QUENCHING THE THIRST:
INTERNATIONAL INVESTMENT LAW
AND FRESHWATER REFORM IN NEW ZEALAND

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"Wars of the next century will be over water."

Ismail Serageldin, former World Bank vice president for Environmentally Sustainable Development.

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ABSTRACT

Freshwater availability and management presents itself as one of the most pressing issues on today's global agenda. A recent study has found that by 2030, human demand for freshwater will exceed available supply by approximately 40 per cent. This will place freshwater at the centre of an unprecedented power struggle between states, corporations and communities. Underlying this fast-approaching global freshwater crisis is arguably a fundamental issue of poor management. Therefore, there is an urgent need for national governments and international institutions to reconsider how water security should be reflected in domestic and global arrangements. The New Zealand Government answered this call to action in March 2013, releasing 'Freshwater reform 2013 and beyond' – a package of proposals representing the most comprehensive reform of our freshwater management system for a generation. However, with increasing trends in foreign investment, the obligations New Zealand owes to foreign investors under international investment agreements become highly relevant to any proposed reform measures. This dissertation critically examines New Zealand's international investment regime, illustrating the ways in which it might constrain the Government in its implementation of the package of reforms in 'Freshwater reform 2013 and beyond.'

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ABBREVIATIONS

AANZFTA	Agreement establishing the ASEAN-Australia-New Zealand Free Trade Area
BIT	Bilateral Investment Treaty
CEP	Closer Economic Partnership
CER	Australia-New Zealand Closer Economic Relations Trade Agreement
FET	Fair and Equitable Treatment
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services (WTO)
GATT	General Agreement on Tariffs and Trade (WTO)
ICSID	International Centre for the Settlement of Investment Disputes
IIA	International Investment Agreement
ISDS	Investor-State Dispute Settlement
MFN	Most-Favoured-Nation (Treatment)
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
OIA	Overseas Investment Act 2005 (NZ)
OIO	Overseas Investment Office (NZ)
RMA	Resource Management Act 1991 (NZ)
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

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Introduction

Freshwater availability and management is one of the most pressing issues on today's global agenda. A recent study has found that within just two decades, human demand for freshwater will exceed supply by approximately 40 per cent.[1] This will place freshwater at the centre of an unprecedented power struggle between states, corporations and communities.

National governments and international institutions are responsible for shaping the environment in which these diverse interests operate. However, they have often not thought ahead as to how domestic and global arrangements should reflect water security in their incentives.[2] As a result, water has been used wastefully and inefficiently, and global trading patterns are completely misaligned with freshwater resources – the world's top ten food exporters are water-scarce countries.[3]

Already, state and corporate actors have taken matters into their own hands, utilising trade and investment mechanisms in an attempt to lock in future access to freshwater. As a result, international investment agreements have become increasingly relevant to this power struggle.[4] These agreements afford special protections and dispute resolution processes to foreign investors, and have often been criticised for restricting a government's ability to act in the broader public interest.[5]

In March 2013, the New Zealand Government acknowledged the issue of water scarcity in its release of the discussion document 'Freshwater reform 2013 and beyond'.[6] This document

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[1] 2030 Water Resources Group "Charting Our Water Future: Economic frameworks to inform decision-making" (2009) 2030 Water Resources Group <www.2030wrg.org> at 5.

[2] Dominic Waughray (ed) *Water Security: The Water-Food-Energy-Climate Nexus: The World Economic Forum Water Initiative* (Island Press, Washington DC, 2011) at 1 [*Water Security*].

[3] *Water Security*, above n 2, at 1.

[4] Global foreign direct investment inflows have increased from US$207 million in 1990 to US$1.35 billion in 2012: United Nations "World Investment Report 2013: Global Value Chains: Investment and Trade for Development" (2013) UNCTAD <www.unctad.org>.

[5] See Miguel Solanes and Andrei Jouravlev "Revisiting privatization, foreign investment, international arbitration, and water" (November 2007) United Nations Economic Commission for Latin America and the Caribbean <www.eclac.org> at 5; "Jane Kelsey: Trading sovereignty for short-term advantage" *The New Zealand Herald* (online ed, Auckland, 8 November 2010); David Schneiderman *Constitutionalizing Economic Globalization: Investment Rules and Democracy's Promise* (Cambridge University Press, Cambridge, 2008); Public Statement on the International Investment Regime (31 August 2010) Osgoode Hall Law School <http://www.osgoode.yorku.ca/public_statement>.

[6] Ministry for the Environment *Freshwater reform 2013 and beyond* (March 2013).

"contains the Government's proposals for the most comprehensive and positive reform of our freshwater management system for a generation".[7] However, will New Zealand's international investment regime constrain the Government in its introduction of measures for the sustainable management of our freshwater resources?

This paper sets forth the principal elements of New Zealand's international investment regime, and examines how they may intervene in the freshwater reform process.

Chapter I forms an introduction to the issue of freshwater availability and management both globally and in New Zealand, emphasising the links that freshwater has with investment activity and international investment law.

Chapter II then sets out the three principal sources of law governing foreign direct investment in New Zealand.

Chapter III details the key foreign investment protections in New Zealand's international investment agreements, and how they might apply in the context of freshwater. Chapter IV then consolidates this analysis, providing a focussed examination of possible legal challenges to the Government's proposed freshwater reform measures.

This paper will conclude by acknowledging that New Zealand's international investment regime does have the potential to constrain the Government in several aspects of its freshwater reform agenda. Accordingly, awareness of New Zealand's international investment obligations should be raised at all levels of government to ensure such constraints are appropriately managed.

[7] *Freshwater reform 2013 and beyond*, above n 6, at 5.

Chapter I: Freshwater – Managing the Growing Global Thirst

A. The 'Global Freshwater Crisis' and its Links with Trade and Investment

> In 1911, John Muir observed how, "When we try to pick out anything by itself in nature, we find it hitched to everything else in the Universe." A century later, a gathering of the World Economic Forum discovered the same phenomenon. Four hundred top decision-makers listed the myriad looming threats to global stability, including famine, terrorism, inequality, disease, poverty, and climate change. Yet when we tried to address each diverse force, we found them all attached to one universal security risk: fresh water.
>
> *Margaret Catley-Carlson, Patron, Global Water Partnership, 2008–2010 Chair of World Economic Forum Global Agenda Council on Water Security.*

'Water security', at its simplest, refers to the capacity of a population to sustainably provide adequate quantities of acceptable quality water for health, livelihoods and development.[8] However, in recent times mankind has used water in an unsustainable manner – using it as if it might never run out, depleting and polluting it. It is time to face the facts.

Of current global water withdrawals, 71 per cent are attributable to agriculture.[9] Industrial withdrawals account for 16 per cent, but are expected to grow to 22 per cent of global demand by 2030 as the production of technology and consumer goods continues to develop.[10] Not only will there be competition between *uses*, there will also be competition between *users*, as our world population of 7.2 billion in 2013 is projected to increase to 8.1 billion by 2025, and 9.6 billion by 2050.[11] Furthermore, the diet of this population is shifting so that annual meat consumption is expected to increase from an average of 37.4kg per person in 2000 to over 52kg per person by 2050.[12] While it takes approximately 1,300 litres of water to

[8] See David Grey and Claudia Sadoff "Sink or Swim? Water security for growth and development" (2007) 9 Water Policy 545; UN-Water Task Force on Water Security "Water Security and the Global Water Agenda – A UN-Water Analytical Brief" (2013) UN-Water <www.unwater.org> at vi.
[9] 2030 Water Resources Group, above n 1, at 6.
[10] 2030 Water Resources Group, above n 1, at 6.
[11] "UN World Population Prospects: The 2012 Revision" (2013) United Nations, Department of Economic and Social Affairs, Population Division, Population Estimates and Projections Section <www.esa.un.org/wpp/> at xv.
[12] Christian Nellemann and others (eds) "The Environmental Food Crisis: The Environment's Role in Averting Future Food Crises: A UNEP Rapid Response Assessment" (2009) United Nations Environment Programme <www.unep.org> at 17.

produce one kilogram of wheat; it takes between 10,000 and 20,000 litres of water to produce one kilogram of beef.[13]

Therefore, a rapidly growing population, shifting consumer preferences and large-scale industrialisation are placing unprecedented pressure on freshwater resources. Studies predict that by 2030, only 17 years from now, global water requirements will be 40 per cent above current accessible, reliable supply.[14] Add to this the uncertain effects that climate change will have on freshwater availability, and it becomes clear why commentators are labelling this a looming global freshwater crisis.[15]

As a result, many state and corporate entities have been utilising trade and investment mechanisms to address water scarcity issues. Trade avenues create the potential to solve local water shortages, as water-scarce countries may 'virtually' import the water needed to meet demand.[16] To illustrate, rather than using 1,300 litres of water to produce one kilogram of wheat at home, a water-scarce country can 'virtually' import 1,300 litres of water by simply importing one kilogram of wheat. This concept is not restricted to agricultural products; it can be extended across all kinds of products and services that a water-scarce economy requires.

Given 'virtual water', trade appears to be a viable solution to water scarcity. However, this is tragically not the case. Water-abundant countries may only service the export demands of water-scarce countries up to a certain point, beyond which they themselves may begin to experience water shortages. Shortages inevitably spur protectionist measures, such as those seen in 2008 when volatility in global food prices led to over 40 countries imposing export bans to improve domestic food security.[17] Given the tendency for countries to prioritise their own food and water security over trade liberalisation, it has been warned that "countries

[13] *Water Security*, above n 2, at 68.
[14] 2030 Water Resources Group, above n 1, at 5.
[15] See Maude Barlow and Tony Clarke *Blue Gold: The Battle Against Corporate Theft of the World's Water* (Earthscan Publications Ltd, London, 2002) at xii [*Blue Gold*]. For discussion of the uncertain effects of climate change on freshwater and other aspects of the natural and human environment, see Martin Parry and others (eds) "Climate Change 2007: Impacts, Adaptation and Vulnerability. Contribution of Working Group II to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change" (2007) Intergovernmental Panel on Climate Change <www.ipcc.ch> at 8-20.
[16] 'Virtual water' was conceived by Professor Tony Allan of Kings College and the School of Oriental and African Studies in London. It refers to the water used in the production of a good or service: *Water Security*, above n 2, at 69.
[17] "Soaring food prices jeopardizing UN's ability to feed the world's hungry" *UN News Centre* (online ed, 24 April 2008).

would indeed be risking their futures if they decided to rely on the global market for their food supplies".[18]

As a result, water-scarce countries are turning to direct investment in agricultural land overseas to grow the crop they need to export back home. For example, Hassad Food, a US$1 billion company established by a Qatar sovereign wealth fund, has so far acquired farmland in Australia and Sudan, and has intentions for further acquisitions in Turkey, Brazil, Vietnam, Pakistan and India.[19] Corporations are also involved in these transactions, which are occurring at an astounding rate.[20] Daewoo Logistics was involved in one of the largest and most famous deals that ultimately collapsed due to political upheavals.[21] It had been seeking a 99-year lease to grow crops on 1.3 million hectares of farmland in Madagascar. However, other megadeals have since been completed, with the United Arab Emirates Sayegh Group announcing in September 2009 that it had acquired 1.5 million hectares of agricultural land in the Nile Delta of Sudan.[22] These deals have been labelled 'land grabs', and while, early on, the trend was portrayed as rich countries 'grabbing up' land of poor developing nations, this has turned out to be a naïve picture – keen interest in New Zealand and Australian farmland undermines the perception that it is only the developing world being targeted.[23] The Hassad Group referred to above has acquired 750,000 hectares of farmland in Australia, and in recent years, New Zealand has completed land deals with investors from China, Australia, Germany, Denmark, Italy, Switzerland, the US and the UK.[24]

[18] Biswajit Dhar "Agricultural Trade and Government Intervention: A Perspective from a Developing Country" in *Agricultural Trade: Planting the Seeds of Regional Liberalization in Asia: A Study by the Asia-Pacific Research and Training Network on Trade (Studies in Trade and Investment No. 60)* (United Nations, 2007) 211 at 220.

[19] "GRAIN releases data set with other 400 global land grabs" (23 February 2012) GRAIN <www.grain.org> at 5 ["GRAIN land deals summary"].

[20] In 2012, the International Land Coalition (ILC) presented data suggesting that 203 million hectares' worth of land deals were approved or under negotiation between 2000 and 2010: Ward Anseeuw and others "Land Rights and the Rush for Land: Findings of the Global Commercial Pressures on Land Research Project" (January 2012) International Land Coalition <www.landcoalition.org>.

[21] See Tom Burgis and Javier Blas "Madagascar scraps Daewoo Farm Deal" *The Financial Times* (online ed, London, 18 March 2009).

[22] "GRAIN land deals summary", above n 19, at 53.

[23] Michael Kugelman and Susan Levenstein (eds) *The global farms race: land grabs, agricultural investment, and the scramble for food security* (Island Press, Washington DC, 2013) at 2; see also "GRAIN land deals summary", above n 19.

[24] "GRAIN land deals summary" above n 19.

While these deals have been labelled 'land grabs', they might better be described as 'water grabs'.[25] Many countries have plenty of land; but not necessarily sufficient water to make it cultivable land. One commentator has said that: "In essence, early movers are seeking to lock in access to water for agriculture with investments in states perceived to have a surplus of water today."[26] The World Economic Forum has described this as a "new and potentially significant trend – the virtual water thesis writ large".[27] However, land acquisitions are not the only concern. Freshwater is inextricably linked to all kinds of investment activities that are water-intensive, or where water is an essential input. Industrial, energy and mining activities are water-intensive, with approximately 400,000 litres of water needed to produce one car.[28] Investment in a car manufacturing plant abroad and acquisition of any associated water rights could therefore also represent an instance of a 'water grab'.

While this 'water grab' trend is undoubtedly driven by water scarcity, at its heart it reflects an underlying structural problem – the failure of national governments and the wider global economy to adequately manage freshwater resources. It is therefore a management challenge, "a factor that we as human societies can control – that threatens our economies, human life and health, and natural ecosystems".[29] What then, should be done to address this situation? The answer emerging from the literature is that governments must lead the agenda for freshwater management reform.[30] This is because water has "potent social, cultural, and religious dimensions" that require government oversight and regulation; "an unfettered reliance on markets will not deliver the social, economic, and environmental outcomes needed".[31] However, while governments must lead the agenda, a collaborative, multi-stakeholder approach is ultimately required.

The most promising approaches so far have targeted and transformed incentive structures so that the best quality water naturally ends up being allocated to high-value activities. For

[25] See David Williams "NZ's water attracts Chinese dairy investment" *The National Business Review* (online ed, New Zealand, 25 January 2013); "Squeezing Africa dry: behind every land grab is a water grab" (11 June 2012) GRAIN <www.grain.org>.
[26] Carin Smaller and Howard Mann "A Thirst for Distant Lands: Foreign investment in agricultural land and water" (May 2009) International Institute for Sustainable Development <www.iisd.org> at 5 ["A Thirst for Distant Lands"].
[27] *Water Security*, above n 2, at 73.
[28] Joanne Zygmunt "Hidden Waters: embedded water and water footprints" (February 2007) Waterwise <www.waterwise.org.uk> at 6.
[29] 2030 Water Resources Group, above n 1, at 24.
[30] See *Water Security*, above n 2; 2030 Water Resources Group, above n 1.
[31] *Water Security*, above n 2, at 2.

example, the Murray-Darling basin project in Australia rewards those who volunteer to give up some or all of their water rights,[32] and Israel has incentivised the purchase and reuse of grey water[33] for agricultural irrigation.[34] Lessons can also be learned from history – in Aflaj in Oman, tradable water rights among farmers have created incentives for sustainable and efficient agricultural irrigation practices for more than 4,500 years.[35]

What is important to emphasise, is that a collaborative, multi-stakeholder reform of freshwater management will engage with foreign direct investment (FDI) on several levels. There is the opportunity for FDI to be utilised in developing more efficient freshwater technologies and systems; however, FDI protections may also frustrate the implementation of governmental freshwater reforms. The latter is an issue that has yet to be comprehensively examined in the context of New Zealand's international investment regime; however such an examination is necessary when formulating water policy and regulations, granting water permits, and entering into investment contracts for activities related to water. Such an examination is also very timely given the release in March this year of the discussion document 'Freshwater reform 2013 and beyond'.

It will therefore be necessary to canvas New Zealand's current system and intended reforms for freshwater management, before moving on to consider how our international investment regime may intervene in the reform process.

B. Freshwater Availability and Management in New Zealand

> Fresh water matters to all New Zealanders. It is central to the environment, the economy and our identity. It is a key aspect of who New Zealanders are and what they bring to the world.
>
> *Freshwater reform 2013 and beyond*

[32] The Australian Government has committed A$3.1 billion to the 'Restoring the Balance in the Murray-Darling Basin program' to purchase water for the environment from irrigators who offer their water entitlement for sale. See "Restoring the Balance in the Murray-Darling Basin" Australian Government, Department of the Environment <www.environment.gov.au/water/>.
[33] Grey water refers to treated sewer water.
[34] *Water Security*, above n 2, at 28.
[35] Montgomery F Simus and James G Workman "The Wealth of Thirsty Nations" in Scott G McNall, James C Hershauer, and George Basile (eds) *The Business of Sustainability: Trends, Policies, Practices and Stories of Success* (ABC-CLIO LLC, Santa Barbara (California), 2011) 47 at 58.

New Zealand is a country with an abundance of natural resources and it places great emphasis on its 'clean green image' as a source of competitive advantage in the global market. Freshwater in particular, is one of New Zealand's most important assets. In 2012, primary industries dependent on freshwater accounted for more than 12 per cent of GDP and over 52 per cent of total exports.[36] The tourism industry also relies heavily on the beauty of New Zealand's water, and approximately 58 per cent of New Zealand's electricity comes from hydropower stations.[37] Therefore, given the value of freshwater to New Zealand and its importance to a range of users, it is essential for it to be managed in a sustainable way.

1. Current Approach to Freshwater Management

Freshwater resources in New Zealand are currently managed under the Resource Management Act 1991 (RMA),[38] The purpose of the Act is "to promote the sustainable management of natural and physical resources",[39] and it defines "water" very broadly to include "water in all its physical forms whether flowing or not and whether over or under the ground", "fresh water, coastal water, and geothermal water", but not water "in any form while in any pipe, tank, or cistern".[40]

The RMA contemplates that the national government will provide strategic direction on management issues through National Policy Statements and setting National Environmental Standards;[41] however, primary responsibility for integrated management of freshwater resources is devolved to local government bodies.[42]

The starting point of the RMA with respect to freshwater is that, unless an activity is expressly allowed by a rule in a regional plan or an exception in the Act, a resource consent must be obtained for the taking and use of water, or the discharge of contaminants into it.[43]

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[36] *Freshwater reform 2013 and beyond*, above n 6, at 7.
[37] *Freshwater reform 2013 and beyond*, above n 6, at 7.
[38] Resource Management Act 1991 [RMA].
[39] RMA, s 5(1).
[40] RMA, s 2(1).
[41] RMA, s 24; see also Neil Gunningham *Innovative Governance and Regulatory Design: Managing Water Resources* (Landcare Research New Zealand Ltd, LC0708/137, 2008) at 15-16.
[42] RMA, ss 30, 31; New Zealand has a unitary system of government, with the national government capable of delegating some of its powers to the regional and territorial levels. The last two are collectively referred to as local government: see Gunningham, above n 41, at 13, footnote 14.
[43] See RMA, ss 14, 15, 87A.

The main exception provided for in the Act is the taking of water for an individual's "reasonable domestic use".[44]

Therefore, local government bodies have significant power to control the allocation and use of freshwater through the creation and enforcement of rules and guidelines in regional plans.[45] Regional councils are also responsible for the granting of resource consents, and must evaluate the "actual and potential effects on the environment of allowing the activity" in assessing consent applications.[46] With regard to groundwater takes in particular, case law provides that this involves evaluation of: [47]

> . . . issues relating to [the groundwater's] nature, its quality and quantity, its linkages to surface water and its responses to natural fluctuations in rainfall and river recharge and to abstractions by wells.

When it was enacted, the RMA was hailed as a world-leading piece of legislation.[48] However, several issues have arisen since its enactment warranting serious attention, especially in relation to freshwater management.[49] For example, allocation of water resource consents (water permits) on a 'first-come first-served' basis, coupled with the fact that water is 'free', provides no incentive for those who 'come first' to limit their demand.[50] Instead, there is incentive to ask for more than is required, denying access to later applicants who may be equally or more deserving of the water rights. This has led to inefficiency and a failure to allocate water to its highest value use.[51] Also of concern is the declining quality of water, with 44 per cent of monitored freshwater bathing sites recently reported as 'poor' or 'very poor', and strong increasing trends in phosphorus and nitrogen levels in some catchments.[52]

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[44] RMA, s 14(1); note however, this exception will only apply so long as the domestic use does not, or is not likely to, have an adverse effect on the environment.
[45] RMA, s 30.
[46] RMA, s 104(1)(a).
[47] *Lynton Dairy Ltd v Canterbury Regional Council* EnvC Christchurch C108/2005, 22 August 2005 at [66].
[48] See Ton Buhrs and Robert Bartlett *Environmental Policy in New Zealand: The Politics of Clean and Green?* (Oxford University Press, Auckland, 1993); P Memon and B Gleeson "Towards a new planning paradigm? Reflections on New Zealand's Resource Management Act" (1995) 22(1) Environment and Planning B: Planning and Design 109.
[49] See generally Gunningham, above n 41.
[50] Gunningham, above n 41, at 19.
[51] James Lennox, Wendy Proctor and Shona Russell "Structuring stakeholder participation in New Zealand's water resource governance" (2011) 70 Ecological Economics 1381, at 1383; see also Gunningham, above n 41.
[52] *Freshwater reform 2013 and beyond*, above n 6, at 13.

Freshwater issues were first acknowledged by the New Zealand Government in 2009 through the initiation of the 'New Start for Fresh Water' programme and the setting of a strategic direction for freshwater reform.[53] At this time, the Land and Water Forum was commissioned to conduct a stakeholder-led collaborative process to consider reform of our freshwater management system.[54] Based on several reports produced by this Forum, and following on from a 2011 National Policy Statement for Freshwater Management,[55] the Government finally released its proposals in March 2013 for the comprehensive reform of freshwater management in New Zealand in the document 'Freshwater reform 2013 and beyond'.[56]

2. 'Freshwater Reform 2013 and Beyond'

'Freshwater reform 2013 and beyond' is envisioned to be the "most comprehensive and positive reform of our freshwater management system for a generation".[57] The paper sets out the Government's immediate intended actions for freshwater reform, and indicates proposals that will be developed and implemented over time.[58] The immediate and next-step reforms are grouped into three key areas: planning as a community; a National Objectives Framework; and managing within quantity and quality limits.[59]

Many of the immediate reforms involve procedural aspects of the RMA, such as planning and information processes;[60] however several of the next-step reforms may interfere more directly with water permits and water users' rights. For example, in areas where freshwater is over-allocated, the Government suggests reducing all permits by the same amount or on a pro rata basis to bring use within the limit.[61] This type of action directly interferes with existing water rights, and, where these are in the hands of foreign investors, the effect of protections in international investment agreements becomes directly relevant. As one commentator

[53] See "Backgrounder on 'New Start for Fresh Water' Cabinet paper" (24 September 2009) Ministry for the Environment <www.mfe.govt.nz>.
[54] Nick Smith and David Carter "Fresh water reform process announced" (press release, 8 June 2009). The Land and Water Forum is made up of a range of industry groups, environmental and recreational NGOs, iwi, scientists, and other organisations with a stake in freshwater and land management: for further information see <www.landandwater.org.nz>.
[55] *Freshwater reform 2013 and beyond*, above n 6, at 8.
[56] *Freshwater reform 2013 and beyond*, above n 6, at 8.
[57] *Freshwater reform 2013 and beyond*, above n 6, at 5.
[58] *Freshwater reform 2013 and beyond*, above n 6, at 9.
[59] *Freshwater reform 2013 and beyond*, above n 6, at 10.
[60] See *Freshwater reform 2013 and beyond*, above n 6.
[61] *Freshwater reform 2013 and beyond*, above n 6, at 41.

acknowledged, implementing new mechanisms for freshwater management can be "controversial and not immune from legal challenge, particularly when implementation implies a review of existing allocations and a re-allocation of resources".[62]

The next chapter will outline the three sources of law that govern FDI in New Zealand with a view to establishing which sources may attract legal challenges, or constrain the Government in its implementation of the reforms in 'Freshwater reform 2013 and beyond'.

[62] Stefano Burchi "A comparative review of contemporary water resources legislation: trends, developments and an agenda for reform" (2012) 37(6) Water International 613 at 623; see also Gunningham, above n 41, at 9.

Chapter II: Governance of Foreign Direct Investment in New Zealand

New Zealand has adopted an open stance towards foreign direct investment (FDI) since the economic reforms of the 1980s.[63] If managed properly, FDI can be incredibly beneficial, providing scope for higher levels of economic activity, employment and global competitiveness than could be achieved from domestic levels of savings.[64] If managed poorly however, FDI can result in negative externalities, bad publicity and a source of direct legal challenge against host states.[65]

Three sources of law govern FDI in New Zealand: domestic law; investment contracts; and international investment agreements (IIAs). Of these sources, New Zealand's IIAs are likely to be the principal constraint on the Government's introduction of freshwater reforms.

A. Domestic Law

The primary source of law governing FDI in New Zealand is domestic law. The domestic law system includes laws relating to the admission of foreign investment, taxation, property, resource management, and those regulating the impacts of the investment on society, such as environmental, health and safety, and labour laws.

The RMA clearly plays a crucial role in governing freshwater use by investors; however this section will focus on the law relating to the admission of foreign investment. This is important to discuss because of the existence of IIAs which impose significant obligations on the Government to protect foreign investment. Because these obligations are owed for the full lifetime of an investment, and are owed at all levels of government, the implications of each obligation are extensive and potentially burdensome given the uncertain nature of long-term investments. It is therefore vital to set the right domestic law framework for initial decisions on the admission of foreign investment.

[63] Peter Enderwick "Inward FDI in New Zealand and its policy context" (July 2012) Vale Columbia Center on Sustainable International Investment <www.vcc.columbia.edu> at 1.
[64] See generally "Foreign Direct Investment for Development: Maximising Benefits, Minimising Costs" (2002) OECD <www.oecd.org> ["FDI for Development"].
[65] "FDI for Development", above n 64.

1. The Overseas Investment Regime

New Zealand welcomes most foreign investment; however there is a screening regime contained in the Overseas Investment Act 2005 (OIA)[66] and its accompanying regulations[67] for certain transactions of critical interest involving "overseas persons"[68] and their "associate[s]".[69] The screening regime requires consent from the Overseas Investment Office (OIO) for any transaction involving an overseas investment in sensitive New Zealand assets, defined as: sensitive land or an interest in sensitive land; significant business assets; or fishing quota or an interest in fishing quota.[70] The screening regime is therefore targeted, and investments outside these asset categories do not require OIO consent.

Land will be considered sensitive if it comes within the types of land and area thresholds detailed in the Act.[71] The types of land considered sensitive include non-urban land in excess of 5 hectares, the foreshore and seabed, land held for conservation purposes, and land subject to heritage orders.[72] Significant business assets are considered to be securities or business

[66] Overseas Investment Act 2005 [OIA].
[67] Overseas Investment Regulations 2005.
[68] The OIA, s 7(1) provides that "persons are overseas persons if they themselves are overseas persons (for example, not a New Zealand citizen or resident or, for companies, incorporated overseas) or they are 25% (or more) owned or controlled by an overseas person or persons" as defined in s 7(2).
[69] The OIA, s 8(1) provides that "a person (A) is an associate of another person (B) in relation to an overseas investment or any other matter if: (a) A is controlled by B or is subject to B's direction: (b) A is B's agent, trustee, or representative, or acts in any way on behalf of B, or is subject to B's direction, control, or influence, in relation to the overseas investment or the other matter: (c) A acts jointly or in concert with B in relation to the overseas investment or the other matter: (d) A participates in the overseas investment or the other matter as a consequence of any arrangement or understanding with B: (e) A would come within any of paragraphs (a) to (d) if the reference to B in any of those paragraphs were instead a reference to another associate of B."
[70] OIA, s 10.
[71] OIA, s 12(a)(i); s 12(a)(ii) also requires that "the interest acquired is a freehold estate or a lease, or any other interest, for a term of 3 years or more (including rights or renewal, whether of the grantor or grantee), and is not an exempted interest"; s 12(b) further states an overseas investment will be an investment in sensitive land if the person, or persons' associate, acquires "rights or interests in securities of a person (A) if A owns or controls (directly or indirectly) an interest in land" as described above, and "as a result of the acquisition, - (i) the overseas person or the associate (either alone or together with its associates) has a 25% or more ownership or control interest in A; or (ii) the overseas person or the associate (either alone or together with its associates) has an increase in an existing 25% or more ownership or control interest in A; or (iii) A becomes an overseas person".
[72] OIA, Part 1 Schedule 1 Table 1.

assets with a value exceeding $NZ100 million,[73] and investments in fishing quota will require consent in accordance with relevant sections of the Fisheries Act 1996.[74]

In the recently concluded Investment Protocol to the Australia-New Zealand Closer Economic Relations Trade Agreement (CER), New Zealand has extended preferential screening thresholds to Australian investors. This has direct consequences for the operation of the OIA. Whereas consent is usually required for investment in business assets with a value exceeding NZ$100m, Australian investors can now invest up to NZ$477m without prior approval.[75] This effectively reduces control over inward FDI in sensitive business assets, eliminating the potential ability of the OIO to consider freshwater implications of Australian investments under NZ$477m before they are permitted. As Australia is New Zealand's largest contributor of FDI, this effect may be significant.[76] However, as the preferential threshold applies to business assets only, Australian investors will still have to seek approval for investments in sensitive land and fishing quota.

The OIO's role in administering the OIA is to assess applications for overseas investments in sensitive New Zealand assets, and advise the relevant Ministers as to whether or not consent

[73] OIA, s 13. Section 13 provides that an overseas investment in significant business assets is "(a) the acquisition by an overseas person, or an associate of an overseas person, of rights or interests in securities of a person (A) if - (i) as a result of the acquisition, the overseas person or the associate (either alone or together with its associates) has a 25% or more ownership or control interest in A or an increase in an existing 25% or more ownership or control interest in A; and (ii) the value of the securities or consideration provided, or the value of the assets of A or A and its 25% or more subsidiaries, exceeds $100 million; or (b) the establishment by an overseas person, or an associate of an overseas person, of a business in New Zealand (either alone or with any other person) if - (i) the business is carried on for more than 90 days in any year (whether consecutively or in aggregate); and (ii) the total expenditure expected to be incurred, before commencing the business, in establishing that business exceeds $100 million; or (c) the acquisition by an overseas person, or an associate of an overseas person, of property (including goodwill and other intangible assets) in New Zealand used in carrying on business in New Zealand (whether by 1 transaction or a series of related or linked transactions) if the total value of consideration provided exceeds $100 million".

[74] OIA, s 10(2).

[75] Protocol on Investment to the Australia-New Zealand Closer Economic Relations Trade Agreement (signed 16 February 2011, entered into force 1 March 2013), Annex 1, I-NZ-2 [CER Investment Protocol].

[76] During the period 2005 to 2010, it is estimated that at least 90 Australian investment applications would not have been required had the CER Investment Protocol not been in place. Data suggests that the Protocol will therefore reduce applications for investment in sensitive business assets from Australian investments by around two-thirds: "Protocol on Investment to the New Zealand-Australia Closer Economic Relations Trade Agreement: National Interest Analysis" (tabled in Parliament 16 February 2011) at 32.

should be granted in each case.[77] In assessing applications, there are several criteria outlined in the Act that the relevant Ministers must consider in granting consent. If these criteria are met, then consent must be granted, giving the overseas person a right to invest in New Zealand.[78] Conversely, if the relevant criteria are not met, the application for consent must be declined.[79]

In the freshwater context, it should be noted that consent to invest in New Zealand does not guarantee the investor the necessary resource consents to begin operating. Upon obtaining OIO consent, the investor is responsible for seeking the relevant permits under the auspices of the RMA. However, where purchases of land are involved, investors may automatically acquire the associated water permits.[80] Furthermore, investors may indirectly access water permits by purchasing shares in irrigation, hydropower, or other water-related companies.[81] Therefore, if the Government wishes to retain oversight of the allocation of water permits to foreign investors, investments in sensitive land and business assets should be monitored closely.

The criteria for overseas investment in significant business assets are threefold. The relevant overseas person must have the necessary business experience and acumen, demonstrated financial commitment to the investment, and must be of good character.[82]

In addition to these criteria, for consent to acquire fishing quota the overseas person must be a body corporate and the interest in the quota must be capable of being registered in a Quota Register.[83] Applications to acquire fishing quota must also meet a "national interest" test.[84]

For an overseas investment in sensitive land, the relevant Ministers must be satisfied, in addition to the significant business assets criteria, that the overseas investment will, or is

[77] OIA, s 31. Note, the relevant Ministers are: the Minister of Finance and the Minister of Land Information for land applications; the Minister of Finance for significant business applications; or the Minister of Finance and the Minister of Aquaculture and Fisheries for fishing quota applications. However, in some cases, the relevant Minister or Ministers have delegated decision-making powers to OIO officials: see APEC Secretariat "2010 Guide to Investment Regimes of APEC Member Economies (Revised)" (APEC#211-CT-03.1, December 2010) APEC <www.publications.apec.org> at 127.
[78] OIA, s 14(1)(c).
[79] OIA, s 14(1)(d).
[80] Gunningham, above n 41, at 18.
[81] Gunningham, above n 41, at 18.
[82] OIA, s 18(1).
[83] Fisheries Act 1996, s 57G.
[84] "National interest" is assessed by reference to seven factors set out in the Fisheries Act 1996, s 57H(2).

likely to, benefit New Zealand, and if the relevant land includes non-urban land that exceeds 5 hectares, the benefit will be, or is likely to be, "substantial and identifiable".[85]

"Benefit to New Zealand" is assessed by reference to several factors outlined in the Act and accompanying regulations.[86] These include factors such as whether the overseas investment is likely to result in the creation of new jobs, the introduction of new technology or skills, or increased export receipts to New Zealand.[87] The relevant Ministers determine the relative importance to be given to each factor in light of the investment under consideration.[88]

a) Ministerial Directive Letter 2010

In response to concerns about overseas investment in New Zealand farmland, the Government released draft regulations and a Ministerial directive letter in December 2010 introducing two new factors to be considered in assessing overseas applications for investment in sensitive land.[89] In the letter, the Government referred to the importance of the land-based primary sector for the New Zealand economy and two specific concerns it had about overseas investment in this sector: the first related to "overseas investment in vertically-integrated firms which involve production, processing and distribution of products from the land-based primary sector on a large scale"; and the second related to the "aggregation of farm land by overseas investors which may not be beneficial to New Zealand's economic interests".[90] The two factors introduced to address these concerns were the 'economic interests' factor, and the 'mitigating' factor.[91]

The 'economic interests' factor requires considering "whether New Zealand's economic interests will be adequately promoted by the overseas investment", including matters such as whether New Zealand will be able to continue to supply reliable primary products to the global economy, and whether New Zealand's "strategic and security interests" will be

[85] OIA, s 16(1)(e); s 16(1)(f) further provides that if the relevant land includes farm land, then the land must have been advertised on the open market for sale (unless subject to an exemption).
[86] OIA, s 17(2); Overseas Investment Regulations 2005, reg 28.
[87] OIA, s 17(2)(a)(i)-(iii).
[88] OIA, s 17(1)(c).
[89] Letter from Hon Bill English (Minister of Finance) to Colin MacDonald (Chief Executive, Land Information New Zealand) regarding the Overseas Investment Act 2005 (8 December 2010) [Ministerial Directive Letter].
[90] Ministerial Directive Letter, above n 89, at 2.
[91] These two factors now appear in regulations 28(i) and 28(j) of the Overseas Investment Regulations 2005.

enhanced.[92] The reference to 'strategic and security interests' is not elaborated upon; however it could reasonably be interpreted as encompassing concerns about 'land grabs' and food and water security as discussed in Chapter I. Such an interpretation is supported by the Government's specific reference in the Ministerial Directive Letter to a concern about aggregation of farm land by overseas investors.[93]

The 'mitigating' factor is intended to "provide investors with an opportunity to show how they may allow for New Zealanders to oversee or participate in, the overseas investment".[94] However, overseas investors are not required to implement such measures. They may just be taken into account as mitigating factors in assessing the benefits to New Zealand from the overseas investment.

In an apparent reduction in Ministerial discretion, the letter also directs the OIO to place high relative importance on the 'economic interests' and 'mitigating' factors in determining whether overseas investment in 'large' areas of farmland[95] will, or is likely to, bring substantial and identifiable benefits to New Zealand.[96]

The effect of these changes on the admission of foreign investment to New Zealand is yet to be fully played out. However, in theory, the addition of these criteria provides greater potential for Ministers to decline applications for consent to invest in sensitive land if they are concerned that investments have ulterior motives. For example, the 'economic interests' criteria can be relied upon to deny the admission of speculative investments in agriculture that are not likely to support New Zealand's ability to continue to supply reliable primary products to the global market. The inclusion of a vague reference to 'New Zealand's strategic and security interests' in particular, provides the opportunity for Ministers to decline an application if the investment could frustrate any of the Government's freshwater reform measures.

However, ultimately the ability of the Government to control inward investment in water-related activities is limited, as the OIA only applies to a very small number of investments in

[92] Overseas Investment Regulations 2005, reg 28(i).
[93] Ministerial Directive Letter, above n 89, at 2.
[94] Ministerial Directive Letter, above n 89, at 3.
[95] An overseas investment in farm land would be considered large if it were to result in the relevant overseas person "owning or controlling an area of land that is more than ten times the average farm size for the relevant farm type", with the average farm size to be based on Statistics New Zealand data: Ministerial Directive Letter, above n 89, at 3.
[96] Ministerial Directive Letter, above n 89, at 2-3.

practice, and an abundance of water-related investment has already have been admitted.[97]

B. Investment Contracts

An investment contract is an agreement between a foreign investor and a host government that defines the terms of a particular investment project and the distribution of risks, costs and benefits between the parties.[98] Investment contracts should not be confused with investment treaties (another name for IIAs),[99] which are concluded between two or more states to regulate the treatment of investments by nationals of one state in the territory of the other state(s).[100]

Investment contracts can take many different forms and typically address a wide range of substantive issues such as loan agreements, employment matters, infrastructure requirements, and sometimes investment and taxation incentives for the investor.[101] Investment contracts will also govern procedural aspects of dispute settlement, such as which law applies to interpret the contract in the event of a dispute, which forum the dispute will be heard at, and will sometimes also impose caps on the quantum of liability.

In addition to the dispute settlement mechanism provided for in the contract, an investor alleging a breach of contract may also have recourse to investor-state dispute settlement (ISDS) at an international arbitral tribunal where the host state has consented to this in an investment treaty.[102] The availability of ISDS for contractual breaches will depend however on whether the contractual breach amounts to a breach of a substantive treaty provision, or alternatively whether the treaty has been drafted to extend its protection to investment contracts. Most commonly, the latter is achieved is through the inclusion of an 'umbrella

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[97] APEC Secretariat, above n 77, at 126.
[98] Lorenzo Cotula "Investment Contracts and Sustainable Development: How to make contracts for fairer and more sustainable natural resource investments" (2010) International Institute for Environment and Development <www.iied.org> at 3.
[99] Note that 'investment treaty' is another name for an international investment agreement. The two terms may be used interchangeably throughout this paper.
[100] Cotula, above n 98, at 4.
[101] "UNCTAD Series on issues in International Investment Agreements: State Contracts" (2004) UNCTAD <www.unctad.org> at 3.
[102] Investor-state dispute settlement (ISDS) is provided for in many international investment agreements and allows foreign investors to bring claims against host states directly before international arbitral tribunals. See generally Gus Van Harten *Investment Treaty Arbitration and Public Law* (Oxford University Press Inc, Toronto, 2008).

clause'.

1. Umbrella Clauses

Umbrella clauses are provisions in investment treaties that guarantee the observance of all obligations assumed by the host state with respect to foreign investments. Their effect is to bring contractual and other commitments "under the treaty's protective umbrella", so that a breach of such commitments also constitutes a breach of the treaty.[103] Where host states have consented to ISDS, umbrella clauses have extensive implications for regulatory freedom because they significantly widen the scope of actions for which the host state could face legal challenges under the IIA.

As a result, many modern IIAs have omitted umbrella clauses from their substantive provisions.[104] In fact, New Zealand is subject to only one umbrella clause which appears in its old-style BIT with Hong Kong.[105] However, the effect of umbrella clauses may still be present in IIAs if procedural provisions are defined in terms broad enough to capture claims involving contractual commitments. This can be illustrated by the approach the US has taken in its 2012 Model BIT which allows an investor to submit a claim to arbitration for breach of an "investment agreement".[106] "Investment agreement" is defined broadly as a written agreement between a national authority and a covered investment or investor of the other

[103] Rudolf Dolzer and Christoph Schreuer *Principles of International Investment Law* (2nd eBook ed, Oxford University Press, 2012) at 403.
[104] Mahnaz Malik "Recent Developments in International Investment Agreements: Negotiations and disputes" (2011) International Institute for Sustainable Development <www.iisd.org> at 5.
[105] Agreement between the Government of Hong Kong and the Government of New Zealand for the Promotion and Protection of Investments (signed 15 September 2003, entered into force 6 July 1995), art 3(1) states that: "Each Contracting Party shall observe *any obligations* it may have entered into with regard to investments of investors of the other Contracting Party (*emphasis added*)" [NZ-Hong Kong BIT].
[106] 2012 United States Model Bilateral Investment Treaty, art 24(1)(a)(B) [US Model BIT]. Note that claims may also be brought in respect of breaches of Articles 3 to 10 of the BIT (art 24(1)(a)(A)), and breaches of an "investment authorization" (art 24(1)(a)(C)), defined as "an authorization that the foreign investment authority of a Party grants to a covered investment or investor of the other Party" (art 1) such as an authorisation issued by the host state's investment screening authority (in New Zealand, a consent granted by the OIO).

party that was relied upon in establishing or acquiring a covered investment.[107] This is clearly broad enough to cover investment contracts. However, only agreements that grant rights with respect to natural resources, the provision of public services, or infrastructure projects are "investment agreements".[108] Unlike a traditional umbrella clause, this carve-out limits the types of contractual commitments afforded protection under the treaty. Nevertheless, the types of commitments carved-out are those most likely to relate to water.[109] Therefore, governments subject to provisions such as this should be aware that breaches of water-related contractual commitments may expose them to treaty claims in some cases.

This is a particularly relevant consideration for New Zealand in the current TPP negotiations (in which the US is a major party). Because the US negotiates its IIAs on the basis of its Model BIT, it may push for the inclusion of such a provision in the dispute settlement rules of the TPP. In the event that New Zealand does consent to an umbrella type provision in the TPP, it becomes critically important to draft investment contracts in a way that minimises the risks associated with the extension of the treaty's protection to contractual commitments.[110] In the context of freshwater, this would most likely involve refraining from any water-related guarantees.

2. Stabilisation Clauses

Many investment contracts concluded in relation to capital intensive, long-term projects have been known to contain a guarantee called a 'stabilisation clause'. There is no universal wording for these clauses, so they often vary in function and scope.[111] The strongest version

[107] US Model BIT, art 1; art 1, footnote 4 further provides that the following shall not be considered a 'written agreement': "(a) a unilateral act of an administrative or judicial authority, such as a permit, license, or authorization issued by a Party solely in its regulatory capacity, or a decree, order, or judgment, standing alone; and (b) an administrative or judicial consent decree or order". Importantly in the context of freshwater, this means that claims in respect of water permits and licences cannot be brought under art 24, unless there are guarantees provided in a 'written agreement' supplementary to the unilateral issuance of the permit or licence.
[108] US Model BIT, art 1.
[109] Natural resources contracts may grant rights for the extraction of groundwater, or the distribution or sale of freshwater; public service contracts may grant rights for the provision of services such as water treatment, or hydropower generation and distribution; and infrastructure projects such as the construction of canals, dams and pipelines also have obvious freshwater links.
[110] Note this consideration applies not just in respect of the TPP, but also in respect of potential future IIA negotiations, and also in respect of the already operative umbrella clause included in New Zealand's existing BIT with Hong Kong.
[111] Dolzer and Schreuer, above n 103, at 275.

of a stabilisation clause would exempt the investor from changes the host state may introduce in its legislative or administrative system. Another common version entails a 'freezing' of the legal order of the state, determining that the law applicable to the agreement is the law of the host state at a certain point in time (usually when the contract enters into force).[112] Therefore, these clauses entail a commitment beyond the ordinary requirements of IIAs,[113] and reduce a state's ability to exercise sovereign power over resources within its territory.[114]

The precise legal meaning and effect of stabilisation clauses has never been properly resolved, therefore it is difficult to determine whether and to what extent they might apply to limit state sovereignty over resources, such as freshwater. In any case, it is prudent for governments to refrain from including stabilisation clauses in foreign investment contracts.

C. International Investment Agreements

International Investment Agreements (IIAs) are treaties between states governing the protection of foreign investment. For investors from one state (home state) investing in the territory of another state (host state), the treaties provide special protections and dispute resolution processes enforceable at international law. Many of these protections are derived from the customary international law on state responsibility for the treatment of aliens.[115] Therefore, the real added value of IIAs is twofold: firstly, IIAs give foreign investors direct access to international dispute resolution processes; and secondly, IIAs increasingly include market access commitments.[116]

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[112] Dolzer and Schreuer, above n 103, at 275.

[113] Under an international investment agreement, a host state is not prohibited from introducing new legislative measures to respond to societal needs, comply with obligations under international treaties, or address environmental issues (but it may be required to compensate foreign investors for any losses incurred due to the new measures): see Dolzer and Schreuer, above n 103.

[114] Dolzer and Schreuer, above n 103, at 75.

[115] See generally Newcombe and Paradell *Law and Practice of Investment Treaties* (Kluwer Law International, The Netherlands, 2009).

[116] Market access commitments liberalise trade in services, so that investors of contracting parties can more readily establish a commercial presence in the host state of the other contracting party. This liberalisation is achieved through the inclusion of commitments in 'schedules' to IIAs that list the sectors being liberalised, the extent of market access being given in those sectors (e.g. whether there are any restrictions on foreign ownership), and any limitations on national treatment (whether privileges granted to local companies will not be extended to foreign companies): see "Services: rules for growth and investment" World Trade Organization <www.wto.org>.

IIAs come in several forms, the most common being bilateral investment treaties (BITs). There are also a growing number of free trade agreements (FTAs) that include investment chapters with provisions similar to those found in BITs. Finally, some IIAs take the form of regional investment treaties involving several countries, for example the countries in the Association of Southeast Asian Nations (ASEAN).

There has been a huge proliferation in IIAs over the past few decades, with the total number of concluded agreements now in excess of 3,200.[117] However, New Zealand has relatively few IIAs compared with other countries. Australia, for example, has concluded 21 BITs and is also subject to investment obligations under several FTAs.[118]

New Zealand's current IIAs include a BIT with Hong Kong,[119] investment chapters in FTAs with China,[120] ASEAN and Australia,[121] Malaysia,[122] and Closer Economic Partnership (CEP) Agreements with Singapore,[123] and Thailand.[124] New Zealand also recently signed the CER Investment Protocol which entered into force on 1 March 2013.[125] This is an important investment agreement, as Australia is the single largest contributor of FDI to New Zealand.[126]

[117] This includes over 2,860 Bilateral Investment Treaties, and over 340 'other' IIAs, including regional, bilateral and interregional agreements with an investment dimension (such as free trade agreements and closer economic partnership agreements): "International Investment Policymaking in Transition: Challenges and Opportunities of Treaty Renewal" (IIA Issues Note, June 2013) UNCTAD <www.unctad.org> at 1.

[118] UNCTAD maintains a list of BITs that are signed and in force on its website: <www.unctadxi.org.iia> (accessed 5/09/2013).

[119] NZ-Hong Kong BIT, above n 105. This BIT is expected to be replaced by an Investment Protocol to the New Zealand-Hong Kong, China Closer Economic Partnership: see "New Zealand-Hong Kong, China Closer Economic Partnership" New Zealand Ministry of Foreign Affairs & Trade <www.mfat.govt.nz>.

[120] Free Trade Agreement between The Government of New Zealand and The Government of the People's Republic of China (signed 7 April 2008, entered into force 1 October 2008), Chapter 11 [NZ-China FTA].

[121] The Agreement establishing the ASEAN-Australia-New Zealand Free Trade Area (signed 27 February 2009, entered into force 1 January 2010), Chapter 11 [AANZFTA].

[122] The New Zealand-Malaysia Free Trade Agreement (signed 26 October 2009, entered into force 1 August 2010), Chapter 10 [NZ-Malaysia FTA].

[123] The Agreement between New Zealand and Singapore on a Closer Economic Partnership (signed 14 November 2000, entered into force 1 January 2001), Part 6 [NZ-Singapore CEP].

[124] Thailand-New Zealand Closer Economic Partnership Agreement (signed 19 April 2005, entered into force 1 July 2005), Chapter 9 [NZ-Thailand CEP].

[125] CER Investment Protocol, above n 75.

[126] The countries with the largest total investment in New Zealand at end-March 2013 were Australia (54.8%), the United States (10.7%), the Netherlands (3.1%) and Japan (2.8%): "New Zealand: Investment regulations" *EIU ViewsWire* (online ed, New York, 11 July 2013).

The most significant agreement currently under negotiation for New Zealand is the Trans-Pacific Partnership Agreement (TPP).[127] The TPP is intended to be a regional FTA involving 12 Asia Pacific countries.[128] Assessing any legal implications of this agreement for freshwater policies would be difficult, because the parties have agreed to keep the negotiations confidential.[129] While some texts of the proposed agreement have been leaked, there is no guarantee that they will appear in the final version, therefore this paper will not address the implications of these texts.[130]

1. Foreign Investment Protections

To be eligible for protection under a New Zealand BIT or FTA, the relevant party has to be an investor from a contracting state and must have made an investment in New Zealand in accordance with the relevant laws, regulations and policies.[131] "Investment" is defined broadly in all of New Zealand's agreements, to cover "every kind of asset invested, directly or indirectly, by the investors of a Party in the territory of the other Party", including, relevantly for this paper, rights conferred pursuant to law or contract such as concessions, licences, authorisations, and permits.[132] This definition would therefore clearly extend protection to business assets with a reliance on access to freshwater, and water permits.

[127] For details of the proposed agreement, see "Trans-Pacific Partnership (TPP) Negotiations" New Zealand Ministry of Foreign Affairs & Trade <www.mfat.govt.nz> [MFAT TPP page].
[128] As at the date of writing, the countries involved are Australia, Brunei Darussalam, Chile, Malaysia, Peru, Singapore, the United States, Vietnam, Mexico, Canada, Japan and New Zealand: see MFAT TPP page, above n 127.
[129] The parties have also agreed to hold negotiating documents in confidence for four years after the TPP enters into force, or if no agreement enters into force, for four years after the last round of negotiations: Mark Sinclair "TPP Talk: Content of Confidentiality Letters" (29 November 2011) New Zealand Ministry of Foreign Affairs & Trade <www.mfat.govt.nz>.
[130] For information about leaked documents, see "Leaked Trade Negotiation Documents" Public Citizen <www.citizen.org>.
[131] NZ-Hong Kong BIT, art 2; NZ-Singapore CEP, art 26; NZ-Thailand CEP, art 9.3; NZ-China FTA, art 137; AANZFTA, Chapter 11, art 1; NZ-Malaysia FTA, art 10.3; CER Investment Protocol, art 3.
[132] The precise wording in quotation marks is taken from Article 135 of the NZ-China FTA. Contrast Article 9.2(a) of the NZ-Thailand CEP and Article 10.1(h) of the NZ-Malaysia FTA where the words "owned or controlled" are in the place of "invested"; contrast also Article 1.5 of the NZ-Hong Kong BIT where the words "directly or indirectly" are omitted; contrast also Chapter 11 Article 2(c) of the AANZFTA where the words "owned or controlled" are in the place of "invested" and the words "directly or indirectly" are omitted; note finally that in Article 27 of the NZ-Singapore CEP, "investment" is not defined, but is followed by a list of what it includes. The effect of these subtle differences in wording is unlikely to be of great importance in the context of this paper.

Furthermore, protections under IIAs secure not only title to these investments, but also their operations.[133]

The four key foreign investment protections most relevant for the purposes of this paper are as follows: national treatment, most-favoured-nation (MFN) treatment, fair and equitable treatment (FET), and protection from expropriation. In investment treaties, these protections are expressed as obligations on the part of the host state. These obligations have been made particularly burdensome for host states due to conflicting interpretations by international arbitration tribunals. This has created uncertainty as to what will and will not constitute a breach of the obligations in any particular case.[134]

Discussion of these protections and how they might apply in the freshwater context will be the focus of Chapter III.

2. Investor-State Dispute Settlement

Unlike New Zealand's other treaties, such as WTO agreements, the protections afforded to investors under some IIAs can be directly enforced by investors against the Government. This is due to the inclusion of investor-state dispute settlement (ISDS) clauses that involve the Government giving consent for investors to submit legal disputes to binding arbitration. However, certain conditions must often be met before the investor can engage this ISDS process, such as the prior exhaustion of local remedies.[135]

New Zealand currently has ISDS clauses in all of its IIAs, except the CER Investment Protocol. This is significant because it means Australian investors (representing our largest source of FDI) cannot directly enforce the Protocol's protections against the New Zealand Government – if any dispute arose, the Australian Government would have to initiate proceedings against New Zealand on the investor's behalf.

[133] "A Thirst for Distant Lands' above n 26, at 15.
[134] M Sornarajah *The International Law on Foreign Investment* (Cambridge University Press, New York, 2010) at 1.
[135] For example, the NZ-China FTA requires that any legal dispute must first be settled as far as possible through consultations and negotiations (Article 152) and only if this fails may the investor submit a dispute to international arbitration. However, the dispute may not be submitted to arbitration for a period of six months from the date of request for consultations and negotiations, and the investor must give the state party three months' notice prior to submitting the claim, upon receipt of which the state may require the investor to go through domestic administrative review procedures (Article 153).

In ISDS clauses, the investor is typically given the choice to submit the dispute to one of two forums. Most commonly, the agreement provides for conciliation or arbitration at the International Centre for the Settlement of Investment Disputes (ICSID) under the Convention on the Settlement of Disputes between States and Nationals of Other States;[136] or arbitration at an ad hoc tribunal under the rules of the United Nations Commission on International Trade Law ("UNCITRAL").[137]

The extent to which ISDS clauses have been used has taken many by surprise.[138] In respect of the ISDS provision in the North American Free Trade Agreement (NAFTA), commentators writing in 1999 noted that:[139]

> . . . the unexpectedly broad and aggressive use of this process to challenge public policy and public welfare measures, including environmental measures in about half the known cases today . . . has caught governments and observers off guard.

As a result, ISDS clauses and the associated international arbitration proceedings have come under intense scrutiny in recent years, especially against the background of the TPP negotiations. Several features of the ISDS system have encouraged commentators to level the broad criticism that ISDS clauses undermine host state sovereignty.[140] These include a lack of transparency in decision-making, an alleged pro-investor bias, the absence of a system of

[136] Convention on the Settlement of Investment Disputes between States and Nationals of Other States (signed 2 September 1970, entered into force 2 May 1980) [ICSID Convention]. This Convention provides a procedural framework for the settlement of disputes between host states and investors through conciliation or arbitration. It does not contain substantive standards of protection for foreign investments. Being a party to the Convention does not amount to consent to arbitration; consent to arbitration is achieved through express inclusion of ISDS clauses in BITs and FTAs.
[137] The United Nations Commission on International Trade Law Arbitration Rules 1976.
[138] Traditionally, the majority of claims were brought by investors from developed states against developing country host states where property rights were ill-defined, and legal and administrative systems were underdeveloped or corrupt. Accordingly the number of claims relating to environmental and health regulations under the Investment Chapter of the North American Free Trade Agreement (NAFTA) undoubtedly shocked Canada and the United States who didn't see themselves as potential targets for such claims. See generally Guillermo Aguilar Alvarez and William W. Park "The New Face of Investment Arbitration: NAFTA Chapter 11" (2003) 28 Yale J. Int'l L. 365.
[139] Howard Mann and Konrad von Moltke "NAFTA's Chapter 11 and the Environment: Addressing the Impacts of the Investor-State Process on the Environment" (1999) International Institute for Sustainable Development <www.iisd.org> at 5.
[140] See above n 5.

precedent, and lack of a substantive appeal process.[141] Australia has announced it will no longer support the inclusion of ISDS clauses in future FTAs[142] on the back of investment proceedings initiated by Philip Morris Asia challenging Australia's introduction of plain packaging legislation for tobacco.[143] While Philip Morris's claim was not the only reason for Australia's withdrawal of support for ISDS,[144] the Australian Government did explicitly refer to attempts to "limit [Australia's] capacity to put health warnings or plain packaging requirements on tobacco products".[145]

ISDS clauses may therefore be of concern to New Zealand if they have the potential to limit the Government's capacity to introduce freshwater reforms.

3. The Role of International Environmental Obligations

While international investment law's primary focus is the protection of foreign investment, investments "do not take place in a vacuum".[146] Disputes heard at investment tribunals often involve a wide range of issues, extending beyond investor rights to matters of public interest, including the environment.

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[141] However, note that there has since been a trend towards greater transparency in the ISDS system. For example, in 2006, various amendments were made to the ICSID arbitration rules to enhance the transparency and legitimacy of ICSID proceedings. These changes include new rules for amicus curiae submissions by third parties, public attendance at oral hearings, and publication of awards. See ICSID Convention, above n 136, rules 32, 37, 48.

[142] Australian Government Department of Foreign Affairs and Trade *Gillard Government Trade Policy Statement: Trading our way to more jobs and prosperity* (April 2011) [*Gillard Government Trade Policy Statement*].

[143] Philip Morris International "Philip Morris Asia Initiates Legal Action Against the Australian Government Over Plain Packaging" (press release, 27 June 2011); *Philip Morris Asia Limited (Notice of Arbitration),* 21 November 2011.

[144] A report from the Australian Productivity Commission stated that there had been no feedback from Australian businesses or industry associations indicating that ISDS provisions were of much value or importance to them, and concluded that the risks of ISDS provisions far outweighed the limited benefits they provided: *Bilateral and Regional Trade Agreements* (Australian Government Productivity Commission, November 2010) at 270-277 [Productivity Commission Report]. The Gillard Government Trade Policy Statement explicitly acknowledges its reliance on this Research Report in withdrawing support for ISDS: *Gillard Government Trade Policy Statement*, above n 142, at 16.

[145] *Gillard Government Trade Policy Statement*, above n 142, at 14.

[146] Andreas Kulick *Global Public Interest in International Investment Law* (Cambridge University Press, New York, 2012) at 1.

Because two distinct bodies of international law govern investor rights and the environment, where obligations under these two bodies clash, it is often unclear which should prevail.[147] Moshe Hirsch suggests tribunals may draw upon two tool-kits in resolving inconsistencies: first, the public international law rules that regulate inconsistencies among international legal obligations;[148] and secondly, the practices that have emerged from decisions of international investment tribunals.[149]

However, international investment jurisprudence has demonstrated that, rather than referring to the former public international law rules for resolving these inconsistencies, tribunals have preferred to develop their own set of principles whereby environmental obligations of the host state may be incorporated into the application of foreign investment protections.[150]

For example, environmental obligations of the host state may be used to show that a governmental measure affecting a foreign investment has a legitimate public purpose,[151] and the nature of environmental obligations may be relevant to determining what an investor might legitimately expect from the host state and its regulatory environment.[152]

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[147] Note that in an attempt to reconcile trade and investment policy with environmental concerns, New Zealand has negotiated several Environmental Agreements to supplement its various IIAs. These include the Agreement on Environment between New Zealand and the Kingdom of Thailand 2005; Environment Cooperation Agreement among the Parties to the Trans-Pacific Strategic Economic Partnership Agreement 2006; Memorandum of Agreement on Environmental Cooperation between the Government of New Zealand and the Government of the Republic of the Philippines 2008; New Zealand-Malaysia Agreement on Environmental Cooperation 2009; and the New Zealand-Hong Kong, China Environment Cooperation Agreement 2010. These provide for mutual cooperation and discussion on environmental issues; however their effect on the interpretation and application of New Zealand's foreign investment protections has yet to be tested in a case.

[148] This includes in particular, the Vienna Convention on the Law on Treaties 1155 UNTS 331 (opened for signature 23 May 1969, entered into force 27 January 1980), arts 30 and 53.

[149] Moshe Hirsch "Interactions between Investment and Non-investment Obligations" in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds) *The Oxford Handbook of International Investment Law* (Oxford University Press Inc, New York, 2008) 154 at 157.

[150] Hirsch, above n 149, at 173.

[151] See for example *SD Myers Inc v Government of Canada (Merits)* (13 November 2000) 40 ILM 1408, 15(1) World Trade and Arb Mat 184 at [161]-[195] [*SD Myers*]. While the tribunal found in this case that obligations under non-investment treaties did not provide a legitimate environmental reason for introducing an export ban, the decision certainly contemplates that in another case, on another set of facts, such obligations may provide a legitimate reason for the implementation of an environment-related measure.

[152] See for example *Methanex Corporation v United States of America (Merits)* (3 August 2005) 44 ILM 1345, 17(6) World Trade and Arb Mat 61, Part IV Chapter D at [9] [*Methanex*].

Application of these principles by investment tribunals will be evident in the discussion of the four key foreign investment protections in the next chapter.

Chapter III: Protection of Foreign Investment

With the proliferation of IIAs and their special arbitration processes, investors have challenged a wide range of measures adopted by host states, including measures related to freshwater.[153] This activity has created a growing body of jurisprudence which is relevant to determining the implications of foreign investment protections for a host state's ability to manage freshwater resources.

This chapter will examine how the four key investment protections of national treatment, most-favoured-nation (MFN) treatment, fair and equitable treatment (FET), and protection from expropriation have been applied to environmental and water-related measures by tribunals in the past. It will also examine how the protections appear in New Zealand's IIAs, thereby laying the groundwork for Chapter IV's analysis of how they might apply to specific freshwater reforms proposed by the Government.

Importantly, the application of New Zealand's foreign investment protections may differ from the application of analogous protections in other agreements that have been the subject of international arbitration. This is due to subtleties in the wording of the provisions, the increasing tendency to include more 'safeguards' for host states in modern IIAs, and the existence of general and country-specific exceptions.[154]

General exceptions apply to all foreign investment protections in the relevant investment agreement. These will be discussed at the end of this chapter. However, there are also often country-specific exceptions for existing non-conforming measures,[155] and certain sectors

[153] See for example *Methanex*, above n 152, where an investor challenged a ban on the oxygenate MTBE after it was found in contaminated groundwater and subsequent studies showed it was harmful to human health and the environment.

[154] The types of 'safeguards' tending to be utilised include the omission of umbrella clauses, clarification of the scope of substantive obligations through mechanisms such as expropriation annexes, and including provisions relating to the environment: see Malik, above n 104, at 4-6.

[155] There is provision for non-conforming measures in all of New Zealand's IIAs. This creates an exemption for measures already in force in New Zealand that would otherwise breach certain substantive obligations under the relevant IIA. The non-conforming measures provision typically states that National Treatment, Most-Favoured-Nation Treatment, Performance Requirements and obligations relating to senior management and boards of directors shall not apply to: any existing non-conforming measure that is maintained by a party at the central, regional, or local level of government, or; the continuation or prompt renewal of any such non-conforming measure, or; an amendment to any such non-conforming measure to the extent that it does not decrease the conformity of the measure with the excepted investment obligations referred to above: see for example Article 10.11 of the NZ-Malaysia FTA.

called ‘reservations’. Unlike general exceptions, reservations can only be entered against the obligations of national treatment, MFN treatment, performance requirements, and obligations with respect to senior management and boards of directors. This means that a host state cannot exempt itself from FET and expropriation provisions in any sector, nor in respect of any existing or proposed legislation. Because breaches of FET and expropriation provisions are most popularly alleged in legal challenges against host state actions, the inability of host states to enter reservations against these obligations has potentially far-reaching consequences for state regulatory freedom.

Reservations are scheduled to an agreement using either a positive list, or negative list approach, depending on the basis upon which the IIA has been negotiated. A positive list approach provides that investment obligations apply only in respect of sectors or industries specifically included in the schedule of commitments. Conversely, the negative list approach provides that investment obligations apply to all sectors and industries unless they are expressly excluded.[156] Because of this, negative list scheduling is considered more trade liberalising, in that it “offers scope to provide more ambitious commitments” in respect of services and investment than positive list scheduling.[157] However, it is harder to schedule reservations under the negative list approach because it requires considering every possible measure or sector which the obligation needs to be reserved against, and it is also difficult to close up loopholes that foreign investors may take advantage of to avoid the application of a reservation. A positive list approach is far more effective for preserving regulatory freedom, as the host state is only required to observe obligations in respect of the sectors and industries expressly included. It is therefore easier to manage and observe investment obligations with a positive list approach to reservations.

New Zealand has negotiated most of its IIAs on the basis of a positive list approach.[158]

[156] Note that there are two Annexes to negative list schedules. Annex I sets out specific regulatory measures the government wishes to maintain that, if not listed, would otherwise violate its investment obligations (also known as ‘non-conforming measures). Annex II is broader, carving out entire sectors or industries whwere the government wishes to maintain regulatory freedom not to comply with investment obligations both now and in the future.

[157] See “NZ-Malaysia Free Trade Agreement (And Associated Instruments): National Interest Analysis” New Zealand Ministry of Foreign Affairs and Trade <www.mfat.govt.nz> at 22.

[158] NZ-Singapore CEP; NZ-Thailand CEP; NZ-China FTA; AANZFTA; NZ-Malaysia FTA.

However, in its agreements with Hong Kong and Australia (and in the P4 Agreement),[159] a negative list approach to scheduling has been adopted.[160]

The potential application of the four key investment protections to water-related investments in New Zealand may therefore differ between the various IIAs.

A. National Treatment

One of the main protections in IIAs aims to neutralise the protectionist tendencies of governments by providing a level playing field between foreign investors and their domestic competitors.[161] This is achieved through a national treatment provision requiring the host state to accord foreign investors and their investments treatment 'no less favourable' than that accorded to domestic investors 'in like circumstances'.

New Zealand has national treatment provisions in all of its IIAs mentioned in Chapter II. However, the provisions vary in scope with some applying only in respect of the "management, conduct, operation" and disposal of investments,[162] and others extending their scope further to apply also in respect of the establishment,[163] acquisition, and expansion of investments.[164]

In the freshwater context, national treatment means that a foreign investor could not be subject to less favourable water charges, or environmental standards than other domestic

[159] Trans-Pacific Strategic Economic Partnership Agreement (signed 20 April 2006, entered into force 28 May 2006). This agreement is also known as the P4 Agreement, standing for "Pacific 4", and is an agreement between Brunei Darussalam, Chile, Singapore, and New Zealand. While not technically an investment agreement, the P4 includes market access commitments which are relevant to investment.

[160] NZ-Hong Kong BIT; NZ-Hong Kong, China Closer Economic Partnership; CER Investment Protocol.

[161] See Dolzer and Schreuer, above n 103, at 449; "UNCTAD Series on International Investment Policies for Development: Investor-State Disputes Arising from Investment Treaties: A Review" (2005) UNCTAD <www.unctad.org> at 32.

[162] NZ-Hong Kong BIT, art 4; NZ-China FTA, art 138.

[163] While in theory there is a distinction between the 'establishment' and the 'admission' of an investment, in practice, where 'establishment' is referred to, New Zealand would see its national treatment obligation as extending also to the admission of investments.

[164] NZ-Singapore, art 29; NZ-Thailand CEP, arts 9.6, 9.7; AANZFTA, Chapter 11, art 4; NZ-Malaysia FTA, art 10.4; CER Investment Protocol, art 5; note the NZ-Singapore CEP uniquely provides for national treatment also in relation to the "protection and expropriation (including any compensation) of investments" (Article 29). This would mean that if the New Zealand government expropriated the investments of domestic investors in like circumstances, Singapore investments would have to be afforded the same treatment and compensation.

investors in like circumstances. Generally, treatment will be considered 'less favourable' if it is motivated by nationality or impacts adversely on the competitive opportunities available to the foreign investor.[165]

There are various specific reservations that have been entered in respect of the national treatment obligations under New Zealand's IIAs.[166] For example, one has been entered so that the screening regime under the OIA[167] will continue to apply to overseas persons.[168] Otherwise, requiring overseas investors (but not domestic investors in like circumstances) to obtain consent to invest in sensitive New Zealand assets would constitute a breach of national treatment.

Of most relevance however, is the water allocation reservation entered against national treatment in the CER Investment Protocol. This reservation applies across all sectors, and states that New Zealand "reserves the right to adopt or maintain any measure with respect to the allocation of water rights".[169] It is therefore unlikely New Zealand would be in breach of its national treatment obligation to Australian investors where a reduction in their water permit allocations (or any measure involving the allocation of water rights) constituted less

[165] *Pope & Talbot Inc v Government of Canada* (*Merits, Phase 2)* (10 April 2001) 13(4) World Trade and Arb Mat 61 at [79] [*Pope & Talbot (Merits, Phase 2)*]. See also where a tribunal considered that adverse tax effects felt by foreign investors to the benefit of domestic investors would be sufficient to establish that 'less favourable treatment' had been accorded: *Corn Products International Inc v United Mexican States (Decision on Responsibility)* ICSID ARB(AF)/04/01, 15 January 2008 at [56].

[166] The BIT with Hong Kong is an exception to this, being an early agreement lacking the sophistication and detail of more modern IIAs.

[167] Reference to the OIA here also includes the Overseas Investment Regulations 2005 and relevant provisions from the Fisheries Act 1996.

[168] Some of these reservations to national treatment are in the form of positive list reservations in respect of market access commitments on commercial presence (NZ-Singapore CEP, Annex 2.1; NZ-China FTA, Annex 8 Part B; AANZFTA, Annex 3; NZ-Malaysia FTA, Annex 4); whereas the rest are entered as negative list reservations (NZ-Thailand CEP, Annex 4.2; CER Investment Protocol, Annex 1, I-NZ-2).

[169] CER Investment Protocol, Annex 1, II-NZ-2; In a side letter to the Protocol, the Rt Hon John Key, Prime Minister of New Zealand proposed that in light of the friendship between Australia and New Zealand and the commitment to achieving a trans-Tasman Single Economic Market, New Zealand would review the reservation with respect to water within 5 years of the Protocol entering into force, and, if a reservation remained, would commit to further regular reviews. The Rt Hon John Key also proposed that if Australia considered that New Zealand had adopted or was going to adopt a measure which, but for the water reservation, would constitute a breach of national treatment, Australia could request consultations with New Zealand. Any such request would be met promptly by New Zealand with a view to seeking a mutual resolution: Letter from The Rt Hon John Key (Prime Minister of New Zealand) to The Hon Julia Gillard (Prime Minister of Australia) regarding New Zealand's Reservation with Respect to Water in the Investment Protocol to the Australia-New Zealand Closer Economic Relations Trade Agreement.

favourable treatment than that accorded to New Zealand domestic investors in like circumstances.

The key to the national treatment issue is determining whether the relevant foreign and domestic investors are in 'like circumstances'. If this cannot be established, then a claim for breach of national treatment will fail. National treatment provisions typically do not identify criteria by which 'like circumstances' are to be established;[170] and jurisprudence has acknowledged that 'circumstances' by their very nature, are context dependent.[171] However, it has often been held that for investors to be in 'like circumstances', they must at least be in a competitive relationship with each other.[172]

In respect of this issue, several tribunal decisions are particularly significant in the context of freshwater resources, because they provide guidance for when environmental circumstances might be relevant to determining 'like circumstances'.

In *SD Myers Inc v Government of Canada (SD Myers)*, a company in the business of exporting PCB[173] waste for disposal outside of Canada, and domestic Canadian investors in the business of actual PCB waste disposal, were found to be 'in like circumstances' due to the fact that they were in competition, and one could take business away from the other.[174] While the tribunal did acknowledge environmental concerns,[175] this was a clear case where the Canadian government had been motivated by a protectionist agenda in implementing the ban.[176] If there had been a legitimate environmental objective behind the ban, this might have been highly relevant to determining 'like circumstances'.

In *Pope & Talbot Inc v Government of Canada (Pope & Talbot)*, the tribunal stated that "the character of the measures under challenge" was important to determining whether the investor was 'in like circumstances' to Canadian softwood lumber exporters.[177] Accordingly, it found that they were not in 'like circumstances' because the measure at issue was

[170] See "UNCTAD Series on International Investment Policies for Development: Investor-State Disputes Arising from Investment Treaties: A Review" above n 161, at 33.
[171] *Pope & Talbot* (*Merits, Phase 2)*, above n 165, at [75].
[172] *SD Myers*, above n 151, at [251]; See also *Methanex* above n 152, Chapter IV Part B at [17]-[19].
[173] PCB stands for Polychlorinated Biphenyls which belong to a broad family of man-made organic chemicals known as chlorinated hydrocarbons.
[174] *SD Myers*, above n 151, at [251].
[175] *SD Myers*, above n 151, at [250].
[176] *SD Myers*, above n 151, at [162].
[177] *Pope & Talbot (Merits, Phase 2)*, above n 165, at [76].

"reasonably related to" rational government policy.[178] The tribunal also found it material that the measure affected over 500 domestic Canadian owned producers just as it affected the foreign investors, meaning it could not have been motivated by a protectionist agenda.[179]

In *Methanex Corporation v United States of America (Methanex)* the nature of the measures under challenge was also considered relevant to determining 'like circumstances'.[180] In this case, after a harmful oxygenate MTBE[181] was found in contaminated groundwater, California banned the use of MTBE as a gasoline additive, and passed regulations stating that only ethanol could be used as an oxygenate in California gasoline. In its claim, Methanex (a manufacturer of methanol used in the production of MTBE) relied upon *SD Myers* to argue that the methanol and ethanol industries were in like circumstances because they both produced oxygenates used in the manufacture of US gasoline additives, and were therefore in competition with each other. Methanex therefore argued that a ban on MTBE was more favourable to US domestic ethanol producers, and therefore constituted a breach of national treatment.[182] However, the tribunal rejected this argument, determining that legitimate environmental reasons existed to justify the differential regulatory treatment of methanol and ethanol in this case, and therefore the investors were not in 'like circumstances'. It also found *Pope & Talbot* instructive in determining that there were other more directly comparable domestic producers of methanol who were equally affected by the ban, so Methanex did not receive less favourable treatment than these comparators.[183]

In light of these decisions, where a legitimate environmental justification for differential treatment between investors exists, including for the protection of water resources, this may be enough to establish that those investors are not in 'like circumstances', and therefore the national treatment obligation has not been breached.

The other issue in national treatment cases is whether the foreign investor received 'less favourable' treatment than the domestic comparator. In this respect, the scope of protection extends to both de jure and de facto discrimination. De jure discrimination involves explicit differential treatment of foreign investors in national laws and regulations. For example, a

[178] *Pope & Talbot (Merits, Phase 2)*, above n 165, at [87]-[88].
[179] *Pope & Talbot (Merits, Phase 2)*, above n 165, at [87].
[180] *Methanex*, above n 152, Part IV Chapter B at [21].
[181] MTBE stands for Methyl Tertiary Butyl Ether and is a chemical compound produced by the chemical reaction between methanol and isobutylene.
[182] *Methanex*, above n 152, Part IV Chapter B at [6].
[183] *Methanex*, above n 152, Part IV Chapter B at [19].

regulation requiring foreign investors in agricultural land (but not their domestic comparators) to implement green irrigation technology would be de jure discrimination. De facto discrimination encompasses treatment that appears to be discriminatory, or has the practical effect of discrimination (regardless of the intention).[184] An example of de facto discrimination would be a ban on inefficient water technologies that happen to be produced only by foreign investors. Although such a requirement would have the legitimate purpose of sustainable freshwater management, it would have the practical effect of discrimination because foreign investors would no longer be able to produce and sell their technologies, but domestic investors would. Of course, differential treatment in itself is not enough. It must also be established that the treatment is 'less favourable', as described above.

B. Most-Favoured-Nation Treatment

Most-favoured-nation treatment (MFN treatment) is a protection aimed at preventing discrimination between foreign investors from one country and foreign investors from another country. The purpose of the standard is to guarantee the equality of competitive opportunities between investors.[185] To achieve this, it requires investors from one country to be accorded the highest standard of treatment available to investors from any other country "in like circumstances". The determination of 'like circumstances' is approached in the same manner as under the national treatment obligation,[186] meaning environmental and public policy concerns may be relevant.[187]

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[184] *SD Myers*, above n 151, at [252]; *Occidental Exploration and Production Company v Republic of Ecuador (Merits)* (1 July 2004) 17(1) World Trade and Arb Mat 165 at [177]; *Siemens AG v The Argentine Republic (Merits)* ICSID ARB/02/8, 6 February 2007 at [321].

[185] "UNCTAD Series on issues in International Investment Agreements: Most-Favoured-Nation Treatment" (1999) UNCTAD <www.unctad.org> at 1.

[186] See above discussion of "like circumstances" at Chapter III, Part A.

[187] See for example, *Parkerings-Compagniet AS v Republic of Lithuania (Merits)* ICSID ARB/05/8, 11 September 2007 at [392]-[396]. This case involved two proposed developments extending into a UNESCO World Heritage site. The extension of one investment further into the protected area than the other was material to determining that the investors were not in like circumstances, and therefore, declining that investor's development proposal and accepting the other was not a breach of MFN treatment.

All of New Zealand's IIAs contain MFN clauses except for the AANZFTA, where the MFN clause is subject to future negotiation.[188] These MFN provisions all apply after an investment has been established in New Zealand,[189] with some extending their scope to apply also in respect of the "establishment, acquisition, [and] expansion" of investments.[190]

The effect of MFN obligations owed in relation to the admission of investment to New Zealand was illustrated during the sale of the Crafar Farms to Chinese investor Shanghai Pengxin in 2012. While many New Zealanders did not approve of large areas of farmland being sold to Chinese investors, the NZ-China FTA's MFN clause meant the Government's "hands [were] tied", [191] in the sense that they could not deny admission based solely on the nationality of the investors. 'Stuff'[192] columnist Chris Trotter elaborated on this, explaining that MFN means: [193]

> If it's OK to sell New Zealand farmland to Americans, Englishmen, Germans and Indonesians, then it must also be OK to sell farmland to the Chinese. Under the terms of the FTA, China is legally entitled to no lesser consideration than that shown to the most favoured of our trading partners.

Note of course that the Government can deny admission based on the objective application of the OIA criteria; it just cannot discriminate on the basis of nationality. Interestingly, even if the Government did discriminate on the basis of nationality, New Zealand's ISDS clauses only apply to disputes "directly concerning an investment" made in the territory of the other

[188] AANZFTA, Chapter 11, art 16(2). Note also that the MFN provision in the NZ-Malaysia FTA does not currently apply, and will not apply until the Parties have agreed on schedules of reservations to the investment chapter in accordance with specially established Work Programmes (NZ-Malaysia FTA, art 10.17).
[189] NZ-Hong Kong BIT, art 4; NZ-Singapore CEP, art 28; NZ-Thailand CEP, art 9.8; NZ-China FTA, art 139; NZ-Malaysia FTA, art 10.5; CER Investment Protocol, art 6.
[190] NZ-Singapore CEP, art 28; NZ-China FTA, art 139; NZ-Malaysia FTA, art 10.5; CER Investment Protocol, art 6. Note that the NZ-Thailand MFN provision applies in respect of the "promotion and protection of investments" which would arguably extend its coverage to the "establishment, acquisition, [and] expansion" of investments also (NZ-Thailand CEP, art 9.8). Again, the NZ-Singapore CEP uniquely provides for MFN treatment in relation to the "protection and expropriation (including any compensation) of investments" (NZ-Singapore FTA, art 28). This would mean that if the New Zealand government expropriated the investments of non-Singapore foreign investors in like circumstances, Singapore investments would have to be afforded the same treatment and compensation
[191] Chris Trotter "Our hands were tied over the Crafar farms sale" *Stuff* (online ed, New Zealand, 3 February 2012).
[192] 'Stuff' is a popular New Zealand news media website that can be accessed at <www.stuff.co.nz>.
[193] Trotter, above n 191.

party (i.e. an investment must have been made).[194] As a consequence, investors cannot bring a claim for breach of MFN in respect of decisions relating to the admission of investments in New Zealand, and the screening of investments under the OIA.[195]

What is important to emphasise is that an MFN clause may not have any practical significance if the host state has not granted any relevant benefit to a third party. However, as soon as the state does confer a relevant benefit, it is automatically extended to the beneficiary of the MFN clause.[196] To provide an example, if New Zealand decided to implement a scheme to reward efficient water use, and was going to extend these rewards to Chinese investors, it would also have to extend the rewards to foreign investors in like circumstances that are the beneficiaries of MFN clauses in its other IIAs.

As noted in Chapter II, New Zealand has recently given Australian investors preferential thresholds for investing in sensitive New Zealand business assets.[197] While MFN would usually apply to extend the benefit of these thresholds to other investors, there is an exception to MFN in all of New Zealand's IIAs that applies to measures taken in regional integration processes.[198] These preferential thresholds would be considered part of the process of economic integration between New Zealand and Australia, and therefore MFN would not apply to extend these thresholds to other investors. This means the Government can maintain its current level of control over water-related investments in sensitive business assets.

The MFN obligation has attracted much debate, because it is unclear whether it operates to extend the scope of an investors' procedural and substantive rights beyond those contained in

[194] NZ-Hong Kong BIT, art 9; NZ-Singapore CEP, art 34(1); NZ-Thailand CEP, art 9.16(1); NZ-China FTA, art 152; AANZFTA, Chapter 11, art 18(1); NZ-Malaysia FTA, art 10.19(1); note the CER Investment Protocol does not contain a dispute settlement provision, however there is provision for consultations if one Party does not consider that the obligations of the Protocol are being met, or where the Protocol's intent is being frustrated by the Other Party: CER Investment Protocol, art 25.

[195] If any dispute were to be elevated to the international level, the relevant foreign government would have to bring a claim against the New Zealand Government.

[196] Dolzer and Schreuer, above n 103, at 461.

[197] See above discussion at Chapter II, Part A, Subpart 1.

[198] NZ-Hong Kong BIT, art 8(1); NZ-Singapore CEP, art 81; NZ-Thailand CEP, art 18.7; NZ-China FTA, art 139(4); NZ-Malaysia FTA, art 10.5(4); CER Investment Protocol, Annex 1, II-NZ-6. However, note that despite the reservation in the CER Investment Protocol, in a side letter to the agreement New Zealand proposed to extend to Australian investors and covered investments no less favourable treatment than that agreed with any other country or countries in the context of a wider process of economic integration or trade liberalisation as referred to in Paragraph 2 of reservation II-NZ-6: Letter from The Rt Hon John Key (Prime Minister of New Zealand) to The Hon Julia Gillard (Prime Minister of Australia) regarding the New Zealand MFN Reservation in the Investment Protocol to the Australia-New Zealand Closer Economic Relations Trade Agreement. Note that the AANZFTA does not have an MFN provision.

the agreement under which it is protected (i.e. whether MFN allows investors to 'borrow' provisions from other treaties).[199]

The weight of authority tends to suggest that MFN clauses give foreign investors the right to benefit from substantive provisions in other treaties.[200] However, in New Zealand's IIAs, this is qualified by an exception to MFN for agreements that are already in force.[201] This means investors cannot claim the benefit of provisions in prior treaties. This is important in the context of the water allocation reservation in the CER Investment Protocol because it means Australian investors cannot avoid the reservation by taking advantage of the fact that it was not included in prior FTAs. Note, however that this would be different if the water reservation was not included in *future* treaties. Therefore, if New Zealand wants to maintain this reservation in respect of Australian investors, it should include an identical reservation in any future FTA it negotiates.

Surprisingly, the majority of cases on MFN deal not with its application to substantive provisions, but to procedural provisions concerning dispute settlement. The jurisprudence in this area is much more divided. In *Maffezini (Emilio Agustin) v Kingdom of Spain*, Argentine investors were allowed to claim the benefit under a third treaty providing for shorter 'cooling off' periods[202] before a dispute could be submitted to arbitration, based on the tribunal's view that dispute settlement arrangements were inextricably related to the protection of foreign investors.[203] The tribunal in *Plama Consortium Ltd v Republic of Bulgaria* agreed with this view in principle, however it considered that dispute settlement procedures from a third treaty could not be incorporated by virtue of an MFN clause in a basic treaty unless there was evidence of a clear intent by the contracting states to this effect.[204]

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[199] "UNCTAD Series on issues in International Investment Agreements II: Most-Favoured-Nation Treatment" (2010) UNCTAD <www.unctad.org> at 2-3.
[200] Dolzer and Schreuer, above n 103, at 468.
[201] NZ-Hong Kong BIT, art 8(1); NZ-Singapore CEP, art 81; NZ-Thailand CEP, art 18.7; NZ-China FTA, art 139(3); NZ-Malaysia FTA, art 10.5(3); CER Investment Protocol, Annex 1, II-NZ-6.
[202] In many international investment treaties, there is a requirement that investors first exhaust local remedies before submitting a dispute to international arbitration. In addition, there is often provision for a 'cooling off' period where the investors are not be able to submit a dispute to international arbitration for a specified length of time after the local remedies have been exhausted: see generally Dolzer and Schreuer, above n 103, at 551-560.
[203] *Maffezini (Emilio Agustin) v Kingdom of Spain (Jurisdiction)* (25 January 2000) 16 ICSID Rev 212, 124 ILR 9 at [54] – [56] [*Maffezini*].
[204] *Plama Consortium Ltd v Republic of Bulgaria (Jurisdiction)* (8 February 2005) 20 ICSID Rev 262, 44 ILM 721, 17(4) World Trade and Arb Mat 215 at [223].

In light of this divergent case law and for the avoidance of doubt, New Zealand has recently started drafting treaty wording to exclude the application of MFN provisions to dispute settlement procedures.[205] Apart from the earlier drafting in its Agreements with Hong Kong, Singapore, and Thailand, New Zealand has now taken this approach in all of its IIAs.[206] As such, foreign investors subject to these more recent IIAs must use the dispute settlement procedures afforded to them in the agreement to which their home state is party.[207]

C. Fair and Equitable Treatment

Fair and equitable treatment (FET) is an 'absolute' standard of treatment derived from the customary international law minimum standard of treatment, which establishes a floor below which the host state's treatment of the investment must not fall.[208] The meaning of 'fair and equitable treatment' is inherently ambiguous, so it appears as an all-encompassing standard which investors will frequently claim has been breached, and which tribunals perhaps feel most comfortable awarding damages under.[209] It is therefore important to examine.

[205] Note, it is not immediately clear how the extension of MFN treatment to dispute settlement provisions would impact a host state's ability to implement freshwater reform measures. If an MFN provision allowed investors to avoid 'exhaustion of local remedies' clauses, they would have more direct and improved access to investor-state arbitration in the event of water-related disputes. This more imminent threat of legal action would perhaps discourage host states from implementing freshwater reforms that might interfere with water-related foreign investments. However, New Zealand does not require the exhaustion of local remedies in any of its dispute settlement provisions, requiring only that the parties undergo "amicable" negotiations for between 3 and 6 months before a claim is submitted. Therefore the impact of MFN provisions potentially extending to dispute settlement provisions would not be of great concern to the New Zealand government in the context of freshwater reform, because the threat of arbitration is already imminent and would not be significantly altered.

[206] NZ-China FTA, art 139(2); NZ-Malaysia FTA, art 10.5(2); CER Investment Protocol, art 6(2).

[207] There may be scope for Hong Kong, Singaporean and Thailand investors to claim the benefits of dispute settlement procedures under other treaties New Zealand has concluded, however this is not an issue of critical importance to the issue of freshwater reform: see above n 205.

[208] "Fair and Equitable Treatment Standard in International Investment Law" (Working Papers on International Investment, Number 2004/3, September 2004) OECD <www.oecd.org> at 2.

[209] See Dolzer and Schreuer, above n 103, at 354.

New Zealand has FET provisions in the majority of its IIAs.[210] The provisions require the Government to accord FET at all times to investments in its territory. This includes the obligation not to deny justice in legal or administrative proceedings in accordance with due process; but does not require additional treatment beyond that required by the customary international law minimum standard. Furthermore, a determination that there has been a breach of another provision of an investment treaty does not establish a breach of FET.

The wording of New Zealand's provisions dictate that FET only applies to investments once they are established in New Zealand, and because of the conventional drafting of the provision, case law will be relevant to determining its application in the context of freshwater.

Because no reservations can be made against FET obligations, New Zealand can only limit the scope of potential legal challenges by relying on general exceptions and clarifications to the standard in the provisions themselves.

The classic statement of the customary international law minimum standard was given in *Neer v United Mexican States*, which established that the treatment of a foreign investor must amount to "an outrage, to bad faith, [or] to wilful neglect of duty" before falling foul of the minimum standard – a very high threshold to meet.[211] The international school of thought on treatment of foreigners has progressed since then. Nevertheless, Van Harten notes that:[212]

> . . . the continued widespread reference to the Neer standard by states and commentators alike indicates that a state's misconduct must be of a very serious nature before it violates the customary standard.

Despite this, tribunals have taken divergent approaches to the standard of FET so that its application in any case remains uncertain. However, in general, factors that may point to a breach of FET include arbitrary or discriminatory conduct, bad faith, an absence of

[210] NZ-Hong Kong BIT, art 3(2); NZ-China FTA, art 143; AANZFTA, Chapter 11, art 6; NZ-Malaysia FTA, art 10.10; CER Investment Protocol, art 12. The NZ-Singapore CEP and the NZ-Thailand CEP do not explicitly mention 'fair and equitable treatment'; however, in the NZ-Thailand CEP, the relevant provision requires the NZ Government to accord "appropriate protection" to investors and covered investments (Article 9.10); and the NZ-Singapore CEP requires the New Zealand government to provide "the better of" national treatment or most-favoured-nation treatment (Article 30).
[211] *Neer v United Mexican States (United States v Mexico)* (1926) 4 RIAA 60, at 61-62.
[212] Van Harten, above n 102, at 87-88.

transparency, failure to accord due process, or frustration of investors' legitimate expectations.

Perhaps the most generous reading of the FET standard was in *CMS Gas Transmission Company v Argentine Republic*, where the tribunal concluded that the standard required Argentina to maintain a stable legal and business environment during a severe financial crisis.[213] It was stated that this was "an objective requirement unrelated to whether [Argentina] has had any deliberate intention or bad faith".[214] This interpretation has major drawbacks for governments when they are faced with difficult policy decisions in times of crises, and many states have since sought to address this concern in the drafting of their FET provisions and exceptions.[215]

Besides characteristics of the investment environment, the investor's legitimate expectations also play a central role in the application of the FET standard.[216] Such expectations are subjective and therefore provide considerable scope for a breach of the FET standard. However, both IIAs and tribunals have attempted to reduce this scope by providing guidance on what constitutes a legitimate expectation. For example, the NZ-China FTA refers to "binding written commitments" in the Annex on Expropriation,[217] and the *Glamis Gold Ltd v United States of America (Glamis)* tribunal and the 2012 US Model BIT both refer to "reasonable, investment-backed expectations".[218] With regard to the latter, the *Glamis* tribunal held that "reasonable, investment backed expectations" require at least a "quasi-contractual relationship" between the state and the investor setting out the commitments upon which the investor is relying in forming their expectations.[219]

In the freshwater context, measures that might frustrate investors' legitimate expectations include the introduction of or increase to water charges in a permit or its governing

[213] *CMS Gas Transmission Company v Argentine Republic (Merits)* (12 May 2005), 44 ILM 1205, 17(5) World Trade and Arb Mat 63 at [274] [*CMS*].
[214] *CMS*, above n 213, at [280].
[215] New Zealand has a general exception in many of its free trade agreements to the effect that it shall not be prevented from taking measures for prudential reasons to ensure the integrity and stability of the financial system, so long as they are not used as a means of avoiding commitments or obligations under the agreement (see for example NZ-China FTA, art 203). New Zealand has also drafted general exceptions allowing it to take measures to safeguard the balance of payments (see for example NZ-China FTA, art 202).
[216] See Dolzer and Schreuer, above n 103, at 370.
[217] NZ-China FTA, Annex 13, 4(b).
[218] *Glamis Gold Ltd v United States of America (Merits)* (8 June 2009) 48 ILM 1038 at [761], [766] [*Glamis Gold*]; 2012 US Model BIT, Annex B, 4(a)(ii).
[219] *Glamis Gold*, above n 218, at [766], [813].

legislation, changes to water allocations for a water-intensive investment, or stricter pollution controls.

However, several countervailing factors must be balanced against the legitimate expectations of the investor. Firstly, tribunals have emphasised that foreign investors must take the host state law as they find it;[220] and secondly, there must be some legitimate scope for state regulatory flexibility.[221]

In carrying out this balancing exercise, considerations such as the purpose and effect of the regulation and the transparency of the regulatory process have been important.[222] However, this has allowed investors to challenge the effectiveness of regulatory measures in invoking the FET standard. For example, in Philip Morris Asia's claim against Australia, it is alleged that their legitimate expectations as investors of being able to use their intellectual property rights in Australia are not outweighed by Australia's sovereignty, because in the circumstances the regulation has "no demonstrable utility to improve public health . . . and effective alternative measures [were] available".[223]

This type of legal challenge might also be attracted in the context of freshwater reform, because a lot of science is involved, and the effectiveness of any reform would be difficult to measure in practice. Significantly however, the *Methanex* tribunal held that it does not matter if scientific facts are disputed, as long as the state's reliance on them is genuine.[224] This case therefore provides some reassurance to New Zealand in the context of freshwater reform.

D. Expropriation

Expropriation is considered the most severe form of interference with a foreigner's property.[225] While modern investment treaties do not prohibit expropriation of foreign investments, they condition such expropriation on several criteria, including at least prompt,

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[220] See *MTD Equity Sdn Bhd and MTD Chile SA v Republic of Chile (Merits)* ICSID ARB/01/7, 25 May 2004 at [205]; see also *GAMI Investments Inc v Government of the United Mexican States (Merits)* (15 November 2004) 44 ILM 545, 17(2) World Trade and Arb Mat 127 at [91].
[221] *Saluka Investments BV v Czech Republic (Merits)* (17 March 2006), 18(3) World Trade and Arb Mat 166 at [305]-[306] [*Saluka*]. It has also been said that investment treaties should not be used as insurance policies for bad business judgment: *Maffezini*, above n 203, at [64].
[222] *Saluka*, above n 221, at [307].
[223] *Philip Morris Asia Limited (Notice of Arbitration)*, above n 143, at 7.7
[224] *Methanex*, above n 152, Part III Chapter A at [101]-[102].
[225] Dolzer and Schreuer, above n 103, at 299.

adequate and effective compensation.[226] It is generally also required that the expropriation is for a public purpose; is carried out in accordance with applicable laws and due process; and is non-discriminatory.[227] New Zealand's expropriation provisions follow this general formula.[228]

One issue that has been incredibly controversial is which kinds of government measures constitute expropriation requiring compensation.

There are two broad kinds of expropriation covered by IIAs – direct and indirect.[229] Direct expropriation involves the actual taking of property, either by transferring all foreign-owned assets in an industry or sector into national ownership (nationalisation), or by taking specific foreign-owned assets (expropriation).[230] Today, direct expropriations have become rare, because states are aware of the negative impact an outright taking of foreign property would have on their attractiveness as an investment destination .[231] Therefore, indirect expropriations have gained importance. An indirect expropriation does not involve a deliberate taking; however it achieves the same effect by depriving the investor of the ability to utilise the investment in a meaningful way.[232]

The major issue with indirect expropriation is distinguishing between non-compensable legitimate exercises of government power that incidentally interfere with foreign investment, and those exercises of government power that have an impact sufficient to amount to a compensable expropriation. Given the uncertainty surrounding this issue, many commentators have expressed concerns that expropriation provisions may result in a 'regulatory chill' effect, where governments refrain from introducing environmental and

[226] Dolzer and Schreuer, above n 103, at 299; see also Van Harten, above n 102, at 91.
[227] See Dolzer and Schreuer, above n 103, at 301-302.
[228] NZ-Hong Kong BIT, art 6; NZ-Thailand CEP, art 9.11; NZ-China FTA, art 145; AANZFTA, Chapter 11, art 9; NZ-Malaysia FTA, art 10.8; CER Investment Protocol, art 14. The exception to this is the NZ-Singapore CEP which is the only agreement that does not contain an expropriation provision. However its national treatment and MFN treatment provisions explicitly apply to the expropriation of investments, meaning that any expropriation of Singaporean investments in New Zealand would have to be on terms no less favourable than expropriations of third country and domestic investments (Articles 28 and 29).
[229] See Dolzer and Schreuer, above n 103, at 304; note that the application of international investment treaties to both direct and indirect expropriation is made clear through the inclusion of a reference to "expropriation", and "measures tantamount to" or "measures equivalent to" expropriation: at 305.
[230] "UNCTAD Series on International Investment Policies for Development: Investor-State Disputes Arising from Investment Treaties: A Review", above n 161, at 41.
[231] Dolzer and Schreuer, above n 103, at 304.
[232] Dolzer and Schreuer, above n 103, at 304.

other public welfare regulations for fear of being exposed to lengthy and costly dispute settlement proceedings and having to pay large compensation awards to foreign investors.[233]

Expropriation clauses are directly relevant to environmental and freshwater measures. For example, measures taken to restrict or prohibit water takes, as well as measures aimed at reducing pollution of freshwater bodies could be challenged under expropriation provisions if the measures impact on the use and enjoyment, or value of a foreign investment. The effect of expropriation provisions is further exacerbated by the broad definition of "investment" in IIAs, creating a large and diverse range of rights that can be subject to expropriation requiring compensation.[234] Some NAFTA tribunals have gone as far as finding that the definition of investment under Chapter 11 also covers access to markets and market shares.[235]

There have been numerous cases where tribunals have examined the question of whether an environmental measure taken by a host state amounted to a compensable expropriation. In these cases, relevant factors have included the severity of the economic impact caused by the measure, the duration of such impact,[236] and the frustration of any legitimate expectations.[237]

An early decision which found that environmental measures did amount to a compensable expropriation was *Metalclad Corporation v United Mexican States (Metalclad)*.[238] The measures at issue in this case were the denial of a permit for the construction and operation of a hazardous waste landfill, and a subsequent ecological decree declaring the creation of a protected area. The tribunal determined that a compensable expropriation does not require the total loss of value of the investment, nor a severe interference with it; but includes incidental interference with the investment which has "the effect of depriving the owner, in whole or in

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[233] See Nathalie Bernasconi-Osterwalder and Edith Brown-Weiss "International Investment Rules and Water: Learning from the NAFTA Experience" in Edith Brown-Weiss, Laurence Boisson de Chazournes, and Nathalie Bernasconi-Osterwalder (eds) *Fresh Water and International Economic Law* (Oxford University Press, New York, 2005) 263 at 277 ["International Investment Rules and Water: Learning from the NAFTA Experience"].

[234] Refer to the discussion of the definition of "investment" above at Chapter II, Part C, Subpart 1.

[235] See *Pope & Talbot Inc v Government of Canada (Merits, Phase 1)* (26 June 2000) 13(4) World Trade and Arb Mat 19 at [96] [*Pope & Talbot (Merits, Phase 1)*]; *SD Myers*, above n 151, at [232].

[236] See *LG&E Energy Corp, LG&E Capital Corp and LG&E International Inc v Argentine Republic (Merits)* ICSID ARB/02/1, 3 October 2006 at [198]-[200]. There it was held that there must be a severe, permanent deprivation of investor rights to amount to an expropriation.

[237] See *Tecnias Medioambientales Tecmed SA v United Mexican States (Merits)* ICSID ARB(AF)/00/2, 29 May 2003. In this case, it was found that the investor legitimately expected to have a long term investment in Mexico; therefore the government's non-renewal of a permit after a year was a frustration of these legitimate expectations amounting to a compensable expropriation.

[238] *Metalclad Corporation v United Mexican States (Merits)* (30 August 2000) 16 ICSID Rev 168, 40 ILM 36, 5 ICSID Rep 212, 13(1) World Trade and Arb Mat 45 [*Metalclad*].

significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State".[239] This decision has often been criticised for neglecting environmental concerns. However, the Mexican government had misled Metalclad, and was not transparent about what permits were necessary for the landfill's construction and operation. Therefore, the tribunal found that this behaviour, coupled with the ecological decree, was enough to require the government to compensate Metalclad.

Case law has since provided many different formulations of what is required for a compensable expropriation. According to *Pope & Talbot*, the interference must be "substantial" – that is, so great that the measure "prevents, unreasonably interferes with, or unduly delays" the effective enjoyment of the foreign investment.[240] In the more recent case of *Feldman Karpa (Marvin Roy) v United Mexican States*, the tribunal dismissed the claim for expropriation because it found that the claimant's investment, a cigarette exporting business, "remained under his complete control and had the ability to continue exporting cigarettes as it had done before".[241]

Interestingly, some tribunals have held that an interference with an investment resulting from certain government measures is not compensable, and further, does not constitute an expropriation at all. This has been held where tribunals have relied upon the customary international law 'police powers' doctrine, which preserves the higher authority of the government to protect the public order and morality, including environmental and health issues.[242]

The *Methanex* Tribunal found an expropriation did not include measures taken by the government in the exercise of its 'police powers'.[243] Although it did not use those exact words, it held that a non-discriminatory regulation for a public purpose, enacted in accordance with due process would not amount to a compensable expropriation unless the host state had made express assurances that it would refrain from such regulation.[244] It

[239] *Metalclad*, above n 238, at [103].
[240] *Pope & Talbot (Merits, Phase 1)*, above n 235, at [102].
[241] *Feldman Karpa (Marvin Roy) v United Mexican States (Merits)* (16 December 2002) 18 ICSID Rev 488, 42 ILM 625, 7 ICSID Rep 341, 15(3) World Trade and Arb Mat 157 at [111] [*Marvin Feldman*].
[242] See *Saluka*, above n 221, at [262]; *Chemtura Corporation (formerly Crompton Corporation) v Government of Canada*, UNCITRAL, Award (2 August 2000) at [266].
[243] *Methanex*, above n 152, Part IV Chapter D at [7].
[244] *Methanex*, above n 152, Part IV Chapter D at [7].

therefore stressed the importance of the investor's legitimate expectations of the legal and regulatory environment in which it had invested. In *Methanex*, the US had made no such assurances as to the regulatory framework governing the use of MTBE and gasoline additives. The tribunal ultimately dismissed Methanex's claim because:[245]

> Methanex entered a political economy in which it was widely known, if not notorious, that governmental environmental and health protection institutions at the state and federal level, operating under the vigilant eyes of the media, interested corporations, non-governmental organisations and a politically active electorate, continuously monitored the use and impact of chemical compounds and commonly prohibited or restricted the use of some of those compounds for environmental and / or health reasons.

Therefore, while it will always be easy to identify a direct expropriation, the jurisprudence illustrates that drawing a line between compensable and non-compensable indirect expropriation remains difficult. Because reservations cannot be made against expropriation obligations, New Zealand has attempted to draw such a line by including relevant clarifications and Annexes to its more recent expropriation provisions.[246] These are intended to provide guidance on the application of the expropriation provisions, stating that that "non-discriminatory regulatory actions by a Party that are designed and applied to achieve legitimate public welfare objectives, such as the protection of public health, safety, and the environment" do not constitute an indirect expropriation.[247]

In the context of freshwater reform, these clauses might protect New Zealand from legal challenges of expropriation by investors subject to these clarifications and Annexes, if it could be proven that the measures were non-discriminatory, and were designed and applied to protect the environment. However, under its other IIAs, such guidance on indirect expropriation is not provided. Nevertheless, case law suggests that the introduction of legitimate, non-discriminatory regulations with the purpose of protecting freshwater resources would not constitute a compensable expropriation, unless the government had given express assurances otherwise, or the investor was completely deprived of the ability to

[245] *Methanex*, above n 152, Part IV Chapter D at [9].
[246] NZ-China FTA, Annex 13; ANZFTA, Chapter 11, Annex on Expropriation and Compensation; NZ-Malaysia FTA, Annex 7; CER Investment Protocol, art 14.
[247] Note that Article 14 of the CER Investment Protocol contains a footnote stating that "except in rare circumstances" non-discriminatory, legitimate public welfare regulations will not constitute an indirect expropriation.

continue operating their investment (this would most likely occur if freshwater was essential to the investment activity, and access to it was reduced or removed).

E. General Exceptions to Foreign Investment Protections

New Zealand's IIAs have several general exceptions that apply in respect of all foreign investment protection obligations and that are potentially relevant to freshwater reform.

1. Exceptions Incorporated from GATT and GATS

The general exceptions contained in Article XX of GATT 1994[248] and Article XIV of GATS[249] are incorporated into New Zealand's IIAs so that they apply also in respect of investments.[250] Relevantly for freshwater reform, the exceptions provide that the government is not precluded from adopting or enforcing measures "necessary to protect human, animal or plant life or health",[251] or "relating to the conservation of exhaustible natural resources".[252] These exceptions will only apply subject to the chapeau that measures are not applied in a manner which would amount to an "arbitrary or unjustifiable discrimination" between investors (or investments) of one party and another where they are in like circumstances, or a "disguised restriction on investment".[253] Significantly, this exception does not apply in respect of expropriation and FET in the CER Investment Protocol.[254]

However, these exceptions have little practical effect, because no foreign investment protection (not even expropriation) precludes the government from exercising its sovereign right to adopt or enforce measures in the circumstances carved out in these exceptions

[248] General Agreement on Tariffs and Trade 1867 UNTS 187 (signed 15 April 1994, entered into force 1 January 1995), art XX [GATT 1994]. Note GATT 1994 must be read in conjunction with the General Agreement on Tariffs and Trade 55 UNTS 194 (signed 30 October 1947, entered into force 1 January 1948) [GATT 1947].
[249] General Agreement on Trade in Services 1869 UNTS 183 (signed 15 April 1994, entered into force 1 January 1995), art XIV [GATS].
[250] The exception to this is the NZ-Hong Kong BIT which does not expressly incorporate these general exceptions: Article 8.
[251] GATT 1994, art XX(b); GATS, art XIV(b).
[252] GATT 1994, art XX(g); note that such measures must be made in conjunction with restrictions on domestic production or consumption.
[253] GATT 1994, art XX; GATS, art XIV.
[254] CER Investment Protocol, art 19.

anyway.[255] Arguments for the application of these exceptions to foreign investment protections are therefore very difficult to make out, and in some cases, very odd. For example, in the context of the expropriation protection, the obligation is to compensate the investor for an expropriation of their property. It would be difficult to imagine when a government could argue that a decision not to compensate (or a measure denying compensation) was necessary to protect life or health, or was related to the conservation of exhaustible natural resources. Likewise, in the context of national treatment, MFN, and FET, the obligations are not to discriminate against investors or treat them unfairly. In this case, even if an argument could be made out that treating foreign investors arbitrarily or in a discriminatory fashion was necessary for the protection of life or health, or was related to the conservation of exhaustible natural resources, the government would fall foul of the chapeau to the exceptions which prohibits measures being applied in a manner that would amount to "arbitrary or unjustifiable discrimination".

Therefore, given the relative inapplicability of these exceptions to foreign investment protections, coupled with the fact that they have only ever been successfully employed to defend a challenged measure in one of 35 attempts, these exceptions are highly unlikely to assist in safeguarding New Zealand's interests during the freshwater reform process.[256]

2. Treaty of Waitangi Exception

The general exception which is perhaps most relevant to freshwater reform is that pertaining to obligations owed to Māori under the Treaty of Waitangi. This provides that:[257]

> . . . nothing shall preclude the adoption by New Zealand of measures it deems necessary to accord more favourable treatment to Māori in respect of matters covered by this

[255] See Dolzer and Schreuer, above n 103, at 299. Expropriation protections do not prohibit the government from adopting or enforcing regulatory measures; rather the protection is for compensation to be paid if an expropriation occurs as a result of a direct taking, or the adoption or enforcement of regulatory measures amounting to an expropriation.

[256] See "Only One of 35 Attempts to Use the GATT Article XX/GATS Article XIV 'General Exception' Has Ever Succeeded: Replicating the WTO Exception Construct Will Not Provide for an Effective TPP General Exception" (September 2013) Public Citizen <www.citizen.org>. Note the case that succeeded in using the general exception was: *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products* WT/DS135/AB/R, 12 March 2001 (Reports of the Appellate Body adopted on 5 April 2001).

[257] See for example, NZ-China FTA, art 205.

Agreement including in fulfilment of its obligations under the Treaty of Waitangi.

Like the GATT/GATS exceptions, this exception will not apply if the measures are used as a "means of arbitrary or unjustified discrimination against persons of the other Party" or a "disguised restriction" on investment.[258]

The Treaty of Waitangi exception is designed to ensure that the Government retains its ability to implement domestic measures that favour Māori without having to offer equivalent treatment to foreign investors. This is a vital exception in the context of freshwater reform because the Treaty of Waitangi is "the underlying foundation of the Crown-iwi/hapū relationship with regard to freshwater resources", and addressing Māori interests and involving the Māori community in the management of freshwater have been described as "key to meeting obligations" under the Treaty.[259] Therefore, where freshwater reforms are specifically designed to give special treatment to Māori interests and their cultural relationship with water, this exception will play a vital role in shielding the government from liability under its IIAs.

Importantly, the exception is also self-judging, so that the Government, and not an arbitration panel, has the sole discretion to determine what measures are necessary to fulfil its obligations under the Treaty of Waitangi. The exception also provides that the interpretation of the Treaty will not be the subject of international investment dispute settlement. These two factors provide additional protection for both the New Zealand Government in adopting measures that favour Māori, and Māori themselves, because they prevent an international arbitration panel determining that the exception does not apply because it considers the measures were not "necessary" or the Treaty obligations were interpreted incorrectly.

3. Other Considerations

Finally, in times of extraordinary events, such as state emergencies, armed conflicts, force majeure, and periods of economic and social disorder, host states may have customary international law defences available to them so they can deal with extraordinary situations

[258] See for example, NZ-China FTA, art 205.
[259] See Ministry for the Environment *National Policy Statement for Freshwater Management 2011* (issued by notice in The New Zealand Gazette on 12 May 2011) at 3.

without incurring liability towards foreign investors. In this case, the relevant international rules will apply.[260]

[260] Dolzer and Schreuer, above n 103, at 426-427.

Chapter IV: Implications of New Zealand's International Investment Regime for 'Freshwater reform 2013 and beyond'

This chapter will consolidate the analysis in Chapter III, addressing specific legal issues that may arise in the introduction of the Government's key proposed measures in 'Freshwater reform 2013 and beyond'. The chapter will then look at another potential implication of our international investment regime for freshwater reform – the concept of 'regulatory chill'.

A. Key proposed Freshwater Reform Measures and Potential Legal Issues

1. A Collaborative Process and Provisions for Māori Involvement in Freshwater Planning

An immediate reform proposed by the Government is to amend the RMA to provide a collaborative planning process that councils may choose to adopt when preparing, changing and reviewing freshwater policy statements and plans.[261] The collaborative planning process involves the council appointing a stakeholder group including representatives of the community and parties with a major interest in the water catchment concerned. A statutory requirement will also ensure that iwi are involved in this process. The council will be responsible for approving a plan based on a consensus view of the stakeholder group. However, there will be a statutory requirement for advice and recommendations of iwi to be explicitly considered before decisions are made. Because addressing Māori interests and involving the Māori community in the management of freshwater have been described as "key to meeting obligations" under the Treaty,[262] the preference accorded to Māori views will be unlikely to attract legal challenges of national treatment due to New Zealand's Treaty of Waitangi exception.

[261] See *Freshwater reform 2013 and beyond*, above n 6, at 25. Note that with this reform, councils would still be able to use the existing planning process in Schedule 1 of the RMA if they desired. Note also that a policy statement provides an overview of resource management issues of the particular area and policies and methods to achieve integrated management of the natural and physical resources of the whole area. A freshwater plan is meant to assist a council in carrying out its functions under the RMA. It will provide a more detailed account of procedures and processes that will be implemented to give effect to the policy statement: see RMA, Part 5.

[262] See *National Policy Statement for Freshwater Management 2011*, above n 259, at 3.

Potential legal challenges to this reform would only arise if the collaborative planning process failed to involve foreign investors with a major interest in the water catchment concerned. Exclusion of foreign investors from this process could attract claims of a breach of FET, or national treatment if only New Zealand nationals were involved in the process. In addition, a breach of MFN treatment could be alleged if one group of foreign investors was excluded from the process, resulting in less favourable treatment than that accorded to other foreign investors in like circumstances who were allowed to participate.

Therefore councils should ensure that any collaborative process is transparent and inclusive.

2. Freshwater Accounting Systems

During 2013-2014, the Government will develop a freshwater accounting system that will identify and record all water takes to allow for the best decisions to be made about freshwater allocation and use.[263] This will predominantly impact councils. However amendments to the RMA will require councils to collect data from all water users.

The Government has indicated that the costs (if any) to freshwater users of providing additional information to councils would be "small".[264] However, the cost will inevitably vary between water users depending on factors such as the volume of water takes involved, the method of data collection, and the accuracy of data required.

The extent to which these costs might affect foreign investment is therefore difficult to predict. However, they are extremely unlikely to be severe enough to amount to a compensable expropriation depriving them of the use and enjoyment of their investment. Furthermore, requiring such information will not breach national treatment or MFN obligations because the accounting system will require freshwater takes from all users to be included.

[263] *Freshwater reform 2013 and beyond*, above n 6, at 38.
[264] *Freshwater reform 2013 and beyond*, above n 6, at 39.

3. Improving the Efficiency of Water Use

The Government has indicated that tools to improve the efficiency of water use will be addressed in longer term measures. Such measures could include tradability of water rights or regulations requiring particular technologies or processes to be used.[265]

Legal challenges from foreign investors in relation to tradability of water rights would have the most potential to arise in respect of the initial development of a trading platform, or its future removal. This is because these phases of tradability are the most likely to interfere with existing water rights. If development of a trading platform were to scale back or require the purchase by water users of their existing water permits, this could amount to a compensable expropriation, or a breach of FET through frustrating any legitimate expectations of investors to enjoy their water permits for the term and cost they were guaranteed. Of greater concern however, would be the potential future of any trading platform. Once a platform is up and running, foreign investors' water rights could be considered an 'investment' in themselves (a share of the water market).[266] Therefore, any future measure removing the trading platform, or causing significant losses to participating investors could constitute grounds for a claim of compensable expropriation under New Zealand's IIAs. Of course, the success of any claim for expropriation would depend on how the measure was introduced, its intended purpose, and the duration and severity of harm to the investment.[267]

As for the compulsory use of certain technologies and processes, this would be unlikely to attract legal challenges from foreign water users unless the requirement was applied inconsistently or imposed severe and unnecessary costs on them. A breach of FET could be made out if the investors' legitimate expectations had been frustrated, for example, if they were no longer able to use vital technology the Government had assured them they could use; however cases such as this would be extremely rare.

Requiring the compulsory use of efficient technologies and processes may however, have a significant impact on the business of foreign investors who produce or service older, existing technologies not made compulsory by the legislation. If the impact of water users being required to switch to the newer technologies effectively deprives these investors of the

[265] *Freshwater reform 2013 and beyond*, above n 6, at 39.
[266] See *Pope & Talbot (Merits, Phase 1)*, above n 235, at [96]; *SD Myers*, above n 151, at [232].
[267] See discussion above at Chapter III, Part D.

enjoyment of their investment (by eliminating their customer base for example), then they might claim indirect expropriation.

If a claim of indirect expropriation was brought, New Zealand could rely on the Annexes to several of its expropriation provisions stating that non-discriminatory, legitimate public policy measures adopted by the Government do not constitute an indirect expropriation.[268] In this case, it would likely be found that the measure was applied to achieve a legitimate public welfare objective (the protection of freshwater resources); however it would also have to be shown that the measure was non-discriminatory. In this respect, the effect of the measure, not its intent, is usually decisive.[269] Consequently, because the effect of the measure in this case discriminates 'de facto' against producers of the old technology, it is unlikely that such an Annex would apply to prevent a finding of indirect expropriation.

This type of measure may therefore be troublesome for the Government if there are foreign investors that may be affected in a significant way.

4. Dealing with Over-Allocation of Water

The Government has recognised that in setting limits for freshwater catchments, some of these catchments may already be over-allocated.[270] Therefore, bringing freshwater use within the limit will involve time and costs. The Government suggests various ways to bring use within a limit, such as seeking voluntary reductions, adjusting water permit levels to reflect actual use, or reducing all permits by the same amount or on a pro rata basis.[271]

If these measures were applied to all water permit holders, then breaches of national treatment and MFN treatment provisions would be highly unlikely. However, complications could arise if such measures were only applied in respect of selected freshwater catchments.

For example, consider a scenario where a water-intensive Chinese-owned agribusiness holds water permits in the Canterbury region (a region currently experiencing water scarcity issues) and all Canterbury water permits are reduced. Meanwhile, their main domestic or foreign

[268] See above n 246.
[269] See above n 184.
[270] See *Freshwater reform 2013 and beyond*, above n 6, at 40. Note that in this context, 'over-allocated' means that more freshwater is currently being taken from the water catchment than the limit would allow for.
[271] See *Freshwater reform 2013 and beyond*, above n 6, at 41.

agribusiness competitors are situated in the Taranaki region where there is no need to reduce water permits to bring usage within catchment limits. While this measure has a legitimate purpose, it would amount to de facto discrimination because it has the practical effect of discriminating against the Chinese investor. Furthermore, because they are in competition, the Chinese investor and the domestic or foreign investors in Taranaki may be considered to be in 'like circumstances'.[272] There would be potential in this situation for the Chinese investor to bring a successful legal challenge against the New Zealand Government for breaching its obligation to accord national treatment or MFN treatment under the NZ-China FTA. However, this potential may be reduced if the decisions of *Pope & Talbot* and *Methanex* were relied upon, because a legitimate justification exists for the differential treatment between investors in this case – that is, the protection of water resources in Canterbury.[273] This may be enough to establish that the investors are not in 'like circumstances', and therefore the national treatment or MFN obligation has not been breached.

Importantly, because reducing water permits would be considered a water allocation measure, a breach of national treatment could not be claimed by Australian investors due to the water reservation in the CER Investment Protocol, and the absence of an ISDS provision.[274]

Another potential effect of reducing water permits would be to impact the value of water-intensive foreign investments in New Zealand to such an extent that investors could reasonably claim compensable expropriation. A breach of FET could also be established where the right to access the water necessary for the business's long-term operation formed part of the 'legitimate expectations' of the foreign investor.

In any case, the quantity, speed and transparency of reductions would be highly relevant to the risk of legal challenges, as would be the application of the exceptions to New Zealand's IIAs.

[272] See discussion of *SD Myers* above at Chapter III, Part A.
[273] See discussion above at Chapter III, Part A.
[274] Note that Australian investors could still allege a breach of MFN treatment in this situation, however due to the absence of an ISDS provision such a claim would have to be brought by the Australian government on the investor's behalf.

5. Improving the Quality of Water

The Government has indicated that future measures may include regulations to require the implementation of technology or processes that are cost-effective and proven to reduce water discharges.[275] This type of regulation is similar to that already discussed which would require the implementation of more efficient technology or processes to improve the efficiency of water use, therefore, the potential legal issues are analogous to those discussed above.

6. The Whole Package of Reforms

It should be noted finally that a foreign investor may bring a legal challenge against a series of measures as opposed to any one single measure. Because the package of freshwater reforms consists of both immediate measures, and longer-term measures, if the overall effect of these measures taken together is to substantially deprive the investor of the enjoyment of their investment, they may allege a special type of 'creeping' expropriation and be entitled to compensation.[276]

B. Regulatory Chill

Besides possible legal challenges that may arise, another potential obstacle to freshwater reform may represent a greater concern for the Government. This is the concept of 'regulatory chill', which is generally used to describe situations where regulators refrain from adopting new health and environmental regulations for fear of possible legal challenges under international investment law.[277] This fear is typically predicated on the existence of the ISDS mechanism which allows foreign investors to bring such challenges directly against the state.

[275] *Freshwater reform 2013 and beyond*, above n 6, at 50.
[276] "UNCTAD Series on International Investment Policies for Development: Investor-State Disputes Arising from Investment Treaties: A Review", above n 161, at 42.
[277] See Julie Soloway "NAFTA's Chapter 11: Investor Protection, Integration and the Public Interest" in John J Kirton and Peter I Hajnal (eds) *Sustainability, Civil Society and International Governance: Local, North American and Global Contributions* (Ashgate Publishing Limited, Hampshire (England), 2006) 137 at 156.

As such, critics of investment treaty arbitration have warned that ISDS allows:[278]

> . . . the interests of foreign investors to be as central to the government's calculations and decisions as are the public interests of its people, despite the obvious inappropriateness of foreign investors determining the legislative agenda of a sovereign government.

However, the difficulty lies in proving a 'regulatory chill' actually exists in practice. In fact, one commentator recognised that any investigation would require a "sweeping analysis of decision- and policy-making authority across a wide range of agencies and departments vested with environmental-related responsibilities".[279] Further, once the appropriate bodies to be examined were established, it would also be difficult "establishing with any certitude why [they] might forgo particular policy options".[280]

Despite challenges in proving its existence, 'regulatory chill' might be a valid concern in the realm of freshwater reform where large foreign investors with a vested interest in freshwater resources are present, even in situations where ISDS is not available. We have already seen the New Zealand Government bow to pressure from foreign investors, quite recently with respect to the production of the 'Hobbit' film. This involved a deal between Warner Bros executives and the government, who agreed to change labour laws, and grant tax breaks and marketing cost relief to ensure the production of the film remained in New Zealand.[281] While this instance did not involve refraining from regulatory measures, it still involved the influence of the Government's legislative agenda by foreign investors and their interests.

There are several large foreign investors in New Zealand with a vested interest in freshwater resources.[282] One example is PGG Wrightson, which is a NZ$1bn agricultural company majority owned by Singapore investors.[283] Another example is Contact Energy Limited.

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[278] S Ganguly "The Investor-State Dispute Mechanism (ISDM) and a Sovereign's Power to Protect Public Health" (1999) 38 Colum J Transnat'l L 113, at 120.

[279] Chris Tollefson "NAFTA's Chapter 11: The Case for Reform" in John J Kirton and Peter I Hajnal (eds) *Sustainability, Civil Society and International Governance: Local, North American and Global Contributions* (Ashgate Publishing Limited, Hampshire (England), 2006) 177 at 178.

[280] Tollfeson, above n 279, at 178.

[281] Derek Cheng and Paul Harper "CTU: *Hobbit* labour law changes 'opportunistic'" *The New Zealand Herald* (online ed, New Zealand, 28 October 2010).

[282] Note that even if there are not many large foreign investors with an interest in freshwater now, the possibility always exists for them to arrive in the future. Therefore while 'regulatory chill' may not be a concern now, there is potential for it to be a concern in the future.

[283] PGG Wrightson is majority owned by Agria (Singapore) Pte Ltd, and is a provider of products, services and solutions to the agricultural sector. It generated upwards of NZ$1bn in revenue in the most recent financial year. See <www.pggwrightson.co.nz>.

Interestingly, Contact has made a submission to the Government in respect of the allocation of freshwater, contending that there should be special provision for hydropower in any decisions on allocation.[284] This is because hydropower operations rely on large volumes of water being available for electricity generation. Contact is ultimately majority owned by Australian investors, who cannot bring claims against the Government due to the absence of ISDS in the CER Investment Protocol. However, Contact is a large and important investor that the New Zealand Government is likely to take notice of.

Therefore, if the Government suspects it could be challenged by these investors on certain freshwater reform measures it may refrain from adopting these, and consider other, less restrictive freshwater measures. If such measures turn out to be less effective, the sustainability of our water resources could be the price.

[284] *Submission by Contact Energy Limited in response to the Discussion Document: Freshwater reform 2013 and beyond*, available at <www.contactenergy.co.nz/web/pdf/legal/cen-submission-freshwater-reform-201304.pdf>.

Conclusion

This paper began by detailing the fast-approaching global freshwater crisis and the urgent need for national governments and international institutions to reconsider how water security should be reflected in domestic and global arrangements. The New Zealand Government answered this call to action in March 2013, releasing 'Freshwater reform 2013 and beyond' – a package of proposals representing the most comprehensive reform of our freshwater management system for a generation. However, with increasing trends in foreign investment, a concern was raised that obligations owed to investors under New Zealand's international investment regime could constrain the Government in its implementation of these reforms.

Chapters III and IV illustrate that this concern is well-founded. Several of the proposed measures in New Zealand's package of reforms could have the potential to give rise to legal challenges for breach of foreign investment protections under New Zealand's IIAs. The measures with the most potential to attract challenges are those that interfere directly with foreign investments, such as reducing existing water permit allocations on a pro rata basis to deal with over-allocation, or banning the use of certain inefficient water technologies and processes to improve the efficiency of water use.

While the CER Investment Protocol's reservation with respect to water allocation may be effective to exempt the Government from liability if it reduces water permit allocations, the reservation only applies in respect of Australian investors, and national treatment obligations. It does however represent an acute awareness by the Government of the capacity for foreign investment protection obligations to frustrate its ability to introduce freshwater measures. To ensure this reservation continues to apply in respect of Australian investors, the New Zealand Government should include this reservation in future treaties, including the TPP which is currently under negotiation. To further safeguard its ability to implement freshwater reform, the Government could also include additional reservations in future treaties that apply to a more extensive range of water measures beyond just allocation measures.

However, the use of reservations will not completely safeguard New Zealand's ability to carry out freshwater reform, as reservations cannot be made against FET and expropriation obligations. Therefore, any effective blanket exemption for water measures would have to be made in the form of a well-drafted general exception.

As well as representing a potential source of legal challenge to New Zealand's freshwater reform measures, a concern was raised that IIAs could also be capable of causing 'regulatory chill'. This is arguably more troubling than any possible legal challenge, because while legal challenges may have to be met with money, the price of refraining from the introduction of freshwater measures is much greater – the price being the sustainability of our freshwater resources.

In Chapter IV, the circumstances surrounding the production of the 'Hobbit' film illustrated that 'regulatory chill' could be a real concern in the New Zealand context, especially where foreign investors and their investments are important for the economy, and have substantial bargaining power.

Therefore, recognising that the obligations owed under our international investment regime have the potential to constrain the Government in implementing freshwater reform measures, the best solution is to raise awareness of these constraints so that the risks associated with them may effectively be managed.[285] Given the multi-level nature of freshwater management, this entails making sure that all levels of government are aware of foreign investment protection obligations, and ensuring that any introduction of freshwater policy takes these obligations into account.

Finally, it is important to realise that this paper only scratches the surface in terms of illustrating the constraints that New Zealand's international investment regime may have for freshwater reform. International investment law is constantly shifting, and New Zealand is still negotiating further treaties. Therefore, these factors make it difficult to say with much certainty how pervasive New Zealand's international investment obligations really are.

Ultimately, this paper is intended to educate, raise awareness and stimulate discussion on a topic which will inevitably become one of vital importance as the power struggle for

[285] While ways around the foreign investment constraints on freshwater reform are beyond the scope of this paper, it is worth mentioning that encouraging industry self-regulation represents a promising and viable solution to this issue. This type of regulation cannot be challenged under IIAs, so if the Government offers appropriate incentives, it may be able to achieve parts of its freshwater reform agenda through this channel. Some industry self-regulation already exists in New Zealand. For example, riparian fencing is a condition of supply to Fonterra; and some industries have accredited environmental management systems in place that include water quality management: see *Freshwater reform 2013 and beyond*, above n 6, at 50.

freshwater intensifies. As Ismail Serageldin said back in 1995, "[the] wars of the next century will be over water".[286]

[286] Barbara Crossette "Severe Water Crisis Ahead for Poorest Nations in Next 2 Decades" *The New York Times* (online ed, 10 August 1995).

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