal addressed a number of legal issues that are relevant for the protection of states' regulatory power. The interpretation of certain treaty provisions by the tribunal enables to identify the deficiencies of the language used for drafting treaty clauses and informs about its consequences.

To begin with, the tribunal did not take into account the legality of investment in determining the right of Bear Creek to benefit from FTA protection. It grounded its reasoning on the lack of specific requirement in FTA for the investment to be established in accordance with the national law of the host state. [38] Thus, the tribunal extended availability of treaty protection to unlawfully established investments as well. As it was mentioned earlier, the rationale for the protection of foreign investments by means of IIAs was their contribution to the development of the contracting state parties. Since the preamble of the Canada-Peru FTA also demonstrates sustainable development

[29] Ibid para.241
[30] Ibid para.408
[31] Ibid
[32] *Bear Creek Mining Corporation v. Republic of Peru*, ICSID Case No. ARB/14/21, Partial Dissenting Opinion of Philippe Sands (30 November, 2017) paras.4-6

[33] He referred to consultation requirements provided by article 15 of the Convention and mentioned that:
"It may be the function of a State or its central government to deliver a domestic law framework that ensures that a consultation process and outcomes are consistent with Article 15 of ILO Convention 169, but it is not their function to hold an investor's hand and deliver a 'social license' out of those processes. It is for the investor to obtain the 'social license', and in this case it was unable to do so because of its own failures." Ibid paras.7-9
[34] Ibid para. 10
[35] Ibid para.661
[36] *Murpheyores Inc. v. Commonwealth; International Bank of Washington v. OPIC; Ethyl Corporation v. Canada; Metalclad v. Mexico*
[37] Tiryakioğlu, Bilgin, Doğrudan Yatırımların Uluslararası Hukukta Korunması, Dayınlarlı, Ankara, 2003, p. 87-88.
[38] Ibid para.319

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objectives of the contracting parties, [39] it is difficult to assume that the parties intended to extend its application to the protection of illegal investments. This is because such investments undermine good governance within the host state instead of contributing to its development. [40] Therefore, specific legality requirements must be explicitly drafted in IIAs by excluding not only unlawfully established investments, but also investments involving unlawful activities after the establishment from the protection of IIAs.

Furthermore, the arbitral tribunal was unwilling to integrate principles of general international law[41] such as police powers doctrine, while interpreting general exceptions clause of the FTA. Specifically, it called three exceptions included in the FTA as an "exhaustive list" and totally excluded the application of the police powers doctrine. [42] This exclusion can be considered as an excessive restriction of state's right to regulate by ISDS. In order to prevent such kind of interpretation, IIAs containing exception clauses must expressly mention that the list of exceptions is not exhaustive and any relevant rules of international law can be applicable when the state's right to regulate is at issue.

Moreover, the award is significant for finding that foreign investors do not have obligations under the international law in the context of acquiring social license to operate, as long as they are engaged in community consultations in accordance with domestic laws. However, the conflicting approaches taken by the members of the Tribunal demonstrate ongoing changes with regard to the consideration of foreign investors' obligations in international investment law. [43] In order to ensure effective application of the contributory fault principle, [44] IIAs must incorporate investor obligations by obliging them to comply with international obligations of the host states such as human rights, labour and environmental obligations. [45]

CONCLUSION

This article critically examined arbitral award of Bear Creek Mining v. Republic of Peru case concerning the public-interest actions of states. This arbitral award was based on investment-protection-oriented interpretation of the protection standards. Therefore,

[39] The preamble of Canada-Peru FTA 2009
[40] Stefanie Schacherer 'Metal-Tech v. Uzbekistan' (2018) Investment Treaty News < https://www.iisd.org/itn/2018/10/18/metal-tech-v-uzbekistan/> accessed 20 February 2021
[41] According to the general rule of interpretation of VCLT 1969, "for the purpose of the interpretation of the treaty ….any relevant rules of international law applicable in the relations between the parties shall be taken into account" Art.31 (3)(c). Thus, the tribunal had an option to integrate the police powers doctrine through the systematic integration approach.
[42] *Bear Creek Mining Corporation v. Republic of Peru* (n 145) para.473
[43] Jean-Michel Marcoux and Andrew Newcombe 'Bear Creek Mining Corporation v Republic of Peru: Two Sides of a 'Social License' to Operate' (2018) 33 (3) ICSID Review pp.659
[44] This principle is included in Article 39 of the International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts ("ILC Articles"): "In determination of reparation, account shall be taken of the contribution to the injury by wilful or negligent action or omission of the injured State or any person or entity in relation to whom reparation is sought."
[45] Investors' obligations as such take part in Model BITs and IIAs. For instance, Turkish Model of Bilateral Investment Treaty 2009 art. 4; Agreement Between the Government of the Republic of Uzbekistan and the Government of the Republic of Türkiye Concerning the Reciprocal Promotion and Protection of Investments, art. 5/1. Ener, Mustafa Alper, Uluslararası Yatırım Hukuku, Seçkin Yayıncılık, Ankara, 2021, p. 249-250.

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Bear Creek Mining v. Republic of Peru case was selected in order to assess the "chilling effect" of broad interpretations and to identify shortages of treaty mechanisms allowing such interpretation. Accordingly, it highlighted sensitive points of the treaty language and proposed certain mechanisms aimed at eliminating the "chilling effect" of the treaty provisions. Specifically, while negotiating and writing IIAs, states should take into account the interpretation of treaties by arbitral tribunals and their right to regulate resulted from their sovereignty. Lessons taken from this case are states should expressly mention list of exceptions as not exhaustive; they should keep in mind that the application of relevant rules of international law shouldn't be allowed in order to protect themselves from undesired outcome; they should clearly put pen to paper.

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