# Chapter 6

# New Provisions Addressing Sustainable Development

**Cross references**



## 6.1 Making the link between investment and sustainable development

Foreign investment contributes to development in developing countries. However, increased investment inflows alone do not automatically lead to sustainable development. For this reason, the Guide explores various ways that states can channel increased investment into sustainable development.

The Guide discusses treaty provisions that a government can seek in its IIAs in order to support its ability to regulate foreign direct investment so that it contributes to sustainable development. The primary emphasis is on two policy tools. The first is adapting provisions typically found in IIAs, such as national treatment, MFN, FET and protection against expropriation without compensation, so that they are more protective of the state's ability to pursue its sustainable development policies. The discussion in Chapter 5 will help states to evaluate the challenges that their existing agreements represent for the pursuit of sustainable development, as well as help them to negotiate future agreements with provisions better adapted to their needs.

The second tool consists of new sustainable development provisions not found in existing IIAs. In this chapter, the Guide discusses various forms that such provisions can take, such as the inclusion of sustainability assessment processes in the treaty, the imposition of obligations on investors to respect human rights, labour rights, indigenous peoples' rights and the environment, prohibitions on bribery and other forms of corruption, the creation of civil and criminal liability for investors that harm the environment or violate human rights, the use of liability in the home state to hold investors accountable for harms caused in host states and various modifications to the investor–state dispute settlement process that can redress the imbalance between states and investors under current IIAs.

Each state will adopt its own definition of sustainable development and implement policies to achieve its development goals. In doing so, a state will have to address what approaches to regulating foreign investors can best achieve these goals or are most compatible with government policy. The discussion in this chapter of the Guide is intended to provide inspiration to policy-makers about how to build a robust link between investment policy and sustainable development policy.

In this chapter, we frequently refer to international human rights, including labour rights and the rights of indigenous peoples. We also refer to environmental sustainability and best practices for promoting environmentally friendly investment. These references are not meant to be prescriptive. Each developing country will necessarily adapt its pursuit of sustainable development to its social and political circumstances and to the interests of its people.

In particular, not all states have ratified and implemented the same international human rights and labour rights instruments. In consequence, each state will have to determine for itself which rights need to be reflected in its policies on foreign investment.

Finally, not all states will seek the same balance between environmental protection, the protection of human rights, labour rights and indigenous peoples' rights, on the one hand, and natural resource exploitation and other forms of investment on the other. For these reasons, no one set of domestic institutions, laws and regulations or one set of provisions in an IIA can meet the needs of every developing country.

However, if government policy-makers wish to use treaty-based mechanisms to bolster their domestic measures to promote human rights and environmental protection and prohibit corruption, they can draw on various mechanisms discussed in this section of the Guide. This discussion begins with an examination of the difficulties of effectively regulating foreign investors. Later, the Guide discusses the benefits of regulation, both for citizens of the host country, whose communities may benefit from investment, and for investors and domestic businesses, who will be attracted by a predictable regulatory framework based on the best practices of good governance.

## 6.2 The challenges of regulating foreign investors and holding transnational corporations accountable

Developed and developing countries often face challenges regulating foreign investors to ensure that their investments contribute to sustainable development. This is partly because of some fundamental weaknesses in international law as a tool to regulate foreign investors. It is also caused by ineffective regulation of investors by host and home states. A final contributing factor is the risk that international investment arbitrators will subordinate sustainable development considerations to the protection of investors' interests when they are interpreting a state's IIA obligations.

### 6.2.1 Weaknesses in international law

International law does not provide many effective ways of holding to account foreign investors who violate international human rights, labour rights[1] or norms for environmental protection. For example, international human rights law does not impose direct obligations on investors. Rather, it requires states to take steps – through legislation or administrative and other measures – to ensure that private actors such as investors do not violate the human rights of individuals within their territory and subject to their jurisdiction. Victims of human rights abuses committed by an investor or caused by an investment can seek redress from the investor or its investment only in the domestic courts or administrative institutions of the host state.[2] If this fails, the only avenue open to victims of human rights abuses is to bring a complaint against the host state before an international human rights tribunal for failing to take appropriate steps to prevent the investor from violating their rights.[3]

Another problem in holding investors legally accountable for violations of human rights, labour rights, the rights of indigenous peoples and environmental damage is the complex legal structure of many transnational businesses. Typically, they are made up of many distinct entities, including a parent corporation, multiple subsidiaries and joint-venture partners that are incorporated or organised under the laws of different countries. International law and most domestic laws treat each of these entities as a separate legal entity that is governed by the domestic laws of the state in which it is incorporated or organised.[4]

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1 See, for example, B A Frey (1997), 'The Legal and Ethical Responsibilities of Transnational Corporations in the Protection of International Human Rights', 6 *Minnesota Journal of Global Trade* 153 at 163; S Joseph (1999), 'Taming the Leviathans: Multinational Enterprises and Human Rights', 46 *Netherlands International Law Review* 171 at 175; and R McCorquodale (2002), 'Human Rights and Global Business', in S Bottomley and D Kinley (eds), *Commercial Law and Human Rights,* Ashgate Publishing, Aldershot, 89 at 92–7.

2 JD Taillant and J Bonnitcha (2011), 'International Investment Law and Human Rights', in Cordonier Segger et al. (eds), *Sustainable Development in World Investment Law,* Kluwer Law International, The Hague, at 58–60, 73.

3 Ibid.

4 J Crawford and S Olleson (2003), 'The Nature and Forms of International Responsibility', in M D Evans (ed.), *International Law,* Oxford University Press, Oxford and New York, 445 at 448.

However, the reality is that these corporate groups operate as a complex integrated network of actors connected by links of ownership and contract. As result of this network, transnational businesses can allocate their assets within this network to minimise liability risk. For example, a transnational business may seek to minimise risk related to its activities in a host state by allocating few assets to its subsidiary carrying on business in that state.[5] Claimants in the host state who have proved that they were harmed by the transnational business may be able to make a legal claim only against the subsidiary, because the parent corporation and other components of the transnational business are distinct legal entities. Although there may be sufficient assets within the transnational business as a whole, the claimants may have recourse to only the inadequate assets of the subsidiary to satisfy their claims.

### 6.2.2 Weaknesses in domestic law in host states and investors' home states

Sometimes the domestic law of host states does not provide effective remedies that allow individuals to sue foreign investors for harms they have suffered as a consequence of the investor's activities.[6] In addition, the legal institutions of the host state may lack sufficient resources to follow up on complaints. Many developing countries do not possess the technical capacity or the physical and institutional infrastructure to regulate the environmental or the social effects of foreign investments effectively. The problem is sometimes political – industry lobby groups and various political interests may make it difficult for governments to regulate or control foreign investors.[7] It has been suggested that 'where [investors] set up foreign operations in locations characterized by weak, non-existent or corrupt governance, the prospect of effective local regulation is even more remote'.[8]

There is little that those located in the investor's home state or other states can do to support the host state government or citizens of the host state who wish to hold foreign investors accountable for their acts. For instance, there are a wide range of obstacles to bringing a civil suit against a parent corporation in the home state for the acts of its foreign subsidiaries that commit human rights and other violations in the host state, despite the fact that all the companies are linked. These kinds of claims have rarely been successful. Thus, concerned citizens or groups located in the investor's home state that advocate for citizens of a developing country harmed by a foreign investor have few options for obtaining redress for victims.

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5 S Joseph (2012), 'Protracted Lawfare: The Tale of Chevron Texaco in the Amazon', 3 *Journal of Human Rights and the Environment*, 70 at 89.

6 Taillant and Bonnitcha, op. cit., at 74.

7 The California Global Corporate Accountability Project (2002), *Beyond Good Deeds: Case Studies and a New Policy Agenda for Corporate Accountability*, a collaboration of the Nautilus Institute for Security and Sustainable Development, the Natural Heritage Institute, and Human Rights Advocates, Berkeley, July, at xiv.

8 G Gagnon, A Macklin and P Simons (2003), 'Deconstructing Engagement: Corporate Self-Regulation in Conflict Zones: Implications for Human Rights and Canadian Public Policy', University of Toronto, Public Law Research Paper No. 04–07, Toronto at 11, available at: http://ssrn.com/abstract=557002 (accessed 28 May 2012).

A further problem is the potential for investors to use the protections provided to them by an IIA to evade their obligations under the domestic law of the host state. The actions of Chevron Corporation, an American multinational energy company, to avoid liability for severe environmental damage in the Ecuadorian Amazon illustrate this tactic. By means of a merger, Chevron acquired the Ecuador oil interests and liabilities of Texaco, another oil company. Chevron was then sued in Ecuador for harms caused by Texaco. To derail the suit in Ecuador, Chevron engaged in a number of tactics before the Ecuadorian court issued its judgment. One of them was to initiate a claim against Ecuador under the US–Ecuador BIT on the basis that the court proceedings in Ecuador were in breach of the obligation to guarantee fair and equitable treatment to Chevron.

The Ecuadorian court found against Chevron and awarded the plaintiffs US$9.4 billion and conditional punitive damages of US$8.4 billion.[9] This decision was affirmed by an appeals court in January 2012. Chevron has appealed that ruling to the Supreme Court of Ecuador.[10] The international investment arbitration panel then issued a number of interim rulings, one of which called on the Government of Ecuador to 'take all measures necessary to suspend or cause to be suspended the enforcement and recognition within and without Ecuador of the judgments'[11] against Chevron. The Ecuador court refused to do so.[12] The international investment arbitration panel then proceeded to find that it had jurisdiction over Chevron's claim under the BIT.[13] In consequence, Chevron's case against Ecuador for breach of the US–Ecuador BIT will now proceed to the merits. This case illustrates how a transnational corporation such as Chevron can try to use a BIT in order to attempt to nullify rulings of courts in the state where the investment is located.

### 6.2.3 Investor–state tribunals do not give priority to considerations other than investment protection

The decisions of investment tribunals have not been very helpful in asserting the obligations of foreign investors to respect human rights, labour rights or the rights of indigenous peoples. So far, they have not recognised that states can give priority to the protection of the human rights and other rights of their citizens over their obligations to investors under IIAs.

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9 For a full discussion of the Chevron case, see Joseph (2012), op. cit.

10 Ibid., at 91.

11 *Chevron and Texaco v. Ecuador*, PCA Case No. 334877, Second Interim Award on Interim Measures, 16 February 2012, at para 3, available at: www.chevron.com/documents/pdf/ecuador/SecondTribunalInterimAward.pdf (accessed 29 May 2012).

12 E Garcia, 'Ecuador court rejects Chevron arbitration ruling' (*Reuters*, 20 February 2012), available at: www.reuters.com/article/2012/02/20/us-ecuador-chevron-idUSTRE81J17A20120220 (accessed 9 May 2012).

13 *Chevron and Texaco v. Ecuador*, PCA Case No. 334877, Third Interim Award on Jurisdiction and Admissibility, 17 February 2012, at para. 5.2, available at: www.chevron.com/documents/pdf/ecuador/PCA-Jurisdiction-Decision.pdf (accessed 9 May 2012).

Few cases have explored the relationship between human rights and IIAs. Some cases recognise that where an IIA contains a vague standard, human rights law can be used as an aid in interpreting them.[14] However, when states have argued that their IIA obligations conflict with their human rights obligations, tribunals have refused to give priority to the protection of human rights. This means that where a state enacts laws or acts to promote or protect human rights and these laws or actions harm foreign investors, states may have to respect their obligations to investors regardless of whether, in the eyes of the state, this renders their domestic human rights regime or their acts to promote and protect human rights less effective.[15]

Taillant and Bonnitcha summarise their view of the negative consequences of the current cases in stark terms:

> Foreign investment law makes no consideration for stakeholder impact [for example, the impact of investor actions on citizens of the host state]. Rather the rights of the investor are defended despite the impact defending those rights has on stakeholders and in absolute disregard for any obligations the State may have vis-à-vis those stakeholders. Further, vulnerable groups that are often-times adversely and disproportionately impacted by the externalities of such investments in times of turmoil must often bear the costs and burdens of upholding investment profit agreements. Put simply, individual and community stakeholders currently have no place at the dispute settlement table in [international] investment law, except to pay for the check when it comes at an awkward time.[16]

## 6.3 Different approaches to integrating foreign investment and sustainable development

There are many policy options for host states seeking to hold investors accountable for protecting and promoting human rights, good labour practices, the rights of indigenous peoples and the environment. This section of the Guide discusses the advantages and disadvantages of various methods for doing so.

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14 In *Biwater v. Tanzania*, Tanzania cancelled a water concession contract with Biwater without following the termination procedure specified in the contract. Tanzania argued that the concession did not provide adequate water or sewage services, and a number of *amici curiae* argued that the human right to water thus justified the government's actions (*Biwater Gauf v. Tanzania*, ICSID Case No. ARB/05/22, Award, 24 July 2008, at paras. 380, 387. The tribunal interpreted the fair and equitable treatment obligation in the investment treaty in light of Tanzania's obligation to protect the right to water of its citizens (ibid., at para. 601).

15 In *Siemens v. Argentina*, Argentina argued that it was justified in not respecting its contractual obligations to Siemens because the country was facing an economic crisis and it was imperative to protect the human rights of its citizens. The tribunal held that Argentina's obligations to respect Siemen's contractual rights did not conflict with its obligations to protect human rights. In consequence, the tribunal refused to consider Argentina's human rights arguments when deciding whether it had violated its obligations to Siemens (*Siemens A.G. v. The Argentine Republic*, Award, 6 February 2007, at paras. 75, 79). For a summary of the legal consequences of the *Siemens* and *Biwater*, op. cit., cases, see Taillant and Bonnitcha, op. cit., at 77.

16 Ibid. at 78.

### 6.3.1 Using domestic laws, regulations and institutions to promote investor compliance with sustainable development policies

One way to ensure that foreign investors comply with human rights and other norms and implement policies that contribute to environmental protection is to enact domestic laws and regulations and create domestic institutions to implement the country's international legal obligations to respect human rights, labour rights and indigenous peoples' rights, to promote environmental sustainability and address corruption. Of course, different states are parties to different treaties in these areas and so it is necessary for each state to take an inventory of its international obligations and research best practices for implementing them. To the extent that foreign investors are subject to the domestic law of the host state, domestic mechanisms can be used to ensure investor accountability.

It is not possible for this Guide to survey all the best practices for implementing international obligations through domestic law. They extend from incorporating a robust bill of rights into a state's constitution to creating human rights commissions and environmental review boards. However, the Guide considers one mechanism that could be implemented in domestic law in some depth – sustainability assessments (SAs).[17] As will be explained below, this mechanism is explored because the assessment process is directly linked to the process of evaluating, admitting, monitoring and ensuring the ongoing accountability of foreign investments in the host state.

### 6.3.2 Integrating sustainable development into an IIA

In addition to enacting domestic legislation, IIAs could be used to promote sustainable investment. As most existing IIAs do not incorporate principles of sustainable development, few models exist for doing so. However, IIAs can provide several useful and practical mechanisms that enhance host state capacity to ensure that foreign investors operate in a manner consistent with sustainable development. These mechanisms can include:

1. Creating treaty-based standards for investors that require them to act in a manner consistent with sustainable development criteria;[18]
2. Providing ways to enforce those standards in the treaty[19] such as:
    a. requiring *host states* to allow civil and/or criminal suits in their courts against investors who fail to meet norms for sustainable development,

17 See Section 6.6 (Sustainability assessments).

18 See Section 6.7 (Investor obligation to comply with the laws of the host state), Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence), Section 6.9 (Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights), Section 6.10 (Investor obligation to comply with core labour standards) and Section 6.11 (Investor obligations to refrain from acts, or complicity in acts, of bribery and corruption).

19 See Section 6.13 (Enforcement of investor obligations).

b. requiring investors' *home states* to allow civil and/or criminal suits in their courts against investors who fail to meet norms for sustainable development;

3. Creating incentives for investors to comply with obligations by limiting their access to treaty-based remedies against the state; and[20]

4. Requiring that investors' home states provide technical assistance to support host state development of more effective domestic regulatory schemes and the implementation of the agreement.[21]

In addition to including these new kinds of provisions, which will be addressed on an individual basis below, we have already discussed another approach: adapting IIA investor protection provisions to protecting the ability of the host state to regulate effectively.[22] As discussed in Chapter 5 (Substantive Obligations of Host States Regarding Investor Protection), some provisions traditionally included in IIAs have been interpreted by international arbitration panels so as to limit the ability of governments to enact new laws and regulations that adversely affect foreign investors.[23] This is of particular concern from the point of view of sustainable development if the host state is considering creating new legal mechanisms in the future for protecting the environment, protecting or promoting human rights, labour rights or the rights of indigenous peoples or addressing corruption. For example, if these mechanisms have an impact on foreign investors, there is a risk that these investors may claim that the mechanisms violate provisions of an IIA such as the obligation to provide fair and equitable treatment or to prohibit expropriation without compensation. The Guide discusses how these provisions may be adapted to better ensure that states have sufficient policy space to regulate to achieve sustainable development.

### 6.3.3 The elements of sustainable development addressed in the sample provisions

In this chapter of the Guide, examples of a variety of new kinds of provisions not found in existing IIAs are set out. These provisions are designed to facilitate the

20 See Section 7.1 (Investor–state dispute settlement).

21 See Chapter 8 (Investment Promotion and Technical Assistance).

22 See Section 5.2 (Right of establishment), Section 5.3 (National treatment), Section 5.4 (Most favoured nation), Section 5.5 (Fair and equitable treatment and the minimum standard of treatment), Section 5.6 (Limitations on expropriation and nationalisation), Section 5.7 (Compensation for losses), Section 5.8 (Free transfer of funds) and Section 5.10 (Transparency).

23 The line of ICSID cases involving Argentina's response to its financial crisis in the late 1990s and early part of the new millennium illustrate this. For example, in *CMS Gas Transmission Company v. The Argentine Republic*, ICSID Case No. ARB/01/8, Award, 21 May 2005, the tribunal found that Argentina had breached its obligations under the US–Argentina BIT by changing the way in which gas prices were calculated, eliminating the practice of pegging the value of the peso to the US dollar, failing to negotiate what CMS considered a more appropriate exchange rate for the gas industry, and failing to renegotiate gas licences in accordance with an arrangement used in other sectors. Argentina had justified these measures on the basis that the financial crisis it faced made them necessary. The tribunal's decision in effect limited the host state's right to regulate the gas industry in order to respond to a financial crisis.

achievement of sustainable development more positively and directly. It is useful to remember that in designing these sample provisions, it was necessary to make some choices about the meaning of 'sustainable development'. The nature and sources of this conception of sustainable development were discussed in some detail in Section 2.3.[24] The elements of the concept of sustainable development used to create the sample text are summarised here in order to remind host states to review the discussion and the sample provisions critically with an eye to identifying where the concept of sustainable development that they embody differs from a state's preferred approach.

As mentioned above,[25] the Guide uses a conception of sustainable development grounded in widely accepted international legal documents that include the following elements:

- Increased foreign investment can contribute to sustainable development;
- Sustainable development recognises the need to promote and protect human rights, labour rights, the rights of indigenous peoples, the environment and other development priorities consistent with both the home and host states' international obligations;
- To promote sustainable development, foreign investment must contribute to meeting the needs of people in the host country;
- Developing countries require adequate technical preparation and proper information when negotiating international investment agreements;
- Due regard must be had to the political and institutional challenges of developing countries, and IIA commitments should reflect an effort to overcome them;
- To ensure that international investment rules yield outcomes consistent with sustainable development, they should be developed through wide consultation with people in the host country, including local and indigenous communities, to permit them to play an active role in development;[26]
- The negotiation, application and interpretation of international investment agreements should be transparent and consistent;
- The achievement of sustainable development requires the co-operation of both developed and developing countries; and
- The achievement of sustainable development requires the recognition of the equality of all states and the need to overcome political, social and economic barriers to equal participation of all in a fair and just international investment regime.

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24 An explanation of the nature and sources of this conception of sustainable development is provided in Section 2.3 (Links between foreign investment and sustainable development).

25 Section 2.3 (Links between foreign investment and sustainable development).

26 See *New Delhi Declaration of Principles of International Law Relating to Sustainable Development*, Res. 3/2002, 209 UN Doc. A/57/329, reprinted in International Law Association, *Report of the Seventieth Conference, New Delhi 2002*, at 211–16, Principle 5.1. See also, A Boyle and D Freestone (1999), eds., *International Law and Sustainable Development: Past Achievements and Future Challenges*, Oxford University Press, Oxford, at 15–16.

## 6.4 Overview of Guide sample provisions promoting sustainable development

### 6.4.1 Summary of the provisions

The Guide discusses policies in three related categories that may be effective in integrating sustainable development into an IIA.

*Sustainability assessments*

The Guide discusses a process called a 'sustainability assessment' (SA) for assessing environmental, social and human rights impacts.[27] It explains how such assessments can be applied both to investment provisions contained in an international agreement and to particular investments in order to ensure that foreign investment is compatible with a state's sustainable development policy.

The Guide also discusses how to integrate sustainability assessments into an IIA by making it a treaty requirement for some foreign investments that meet identified criteria. If such an approach is adopted, foreign investors would be required to submit investments of a substantial size or in sensitive sectors to an assessment of their social, environmental and human rights impact prior to making the investment. As a result of the assessment process described in the Guide, a management plan for the implementation of the investment would be created in negotiation with the host state. The management plan should demonstrate that the investment has put in place corporate management systems to ensure ongoing assessment, management and monitoring of the investment. The plan should include systems to ensure that the investment contributes to sustainable development.

The Guide also discusses how to use a grievance process to permit persons affected by the investment to make a complaint if they are harmed. In addition, the Guide discusses mechanisms for the host state to deal with a failure of the investor to prevent the harms identified in the sustainability assessment process or to live up to their obligations in the management plan resulting from the assessment, including through civil actions in the host state and the investor's home state.

The Guide discusses how to integrate sustainability assessments into both domestic law and an IIA. The principal difference between these two approaches is that integration of sustainability assessments into an IIA facilitates the use of treaty-based enforcement mechanisms.

*Obligations on investors*

The Guide discusses various ways of ensuring that investors respect human rights, including labour rights, the rights of indigenous peoples and principles of

27 See Section 6.6 (Sustainability assessments).

environmental sustainability.[28] The sample provisions demonstrate ways within the framework of an IIA to create standards that foreign investors must meet, including requirements to comply with the domestic law in the host state, to respect internationally recognised human rights and to meet core international labour standards. The provisions also illustrate how IIA provisions can be used to prohibit investors from engaging in grave violations of human rights, bribery and other forms of corruption.

*Sanctions on investors who fail to comply with their obligations*

As discussed, few sanctions are available in international law against investors who fail to protect human rights or the environment. Section 6.13 (Enforcement of investor obligations) discusses various ways of rectifying this failing.

The sample provisions focus on integrating a comprehensive system for sanctioning foreign investors into an IIA. Since investors are not party to the treaty, in order to make these standards for investor behaviour effective, the provisions contemplate that party states will take responsibility for creating legal institutions to sanction investors who fail to comply with their obligations.

For instance, the sample provisions provide examples of how both the host state and the investor's home state can be obliged to impose criminal liability for investors who commit or are complicit in grave violations of human rights and corrupt activities contrary to treaty obligations for investors in these areas. The sample provisions also show how to create an obligation on both party states to provide in their domestic law for investors to be held civilly liable both for violations of human rights and in situations in which an investor is in breach of IIA standards relating to core labour rights. Civil liability will also result if the investor does not comply with the host state's domestic laws or fails to take the steps set out in the management plan to mitigate the risks posed by its investment as identified in the sustainability assessment of its investment.[29]

Finally, the sample provisions contemplate a counterclaim mechanism[30] that would enable a state against which an investor has made a claim in investor–state arbitration to make a counterclaim for relief for injuries suffered as a result of the investor's failure to comply with the investor obligations set out in the agreement.

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28 See Section 6.7 (Investor obligation to comply with the laws of the host state), Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence), Sections 6.9 (Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights), Section 6.10 (Investor obligation to comply with core labour standards), and Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery or corruption).

29 The process by which each state will implement its obligations in this regard will be determined by its domestic constitutional system.

30 See Sections 6.17 (Counterclaims by states in investor–state arbitration) and 7.1.7 (Sample provisions: investor–state dispute settlement, Article [W] (Counterclaims).

## 6.5 Assessing the costs and benefits of the sample provisions in the Guide

The sample provisions discussed in this chapter are novel and untested. For both these reasons, they may not be readily accepted by countries negotiating IIAs. From the point of view of foreign investors, the provisions may seem to impose additional onerous obligations not contained in existing IIAs. In consequence, they may make an IIA based on the sample provisions less attractive to them. For example, imposing obligations on investors to comply with human rights and protect the environment may discourage them from investing. This may be a concern for both capital-importing and capital-exporting states. In addition, host states may find the implementation and enforcement of these provisions burdensome and a strain on domestic capacity.

Conceptually, it might seem unwise to incorporate principles of sustainable development into a treaty to regulate foreign investment. After all, the agreement is about investment – human rights and environmental protection are addressed in separate international treaties. Furthermore, the meaning of human rights or the wisdom of promoting environmental protection may be politically contested. Some may argue that including sustainable development provisions in an IIA will make it far too long and complicated and may lead to uncertain interpretations of treaty obligations by investment arbitration panels.

This reasoning appears to be reflected in most existing IIAs. To date, few of them address sustainable development in any meaningful way. Those that do refer to sustainable development do not impose enforceable obligations to achieve it. Often, the only mention of sustainable development is a non-binding reference in the preamble of the agreement.[31] Despite the fact that there is no legal or structural barrier to the inclusion of provisions to address the environmental and social impacts of foreign investment,[32] few IIAs currently in force set standards for investors relating to the protection of labour rights,[33] indigenous peoples' rights, human rights or the protection of the environment. They also do not prohibit investor complicity in violations of human rights or acts of corruption.

Despite cogent arguments against doing so, however, there are also a variety of reasons for including provisions designed to promote sustainable development in IIAs:

1. **International law lacks effective mechanisms for holding investors accountable for the harms they cause:** Most international legal obligations to uphold human rights, to protect the environment and to address corruption are imposed on states, not individuals or corporations. Including obligations for an investor to promote and protect human rights and the environment and to avoid corrupt activities in an IIA can help to rectify this problem.

31 E.g. Canadian model FIPA, preamble; Norwegian draft APPI, preamble. The US Model BIT, the Indian Model BIPPA and the UK Model IPPI do not refer to sustainable development.

32 H. Mann (2008), *International Investment Agreements, Business and Human Rights: Key Issues and Opportunities*, IISD Publication Centre, Winnipeg, at 12–13.

33 Ibid. at 11.

2. **There is a need for more balanced agreements:** Including the kinds of provisions discussed in the Guide will create a more balanced agreement. Traditional IIAs focus primarily on the host state's obligations to investors and include few, if any, obligations that flow from investors towards states and their citizens. This imbalance could be redressed so that investors that benefit from profitable investments protected by IIAs are required in return to protect the communities and the natural environment in which they operate.
3. **Developed country investment partners increasingly recognise the importance of sustainable development:** Many developed countries, including the European Union (EU), Canada and the USA, now routinely seek commitments regarding at least labour and environmental standards in their trade and investment agreements.[34] This indicates that some developed country investment partners are becoming more interested in provisions that promote sustainable development.
4. **Developed countries recognise the need to regulate the behaviour of their investors operating abroad:** In some developed countries, there is increasing pressure on governments to develop legal oversight mechanisms to ensure that their investors operating in other states respect human rights, labour rights and environmental standards and do not engage in corruption. However, for a number of reasons, it can be difficult for the investor's home state to impose standards on investors investing abroad through extraterritorial application of its law. For instance, attempts to do so may be viewed by the host state as an intrusion on their sovereignty or even as neo-colonialist interference.[35] However, if states agree to impose obligations on foreign investors through an IIA, this perceived barrier is removed. Instead, home states and host states can work together to regulate foreign investors. In addition, home states may be encouraged to provide other mechanisms for holding their investors accountable. Consequently, there may be an interest in some home states in the kinds of provisions proposed in this section of the Guide, even though they impose additional obligations on their investors.
5. **It can be difficult to put in place a domestic legal regime to protect and promote human rights:** Implementation of human rights protections can be costly and time-consuming and requires significant expertise. Moreover, there may be political hurdles in identifying the rights that should be protected domestically and creating the institutions needed to protect them. However, fewer hurdles may exist for imposing obligations on *foreign* investors rather than on all investors, both foreign and domestic. Creating obligations in an IIA requiring foreign investors to respect human rights and comply with norms of environmental sustainability may be simpler than creating a comprehensive set of domestic institutions.

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34 See for instance the recent Canada–Peru FTA (2008) and the US Model BIT.

35 S Seck, 'Home State Responsibility and Local Communities: The Case of Global Mining' (2008), 11 *Yale Human Rights and Development Law Journal at 177*. Seck describes, for example, how these considerations led to the defeat in 2001 of the Corporate Code of Conduct 2000, Australian legislation that would have imposed environmental, human rights, labour rights and health and safety standards on Australian corporations acting abroad.

6. **Current interpretations of traditional IIA provisions limit host states' ability to regulate foreign investors:** Some controversial decisions by international arbitrators suggest that it may be difficult for a host state to create new laws and institutions to protect human rights or promote environmental sustainability if these impair the investors' expectations about the conditions in which they will operate in the host state or if they are not sufficiently consulted about proposed changes. The introduction of investor obligations into an IIA will support a more balanced interpretation of the treaty that will take into account policy considerations beyond investor protection.

7. **Placing obligations on investors in an IIA allows states to create treaty-based remedies for harms created by foreign investors:** Foreign investors are often able to avoid compensating victims of human rights or environmental disasters because of a lack of robust domestic legal institutions in the host state. IIA provisions can be used to provide effective remedies for host states and their citizens seeking compensation from investors.

8. **Foreign investors may not be deterred by requirements to comply with human rights, prohibitions on corruption or requirements to protect the environment:** Sophisticated foreign investors are generally familiar with requirements to respect human rights and labour rights, to avoid corruption and to protect the environment as they must meet them in their home country. Requiring investors to plan and implement their investments in an environmentally friendly way, with due regard for the rights of the host state's residents, may not discourage investment substantially. Companies in industries with the potential to harm the environment or human rights are increasingly recognising that there is a demand among their investors and the public in their home states to make their foreign investments sustainable.[36]

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36 For example, in November 2006, the Canadian government completed a series of national roundtables on corporate social responsibility (CSR) and the Canadian extractive sector in developing countries. The roundtables were held in response to a report of the Standing Committee on Foreign Affairs and International Trade calling on the federal government to initiate a multi-stakeholder process with the goal of strengthening existing CSR programmes and policies, and developing new programmes and policies for Canadian extractive industries operating outside Canada in developing countries. The roundtables advisory group, composed of members from the private sector, academia and NGOs, produced a consensus report released in March 2007 that recommended to the Canadian government the adoption of a comprehensive CSR framework, including voluntary standards, reporting guidelines and an accountability mechanism. See Parliament, 'Response of the government to the 14th Report of the Standing Committee on Foreign Affairs and International Trade (mining in developing countries – corporate social responsibility)', in Sessional Papers, No. 8512-381–179 (2005); and National Roundtables on Corporate Social Responsibility (CSR) and the Canadian Extractive Sector in Developing Countries, Advisory Group Report, Foreign Affairs and International Trade, Ottawa, Canada, 29 March 2007. However, see also the government response, Government of Canada (2009), 'Building the Canadian Advantage: A Corporate Social Responsibility (CSR) Strategy for the Canadian International Extractive Sector', Foreign Affairs and International Trade Canada, available at: www.international.gc.ca/trade-agreements-accords-commerciaux/ds/csr-strategy-rse-stategie.aspx (accessed 3 September 2011), which puts forward a voluntary self-regulation scheme for Canadian companies, with no reporting requirements or sanctions. It includes a complaints mechanism. However, the mechanism allows for investigation into allegations of human rights abuses by a Canadian company only in cases where the company consents.

Also, because of the adverse impact on their reputation and profitability, many businesses are interested in strategies to avoid the risks of violating human rights, labour rights or the rights of indigenous peoples, participating in corrupt activities or being implicated in environmental degradation. More and more, business associations and investors are developing voluntary standards to promote investment in ways that manage these risks.[37] The standards discussed in the sustainable development sections of the Guide reflect existing and emerging international norms that investors will already be familiar with and may have internalised in their operations in some countries, including in their home state.

9. **Specifying investor obligations in an IIA provides certainty to investors**: Often, these obligations are not clearly set out in the domestic law of the host state, especially if it is still in the process of developing its legal institutions. Clarity through the expression of standards in an IIA could be a benefit in attracting investors. Weak and uncertain standards may discourage reputable companies from investing in the host state.[38]

10. **Attracting desirable investors:** While some investment may be deterred from investing in a regime with a robust sustainable development policy and regulatory framework, these investors may be those unwilling to observe high standards for human and labour rights, avoidance of corruption and protection the environment.

For these and other reasons, the benefits of including provisions in an IIA to promote sustainable development may outweigh any dissuasive effect they might have on potential investors.

The sample provisions for promoting sustainable development contained in the Guide are based on best practices in the field. For instance, they reflect the principles set out in the UN Protect, Respect and Remedy policy framework and the UN Guiding Principles on Business and Human Rights developed by the Special Representative of the UN Secretary-General on the Issue of Human Rights and Transnational Corporations and other Business Enterprises. The framework and Guiding Principles focus on enhancing host state capacity to regulate foreign investors in a manner consistent with the state's international human rights

37 Examples include: AccountAbility 1000 Framework; AA1000 Assurance Standard; Business Principles for Countering Bribery; CERES Principles; Clean Clothes Campaign: Model Code; Eco-Management and Audit Scheme; Ethical Trading Initiative: Base Code; Fair Labor Association: Workplace Code of Conduct; UN Global Compact; Global Reporting Initiative; Global Sullivan Principles of Corporate Social Responsibility; ICC Business Charter for Sustainable Development; Marine Stewardship Council's Principles and Criteria for Sustainable Fishing; The Natural Step Principles; OECD Guidelines for Multinational Enterprises; Shell Business Principles; SIGMA: Sustainable Guidelines for Management; Voluntary Principles on Security and Human Rights; International Council on Mining and Metals Sustainable Development Framework.

38 D Franks (2012), *Social Impact Assessment of Resource Projects*, International Mining for Development Centre, Crawley, at 3.

obligations; they clarify and elaborate the responsibility of corporate actors to respect human rights and to engage in human rights due diligence; and they recommend the development of effective remedies for victims of corporate human rights violations and discuss the principles upon which complaint mechanisms should be based.[39] Both the policy framework and the Guiding Principles have been widely endorsed by states and businesses.[40]

Concerns regarding the burden of the obligations provided for in this section for host states may be met, in part, by technical assistance and investment promotion commitments to be undertaken by investors' home states, as is contemplated in Chapter 8 (Investment Promotion and Technical Assistance).

Each state must determine how best to accommodate investor protection and its freedom to regulate to achieve sustainable development. In addition, the contested and novel nature of the policy tools discussed in this section mean that each state's choices regarding them must be carefully weighed. States negotiating an IIA should adopt only those policy mechanisms that they determine best meet both their need for attracting foreign investment and their need to promote sustainable development in a manner consistent with domestic policy.

## 6.6 Sustainability assessments

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39 See UNHRC (2008), 'Protect Respect and Remedy: A Framework for Business and Human Rights: Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and other Business Entities', UN Doc. A/HRC/8/5; and UNHRC (2011), Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework: Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and other Business Enterprises, John Ruggie, UN Doc A/HRC/17/31.

40 The Guiding Principles on Business and Human Rights were unanimously endorsed by the Human Rights Council (see *Human Rights and Transnational Corporations and Other Business Enterprises*, UNHRC, 17th Sess, UN Doc A/HRC/17/L.17/Rev.1, (2011). For business endorsement see, for example, the International Organization of Employers (2011), Address to the UN Human Rights Council, delivered at the Palais des Nations in Geneva, Switzerland, 31 May 2011, available at: www.un.org/webcast/unhrc/archive.asp?go=110531#pm1 (accessed 8 January 2013), which 'supports the approach taken in the principles to elaborate the implications of existing standards and practice into practical guidance rather than seeking to create new international legal obligations or seek to assign legal liability'. See also the range of letters from business actors endorsing the Guiding Principles, including Coca Cola, Statement by Edward Potter, personal communication, 26 May 2011, available at: www.global-business-initiative.org/SRSGpage/files/Guiding%20Principles%20Endorsement%20from%20Coke.pdf (accessed 29 May 2012); and Total, Statement by Peter Herbl, personal communication, 23 May 2011, available at: www.global-business-initiative.org/SRSGpage/files/Total%20S%20A%20letter%20to%20John%20Ruggie.pdf (accessed 29 May 2012).

Assessing the environmental, social and human rights impacts of foreign investments is an important way to ensure that investment is compatible with sustainable development. Assessments employ sound principles of risk management and evidence-based evaluation to achieve the goals of environmental protection, community participation and the protection of human rights. In addition, they enhance the benefits of an investment both for the investor and the community in which the investment is located.

Assessment is an essential tool to help states to implement their obligations to *protect* human rights, health, labour rights and the rights of indigenous peoples and to protect the environment. It is also useful for ensuring that investors fulfil their responsibility to *respect* human rights.[41] For instance, the UN Guiding Principles on Business and Human Rights state that business enterprises should '[a]void causing or contributing to adverse human rights impacts' and that they should '[s]eek to prevent or mitigate' such impacts.[42] To do this, the Guiding Principles suggest that business enterprises carry out 'human rights due diligence' by assessing 'actual and potential human rights impacts' of their activities.[43] Assessment is thus an important part of actualising the duty of states and investors to protect those affected by an investment.

Assessment can help attract sustainable foreign investment. It is more cost-effective for investors to identify in advance possible risks that their investment might create for environmental sustainability or human rights and adopt strategies to mitigate them than to deal with the damage after it materialises. Also, the assessment process builds a relationship between the investor and the government of the host state that can be beneficial should problems arise. Overall, assessment creates greater certainty for investors that their investment will succeed.[44]

41 UN Guiding Principles on Business and Human Rights, A/HRC/17/31, Principle 12.
42 UN Guiding Principles on Business and Human Rights, ibid., Principle 13. Principles 17–21 provide more detail on how business enterprises should go about doing this.
43 UN Guiding Principles on Business and Human Rights, ibid., Principle 17.
44 A M Esteves, D Franks and F Vanclay (2012), 'Social Impact Assessment: The State of the Art', 30 *Impact Assessment and Project Appraisal* 34 at 36.

Environmental Impact Assessments[45] (EIAs) have become commonplace both domestically and internationally.[46] Obtaining an EIA of an investment, reviewing this assessment and agreeing on a management plan for implementing the recommendations resulting from the assessment and review are all essential elements of a rational plan for ensuring environmental protection.[47] While not required in any existing IIA, Article 12 of the IISD model agreement provides for this kind of assessment of investment prior to its establishment. It also requires states to have in place an effective regulatory structure that sets standards for conducting the assessment and determines the scope of the assessment required of different classes of investors.[48]

As mentioned in Section 2.3 of the Guide (Links between foreign investment and sustainable development), sustainable development also has a social aspect that includes the alleviation of poverty, the protection of human and labour rights, and the rights of indigenous peoples. To eradicate poverty, protect the environment and respect, protect and fulfil economic, social, cultural, civil, political and other human rights in an integrated way, the principle of sustainable development also requires an *assessment of the social impact* of an investment prior to the investment being established.[49] In recognition of this, Article 12(B) of the IISD model treaty requires a social impact assessment of potential investments. The social impact of an investment includes its impact on human rights, and it also extends to

45 Defined as 'the process of identifying, predicting, evaluating and mitigating the biophysical, social, and other relevant effects of development proposals prior to major decisions being taken and commitments made' (International Association for Impact Assessment (2009), *What is Impact Assessment?* IAIA, Fargo). Earlier definitions focused almost exclusively on environmental impacts. For instance, the UNEP defined EIA as an 'assessment of the likely or potential environmental impacts of [a] proposed activity' (UNEP, Governing Council decision: Goals and Principles of Environmental Impact Assessment, Principle 4, UNEP/GC.14/17 Annex III, UNEP/BC/DEC/14/25 (17 June 1987).

46 R K Morgan (2012), 'Environmental Impact Assessment: The State of the Art', 30 *Impact Assessment and Project Appraisal* 5–14.

47 S A Atapattu (2006), *Emerging Principles of International Environmental Law,* Transnational Publishers, Ardsley, New York, at 130. See also J C Dernbach (2003), 'Achieving Sustainable Development: The Centrality and Multiple Facets of Integrated Decision-making', 10 *Indiana Journal of Global Legal Studies* 247; and *Report of the Expert Group Meeting on Identification of Principles of International Law for Sustainable Development*, Geneva, September 1995, prepared by the Division for Sustainable Development for the Commission on Sustainable Development, 4th session, 1996, available at: www.un.org/documents/ecosoc/cn17/1996/background/ecn171996-bp3.htm (accessed 29 May 2012).

48 Art. 21 of the IISD Model Treaty requires states to legislate and pass regulations to protect the environment including setting standards for environmental assessments and criteria for determining which investments should be required to undergo an assessment before they are approved. Art. 12(A) requires the state to apply screening criteria for determining the scope of the assessment required. The Agreement notes that the scope will vary based on the size of the investment and the nature of its inputs and outputs. Small enterprises and some service-related enterprises may be exempt from an environmental impact assessment. Other IIAs provide that party states may not reduce environmental protection and human rights to attract investment. For instance, see Art. 20 of the IISD Model Treaty, as well as provisions in the Canadian, US and draft Norwegian models (Canadian model FIPA, Art. 11; US model BIT, Art. 12; and Norwegian draft model APPI, Art. 11). There is no comparable provision in the Indian model BIPPA or the UK model IPPA.

49 Esteves et al., op. cit.

consideration of impacts on the host state's social policies more generally, including its sustainable development policies. The components of a social impact assessment are set out in Box 6.1.

**Box 6.1 Components of a social impact assessment**

An effective sustainability assessment includes an assessment of the social impacts of an investment. These can include the impact on the following.

1. Way of life
2. Culture
3. Community
4. Political systems
5. Environment
6. Health and well-being
7. Personal and property rights
8. People's fears and aspirations[50]

Recently, Human Rights Impact Assessments (HRIAs) have emerged. They are generally based on the work of the United Nations Special Representative on Human Rights and Business,[51] who has introduced the concept of human rights due diligence. 'Due diligence' refers to the responsibility of business enterprises to assess 'actual and potential human rights impacts', integrate and act on the findings, track responses and communicate to the public how they have addressed the impacts they identified.[52] An HRIA is defined as 'measuring the impact of policies, programmes, projects and interventions on human rights'.[53] This new tool can co-exist with social impact assessments. However, it differs from the social impact assessment (SIA) process because it is based on international legal standards of human rights rather than on the achievement of desirable social outcomes.[54] The relatively recent emergence of HRIAs means that methodologies for assessing human rights impacts are still in their infancy. However, the new emphasis placed on human rights due diligence by the

50 F Vanclay (2003), 'International Principles for Social Impact Assessment', 21 *Impact Assessment and Project Appraisal* 5 at 8.

51 Esteves et al., op. cit.

52 Guiding Principles on Business and Human Rights, op. cit., Principle 17.

53 Human Rights Impact Resource Centre, 'An Introduction to Human Rights Impact Assessment', available at: www.humanrightsimpact.org/hria-guide/overview (accessed 8 January 2013).

54 J Harrison (2011), 'Human Rights Measurement: Reflections on the Current Practice and Future Potential of Human Rights Impact Assessment', 3 *Journal of Human Rights Practice* 162 at 167.

UN Special Representative is likely to spur rapid development of effective assessment tools.

States may wish to integrate all three kinds of assessment into their investment assessment process, thus creating a comprehensive system for *Sustainability Assessment*.

### 6.6.1 Sustainability assessment in practice

Sustainability assessment and its various components – environmental impact assessments and social impact assessments – are well-established tools for the promotion of states' sustainable development goals. Human rights impact assessment, as already noted, is still in its infancy, although various methodologies are being developed.

Despite the general use of select elements of sustainability assessment in many states, assessment in general features little in investment agreements. Apart from model investment agreements such as the IISD model, no agreement requires states to enact domestic laws and regulations to implement SAs, nor do any impose obligations on investors to conduct such an assessment.

Nevertheless, various aspects of sustainability assessment such as environmental impact assessment are common in the domestic legislation of states.[55] EIA is also referred to in a number of international treaties and soft law documents.[56] This demonstrates that states acknowledge that assessment provisions are an effective way of implementing sustainable development policy. Such an effective tool can be transposed to international agreements as discussed below.

While they do not feature in IIAs, the use of EIA in other international agreements is evidence that states accept that 'international EIA commitments are well suited to integrate international environmental norms into decision-making processes and to promote outcomes that reflect prevailing international environmental norms'.[57] In other words, EIA requirements in treaties influence policy-makers to implement their international obligations under international environmental law.[58]

There may be a customary international legal obligation for states to conduct EIAs in some circumstances.[59] The notion that international law requires EIA stems from the duty of states to prevent harm to others beyond its territory and to co-operate with other states to prevent such harm.[60] However, despite this general obligation to prevent harm, international law does not specify what the content of assessments must be or the circumstances in which they are required.[61]

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55 N Craik (2008), *The International Law of Environmental Impact Assessment: Process, Substance and Integration*, Cambridge University Press, Cambridge at 5.

56 Ibid.

57 Ibid. at 12.

58 Ibid. at 12 and 15.

59 See, for example, the separate opinion of Judge Weeramantry in the *Gabcikovo-Nagymaros Case* (Hungary/Slovakia), (1997) ICJ Rep 7 at 111–13. For a helpful interpretation, see Craik, op. cit., at 114–15.

60 Craik, ibid. at 121.

61 Ibid. at 90.

Most specific obligations to conduct EIAs are contained in environmental treaties. States should review their treaty commitments in international environmental treaties to determine if they have taken on any obligations to conduct EIAs that they interpret as applying to the assessment of the impact of IIAs or investments protected by them. For instance, treaties that apply to transboundary pollution may require parties to conduct EIAs to determine potential impacts on other parties of foreign investments located in their territory.[62]

International organisations such as the World Bank also require EIAs as part of their organisations' commitment to implement environmentally sound and sustainable projects.[63] These policies may have a direct impact on developing countries.

In general, the prevalence of EIA requirements in domestic and international legal instruments indicates a general willingness on the part of states to use assessment as a means of implementing their sustainable development policies. It is for this reason that the Guide discusses various ways of applying sustainability assessment to foreign investment in order to establish a strong link between each state's investment policy and its development goals.

### 6.6.2 Policy discussion

*Why do a SA?*

At first glance, it might seem that one of the competitive advantages of developing countries that makes them attractive to foreign investors is the lower cost of complying with a developing country's laws and regulations in comparison with the cost of compliance with the more complicated requirements in place in many developed countries. According to this logic, investors would prefer to operate in a country that does not require costly assessment and consideration of environmental, social or human rights as a precondition to investment. Putting in place a process for conducting such assessments will drive away potential foreign investors.

While some investors may be deterred, other competing concerns must be weighed against the possibility of losing investors when deciding whether to submit potential investments to an assessment process. Assessing an investment to determine the potential risk that it represents for citizens and the environment can fulfil many of the goals of the government's sustainable development policy.[64] In addition, assessment can help governments and investors to determine what community support activities could be useful to help integrate the investment into the

62 However, parties to such treaties as the *Convention on Environmental Impact Assessment in a Transboundary Context* (Espoo Convention), signed 25 February 1991, 1989 *United Nations Treaty Series* 309, 30 International Legal Materials 800, are mostly developed states (Craik, ibid., at 124).

63 Ibid. at 108–10.

64 OECD (2006), *Applying Strategic Environmental Assessment: Good Practice Guidance for Development Co-operation*, OECD, Paris, at 42. For a good overview of the benefits of conducting a sustainability impact assessment, see D Collins, (2010), 'Environmental Impact Statements and Public Participation in International Investment Law', 7 *Manchester Journal of International Economic Law*, 4.

community.[65] Assessment is thus one of the key ways of integrating foreign direct investment into a comprehensive sustainable development policy.

**Conducting a SA allows for public participation in the investment approval process**.[66] This participation is an important element of democracy, which underlies many of the human rights protected in international documents. Public participation also legitimises both the investment and the state's decision to approve it. Assessment of the impact of the investment will allow citizens to gain access to public decision-making processes and inform them about future investments in their community.[67] Investors who conduct a robust SA are likely to encounter less resistance to the investment from individuals and the community that may be affected by the investment.

Assessing the impacts of an investment can be a highly subjective process.[68] Different individuals and communities as well as different investors will identify different impacts depending on their circumstances. They will have differing views on the relative significance of various impacts. Furthermore, different individuals are comfortable with different levels of risk. Conducting an assessment of an investment allows both government agencies and investors to identify risks and impacts and understand how their attitudes towards these impacts may differ from those of the affected community and from each other. Parties can use the assessment process to identify possible conflicting interests between various stakeholders.

**Sustainability assessment helps to uncover information about an investment of which the investor and the government were previously unaware**. Governments will learn about new environmental protection measures employed by cutting-edge firms. They will be able to identify impacts that had not previously been in evidence, and develop policies, plans and programmes to deal with them.[69] Investors, too, benefit from sharing information about relevant regulatory standards and practices and the various dispute resolution mechanisms available to them should a problem arise.

**SA helps the parties to determine the baseline for ongoing monitoring of the performance of investments**.[70] The assessment outlines existing environmental and

65 Franks, op. cit., at 12.

66 Ibid. at 46. A number of international documents stress the importance of stakeholder participation in assessments, including *Rio Declaration on Environment and Development*, principles 10 and 17; *Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters*, signed on 25 June 2009 (Aarhus Convention), 38(3) *European Legal Materials* 517–533, in force 30 October 2001; Espoo Convention, e.g. Art. II.2; and UN Guiding Principles on Business and Human Rights,. op. cit.

67 Ibid.

68 Collins, op. cit.

69 Ibid. at 45.

70 The importance of ongoing monitoring is stressed in Principle 20 of the UN Guiding Principles on Business and Human Rights, op. cit.

social conditions that can be used to measure the benefits and harms of the investment as it proceeds.

**Conducting an impact assessment can reduce the costs of doing business**. The OECD points out that when investors do not conduct an EIA, they are likely to face increased business costs and will not have a feasible plan for avoiding or mitigating future conflicts.[71] Moreover, conducting an assessment helps the investor and the government to determine what technologies and policies will be appropriate for managing potential risks. Esteves et al. identify other benefits to business, including:

1. Greater certainty for project investments and increased chance of project success;
2. Avoidance and reduction of social and environmental risks and conflicts faced by industry and communities;
3. A process to inform and involve internal and external stakeholders and to assist in building trust and mutually beneficial futures;
4. Improved quality of life for employees and improved attraction and retention of skilled workers;
5. A positive legacy beyond the life of the project; and
6. Increased competitive advantage through enhanced social performance and corporate reputation.[72]

**Having a SA process in place will attract responsible investors**. Many multinational businesses have policies that require them to assess the impact of their activities on local communities.[73] Having a SA system in place will help these companies implement their assessment policies. Also, a well-managed SA process signals to socially and environmentally responsible investors that the jurisdiction they are entering has an effective governance regime in place.

**Finally, obtaining investment financing is often conditional on conducting risk assessments, especially environmental impact assessments.** The European Bank for Reconstruction and Development (EBRD) and the Asian Development Bank (ADB), for example, require environmental assessments prior to funding development-related projects. The Multilateral Investment Guarantee Agency (MIGA), which provides financial insurance against non-commercial risks, has a policy on environmental and social impact assessments. Likewise, the International Finance Corporation (IFC) has a similar policy for providing financing.[74]

71 Collins, op. cit., at 45.
72 Esteves et al., op. cit.
73 Ibid.
74 For a comprehensive review of the requirements of these different financing and insurance agencies, see Collins, op. cit.

*Elements of an effective SA system*

An SA can be conducted in a number of ways. However, best practices in the field of impact assessment identify certain essential elements for an effective process.[75] Generally, the costs of a SA are shared by the government, which sets up the impact assessment system, and the investor, which must conduct a review of its investment in accordance with the government system. However, there are various ways of distributing the costs of the actual assessment. For instance, the whole cost of conducting the assessment can be placed on the investor, or various cost-sharing measures between the host state and the investor can be put in place. The elements of an effective SA strategy are set out in Box 6.2.

**Box 6.2 Elements of an effective SA strategy**[76]

1. **Determine scope of assessment:** Initial work involves determining the appropriate scale, timing and focus of the assessment. This may involve identifying those who will be affected by the investment and what activities of the investment are likely to produce impacts.
2. **Produce a profile and conduct baseline studies:** Investors should gather information about the community in which they will invest and identify the important stakeholders. This can include identification of the different needs and interests of stakeholders and communities. Based on this information, a benchmark can be established against which change can be measured.
3. **Predictive assessment:** Once information is gathered and a baseline established, potential impacts can be identified and their likelihood assessed.
4. **Participation:** Civil society groups should be able to participate meaningfully in the assessment process (see UN Guiding Principles on Business and Human Rights, Principle 18(b)). To ensure this participation, investors must communicate with stakeholders about the risks posed by their investment and steps taken to mitigate this risk (see Principle 21). They should also provide stakeholders with an ongoing role in assessing, managing and monitoring the investment.
5. **Agreement-making process:** An SA should identify appropriate processes for arriving at agreements between investors and stakeholders. Especially in the case of indigenous peoples, free, prior and informed consent for major decisions relating to an investment should be obtained.

(Continued)

75 For best practices, see Vanclay, op. cit., and Franks, op. cit.

76 Ibid. For a summary of the classic EIA model, see Morgan, op. cit., at 9. Esteves et al., op. cit., also provide a summary of 'Current good practice' for social impact assessments.

(Continued)

6. **Planning:** The investor should have a management plan, approved by the host state, for protecting the environment, human rights, health, labour rights and the rights of indigenous peoples. The plan can be the basis for ongoing monitoring. It will ensure that the appropriate organisational systems and budget allocations are in place within the investment to address potential impacts (see UN Guiding Principles on Business and Human Rights, Principles 19(a)(i) and (ii)).
7. **Monitoring of harms:** An effective SA should include a system for the community to inform the investor and the government of potential harms at an early stage. This recognises that investors have an obligation to monitor the ongoing risk that their investment poses to the community (see UN Guiding Principles on Business and Human Rights, Principles 17(c) and 20). A 'cumulative effects' approach to monitoring harms should be taken. Isolated harms may be small taken individually, but cumulatively, their impact may be significant.[77]
8. **Monitoring of benefits:** Investments can provide many benefits to a community through procurement, employment and the provision of community support programmes. These should be part of the ongoing system of monitoring.
9. **Enforcement:** The assessment system should provide an effective enforcement mechanism if an investor fails to comply with a management plan. Enforcement mechanisms create incentives for compliance.
10. **Use best practices:** An effective SA system should be based on international best practices for environmental, social and human rights protection.

*Assessing the sustainability of IIAs*

One complementary approach to conducting SAs of investments that reflects international best practices is to conduct an assessment of IIAs themselves. While the assessment of individual projects will always have a central place in an effective sustainable development policy, the assessment literature increasingly recognises the importance of assessing the sustainability impacts of broad government policies and programmes.[78] Assessing the sustainability of IIAs is described in Box 6.3.

77 Morgan, op. cit.

78 Morgan, for instance, notes that strategic environmental assessment 'has been vigorously promoted as a way to extend impact assessment to higher level decision-making at policy, programme and plan levels, a reaction to the project orientation of most EIA applications', op. cit., at 7, citing B Sadler et al. (2011), 'Taking Stock of SEA', in B Sadler (ed.), *Handbook of Strategic Environmental Assessment*, Earthscan, London, 1.

**Box 6.3 Submitting proposed IIAs or model IIAs to an assessment process**

The *Guiding Principles on Human Rights Impact Assessments of Trade and Investment Agreements* affirm that all states ought to evaluate the human rights impact of both trade and investment agreements.[79]

The OECD has developed a comprehensive methodology for assessing the environmental impacts of international trade agreements.[80]

These assessments can influence negotiating positions. They can also inform parties about policies in areas outside the core disciplines of the IIA that can be developed to mitigate detrimental impacts.[81]

Various OECD members such as the USA, the EU and Canada have evaluated the environmental impacts of free trade agreements and even IIAs.[82]

*How to set standards for SAs*

In order to facilitate the conduct of sustainability assessments and to ensure consistency of outcomes, the assessment of environmental and social impacts has often been combined in international initiatives in this area. The IFC's performance standards are an example of a process for assessing social and environmental impacts of an investment in an integrated way.[83] ISO 14001 sets out another system for managing environmental assessments, while ISO 26000 represents a system for implementing best practices in the area of social responsibility.[84]

The starting point for a human rights impact assessment must be the international human rights obligations entered into by the parties to an IIA.[85] States should review these obligations and ensure that any human rights assessment process reflects them.

79 United Nations, 'Report of the Special Rapporteur on the Right to Food, Olivier De Schutter: Guiding Principles on Human Rights Impact Assessments of Trade and Investment Agreements', (19 December 2011, A/HRC/19/59/Add.5, Principle 1.

80 OECD (1994), *Methodologies for Environmental and Trade Reviews*, OCDE/GD(94)103, OECD, Paris.

81 M W Gehring (2011), 'Impact Assessments of Investment Treaties', in Cordonier Segger et al., op. cit., at 155.

82 Ibid. Gehring provides an overview of the processes used and the experience of the various OECD members in using them.

83 For the performance standards, see: www.ifc.org/ifcext/sustainability.nsf/Content/EnvSocStandards (accessed 29 May 2012). See also: International Business Leaders Forum and International Finance Corporation, *Draft* (June 2007), *Guide to Human Rights Impact Assessment and Management, Road-Testing*, available at: www.globalgovernancewatch.org/resources/guide-to-human-rights-impact-assessment-and-management-roadtesting-draft-june-2007 (accessed 29 May 2012).

84 See International Organization for Standardization (ISO) (2010), *Guidance on social responsibility*, ISO 26000:2010, available at www.iso.org/iso/iso26000 (accessed 24 June 2012).

85 UN, 'Guiding Principles on Human Rights Impact Assessments', op. cit., Principle 5.

The International Centre for Human Rights and Democratic Development provides standards for assessing the impact of an investment on human rights.[86] Harrison has produced a comprehensive catalogue of existing human rights assessment tools[87] that can be useful to states contemplating an expansion of their existing domestic assessment processes or the integration of a SA process into an IIA. Both he and the UN Special Rapporteur on the Right to Food have set out the various methodological steps involved in an effective human rights assessment process.[88]

An assessment process designed to promote sustainable development should also give effect to important principles of international environmental law.[89] These principles are:

1. The precautionary principle;
2. The principle of common but differentiated responsibilities; and
3. The polluter pays principle.

### *The precautionary principle*

The precautionary principle reaffirms the ability of the host state to regulate investors and their investments in a way that avoids future environmental harms. Host states may wish to put in place measures to protect human health or the environment even where there is no consensus in the scientific community that the measures are necessary. A good example from the trade context is Europe's measures regarding genetically modified organisms (GMOs) – while there is no scientific consensus that foods incorporating GMOs are more harmful than other products, the EU has chosen to regulate GMOs based on a credible minority of scientific opinion.

The precautionary principle is well recognised in international legal regimes.[90] Increasingly, it is interpreted as placing the onus on the person who wants to engage in an activity, be it a private investor or a state, to demonstrate that its activities will not adversely affect the environment before the state grants it the right to carry out the proposed activity.[91]

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86 E.g. International Centre for Human Rights and Democracy (2007), *Human Rights Impact Assessments for Foreign Investment Projects*, International Centre for Human Rights and Democracy, Montreal, available at: http://publications.gc.ca/collections/collection_2007/dd-rd/E84-21-2007E.pdf (accessed 8 January 2013).

87 J Harrison (2010), 'Measuring Human Rights: Reflections on the Practice of Human Rights Impact Assessment and Lessons for the Future', Warwick School of Law Research Paper No. 2010/26, Warwick, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1706742 (accessed 29 May 2012). See also J Harrison and M-A Stephenson (2010), *Human Rights Impact Assessment: Review of Practice and Guidance for Future Assessments. Report for the Scottish Human Rights Commission*, available at: www.scottishhumanrights.com/ourwork/publications/article/HRIAresearchreport (accessed 29 May 2012).

88 J Harrison, 'Human Rights Measurement', op. cit.; UN, 'Guiding Principles on Human Rights Impact Assessments', op. cit., Principle 7.

89 Vanclay lists the precautionary principle and the polluter pays principle as guiding principles for social impact assessment, op. cit., at 10.

90 *EC-Measures Concerning Meat and Meat Products (Hormones)*, WT/DS48/AB/R, 16 January 1998.

91 P Sands (2003), *Principles of International Environmental Law*, 2d ed., Cambridge University Press, Cambridge, at 27.

The process of carrying out a SA is itself an application of the precautionary principle, as the goals of the assessment are to identify future risks and develop a plan to eliminate or mitigate them.[92]

*Common but differentiated responsibilities*

The principle of common but differentiated responsibilities recognises that states at different levels of economic, social and political development have different capacities to protect against environmental degradation and deal with social, economic and political instability.[93] The principle also recognises that environmental standards can apply in different ways to different states based on their capacity to respond to threats to the environment and the different contributions of developed and developing countries to environmental degradation.[94]

The principle is well known in international law, and it has been implemented in international legal regimes such as international trade law.[95] It is compatible with the well-recognised duty of states to co-operate in good faith.[96] In the domain of investment, the application of the principle of common but differentiated responsibilities requires that developed country parties to an IIA provide technical and financial assistance to developing country parties to implement the provisions of the agreement to the extent that they can.[97]

Reference to this principle in an IIA will help the parties and investment arbitrators to interpret the agreement taking into account sustainable development. For instance, a developed country that is party to an IIA might be held more strictly to deadlines for implementing the agreement than its developing country partner. Provisions requiring technical assistance for a developing country in putting in place various treaty-based mechanisms may also be interpreted in a way that acknowledges the importance of such measures for a country at a particular stage of development.

*Polluter pays principle*

The polluter pays principle requires that the polluter bear the cost of the pollution it causes. Although it is incorporated in a number of international treaties, it remains a contentious principle. The debate about its validity is articulated in the wording of Principle 16 of the Rio Declaration:[98]

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92 Gehring, op. cit., at 150.

93 Ibid. at 286. See also Principle 7 of the *Rio Declaration on Environment and Development*, op. cit.

94 *New Delhi Declaration*, op. cit., at 3.4.

95 For instance, the *Agreement on Technical Barriers to Trade* (33 *International Legal Materials* 9 (1994)) and the *Agreement on Sanitary and Phytosanitary Measures*, both WTO agreements (33 *International Legal Materials* 9 (1994)), contain many such provisions, called 'special and differential treatment' provisions in WTO law.

96 Chapter IX of the UN Charter and the Declaration on Principles of International Law Concerning Friendly Relations and Co-operation among States in accordance with the Charter of the United Nations, UNGA Res. 2625 (XXV) (1970).

97 See Chapter 8 (Investment Promotion and Technical Assistance).

98 *Rio Declaration on Environment and Development*, op. cit.

> National authorities should endeavour to promote the internalization of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the costs of pollution, with due regard to the public interests and without distorting international trade and investment.

The polluter pays principle can be helpful to a host state seeking to enforce an investor's obligation to mitigate environmental harms and compensate victims of acts of environmental degradation.

**Box 6.4 Summary of options for sustainability assessments**

1. *Do not submit foreign investments to an assessment procedure prior to approving them*
2. *Use existing domestic laws and regulations to assess the environmental, social and human rights impacts of investments*
3. *Develop new domestic laws and regulations to assess the environmental, social and human rights impacts of an investment*
4. *Integrate SAs into IIAs*

SAs can be integrated into IIAs in the following ways:

a. Specify in the IIA that a SA does not violate the agreement;

b. Specify SA as a condition of investment: Here are some features of a SA process that could be required in an IIA:

   i. Ongoing monitoring,

   ii. Consultation, involvement and participation, or consent of stakeholders;

c. SA as a condition of investment plus effective enforcement mechanisms where an investor does not comply with SA obligations:

   i. Limit access to dispute resolution,

   ii. Create domestic complaint and investigation procedures,

   iii. Allow the host state and private parties to sue investors that harm the environment, human rights, labour rights and the rights of indigenous peoples in the host state, and

   iv. Allow investors' home state and private parties to sue investors for harm to the environment, human rights, labour rights and the rights of indigenous peoples in the home state.

### 6.6.3 Discussion of options

1. *Do not submit foreign investments to an assessment procedure prior to approving them*

The advantage of this approach is that it does not require the host state to devote any resources to assessment. In addition, investors may be attracted to a jurisdiction that

does not have a complex assessment procedure in place, as this will lower its cost of doing business at the front end of the investment.

The disadvantage of this approach is that neither the home state nor the investor will have a clear idea of the magnitude of the risks that the investment represents. Without consulting with the local community, social risks in particular may be hard to foresee. It may also be difficult to put in place systems for avoiding or mitigating risks should they occur. The assessment procedure builds a relationship between the government and the investor, both of whom are involved in a comprehensive assessment. If no assessment takes place, this relationship may not be strong, and the response to pollution or other risks may be slow.

An assessment procedure that involves the public throughout the life of the investment promotes democratic participation and transparency. This transparency can build public support for an investment that can be useful when risks materialise. Also, investors may save money in the long term if they are able to put a risk mitigation plan in place that will be less costly than responding to risks in an ad hoc fashion after they materialise.

Finally, states have an obligation to prevent business enterprises from causing harm to those living in the state's territory.[99] Besides, business enterprises themselves have a responsibility 'to avoid causing or contributing to adverse human rights impacts.'[100] Putting in place an assessment process helps both states and investors fulfil their duties.

2. *Use existing domestic laws and regulations to assess the environmental, social and human rights impacts of investments*

The host state may apply existing domestic laws and regulations to assess investments, or it may update existing assessment provisions to provide a more comprehensive sustainability assessment process. The advantage of this approach is that it allows the use of existing assessment institutions and agencies and permits them to apply their expertise to assessing foreign investments. In dealing with sophisticated transnational corporations, host state personnel may learn about new practices employed by foreign investors to deal with environmental protection or the protection of labour rights, human rights and the rights of indigenous peoples. Using domestic legislation also ensures that there is a common assessment system for domestic and foreign investments that promote fairness and transparency. Finally, a domestic SA system implements the state's duty to protect its citizens and those living in its territory against human rights abuses by domestic and foreign businesses.[101]

A drawback to this approach is that foreign investors may be able to challenge some government actions as part of the assessment process by relying on investor protections in the IIA. For instance, investors may challenge administrative processes to which

99 UN Guiding Principles on Business and Human Rights, Principle 1.
100 UN Guiding Principles on Business and Human Rights, Principle 13.
101 UN Guiding Principles on Business and Human Rights, Principle 1.

they must submit as violating FET requirements. The risk of these actions will depend on the specific obligations in the IIA, including whether the IIA provides a right of establishment.

If a state uses a purely domestic system rather than including SA provisions in an IIA, it is more difficult for a state to use treaty-based enforcement mechanisms such as counterclaims, grievance procedures or state-to-state consultations to encourage investors to comply with their obligations to protect the environment, human rights, labour rights and the rights of indigenous peoples. Treaty-based enforcement mechanisms could be triggered by a failure to comply with domestic SA requirements, however.

3. *Develop new domestic laws and regulations to assess the environmental, social and human rights impacts of an investment*

States may not have existing laws or regulations that require a SA, or existing laws may not contemplate a comprehensive assessment of environmental, social and human rights impacts. One option is to develop such a system using best practices in other jurisdictions. The advantages of this approach are similar to those discussed in option 2 above.

There are a number of drawbacks to this approach. They include the following:

- The financial cost of developing and implementing a new assessment system;
- The political cost of developing and implementing a new assessment system;
- Running afoul of existing IIAs – implementing a new SA process may be challenged by foreign investors as a violation of FET or an expropriation requiring compensation; and
- Lack of access to treaty-based enforcement mechanisms to create incentives for foreign investors to comply with assessments and take steps to prevent or mitigate risks.

4. *Integrate SAs into IIAs*

SAs can be integrated into IIAs in the following ways:

a. **Specify in the IIA that a SA does not violate the agreement:** If this approach is taken, reservations and/or exceptions will be used to exempt existing or future domestic SA requirements from the investor protection provision in the treaty, including the prohibition on expropriation without compensation or the fair and equitable treatment obligation. In this way, the host state will have the regulatory space to apply existing SA processes or to create new ones.

   This approach has the advantage of protecting the state's right to regulate foreign investors by applying an existing domestic SA system or developing a new one. It has the disadvantage of not providing the host state with access to treaty-based enforcement mechanisms.

b. **SA as a condition of investment:** It is possible for the host state to make a SA a condition for both the approval of the investment and the applicability to an investor of the investment protection obligations. The framework for the SA could be spelt out in the treaty, or the treaty could require compliance with the SA process under host state law. An advantage of doing this is that the application of a SA system implements the state's duty to protect its citizens and those living in its territory against human rights abuses by domestic and foreign businesses. It also implements the state's obligation to protect the environment. In addition, if the SA procedure is combined with effective treaty-based remedies, it will create strong incentives for investors to comply with their obligations not to harm third parties.

   The disadvantages are similar to those involved in setting up a new domestic SA system. However, if a host state sets up a system that applies solely to foreign investors pursuant to an IIA, it is likely to be less costly than establishing a comprehensive domestic evaluation system. On the other hand, if the standards that apply to foreign and domestic investors or to foreign investors from different countries are different, this may cause administrative difficulties and lead to perceptions of unfairness and differential treatment.

   If the SA is made a condition of investment, the IIA will include a provision requiring investments of a certain size and/or in certain sectors to undergo an assessment. SAs can be more or less comprehensive. The following are some features of a SA process that could be required in an IIA:

   i. **Ongoing monitoring:** The investor and the state regulatory body will develop a plan for ongoing monitoring of the investment. In this way, the government and local residents are kept informed about the ongoing impacts of an investment on the environment and the community.

   ii. **Consultation, involvement and participation, or consent of stakeholders:** Requiring investors to consult with those affected by the investment and take into account the results of this consultation is a less onerous requirement than requiring them to involve stakeholders in decision-making or obtain the consent of those affected before allowing the investment to proceed. However, best practices, for example in the area of indigenous rights, point to consent as the most rights-protective standard.

c. **SA as a condition of investment plus effective enforcement mechanisms:** It is possible to complement a requirement that an investor conduct a SA as a condition of being permitted to make its investment by creating treaty-based enforcement mechanisms in the IIA to ensure that the investor complies with the plans to mitigate risks posed by the investment elaborated in the initial assessment and the management plan that results from it. Examples of enforcement mechanisms include the following:

   i. **Limit access to dispute resolution:** If the investor fails to meet its obligations to comply with a SA in the treaty, it will not be able to

access investor–state dispute resolution. This approach redresses the imbalance in most IIAs, which provide treaty remedies for harms against investors, but no mechanisms for ensuring that investors comply with their obligations. Making compliance with a SA a condition of accessing treaty-based investor–state dispute resolution creates incentives for the investor to come before an investment tribunal with clean hands.

ii. **Create domestic complaint and investigation procedures:** Allowing community members and those affected by the investment to bring to the state's attention harms to their community or to the environment is a more proactive way of ensuring the investor's ongoing compliance with standards for environmental protection, human rights, labour rights and indigenous peoples' rights than simply limiting access to dispute settlement if an investor is not in compliance with its post-SA management plan. However, there are financial, bureaucratic and political costs associated with establishing such procedures.

iii. **Allow the host state and private parties to sue investors that harm the environment, human rights labour rights or the rights of indigenous peoples:** This involves creating civil and criminal liability for investors when risks identified in the SA, such as violations of human rights or damage to the environment, materialise. There are obvious financial and administrative costs in taking this route. However, there are also many advantages. Most obviously, civil remedies create a process through which injured parties can seek relief. Civil and criminal liability will help deter investors from engaging in the conduct constituting the harm. Also, creating civil and criminal liability will help local administrative tribunals and courts develop expertise in the relevant areas of law. This may improve the quality of due process in the host state. It will also encourage foreign investors to engage with domestic law and domestic courts, integrating them more fully into the democratic life of the host state. Finally, it ensures that domestic decision-makers familiar with local circumstances, laws and norms, rather than an international arbitration panel or court, will adjudicate issues. This will ensure greater integration of the foreign investor into the local community.

iv. **Allow the investor's home state and private parties to sue investors for harm to the environment, human rights, labour rights or the rights of indigenous peoples:** Investors' home states can play a role when an IIA contains obligations relating to SAs. An IIA could include provisions requiring the home state to have similar forms of liability for their nationals investing abroad to ensure investor accountability for environmental harms or infringements of human rights in the host state. In addition to supporting enforcement in the host state, including a treaty provision requiring home state enforcement addresses possible concerns about infringing the host state's sovereignty that might discourage a home state from taking action. The application of the domestic law of the investor's home state in relation to actions in the host state might be

seen as an invasion of the host state's sovereignty. However, providing for home state liability in the IIA should ensure that the parties accept the need for co-operation in protecting the environment and human rights. They will have balanced the costs and benefits of home state enforcement during the negotiation of the IIA, and the host state will have agreed to the outcome.

All of these enforcement mechanisms in an IIA could be tied to a SA process set out in the treaty or a SA process already established under the law of the host state. It is important to recognise, however, that at most, an IIA provision can provide a basic framework for an assessment process. Substantial investment in the development of domestic rules and administration will be required.

### 6.6.4 Discussion of the sample SA provisions

The Guide sample provisions on sustainability assessment aim at achieving the policy goals of sustainable development discussed above. They also take into account best practices in the area. Given the novelty of the provisions and the potential technical difficulties in integrating a SA requirement into an IIA, the sample provisions provide one example of how this can be done. Of course, states may choose to rely on existing domestic assessment regimes or adopt less comprehensive forms of assessment requirements in their IIAs. The main features of the sample SA provisions are summarised in Box 6.5.

**Box 6.5 Key features of the SA system in the sample provisions**

1. Recognises the right of each party state to establish its own level of domestic environmental protection and to pursue its own priorities in regard to sustainable development;
2. Acknowledges that party states will develop a SA system that reflects their international legal obligations in relation to human rights, labour rights and the rights of indigenous peoples, including, but not limited to, rights set out in the eight core ILO conventions,[102] the core UN human

(Continued)

102 *Convention (No. 100) concerning Equal Remuneration for Men and Women Workers for Work of Equal Value*, adopted 29 June 1951, in force 23 May 1953; *Convention (No. 111) concerning Discrimination in Respect of Employment and Occupation*, adopted 25 June 1958, in force 15 June 1960; *Convention (No. 87) concerning Freedom of Association and Protection of the Right to Organize*, adopted 9 July 1948, in force 4 July 1950; *Convention (No. 98) concerning the Application of the Principles of the Right to Organise and Collective Bargaining*, adopted 1 July 1949, in force 18 July 1951; *Convention (No. 138) concerning Minimum Age for Admission to Employment*, adopted 26 June 1973, in force 19 June 1976; *Convention (No. 182) concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour*, adopted 17 June 1999, in force 19 November 2000; *Convention (No. 29) concerning Forced or Compulsory Labour*, adopted 28 June 1930, in force 1 May 1932; and *Convention (No. 105) concerning the Abolition of Forced Labour*, adopted 25 June 1957, in force 17 January 1959.

(Continued)

rights treaties,[103] the Universal Declaration of Human Rights 1948 and the UN Declaration on the Rights of Indigenous Peoples and customary international law;

3. Requires host states to develop standards to be applied in the assessment process through consultation with potentially affected groups;
4. Requires host states to determine the appropriate scope of the SA (i.e. decide what investments require assessment);
5. Requires investors to conduct SA of investments that fall within the scope;
6. Ensures that the assessment will be conducted in consultation with affected groups prior to the approval of the investment;
7. Ensures that the host state reviews the assessment;
8. Ensures that the host state and the investor agree to a management plan for implementing the assessment and the review;
9. Allows those affected by an investment to participate in the SA process and decision-making about investments;
10. Secures the free, prior and informed consent of affected communities before an investment proceeds;
11. Requires the parties to implement an effective system for monitoring the ongoing compliance of investors;
12. Ensures public access to the recommendations in the assessment and the review, and to the results of ongoing monitoring processes;
13. Gives parties the flexibility to revise assessment standards and the methods to achieve them as the circumstances of the state and the investment change;

(Continued)

103 These include the *International Convention on the Elimination of All Forms of Racial Discrimination*, adopted 21 December 1966, in force 4 January 1969; *International Covenant on Civil and Political Rights*, adopted 21 December 1965, in force 4 January 1969, 660 *United Nations Treaty Series* 195; *International Covenant on Economic Social and Cultural Rights*, signed 16 December 1966, in force 23 March 1976. *Convention on the Elimination of All Forms of Discrimination against Women*, adopted 18 December 1979, in force 3 September 1981, 1249 *United Nations Treaty Series* 13; *Convention against Torture and Other Cruel, Inhuman or Degrading Treatment*, adopted 10 December 1984, in force 26 June 1987, 1577 *United Nations Treaty Series* 3; *Convention on the Rights of the Child*, adopted 20 November 1989, in force 2 September 1990, 1577 *United Nations Treaty Series* 3; *International Convention on the Protection of the Rights of Migrant Workers and Their Families*, adopted 18 December 1990, in force 1 July 2003, 2220 *United Nations Treaty Series* 3; *International Convention on the Rights of Persons with Disabilities*, adopted 20 December 2006, in force 3 May 2008, 2515 *United Nations Treaty Series* 3.

(Continued)

14. Provides an effective and affordable grievance procedure for those affected by an investment; and

15. Provides effective remedies for those whose rights have been violated or who suffer harm as a result of an investment.

The Guide contains two provisions for integrating a SA system into an IIA.

*Sample Provision 1: Creation of SA process*

This sample provision (Section 6.6.5) requires that a party state put in place an effective system of laws and regulations for assessing the environmental, social and human rights impact of proposed investments.

The Guide does not prescribe the kind of detailed requirements found in the performance standards of the IFC, ISO 14001 or ISO 26000. Instead, it adopts a more streamlined and customised approach that requires that the standards for the assessment be developed in consultation with all parties potentially affected by them (subsection (2)). Parties may decide that only investments that are substantial or that involve substantial risks will be subject to assessment, while investments by small businesses or in sectors in which investments are unlikely to raise significant environmental, social or human rights issues, such as most services sectors, may be excluded or subject to a less onerous assessment process.

The sample assessment provision envisions that the standards used in the SA will reflect important principles of sustainable development (subsections (1)(a)(i)–(vii)). If parties wish to ensure that there is a mutual understanding of the principles that should underlie the SA system established under this provision, they could include a list of these principles in a similar fashion to the sample provision. Of course, the states negotiating an IIA will have to determine what these principles ought to be in order to best reflect their sustainable development policies and goals. The principles listed in subsections (1)(a)(i)–(vii) are only suggestive examples.

In its non-prescriptive list of sustainable development principles, the Guide sample provision includes the precautionary principle and the polluter pays principle (subsections (1)(a)(iii) and (iv)). The reference to the precautionary principle and the polluter pays principle aims to make clear that the host state can require the investor through the management plan to take measures to internalise the cost of environmental pollution and to protect against environmental harms about which there is scientific uncertainty, but which the host state has reasonable grounds to wish to prevent.

The non-prescriptive list also reflects the need for stakeholders to participate in decision-making (subsection (1)(a)(v)) and for investors to obtain the free, prior and informed consent of indigenous peoples before the investment is approved (subsection

(1)(a)(vi)). Finally, the investment and the assessment process must respect the rights of indigenous peoples recognised by the host state (subsection (1)(a)(vii)).

The IISD model treaty requires that environmental and social impact assessments apply the standards of the party that provides the highest level of protection for environment and human rights. The Guide sample provision 6.6.6 differs in that it requires the parties to determine the appropriate standards for the assessment and the screening criteria in consultation with individuals and communities that will be affected by the standards or their implementation, with the safeguard that these standards cannot be less protective than those of the party that provides the highest degree of protection (subsection (1)(c)).

There are two reasons for adopting this approach. First, consultation with individuals potentially affected by the investments ensures that the standards and screening criteria are appropriate to the type of industry in which the investor is involved as well as to the specific circumstances in the host state.

Second, practical problems arise in requiring the parties to adopt the domestic laws of the state providing the greatest level of protection. For instance, the states may not have in place domestic standards that are relevant to the particular kind of investment that is the subject of the assessment process. In addition, foreign investment may raise different concerns from domestic investment. The process for setting standards outlined in the sample provisions of the Guide ensures that the standards for SA are best adapted to the type of investment that foreign investors are making, as well as to the unique vulnerabilities of the individuals of a party that will be affected by the investment.

Although the sample provisions encourage host states to set standards for the SA in consultation with affected parties, they nonetheless specify that the standards arrived at through the consultative process should not be less protective of the environment or the rights of individuals or groups in the host state than the laws and regulations of the party state providing the highest standards. In other words, a party state should use the best standards available as the starting point for discussions regarding the appropriate standards for the assessment.

One of the challenges for host states associated with the assessment procedure contemplated in the sample provisions is what is frequently called 'ratcheting up'. The SA provisions in the Guide require that the SA process adopted by the parties is no less protective than that provided for in the laws of the party state with the highest standards. Once the host state has compared its regulations with those of other parties, it may find that the new standards it must put in place for foreign investors are higher than existing standards. Foreign investors may be subject to higher standards than those that must be met by domestic investors. The provision in the Guide will thus have the effect of 'ratcheting up' the lower standards of one party to the higher standards of the other.

As discussed earlier, the sample provisions in the Guide may require host states to create a new legal and regulatory framework for SA or expand existing domestic systems. This may be onerous for some because of limited resources or lack of suitable training.

### 6.6.5 Sample provision: standards for sustainability assessment of investments

#### Standards for Sustainability Assessment of Investments

1. Recognising the right of each Party to establish its own level of domestic environmental protection and its own policies and priorities in regard to sustainable development, each Party shall establish laws and regulations to create an effective and efficient system for sustainability assessment of all foreign investments in the Party by an investor of the other Party. These laws and regulations will incorporate standards in accordance with the Party's national and international obligations to promote sustainable development, including the protection of the human and natural environment, human health, the protection and promotion of human and labour rights, and the recognition and promotion of the rights of indigenous peoples.

    a. The standards must take into account:

        i. The promotion of sustainable development;

        ii. The need to respect national and international human rights, labour rights, the rights of indigenous peoples and environmental standards consistent with a Party's international obligations under treaty and customary international law;

        iii. The precautionary principle;

        iv. The principle that the polluter should bear the costs of pollution;

        v. The requirement that affected communities should fully participate in decisions regarding aspects of the investment that could potentially affect them;

        vi. The requirement that indigenous peoples give their free, prior and informed consent to the investment on issues that could potentially affect them;

        vii. The promotion of effective environmental, social and human rights performance of investors through the effective integration of risk prevention and mitigation strategies in the investor's management systems; and

        viii. Respect for and promotion of the dignity, human rights, cultures and livelihoods of indigenous peoples as recognised in the national law of the host state and international law, and other international instruments including but not limited to the *UN Declaration on the Rights of Indigenous Peoples* and ILO *Convention (No. 169) concerning Indigenous and Tribal Peoples in Independent Countries, 1989*.

    b. These standards must include screening criteria for determining the appropriate scope of the pre-establishment environmental, social and human rights impact assessment required under [Guide sample provision (Pre-Establishment

Sustainability Assessment Process)], including what investments are subject to review. The criteria will take into account factors including: the size of the investment; the nature of the investment and its potential for harming the environment or infringing the health, human and labour rights of persons of the Party or the rights of indigenous peoples within the territory of the Party; and the standards articulated in subsections (1)(a)(i)–(vii) above.

c. The standards and criteria established in accordance with this section shall not provide less protection than those applied by the Party that provides the highest degree of protection.

2. Before establishing the standards referred to in section 1, a Party shall consult with all persons of the Party potentially affected by the standards or their implementation and take into account the feedback from such persons.

3. The consultation process referred to in section 2 must be open, transparent and accessible to the public and to investors of the other Party and any other person of the Party affected by the standards and criteria.

*Sample Provision 2: Requirement to carry out a SA before the investment is established*

Subsection 1 of this sample provision (Provision 6.6.6) requires that investors carry out a SA, and subsection 2 ensures that the host state reviews this assessment. Section 3 requires that the host state and the investor agree to a management plan for implementing the assessment results. The plan must include an effective system for monitoring ongoing compliance of the investment. The plan must provide the public with access to the recommendations in the assessment and review, and access to the results of ongoing monitoring processes (Section 4 in sample provision 6.6.6). The sustainability assessment, review and management plan must all be completed before the host state approves the investment.

This sample provision in the Guide seeks to improve on the IISD model agreement[104] in various respects. The IISD model agreement does not require the host state to review the SA, nor does it require that a management plan be formulated to ensure that the investment complies with good environmental and social practices throughout the life of the investment. The inclusion of these requirements in the Guide orients the party states, investors and affected parties towards practical solutions for avoiding or mitigating potential harms.

### 6.6.6 Sample provision: pre-establishment sustainability assessment process

#### Pre-establishment Sustainability Assessment Process

Before a Party approves an investment in that Party by an investor of the other Party, the following must occur.

104 IISD model treaty, Art. 21.

1. Where required under the standards and screening criteria determined under [Guide sample provision 6.6.5 (Standards for sustainability assessment of investments)], the investor or its investment must conduct a sustainability assessment of the proposed investment in accordance with the laws and regulations established in accordance with that article.
2. The Party approving the investment shall review the assessment.
3. The investor and the investment and the Party approving the investment shall agree on a management plan in relation to the investment that is in accordance with the assessment as reviewed by the Party, and that provides steps to ensure that the investment achieves the assessment standards determined under [Guide sample provision 6.6.5 (Standards for sustainability assessment of investments)] and that it avoids, minimises, mitigates or compensates for adverse impacts of the investment on workers, affected communities and the environment.
4. Each Party shall make sustainability assessments, reviews and management plans relating to investments in its territory public and accessible to persons in the Party affected by them.

### 6.6.7 Technical assistance

In order to make it more feasible for host states to implement the SA scheme in the sample provisions, the Guide provides an example of a provision on technical assistance that requires parties to provide each other with the information necessary for them to comply with their obligations.[105] This provision also requires the parties to agree on technical and financial assistance to help developing country parties to create and implement the assessment framework. These provisions are based on the idea that the relationship between the parties is a partnership aimed at facilitating sustainable development in both states. It also recognises that the parties have common but differentiated responsibilities as a result of their different levels of development and that technical assistance should reflect these differences.

A variety of other sample provisions throughout the Guide are designed to ensure the effectiveness of the assessment process. One sample provision creates a grievance procedure under which affected individuals and groups may complain about actions by an investor that harms their interests.[106] The Guide also includes a sample provision that establishes a procedure for securing compliance with the management plan created through the assessment process.[107] Finally, another sample provision contemplates that in some circumstances of persistent non-compliance, damages or an order for compliance may be sought in the domestic courts of the host state or the investor's home state.[108]

105 See Section 8.2 (Technical assistance).
106 See Section 6.15 (Grievance procedure and other measures to enforce the management plan produced in the sustainability assessment).
107 See Section 6.15 (Grievance procedure and other measures to enforce the management plan produced in the sustainability assessment).
108 See Section 6.16 (Civil liability of investors).

## 6.7 Investor obligation to comply with the laws of the host state

### Cross references


| | | |
|---|---|---|
| Section 4.5 | Scope of application | 94 |
| Section 6.16 | Civil liability of investors | 387 |
| Section 6.17 | Counterclaims by states in investor–state arbitrations | 401 |
| Section 7.1.7 | Sample provisions: investor–state dispute settlement, Article [W] (Counterclaims) | 478 |


It is fundamentally important to all states that foreign investors operating in their territories comply with the requirements of their domestic laws. Otherwise, the achievement of state regulatory goals will be undermined. In addition, the principles of sustainable development require that investors comply with the domestic laws and regulations enacted by host states to protect the environment, human rights, labour rights and rights of indigenous peoples of the states in which they operate. IIA provisions can encourage compliance with domestic law by imposing requirements on foreign investors to do so. As discussed in Section 4.5 (Scope of application), many IIAs limit the application of the agreement to investments made in accordance with host state law. This section addresses obligations of investors to comply with host state law generally.

### 6.7.1 IIA practice

The *OECD Guidelines for Multinational Enterprises* state that compliance with the domestic laws of the states in which they operate is the first obligation of transnational corporations.[109] UNCTAD, in its *Investment Policy Framework for Sustainable Development*, has suggested that states could include a provision in their IIAs requiring investors to comply with domestic law at the entry and post-entry stages of investment.[110]

Some investment treaties incorporate requirements to comply with domestic law. For example, the COMESA Investment Agreement includes a provision requiring COMESA investors to comply with the domestic law of the host state.[111] The IISD model treaty incorporates a similar obligation, and also requires investors to strive to contribute to the host state and local government's development goals.[112] However, most IIAs, such as the Canadian model FIPA, the 2012 US model BIT, the UK model IPPA and the Indian model BIPPA, contain no such provision.

109 OECD (2011), 'The OECD Guidelines for Multinational Enterprises', 25 May ; OECD Declaration on International Investment and Multinational Enterprises (Ministerial Meeting) at 15.

110 UNCTAD (2012), *Investment Policy Framework for Sustainable Development*, United Nations, New York and Geneva, at 58.

111 COMESA Investment Agreement (2007), Art. 13.

112 IISD model treaty, Art. 11.

**Box 6.6 Summary of options for obligation on investors to comply with the laws of the host state**

1. No obligation on investors to comply with domestic law
2. Incorporate into an IIA an obligation on investors to comply with domestic law

### 6.7.2 Discussion of options

Failure by foreign investors to comply with domestic law challenges state governance and sovereignty[113] and can undermine the rule of law. There are important advantages for host states that wish to pursue sustainable development in incorporating a clear obligation into an IIA requiring investors to comply with domestic laws and regulations, including laws and regulations related to environmental protection, human rights, labour rights and indigenous peoples' rights.

**Clarifies expectations and complements domestic law:** A treaty obligation to comply with domestic law clarifies the expectations on investors and raises the obligation to the international level. It thus balances the requirement to obey the laws of the host state with investor protections in the IIA.[114]

**Access to treaty-based compliance mechanisms:** Host states may face difficulties in regulating the environmental, social and human rights impacts of investors' activities. Incorporating the investor's obligations to comply with domestic law into an IIA creates a straightforward way to use a menu of treaty-based enforcement options beyond the usual domestic mechanisms that may be available to the host state. The sample provisions of the Guide provide options for additional enforcement mechanisms, such as civil liability for investors who violate treaty obligations in both the host state and the investor's home state.[115] They also include the possibility for the host state to seek relief from the investor's non-compliance by way of counterclaim in any investor–state arbitration initiated by the investor.[116]

### 6.7.3 Discussion of sample provision

Drawing on both the COMESA Investment Agreement and the IISD model treaty,[117] the Guide sample provision reiterates the general obligation of investors to comply with domestic law, but also makes specific reference to human rights, labour rights, the rights of indigenous peoples and environmental laws, regulations and standards. This provision simply requires that all legal obligations be complied with. It may be

113 I Brownlie (2003), *Principles of Public International Law*, 6th ed., Oxford University Press, Oxford, at 106.
114 UNCTAD (2012), *Investment Policy Framework for Sustainable Development*, op. cit., at 7, 11, 12, 39, 58.
115 See Section 6.16 (Civil liability of investors).
116 See Sections 6.17 (Counterclaims by states in investor–state arbitrations) and 7.1.7 (Sample provisions: investor–state dispute settlement, Article [W] (Counterclaims)).
117 COMESA Investment Agreement (2007), Art. 13; IISD model treaty, Art. 11(A).

that an investor–state tribunal hearing a state counterclaim alleging that an investor had not complied with this obligation would not grant relief for every minor instance of non-compliance. A tribunal might establish some threshold of significance before it would award damages.

The sample provision includes an obligation on investors to orient their policies and practices so as to support and contribute to the development objectives of the state in which they operate.[118] In light of the inherently broad and uncertain content of development objectives, it must be recognised that this latter obligation is largely aspirational.

### 6.7.4 Sample provision: obligation to comply with the laws of the host state

**Obligation to Comply with the Laws of the Host State**

1. Investors of a Party and their investments are subject to and shall respect the laws and regulations of the other Party, including, but not limited to its laws, regulations and standards for the protection of human rights, labour rights, the rights of indigenous peoples and the environment, and they shall not be complicit or assist in the violation of such rights by others in the other Party, including by public authorities or during civil strife.
2. Investors of a Party and their investments shall strive, through their management policies and practices, to contribute to the development objectives of the other Party and of sub-national levels of government that govern the area where the investment is located.

## 6.8 Investor obligation to respect internationally recognised human rights and undertake human rights due diligence

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118 See IISD model treaty, Art. 11(C) for the equivalent provision.

The protection of human rights is a fundamental aspect of sustainable development, as discussed in Section 2.3 of the Guide.[119] An IIA that purports to support sustainable development must therefore support the protection of the human rights of individuals and communities affected by investment.

### 6.8.1 The impacts of foreign investment

The investment activities of investors may have both negative and positive impacts on the human rights of individuals in the host state. On the positive side, increased investment leads to economic growth and can provide a host state with economic resources to put in place programmes to fulfil human rights, particularly economic, social and cultural rights. Increased revenues from foreign investment can provide host states with resources to pay for primary, secondary and tertiary education and to create new jobs, for example.

On the negative side, investment does not, on its own, ensure that the human rights of individuals and communities are protected. The individuals most likely to suffer direct impacts of the foreign investment on their human rights (including labour rights and the rights of indigenous peoples) are local employees of the investor and the people in the communities living in and around the investment, as well of those who might be affected by environmental pollution to water sources, air and land that may spread beyond the immediate area of the investment site.

Not all investments will have the same impact on human rights. Such impacts will differ depending on the nature and size of the business, the location of the proposed investment and the social, political, legal and ecological context of its operations. For example, the risk of human rights impacts will be different and less serious in connection with the establishment of a bank in an urban centre than a gold mine or other extractive venture located on indigenous land or in an ecologically sensitive area.

For investment to contribute to sustainable development, and in particular to the protection of human rights, it must be effectively regulated to ensure that foreign investor activity does not violate human rights within the host state. Investment treaties can constrain the ability of states to regulate in the public interest, including laws and regulations aimed at protecting and promoting respect for human rights.[120] IIAs can be drafted to minimise this constraining effect as discussed below.

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119 See Section 2.3 (Links between foreign investment and sustainable development).

120 UNHRC (2008), 'Protect Respect and Remedy', op. cit., at paras. 34–6. See also, for example, D Schneiderman (2000), 'Investment Rules and the New Constitutionalism', 25 *Law and Social Inquiry* 757 at 758; M Sornarajah (2010), *The International Law of Foreign Investment*, 3d ed., Cambridge University Press, Cambridge, at 227–9. See also K Miles (2010), 'International Investment Law: Origins, Imperialism and Conceptualizing the Environment', 21 *Colorado Journal of International Environmental Law and Policy* 1 at 40, 47, discussing the restraint on state capacity to regulate with respect to the environment.

### 6.8.2 The UN Guiding Principles on Business and Human Rights

The United Nations Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises (SRSG) has developed Guiding Principles on Business and Human Rights.[121] These principles clarify the international human rights obligation of states to exercise due diligence to protect individuals from violations of human rights caused by private actors, including investors. This is known as the obligation to *protect*. The Guiding Principles also recognise that business actors have a responsibility to respect human rights. The principles provide guidance for corporations on the substance and operational aspects of this responsibility. The Guiding Principles acknowledge that business activity can potentially affect 'virtually the entire spectrum of internationally-recognised human rights'. Business actors therefore have a responsibility to respect *all* human rights.[122]

The UN Human Rights Council unanimously endorsed the Guiding Principles in June 2011.[123] The latter have also been well received by the global business community.[124] These core principles on the responsibility to respect human rights have also been reiterated in the *OECD Guidelines for Multinational Enterprises*[125] and the ISO 26000 standards.[126] Both these instruments provide voluntary standards for socially responsible business behaviour. UNCTAD has also recognised these principles as standards of responsible investment, to which governments should encourage adherence.[127] The key principles relevant for investment are set out in Box 6.7. The rationale for a due diligence process that businesses should follow in relation to human rights is set out in Box 6.8.

**Box 6.7 *Guiding Principles on Business and Human Rights:* Implementing the United Nations 'Protect, Respect and Remedy' framework**

UN Doc. A/HRC/17/31 (2011)

II. The corporate responsibility to respect human rights

A. Foundational principles

Principle 11. Business enterprises should respect human rights. This means that they should avoid infringing on the human rights of others and should address adverse human rights impacts with which they are involved.

(Continued)

121 UN Guiding Principles on Business and Human Rights, op. cit.

122 Ibid. at Principle 12, commentary.

123 Human Rights and Transnational Corporations and Other Business Enterprises, UNHRC, 17th Sess, UN Doc A/HRC/17/L.17/Rev.1 (2011).

124 See, for example, the 'IOE Statement', op. cit. See also the range of letters from business actors endorsing the Guiding Principles, including 'Coca-Cola Statement', op. cit., and 'Total Statement', op. cit.

125 *OECD Guidelines*, op. cit.

126 ISO 26000:2010.

127 UNCTAD (2012), *Investment Policy Framework for Sustainable Development*, op. cit., at 29.

(Continued)

Principle 12. The responsibility of business enterprises to respect human rights refers to internationally recognized human rights – understood, at a minimum, as those expressed in the International Bill of Human Rights and the principles concerning fundamental rights set out in the International Labour Organization's Declaration on Fundamental Principles and Rights at Work.

Principle 13. The responsibility to respect human rights requires that business enterprises:

a. Avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur;

b. Seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts.

Principle 14. The responsibility of business enterprises to respect human rights applies to all enterprises regardless of their size, sector, operational context, ownership and structure. Nevertheless, the scale and complexity of the means through which enterprises meet that responsibility may vary according to these factors and with the severity of the enterprise's adverse human rights impacts.

Principle 15. In order to meet their responsibility to respect human rights, business enterprises should have in place policies and processes appropriate to their size and circumstances, including:

a. A policy commitment to meet their responsibility to respect human rights;

b. A human rights due-diligence process to identify, prevent, mitigate and account for how they address their impacts on human rights;

c. Processes to enable the remediation of any adverse human rights impacts they cause or to which they contribute.

**Box 6.8 What is human rights due diligence and why is it important?**

- *Definition*. Due diligence refers to exhaustive processes undertaken by corporations or financial institutions, for example, when preparing a business transaction such as a merger or acquisition or when determining whether to lend money to a business entity for a specific project.
- *Purpose*. The aim of the due diligence process is:

  a. To ensure that the corporation has all of the information necessary to properly understand the full range potential liabilities of the entity it proposes to buy or to merge with;

(Continued)

(Continued)

b. To ensure that a financial institution providing a loan to a corporation is fully apprised of all potential liabilities regarding the project for which the loan is being sought;[128] and

c. To ensure that corporations and financial institutions discharge their legal responsibilities to fully assess the risk of the merger, acquisition or loan, as the case may be. Due diligence, therefore, has a legal dimension since it 'is part of the process of dealing with legal liability and so has to meet the standards set up in law to discharge a duty of care'.[129]

- *Human rights due diligence for the state*. States have an obligation under international human rights law to exercise due diligence to protect the human rights of individuals from the acts of private parties that may violate such rights.[130]
- *Human rights due diligence for business actors*. This is a new concept. A human rights due diligence process does not assess the risks of an investment to the corporation, but rather requires a corporation to fully apprise itself of the potential adverse impacts of its presence and activities on the human rights of individuals and communities in the country in which it plans to invest or in which it is already in the process of investing. It also requires the corporation to take steps to prevent, avoid and, if necessary, mitigate such impacts and report on the effectiveness of such measures.
- *Why human rights due diligence is important*.
  a. *Puts human rights on the 'corporate radar'*. A duty to engage in human rights due diligence can help to internalise 'concerns over human rights impacts into corporate psyche and culture [and] [t]he due diligence process then allows this concern to be put into operation'.[131]
  b. *Shows corporations take their duty to protect human rights seriously*. Human rights due diligence is also one of the means by which corporate actors can demonstrate that they are taking their obligation to respect human rights seriously.
  c. *Limits legal liability of corporations*. Undertaking due diligence may help to mitigate potential legal liability. According to the SRSG:

> Conducting appropriate human rights due diligence should help business enterprises address the risk of legal claims against them by showing that they took every reasonable step to avoid involvement with an alleged human rights abuse. However, business enterprises conducting such due diligence should not assume that, by itself, this

(Continued)

128 P Muchlinski (2012), 'Implementing the New UN Corporate Human Rights Framework: Implications for Corporate Law, Governance, and Regulation', 22 *Business Ethics Quarterly* 145 at 156.

129 Ibid. at 157.

130 *Velásquez Rodriguez v. Honduras*, op. cit., at paras 172, 176.

131 Muchlinski, op. cit., at 156.

(Continued)

will automatically and fully absolve them from liability for causing or contributing to human rights abuses.[132]

d. *Human rights due diligence is a risk prevention tool.* Where a corporation engages in a robust human rights due diligence process, it should be possible to prevent most human rights abuses and mitigate adverse impacts that cannot be avoided or prevented. It may also identify situations in which the investment should not proceed.

- *Putting human rights due diligence into practice:* Human rights due diligence is defined in the Guiding Principles as a process in which corporations 'identify, prevent, mitigate and account for how they address their adverse human rights impacts', and it requires the corporation to determine both actual and potential human rights impacts, integrate and act on its findings, track responses and report on how the impacts are to be addressed.[133] Guiding Principle 17 states that:

  Human rights due diligence:

  a. Should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships;

  b. Will vary in complexity with the size of the business enterprise, the risk of severe human rights impacts, and the nature and context of its operations;

  c. Should be ongoing, recognizing that the human rights risks may change over time as the business enterprise's operations and operating context evolve.[134]

- *Due diligence includes consultation with, and involvement of, those affected by the investment.* The human rights due diligence process outlined in the Guiding Principles includes consultation with indigenous and other communities as well as other stakeholders in a manner that allows for their effective participation in such consultation. Where such consultation is not possible, corporations are encouraged to consult with human rights non-governmental organisations.[135]

The Guiding Principles lay out in Principles 17–21 the minimum requirements for such a due diligence process for a business:

- It must be initiated at the earliest possible stage of the project and be ongoing.
- It should include a human rights impact assessment (HRIA):[136]
  - The process should have input from an internal human rights expert or an external independent expert,

132 UN Guiding Principles on Business and Human Rights, op. cit., at Principle 17, commentary.
133 Ibid., at Principle 17.
134 Ibid.
135 Ibid., at Principle 18, commentary.
136 See Section 6.6 (Sustainability assessments).

  - The business should engage in 'meaningful consultation' with affected stakeholders, including indigenous and other communities and individuals; this means that the consultation should take into account language and other barriers to seeking such input.[137]
- The findings of the HRIA should be integrated into the business's management processes.
- The business must take appropriate action to prevent and/or mitigate adverse impacts. This may include ending relationships with contractors or suppliers.[138]
- The business must 'track the effectiveness of their response' to any potential or actual adverse impacts by drawing on internal and external feedback.[139]
- The business should report accurately and accessibly on how it addresses its human rights impacts, providing sufficient information to assess the adequacy of its response without posing risks to stakeholders or compromising confidential commercial information.[140]
- The business should provide or assist in providing remediation to victims, where the due diligence process reveals that the business has caused or contributed to adverse human rights impacts.[141]

The responsibility of investors to respect human rights as set out in the Guiding Principles is not legally binding since it has not been incorporated into a treaty or into the domestic laws of states. This means that the corporate responsibilities to respect human rights, engage in human rights due diligence and to provide remediation for adverse human rights impacts remain voluntary duties.

### 6.8.3 IIA practice

No existing IIA includes an obligation on investors to respect human rights and/or to engage in a process of human rights due diligence. However, a few IIAs do incorporate language on human rights. For example, the preamble of the draft Norwegian APPI, which has now been shelved,[142] reaffirms the parties' commitments to human rights and fundamental freedoms and references the principles set out in the UN Charter and the Universal Declaration of Human Rights.[143] In the EU–Russia Cooperation and Partnership Agreement, the parties commit in the body of the treaty to engage in regular political dialogue to ensure that they 'endeavour to cooperate on matters pertaining to the observance of the principles of democracy and human rights' and consult if necessary on implementation of such principles.[144]

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137 UN Guiding Principles on Business and Human Rights, op. cit., at Principle 18, commentary.
138 Ibid., at Principle 19, commentary.
139 Ibid., at Principle 20, commentary.
140 Ibid., at Principle 21, commentary.
141 Ibid., at Principle 22, commentary.
142 See draft Norwegian APPI.
143 Draft Norwegian APPI, preamble. See also the European Free Trade Association–Singapore Free Trade Agreement, signed 26 June 2002, in force 1 January 2003, preamble.
144 European Union–Russia, Agreement on Partnership and Cooperation between the European Communities and the Russian Federation, signed 24 June 1994, in force 1 December 1997, Art. 6.

More recently, some states have begun to incorporate provisions into IIAs that deal with corporate social responsibility (CSR) and make reference to human rights or to standards that address human rights.[145] The Canada–Colombia FTA, for example, includes a non-binding recommendation that party states encourage foreign investors to 'voluntarily incorporate internationally recognized standards of corporate social responsibility in their internal policies' relating to human rights, labour rights, environmental issues, anti-corruption and community relations.[146] A similar provision can be found in the Canada–Peru FTA.[147] The draft Norwegian APPI includes an obligation on party states 'to encourage investors to conduct their investment activities in compliance with the OECD Guidelines for Multinational Enterprises and to participate in the United Nations Global Compact'.[148] Both the OECD Guidelines[149] and the Global Compact[150] are voluntary codes of conduct establishing ethical rules for corporate behaviour.

UNCTAD notes that CSR standards are increasingly being taken into account in states' investment policies. It suggests that these policies should encourage investors to adopt and comply with international corporate social responsibility standards, and that some states may wish to incorporate these standards, including the Guiding Principles on Business and Human Rights, into domestic laws and regulations.[151]

**Box 6.9 Summary of options for investor obligation to respect human rights and undertake human rights due diligence**

1. *Do not require foreign investors or their investments to respect human rights and undertake human rights due diligence prior to approving them*
2. *Use existing domestic laws to regulate the human rights impacts of investors and their investments*
3. *Incorporate into domestic law an obligation on investors to respect human rights and engage in human rights due diligence*
4. *Incorporate a provision in an IIA recommending that states encourage their investors to include internationally recognised CSR standards in their corporate policies*
5. *Integrate into IIAs an obligation on investors to respect human rights and engage in human rights due diligence*

145 J Hepburn and V Kuuya (2011), 'Corporate Social Responsibility and Investment Treaties', in Cordonier Segger et al., op. cit., 589 at 599ff.
146 Canada–Colombia FTA (2008), Art. 816.
147 Canada–Peru FTA (2008), Art. 810.
148 Draft Norwegian APPI, Art. 32.
149 *OECD Guidelines*, op. cit.
150 *UN Global Compact*, available at: www.unglobalcompact.org (accessed 8 January 2013).
151 UNCTAD (2012), *Investment Policy Framework for Sustainable Development*, op. cit., at 29.

### 6.8.4 Discussion of options

States will have to determine the most appropriate course of action for dealing with investor activities that may have adverse human rights impacts, taking into consideration the costs and benefits of the options outlined below.

1. *Do not require foreign investors or their investments to respect human rights and undertake human rights due diligence prior to approving them*

**It is costly to develop a regulatory framework:** States may decide, for instance, not to take any steps to require investors and their foreign investments to respect human rights and to undertake human rights due diligence prior to approval of the investment. This course of action has the advantage of not requiring the outlay of resources to develop and enforce a regulatory framework to ensure that businesses engage in a comprehensive human rights due diligence process, either as a part of a broader sustainability assessment or as a free-standing process. This will keep costs lower both for investors and for the host state from the pre-establishment phase throughout the life cycle of the investment.

**Leaving investors to self-regulate does not protect human rights:** Human rights due diligence is not currently required by most host states and only some investors in a few industries are beginning to assess stakeholder concerns as part of an overall social impact assessment.[152] This means that investors that currently carry out such assessments can pick and choose the standards that they apply. Experience has shown that self-regulation has failed to prevent business actors, in any consistent way, from violating human rights or becoming complicit in such violations.[153]

**Lack of information can result in a failure to prevent and mitigate adverse human rights impacts:** Where the investor fails to undertake human rights due diligence, neither the host state nor the investor will have a clear idea of the potential human rights impacts of the investment. In particular, without consultation of affected individuals and communities, the specific human rights impacts will be difficult to determine. This will make it challenging for the state and the investor to develop appropriate systems to prevent and mitigate adverse human rights impacts. The investor will also have no means to demonstrate that it and its investment are respecting human rights.

**Human rights violations have social and financial costs:** When deciding whether or not to regulate the human rights impacts of investor activity, states may wish to consider the less obvious social and financial costs of failing to require investors to engage in human rights due diligence.

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152 R Davis and D M Franks, 'The Costs of Conflict with Local Communities in the Extractive Industry', in D Brereton, D Pesce and X Abogabir (eds), *Proceedings of the First International Seminar on Social Responsibility in Mining,* Santiago, Chile, 19–21 October 2011, at 5 (copy of full paper on file with the authors).

153 P Simons (2004), 'Corporate Voluntarism and Human Rights: The Adequacy and Effectiveness of Voluntary Self-Regulation Regimes', 59 *Relations industrielles/Industrial Relations* 101; P Simons and A Macklin (2013 forthcoming), *The Governance Gap: Extractive Industries, Human Rights, and the Home State Advantage*, Routledge London, at Chapter 3.

- *Social costs*. Abuses of human rights by investors can lead to increased discrimination, marginalisation of vulnerable populations, increased poverty[154] and civil unrest. In the most serious cases, human rights abuses can lead to deaths and conflict. In doing so, they undermine state goals of sustainable development and even economic development.
- *Impacts on investment*. Blume and Voigt's study of the economic effects of human rights found that strong human rights protections are beneficial for economic growth and welfare; they can influence productivity and the development of human capital.[155] States with robust human rights protections attract more investment than states with weak records of protecting human rights.[156] Therefore, host states that fail to protect human rights may lose foreign investment to other states that have stronger regulatory protection of human rights, undermining their ability to meet both their economic development and sustainable development goals.

**States may be in breach of their human rights obligations:** Finally, states have an obligation under international human rights law to protect human rights. This means they must take steps through legislative and other measures to ensure that investors do not violate the human rights of individuals and groups, consistent with the state's international human rights obligations. The SRSG notes in the *Guiding Principles* that '[w]hile States generally have discretion in deciding upon these steps, they should consider the full range of permissible preventative and remedial measures, including policies, legislation, regulations and adjudication'.[157] Requiring human rights due diligence by corporations is an important means to accomplish this end. The responsibility of businesses to conduct human rights due diligence as articulated in the Guiding Principles was unanimously endorsed by the UN Human Rights Council.[158] Therefore, by failing to require investors to engage in a robust due diligence process consistent with the nature, scope and location of the investment, states could be found to be in breach of their obligations by international human rights tribunals.

2. *Use existing law to regulate the human rights impact of investors and their investments*

States that have a robust regulatory system in place to protect the human rights of individuals and communities from the human rights impacts of foreign investors may not wish to put further resources into developing new laws and regulations on this issue. However, existing domestic laws are unlikely to include the requirement for investors to engage in human rights due diligence, since this is a new concept

154 M Sepúlveda and C Nyst (2012), 'The Human Rights Approach to Social Protection', Ministry for Foreign Affairs of Finland, available at: www.ohchr.org/Documents/Issues/EPoverty/HumanRightsApproachToSocialProtection.pdf, at 17.

155 L Blume and S Voigt (2004), 'The Economic Effects of Human Rights', University of Kassel Working Paper 66/04, University of Kassel, Kassel, at 3, 30, 37.

156 Ibid. at 35.

157 UN Guiding Principles on Business and Human Rights, op. cit., at Principle 1, commentary.

158 Human Rights and Transnational Corporations and Other Business Enterprises, UNHRC, op.cit.

developed and disseminated by the SRSG. The main disadvantages of not specifically requiring foreign investors to engage in such a due diligence process prior to investment are discussed in the preceding subsection. Additionally, even where good laws and regulations exist to protect human rights, states may still encounter challenges in enforcing such laws against foreign investors. All states face difficulties in regulating the conduct of transnational corporations.[159] These entities can restructure themselves or transfer assets to another jurisdiction in order to avoid liability under domestic law.

3. *Incorporate into domestic law an obligation on investors to respect human rights and engage in human rights due diligence*

Given the novelty of the concept of the business responsibility to respect human rights and engage in human rights due diligence, the impacts of incorporating such an obligation into domestic law are unknown. However, it is possible to identify some potential problems as well as benefits.

**It is costly to develop a regulatory framework:** Incorporating into domestic law a requirement on investors to respect human rights and to engage in human rights due diligence could be burdensome for host states. Both financial and human resources would have to be dedicated to developing the regulatory framework and institutions to facilitate and monitor such a process. While some industries, such as those in the extractive sector, are in the process of operationalising the requirements of the Guiding Principles, the concept of human rights due diligence is in its infancy and the specific modalities of such a process have not yet been fully developed. A further important point is that current practice of human rights impact assessment consists of privately undertaken assessments that are not publicly reported. There are few examples of human rights impact assessments of investments that have been publicly released.[160]

**States will need to determine the appropriate human rights for any due diligence process based on their international obligations:** In developing an appropriate regulatory framework, states will need to consider the range of human rights that investors will have to take into account in their due diligence process in light of the nature, size, location and context of the investment. As mentioned above, states have international human rights obligations to take steps to *protect* individuals from violations of human rights perpetrated by private actors, including investors. States will therefore have to ensure that the due diligence requirements reflect their international obligations. The United Nations core human rights treaties[161] include:

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159 S Marks (2003), 'Empire's Law', 10 *Indiana Journal of Global Legal Studies* 449 at 461.

160 See, for example, the human rights impact assessment undertaken by a consultant for Goldcorp in relation to the controversial Marlin mine in Guatemala: On Common Ground Consultants Inc. (2010), 'Human Rights Assessment of Goldcorp's Marlin Mine', available at: www.hria-guatemala.com/en/MarlinHumanRights.htm (accessed 8 January 2013).

161 This excludes the optional protocols. See OHCHR, 'The Core International Human Rights Instruments and their Monitoring Bodies', available at: www2.ohchr.org/english/law/index.htm#core (accessed 8 January 2013).

- *International Convention on the Elimination of All Forms of Racial Discrimination* 1965 (ICERD);
- *International Covenant on Civil and Political Rights* 1966 (ICCPR);
- *International Covenant on Economic Social and Cultural Rights* 1966 (ICESCR);
- *Convention on the Elimination of All Forms of Discrimination against Women* 1979 (CEDAW);
- *Convention against Torture and Other Cruel, Inhuman or Degrading Treatment and Punishment* 1984 (CAT);
- *Convention on the Rights of the Child* 1989 (CRC);
- *International Convention on the Protection of the Rights of Migrant Workers and Their Families* 1990 (ICRMW);
- *International Convention for the Protection of All Persons from Enforced Disappearance 2006* (CPED); and
- *Convention on the Rights of Persons with Disabilities* 2006 (CRPD).

Only 12 Commonwealth member countries have ratified the ICRMW and only two have ratified the CPED. However, 28 Commonwealth member countries have ratified the CRPD, and an overwhelming majority of Commonwealth member countries have ratified the other core treaties and therefore have obligations under them.

The Declaration on the Rights of Indigenous Peoples (UNDRIP) provides the most comprehensive articulation of indigenous peoples' rights and although it is a non-binding declaration, it has been endorsed by the UN General Assembly, including by 38 Commonwealth countries. In addition, some of the rights set out in the UNDRIP are entrenched in customary international law. These include the duty to consult indigenous peoples[162] and the obligation to obtain the free, prior and informed consent of indigenous peoples in three key situations:

- Where a proposal contemplates the removal of indigenous communities from their lands and territories;[163]
- Where a state is considering storing or disposing of hazardous waste on indigenous territory;[164] and

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162 P Simons and L Collins (2010), 'Participatory Rights in the Ontario Mining Sector: An International Human Rights Perspective', 6 *McGill International Journal of Sustainable Development Law and Policy* 177 at 193–4.

163 A Perrault, K Herbertson and O J Lynch (2007), 'Partnerships for Success in Protected Areas: The Public Interest and Local Community Rights to Prior Informed Consent (PIC)', 19 *Georgetown International Environmental Law* Review 475 at 491; J Anaya (2005), 'Indigenous Peoples' Participatory Rights in Relation to Decisions about Natural Resource Extraction: The More Fundamental Issue of What Rights Indigenous Peoples Have in Lands and Resources', 22 *Arizona Journal of International and Comparative Law* 7 at 17.

164 Perrault et al., op. cit., at 491. *Declaration on the Rights of Indigenous Peoples*, GA Res 61/295, UNGAOR, 2007, 61st Sess, UN Doc A/ RES/61/295 (2007) Art. 29 (2): 'States shall take effective measures to ensure that no storage or disposal of hazardous materials shall take place in the lands or territories of indigenous peoples without their free, prior and informed consent'.

- According to a recent decision of the Inter-American Court on Human Rights, where large-scale projects may have a significant impact within indigenous territory.[165]

Where states wish to go beyond their customary international law obligations and incorporate into domestic law a general right of indigenous peoples to free, prior and informed consent, each state will have to consider the appropriate legislative, administrative and policy measures necessary to do so. This could include constitutional, legislative and regulatory amendments, as well as the establishment of institutions to ensure that indigenous title can be registered if necessary.

**It could deter investment:** There is a possibility that incorporating into domestic law an obligation on investors to respect human rights and engage in human rights due diligence could deter investment for a number of reasons. Investors may feel that it will be too costly to develop the internal management, tracking, response and reporting requirements. Investors may also be concerned that a legal obligation to engage in a human rights due diligence process may expose them to the risk of further legal liability. The requirement on investors to publicly undertake due diligence, including a human rights impact assessment, and report on how they are addressing any harmful human rights impacts of the investment may put into the public domain information about conduct that could be perceived by the investor to expose them to liability. Transnational human rights claims brought against investors in their home state for human rights abuses allegedly committed in the host state are becoming more frequent, as are civil actions brought in the host state. However, these suits have generally dealt with only the most egregious violations of human rights or environmental abuse.[166] Finally, investors may be reluctant to engage in human rights due diligence where such a process could also expose abusive practices by the host state.

**Domestic laws can be difficult to enforce against a foreign investor:** As discussed above, even where a state introduces laws and regulations requiring investors to respect human rights and engage in human rights due diligence, it may face considerable difficulties enforcing them against foreign investors.

**Risk of investor challenge under an IIA:** Another problem in introducing such an obligation into domestic law is the potential for investors to challenge such measures

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165 *Case of the Saramaka People v. Suriname* (Preliminary Objections, Merits, Reparations, and Costs), (2007) Inter-American Commission on Human Rights, No. 172/5 at para. 134.

166 See, for example, *Recherches Internationales Quebec v. Cambior Inc.* [1998] QJ no 2554 (QL) (Qc Sup Ct). That case involved a claim concerning the rupture of Cambior's gold mine dam releasing 'some 2.3 billion litres of liquid containing cyanide, heavy metals and other pollutants spilled into two rivers, one of which is Guyana's main waterway'. See also *Association canadienne contre l'impunité (ACCI) c Anvil Mining Ltd*, 2011 QCCA 1035, in which the plaintiffs claimed that Anvil Mining was complicit in egregious violations of human rights perpetrated by the Congolese military in suppressing an uprising in the port town of Kilwa. Anvil provided logistical support to the troops, including transport, and the plaintiffs allege that the company also transported civilians to places where they were executed.

under an existing IIA as a violation of the FET provisions. A number of investment tribunals have defined FET obligations expansively to the effect that the introduction or amendment of domestic laws that are inconsistent with the reasonable expectations of investors is considered a breach of the fair and equitable treatment obligation.[167] If the investor were successful in an investor–state arbitration claim, the state would be required to pay compensation. The magnitude of this risk will depend on the scope and nature of the obligations in the treaty.

**Implements the state's duty to protect human rights and sets a clear standard for investor behaviour:** An advantage of incorporating such a requirement into domestic law is that it implements a state's international human rights obligations and clarifies expectations for the behaviour of foreign investors. Creating a legal obligation for investors to respect human rights and undertake human rights due diligence is an important step towards ensuring that investors and their investments contribute to, rather than detract from, sustainable development in a host state. Having a domestic law in place that specifically implements a human rights due diligence requirement and which is accompanied by administrative and legal compliance mechanisms would go a long way towards regulating the human rights behaviour of investors and domestic corporations, thereby better protecting human rights of individuals and communities within the host state.

**There is a growing practice among investors of human rights due diligence:** Although corporate due diligence processes are routine for most businesses, as discussed above, *human rights* due diligence is a new concept. Some foreign investors have begun to develop the necessary tools and internal processes and procedures for engaging in human rights due diligence processes, including a human rights impact assessment. The International Council on Mining and Metals, for instance, has developed a guide for mining companies on how to incorporate human rights due diligence (as recommended by the Guiding Principles on Business and Human Rights) into general corporate risk and management processes.[168] In addition, many extractive companies have begun to develop and undertake human rights impact assessments.[169] Other investors, however, may not be familiar with the term, let alone have developed a practice of undertaking human rights due diligence.

**Respecting human rights can be cost-effective:** As with a full sustainability assessment,[170] a human rights due diligence process creates transparency and accountability. It provides information and allows for public participation, and it therefore helps to establish a social licence to operate. An investor that does not assess and take action based on such an assessment to prevent, avoid, mitigate or

167 See Section 5.5 (Fair and equitable treatment and the minimum standard of treatment).

168 ICCM (2012), 'Integrating Human Rights Due Diligence into Corporate Risk Management Processes', ICCM, available at: www.icmm.com/page/75929/integrating-human-rights-due-diligence-into-corporate-risk-management-processes (accessed 8 January 2013).

169 R Boele and C Crispin, 'Should We Take the "Impact" Out of Human Rights Impact Assessment?' at 2 (copy on file with the authors).

170 See Section 6.6 (Sustainability assessments).

address human rights impacts could lose such a licence. In cases of severe human rights abuses, this could exacerbate local tensions and create conflict, which could put the investment at risk. A recent study examined the economic costs of clashes between extractive corporations and local communities. This included situations ranging from administrative proceedings and litigation to publicity campaigns, public protests, physical violence and deaths. It found that companies involved in such conflict suffered financial losses for employee time allocated to managing such issues, disruption to production, loss of property value, property damage, suspension of operations or development, and injury to, or death of, employees. For a major mining project, losses for delays in exploration or lost productivity alone were found to amount to US$10 million and US$20 million respectively per week.[171]

**Reduces corporate risk and attracts socially responsible investment:** Developing a domestic law that requires investors to respect human rights and engage in a human rights due diligence process may also help to attract socially responsible investors and investments, as well as investors concerned about their global reputations. More and more investors are interested in managing risks related to human rights liability and projecting a socially responsible image. Where a corporation engages in a robust human rights due diligence process, it should be possible to prevent most human rights abuses and mitigate adverse impacts that cannot be prevented. Such a process will also identify situations in which the potential human rights impacts are severe and cannot be prevented or mitigated, and therefore where the investment should not proceed. Identifying such situations will be beneficial both for investors, who may not want to risk the potential liability, and for states wishing to protect human rights and in particular to avoid approving investments that are likely to cause such serious harm.

4. *Incorporate a provision in an IIA recommending that states encourage their investors to include internationally recognised CSR standards into their corporate policies*

**Highlights the need for socially responsible conduct:** These types of provisions could be considered important for underlining the need for investors to operate in a socially responsible manner.

**Does not protect human rights:** However, such provisions are hortatory and do not require states to implement a policy on corporate social responsibility. Nor do they require investors to operate pursuant to best CSR practices. Rather, these provisions leave investors to self-regulate and, as noted above, self-regulation has not prevented investors, in any consistent way, from violating human rights. Nor has it ensured that investors operate in compliance with internationally accepted CSR standards.[172]

171 Davis and Franks, op. cit., at 3–8.

172 Simons and Macklin, op. cit.

5. *Integrate into IIAs an obligation on investors to respect human rights and engage in human rights due diligence*

There are a number of ways to integrate the due diligence requirement into an IIA; these are similar to those canvassed in the section on sustainability.[173]

The potential benefits and drawbacks of integrating an obligation to respect human rights and to engage in human rights due diligence into an IIA are similar to those identified above with respect to incorporating the obligation into domestic law. There are, however, several additional advantages to including such a provision in an IIA.

- **Supports domestic law.** Including such an obligation in an IIA will complement any domestic law in place requiring investors to respect human rights and conduct human rights due diligence. If included in an IIA, such an obligation would also need to be supplemented by domestic laws and regulations in order to further interpret the obligation and specify the required measures needed to fulfil it, as well as to create institutions to monitor corporate compliance.
- **Overcomes the problem of a potential investor challenge.** Including a provision requiring a human rights due process in an IIA overcomes the possibility of investor challenge in investor–state arbitration under the IIA. The imposition of such a requirement could be specifically authorised through a general exception[174] and/or qualifications to the core investor protections.[175]
- **Gives access to treaty-based enforcement mechanisms.** The most important benefit of including such a provision in an IIA, rather than relying exclusively on domestic law, is that it raises the obligation to the international level.[176] Host states can rely on treaty-based enforcement mechanisms that can support domestic enforcement mechanisms. These include grievance processes, obligations to comply with a management plan developed based on a sustainability assessment, civil liability and state counterclaims in dispute settlement, as discussed elsewhere in the Guide.[177]

An IIA could be drafted to provide that treaty-based enforcement mechanisms would apply to the failure by the investor to comply with domestic legal requirements regarding a human rights due diligence process. To the extent that such a process is required by domestic law, the treaty obligation to comply with domestic law discussed above has the effect of doing this.[178] Nevertheless, including the obligation in the treaty makes the requirements more transparent. Besides, since the concept of a

173 See Section 6.6 (Sustainability assessments).

174 See Section 5.12 (Reservations and exceptions).

175 See Section 5.3 (National treatment); Section 5.4 (Most favoured nation); Section 5.5 (Fair and equitable treatment and the minimum standard of treatment); and Section 5.6 (Limitations on expropriation and nationalisation). If applied to all foreign investors, there might be a risk of a challenge under another IIA entered into by the host state.

176 UNCTAD (2012), *Investment Policy Framework for Sustainable Development*, op. cit., at 12.

177 See Section 6.6 (Sustainability assessments): Section 6.15 (Grievance procedure and other measures to enforce the management plan produced in the sustainability assessment); Section 6.16 (Civil liability of investors); and Sections 6.17 (Counterclaims by states in investor–state arbitration) and 7.1.7 (Sample provisions: investor–state dispute settlement, Article [W] (Counterclaims)).

178 Section 6.7 (Investor obligation to comply with the laws of the host state).

human rights due diligence process is new, domestic laws will likely not provide for such a process.

### 6.8.5 Discussion of sample provision

The Guide sample provision requires investors to respect internationally recognised human rights by engaging in a due diligence process and sets out the principles for the due diligence process. As discussed above, corporate human rights due diligence is a new concept. States will need to determine, based on their own circumstances and their assessment of the costs and benefits discussed above, whether or not they wish to implement such an obligation into domestic law and/or incorporate it into an IIA. The sample provision in the Guide aims to provide a blueprint for states that wish to do so.

The Guide sample provision draws on the UN Guiding Principles and tracks some of the language. It establishes an obligation on investors to respect human rights. This includes an obligation to exercise due diligence to avoid committing or contributing to human rights abuses and to prevent or mitigate adverse human rights effects linked to their operations and supply chain, even where they have not directly contributed to the violations.

**Investors must respect all human rights:** The content of the responsibility to respect in the Guide sample provision goes beyond the definition in the Guiding Principles. The Guiding Principles define 'internationally recognized human rights', which are to be applicable to business actors in all circumstances, as those rights set out in the International Bill of Rights[179] and the principles set out in the ILO's *Declaration on Fundamental Principles and Rights at Work*.[180] Other rights, such as women's rights, indigenous peoples' rights, children's rights, rights of persons with disabilities and the rights of minorities, are relegated to the category of 'additional standards' that businesses may need to consider in particular circumstances.[181] An investor proposing to establish a bank in an urban centre may not have an impact on certain rights of indigenous peoples and may not need to consider the prohibitions against torture or enforced disappearance in such a context. However, the rights of vulnerable groups such as women, children, disabled persons and migrant workers, as well as rights relating to racial discrimination (including against indigenous peoples), will always be applicable.

As discussed above, where states decide to develop a domestic law or a provision in an IIA imposing an obligation on investors to respect human rights and conduct human rights due diligence, they may wish to ensure that they are in compliance with their obligation to protect human rights. This can be done by requiring investors, in conducting their due diligence, to consider the full range of human rights, consistent with the state's international human rights obligations under treaty and customary

179 This includes the *Universal Declaration on Human Rights*, GA Res 217(III), UNGAOR, 3d Sess, Supp No 13, UN Doc A/810 at 71 (1948) [UDHR], the ICCPR and the ICESCR.

180 37 *ILM* 1233 (1998); CIT/1998/PR20A.

181 *UN Guiding Principles on Business and Human Rights*, op. cit., at Principle 12, commentary.

international law, as well as any domestic constitutional rights or other legal or administrative measures aimed at protecting human rights.

The sample provision therefore goes beyond the Guiding Principles on Business and Human Rights by defining 'internationally recognized human rights' as including those rights set out:

- In *all* the UN human rights treaties (but excluding the optional protocols) that are designated by the UN as core human rights treaties;[182]
- The *Universal Declaration on Human Rights*;[183] and
- The *United Nations Declaration on the Rights of Indigenous Peoples* (UNDRIP).[184]

The sample provision does not deal with investor obligations to respect labour rights since those are dealt with in a separate sample provision.[185]

**Principles of human rights due diligence:** As noted, the Guide sample provision draws on the concept of human rights due diligence set out in the Guiding Principles and tracks some of the language contained in them. The sample provision specifies the following.

- The human rights due diligence process must start *prior* to investment.
- The human rights impact assessment aspect of the due diligence process must be incorporated into the pre-establishment sustainability assessment process where a party requires investors to conduct such a comprehensive assessment.[186]
- The investor must incorporate the relevant aspects of the human rights due diligence process into any agreed management plan arising out of a sustainability assessment. Sustainability assessments are discussed in Section 6.6 (Sustainability assessments).
- The minimum requirements for the human rights impact assessment should be either those established by the host state or the Guiding Principles, whichever are the most rigorous.
- The investor and its investment should seek input from international human rights experts.
- The investor must take feedback received in consultations with affected individuals and communities into account in making decisions regarding how and

182 See OHCHR, op. cit.

183 UDHR. Most of the provisions of the UDHR are considered to be customary international law (see H Hannum (1995), 'Status of the Universal Declaration of Human Rights in National and International Law', 25 *Georgia Journal of International and Comparative Law* 287 at 289; J H Currie, C Forcese and V Oosterveld (2007), *International Law: Doctrine, Practice and Theory*, Irwin Law, Toronto, at 553.

184 UNDRIP, op. cit..

185 See Section 6.10 (Investor obligation to comply with core labour standards).

186 See Section 6.6 (Sustainability assessments).

whether to proceed with the investment. This requirement aims to address the risk that investors may treat consultation as a 'box-ticking' exercise, acknowledging but not acting on vital feedback from stakeholders.

- The investor and its investment must develop appropriate systems for addressing human rights violations and ensuring the effectiveness of their response to abuses and develop a transparent reporting mechanism.
- There will be certain circumstances in which the potential violations of human rights are so egregious, such as where an investor is proposing to operate in a conflict zone, that the investment should not go ahead.

**Investors must prevent, avoid or mitigate adverse human rights impacts and make reparation for such impacts:** Where an investor:

- Violates human rights or is complicit in such violations; or
- Fails to exercise due diligence to prevent and avoid harmful human rights impacts directly linked to its operations, products or services, even if the investor or investment did not directly contribute to such impacts,

it must take steps to mitigate the negative impacts and provide reparations to victims.

**The scope of the due diligence obligation will vary depending on the size of the investor and its investment, the risk of severe human rights violations associated with their operations, products or services, and the nature and contexts of the investor's or the investment's operations:** The requirements of the human rights due diligence process to be carried out by an investor of a party will vary in a manner determined by the investor and approved by the party state in which the investment is to be established. This flexibility is incorporated in the sample provision and recognises that in relation to some investments the human rights risks are small. The range of risks will be related to the scope of investments protected under the treaty.[187] If, for example, loans to the host state are covered by the treaty, a state might determine that there is no need for a human rights due diligence process at all.

**Reparations must be made in good faith.** In order to ensure that reparations are made in good faith and are commensurate to the adverse human rights impacts, the provision also provides that any reparations made will not preclude victims of human rights abuses from bringing a civil claim where such reparations are grossly disproportionate to the damage suffered.

As noted at the outset, each state will have to consider, in light of its particular circumstances and the costs and benefits of the options discussed above, the appropriateness of these standards and whether such standards should be implemented into domestic law, or an IIA, or both. If a state decides to include a requirement for an investor to conduct a pre-establishment sustainability assessment in domestic law or an IIA, some of the components of the Guide's sample provision could be integrated into it. The state would have to decide what aspects would best be dealt with as part

187 See Section 4.3 (Definitions).

of a comprehensive sustainability assessment. Additionally, states will need to take into account the fact that for an IIA obligation on investors to respect human rights and undertake due diligence to be fully effective, it will need to take effect prior to the establishment of the investment.[188]

In situations where the host state has domestic legislation for an environmental impact assessment (or an environmental and social impact assessment) already in place, or has no legislation in place on impact assessments and does not contemplate introducing such legislation (including the requirement for an sustainability assessment into an IIA), the sample provision could also serve as the starting point for a stand-alone domestic law provision to deal specifically with preventing and minimising the human rights impacts of investors and their investments.

### 6.8.6 Sample provision: obligation to respect internationally recognised human rights and undertake human rights due diligence

#### Obligation to Respect Internationally Recognised Human Rights and Undertake Human Rights Due Diligence

1. Investors of a Party and their investments shall respect internationally recognised human rights in their operations in the other Party.
2. For greater certainty, the obligation to respect human rights means that:
    a. Investors of a Party and their investments have a legal obligation to exercise due diligence to avoid violating or contributing to the violation of the human rights of individuals and communities in the other Party;
    b. Investors of a Party and their investments shall exercise due diligence to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships in the other Party, even if the investor or the investment has not contributed to those impacts;
    c. Where an investor of a Party or its investment violates the human rights or is complicit in the violations of human rights of individuals or groups of individuals in the other Party, the investor and/or its investment shall take measures to mitigate such adverse impacts and shall provide reparations to the victims, including restitution, compensation and satisfaction, as appropriate; and
    d. Where an investor of a Party or its investment fails to exercise due diligence to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships in the other Party, even if the investor or the investment has not contributed to those impacts, the investor or its investment shall provide reparations to the victims, including restitution, compensation and satisfaction, as appropriate.

188 The time for the commencement of investor obligations is discussed in Section 5.2 (Right of establishment).

3. The responsibility to respect internationally recognised human rights requires investors of a Party and their investments to respect at a minimum and in all circumstances the rights set out in the following international human rights instruments:

    a. *Universal Declaration of Human Rights* 1948

    b. *International Convention on the Elimination of all Forms of Racial Discrimination* 1965

    c. *International Covenant on Civil and Political Rights* 1966

    d. *International Covenant on Economic Social and Cultural Rights* 1966

    e. *Convention on the Elimination of All Forms of Discrimination against Women* 1979

    f. *Convention against Torture and Other Cruel, Inhuman or Degrading Treatment* 1984

    g. *Convention on the Rights of the Child* 1989

    h. *International Convention on the Protection of the Rights of Migrant Workers and Their Families* 1990

    i. *Convention for the Protection of All Persons from Enforced Disappearance* 2006

    j. *International Convention on the Rights of Persons with Disabilities* 2006

    k. *United Nations Declaration on the Rights of Indigenous Peoples* 2007.

4. The investor of a Party or its investment shall have in place:

    a. A policy commitment to meet its obligation to respect human rights;

    b. A robust human rights due diligence process to identify, prevent, mitigate and account for how it addresses their human rights impacts in the other Party; and

    c. Processes to enable remediation and reparation of any human rights violations they commit or to which they contribute or which are directly linked to their operations in the other Party.

5. Subject to section 6, the human rights due diligence process to be carried out by an investor of a Party in relation to an investment in the other Party shall:

    a. Be initiated prior to the establishment of the investment in the other Party and be ongoing for the lifecycle of the investment;

    b. Include a human rights impact assessment and the minimum requirements for such impact assessment shall be those established by the other Party;

    c. Incorporate the human rights impact assessment into a pre-establishment sustainability assessment where such a comprehensive assessment has been established and is required by the other Party prior to the approval of an investor or an investment;

d. Incorporate the relevant aspects of the human rights due diligence process into any agreed management plan as required under [see Guide sample provision in Section 6.6 (Sustainability assessments)];

e. Include input from independent human rights experts, such as international and domestic human rights lawyers and local and international human rights non-governmental organisations;

f. Consult with potentially affected groups and other relevant stakeholders in the other Party and use that feedback to inform the decision-making process of the investor with respect to the investment;

g. Integrate the findings of the human rights impact assessment into its decision-making processes with respect to the investment by ensuring that:

   – responsibility for addressing human rights violations is assigned to the appropriate level of management within the investor or the investment, and

   – internal decision-making, budget allocations and oversight processes enable effective responses to such impacts;

h. Include systems to verify that the investor and/or the investment addresses any violations of human rights committed by the investor or investment or in which it is complicit, as well as systems to track the effectiveness of the response;

i. Include an accessible and effective reporting mechanism that:

   – provides sufficient information to allow stakeholders to evaluate the adequacy of an investor's and investment's response to each human rights violation, and

   – protects affected stakeholders and personnel, as well as confidential commercial information.

6. Notwithstanding Section 5, the requirements of the human rights due diligence process to be carried out by an investor of a Party may vary from those set out in Section 5 in a manner determined by the investor and approved by the Party in which the investment is to be established, taking into account the size of the investor and its investment, the risk of human rights violations associated with its operations, products or services, and the nature and contexts of the investor's or the investment's operations.

7. Where a human rights due diligence process shows that the investor and/or the investment cannot operate in the territory or a particular area of territory of a Party without committing or becoming complicit in grave violations of human rights, the investor shall not establish the investment in the Party or in the particular area of the territory of the Party.

8. For greater certainty, reparations by the investor or the investment for violations of, or complicity in violations of, human rights shall not prevent the victims of

such violations from bringing a civil claim against the investor or the investment in the courts of either Party, where there is reasonable cause to believe that the reparations made by the investor or the investment were grossly disproportionate to the damage or injury suffered.

## 6.9 Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights

### Cross references


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Investors operating in host states may sometimes find themselves in zones of weak governance, including situations of armed conflict or civil strife. This is particularly true of investors in the extractive industries, whose decisions regarding where to operate are more constrained by the location of resources.[189]

In some cases, the presence of foreign investors can exacerbate minor local tensions, which then escalate into a situation of conflict or worsen an existing conflict. In such circumstances, and in other areas of weak governance,[190] investors may employ private security forces or may be required by the host state to use public security forces to protect their investments. In the course of protecting the investors or the investment, security forces may commit human rights abuses, including grave violations of human rights, some of which may constitute international crimes.[191]

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189 See *Human Rights Principles for Transnational Corporations and Other Business Enterprises, Introduction*, ECOSOC, U.N. Doc. E/CN.4/Sub.2/2001/WG.2/WP.1/ Add.1 (February 2002 for discussion in July/August 2002) at 3.

190 The OECD defines weak governance zones as: 'investment environments in which governments cannot or will not assume their roles in protecting rights (including property rights), providing basic public services (e.g. social programmes, infrastructure development, law enforcement and prudential surveillance) and ensuring that public sector management is efficient and effective'. See OECD (2006), 'OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones', at 11.

191 For example, allegations of complicity in forced displacement, extrajudicial killings, disappearances, rape and abduction, the use of forced labour and violent repression of peaceful protests have been made against investors such as Premier Oil, Talisman Energy Inc, British Petroleum plc (BP) and, Royal Dutch/Shell Group. See Simons, op. cit., at 102–3. See also the cases being brought with respect to Anvil Mining's activities in the DRC (*Association canadienne contre l'impunité (ACCI) c Anvil Mining Ltd*, and Exxon Mobile's activities in Aceh, Indonesia (*John Doe VIII v. Exxon Mobil Corporation*, 654 *Federal Reporter* 3d 11 (DC Cir 8 July 2011)).

It is now widely accepted in international law that, like individuals, corporations and other business entities have an obligation not to commit, or be complicit in, such abuses and crimes.[192] The Guiding Principles on Business and Human Rights recommend that corporations '[t]reat the risk of causing or contributing to gross human rights abuses as a legal compliance issue'.[193] The obligations of corporations and other business entities are not clearly articulated in any treaty or in domestic laws, although there is a growing number of states in which investors can be prosecuted for acts, or complicity in acts, constituting international crimes under the principle of universal jurisdiction.[194] However, few states have initiated criminal prosecutions against investors for their participation in such crimes.[195] The result may be that investors operating outside their home state can commit, or become complicit in, such acts with impunity.[196] No existing IIA imposes an obligation on investors to refrain from the commission or complicity in grave violations of human rights.

**Box 6.10 Options regarding investor obligations to refrain from the commission of, or complicity in, grave violations of human rights**

1. *Do not prohibit foreign investors from committing, or being complicit in, grave violations of human rights*
2. *Use existing domestic laws to address investors committing, or being complicit in, grave violations of human rights*
3. *Incorporate into domestic law an obligation on investors not to commit, or be complicit in, grave violations of human rights*
4. *Integrate into an IIA an obligation on investors not to commit, or be complicit in, grave violations of human rights*

192 A Clapham (2004), 'State Responsibility, Corporate Responsibility, and Complicity in Human Rights Violations', in L Bomann-Larsen and O Wiggen (eds), *Responsibility in World Business: Managing Harmful Side-Effects of Corporate Activity*, United Nations University Press, Tokyo, 50 at 68. See also the recognition of such liability by the SRSG, *Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and other Business Entities, John Ruggie*, UNHRC, UN Doc A/HRC/4/35, (2007) at paras. 19–32; M T Kamminga and S Zia-Zarifi (2000), 'Liability of Multinational Corporations under International Law: An Introduction', in M T Kamminga and S Zia-Zarifi (eds), *Liability of Multinational Corporations under International Law*, Kluwer Law International, The Hague, at 8.

193 *UN Guiding Principles on Business and Human Rights*, op. cit., at Principle 23.

194 Ibid. at Principle 23, commentary. See also A Ramasastry and R C Thompson (2006), 'Commerce, Crime and Conflict: Legal Remedies for Private Actor Liability for Grave Breaches of International Law – A Survey of Sixteen Countries', 536 Fafo-Report, Fafo, Oslo, available at: www.fafo.no/pub/rapp/536/536.pdf (accessed 8 January 2013). Fafo undertook surveys of the relevant laws of 16 countries: Argentina, Australia, Belgium, Canada, France, Germany, India, Indonesia, Japan, The Netherlands, Norway, South Africa, Spain, Ukraine, the UK and the USA.

195 See Simons and Macklin, op. cit., Chapter 4.

196 Gagnon et al., op. cit., at 3.

### 6.9.1 Discussion of options

1. *Do not prohibit foreign investors from committing, or being complicit in, grave violations of human rights*

**States may be in violation of *jus cogens* norms and their international human rights obligations:** States have an obligation under international human rights law to protect human rights. This means they must take steps through legislative and other measures to control, regulate, investigate and prosecute actions by investors that violate the human rights of those within their territory and subject to their jurisdiction. By failing to prohibit the most egregious violations of human rights, states will be in breach of this obligation. In addition, many grave violations of human rights amount to international crimes and their prohibition amounts to a *jus cogens* norm. These are peremptory customary international law norms from which no state may derogate.

**A failure by the state to prohibit and punish egregious acts could deter investment:** Impunity for grave violations of human rights can undermine the peace and stability of a state. Studies have shown a clear link between conflict escalation and grave violations of human rights such as extra judicial killings, torture, enforced disappearance and other violations of liberty and security rights.[197] Investors may perceive the failure of the host state to deal with such abuses as an indication of weak governance capacity and prefer to establish their investments in more stable and effective regulatory environments. Investors perceive host states in which actors have a licence to commit such egregious acts as difficult investment environments that pose increased risks to their investments.[198]

2. *Use existing domestic laws to address investors committing or being complicit in grave violations of human rights*

**Existing domestic laws may not address grave human rights abuses or impose criminal liability on legal persons:** It may be preferable for states that have robust criminal law provisions that address criminal liability of both legal and natural persons for international crimes and effective criminal law institutions to use existing domestic law to regulate such behaviour. There can be a strong deterrent factor in prosecuting both individuals and corporations responsible for the crime, particularly where criminal penalties for the corporation include significant fines or sanctions, such as revocation of a licence to operate. However, some states may not have domestic laws in place that specifically address these types of grave violations of human rights. In addition, some states do not have criminal law regimes that impose criminal liability on legal persons such as corporations, or significant resources to devote to enforcement.

197 O N T Thoms and J Ron (2007), 'Do Human Rights Violations Cause Internal Conflict?', 29 *Human Rights Quarterly* 674 at 694–5.

198 OECD (2006), 'OECD *Risk Awareness Tool*', op. cit.

**Domestic laws can be difficult to enforce against a foreign investor:** States may also encounter challenges in enforcing domestic laws against foreign investors. All states, even the most powerful, face difficulties in regulating the conduct of transnational business actors.[199] Transnational business groups may undercapitalise the entity that is operating the host state, restructure themselves or move assets between jurisdictions in order to avoid liability under domestic law.

3. *Incorporate into domestic law an obligation on investors not to commit or be complicit in grave violations of human rights*

**It is costly to develop a regulatory framework:** It can be burdensome for states to develop a new regulatory framework and oversight mechanisms to address grave violations of human rights. It will require host states to dedicate significant resources to developing the regulatory framework and institutions for investigating allegations, prosecuting investors and enforcing any sentence imposed.

**Domestic laws can be difficult to enforce against a foreign investor:** As noted above, even where a state introduces robust criminal laws to sanction egregious behaviour by foreign investors, it may be difficult to enforce such laws against them.

**It implements states' international human rights and international law obligations:** However, incorporating such a prohibition into domestic law implements the state's duty to protect human rights and sets a clear standard for investor behaviour. Prohibiting and enforcing a prohibition of the most egregious violations of international human rights is fundamental to sustainable development. Having a domestic law in place that specifically targets such grave abuses will help to protect vulnerable communities from the worst forms of violence.

**It may be perceived as increasing potential liability of extractive industry investors:** Investors engaged in resource extraction are more likely to become complicit in grave human rights violations than those in other industries, since the location of their operations is constrained by the location of the resources. This may mean that extraction projects will be situated on, or in close proximity to, indigenous lands or in zones of weak governance, including conflict zones. Investors routinely hire private security companies or use public forces to protect their investments in such locations and may become complicit in serious violations of human rights through the acts of such security forces. A domestic law targeting such violations may be seen by such investors as increasing their potential liability and may therefore deter investment in the natural resource sector.

**It can help reduce corporate risk and attract socially responsible investment:** Nevertheless, as discussed above, most investors prefer to invest in a stable rights-protective regulatory environment. Kofi Annan has emphasised that 'economic success depends in considerable measure on the quality of governance a country enjoys' and this includes ensuring respect for, and the protection of, human rights.[200]

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199 Marks, op. cit., at 461.

200 We the Peoples: The Role of the United Nations in the Twenty-First Century, Report of the Secretary-General, UNGAOR, 54 Sess, UN doc A/54/2000, (2000), at para 84.

Thanks in part to the high-profile work of the SRSG, investors are becoming much more aware of the risks of violating human rights in the states in which they operate and are taking steps to avoid such risks. Having strong human rights obligations in place will reduce the risk that investors will become implicated in these types of abuses. As noted in Section 6.8 above, the majority of transnational litigation against corporate actors relates to allegations of grave violations of human rights. An effective prohibition on grave violations of human rights may help to attract more socially responsible investors, as well as those that wish to improve or protect their global reputations.

4. *Integrate into an IIA an obligation on investors not to commit or be complicit in grave violations of human rights*

The potential benefits and drawbacks of including such a prohibition in an IIA are similar to those identified above with respect to incorporating the obligation into domestic law. An IIA provision has other advantages.

**Access to treaty-based compliance mechanisms:** Another advantage of including such a provision in an IIA is that it raises the obligation to the international level and allows access to treaty-based enforcement mechanisms. The ability of a host state to use treaty-based enforcement mechanisms complements domestic enforcement measures and helps to address the difficulty of ensuring that foreign investors comply with domestic laws and regulations. Such treaty-based mechanisms include grievance processes (which could expose such conduct), civil and criminal liability in the host and home states for an investor in breach of treaty obligations, and state counterclaims in investor–state dispute settlement to recover compensation for losses resulting from an investor's breaches.[201]

It would also be possible to provide in an IIA that these treaty-based enforcement mechanisms could be used for breaches of domestic laws in the host state that prohibit grave violations of human rights. The treaty obligation to comply with domestic law discussed above has the effect of doing this to the extent that such violations are prohibited under domestic law.[202] Tying enforcement to standards expressed in the treaty has the benefit of making clear what the standards for investors are and can help ensure compatibility with international standards.

### 6.9.2 Discussion of sample provision

The Guide sample provision provides an example of an IIA obligation on investors not to commit or be complicit in grave violations of human rights. The aim of the Guide sample provision is to clarify the specific legal obligations of investors with respect to the commission of, or complicity in, grave violations of human rights. Drawing on a similar provision in the *UN Norms on the Responsibilities of Transnational*

201 See Section 6.14 (Criminal sanctions); Section 6.15 (Grievance procedure and other measures to enforce the management plan produced in the sustainability assessment); Section 6.16 (Civil liability of investors); and Sections 6.17 (Counterclaims by states in investor–state arbitration) and 7.1.7 (Sample provisions: investor–state dispute settlement, Article [W] (Counterclaims)).

202 Section 6.7 (Investor obligation to comply with the laws of the host state).

*Corporations and Other Business Enterprises*[203] and a legislative proposal for the regulation of corporate activity in conflict zones,[204] the sample provision incorporates an obligation on investors not to commit, or be complicit, in grave violations of human rights.

The Guide sample provision prohibits the commission of, or complicity in, a range of egregious acts, including genocide, crimes against humanity, war crimes and torture, among others. It also requires investors to take steps to ensure that their investments do not contribute directly or indirectly to, or benefit from, the commission of such acts. Investors must also ensure that any security providers, whether public or private, comply with the international human rights norms on the use of force in their protection of the assets and installations of the investment.

**Relationship with preceding sample provisions:** The sample provision deals with only the most egregious and violent violations of human rights. The preceding sample provision deals with the general obligation on investors and investments to respect human rights and the duty to exercise due diligence to avoid violating or contributing to the violation of human rights.[205] The first sample provision in this section requires investors to comply with the domestic law of a host state, including those laws relating to the protection of human rights.[206] There is, however, a relationship between the sample provision creating an obligation to respect human rights[207] and this sample provision prohibiting commission of, or complicity in, grave abuses of human rights.

- *A violation of this provision would also be a violation of the Obligation to Respect Internationally Recognised Human Rights and Undertake Human Rights Due Diligence*. In most situations, a robust human rights due diligence process would reveal the possibility of the investor and its investment committing, or becoming complicit in, grave violations of human rights in a particular host state or in a specific location within a host state. In such a case, strategies to avoid this risk could be developed and implemented.
- *This sample provision targets specific conduct requiring criminal sanctions*. A violation of the obligation to respect human rights and conduct due diligence triggers an obligation to make reparations to the victims of such abuses. The obligation to refrain from the commission of, or complicity in, grave violations of human rights differs from the preceding general obligation in that it prohibits specific conduct and may lead to criminal sanctions. The idea behind a separate provision is to

203 Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights, ECOSOC, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003); Commentary on the Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights, UN Doc. E/CN.4/Sub.2/2003/38/Rev.2, (2003).

204 Gagnon et al., op. cit.

205 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence).

206 See Section 6.7 (Investor obligation to comply with the laws of the host state).

207 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence).

target egregious behaviour which may violate international criminal law, and for which simple reparations would be wholly inadequate. In addition, it allows for different enforcement mechanisms to be used, in this case criminal liability.

**The prohibition is not limited to situations of conflict:** While egregious violations of human rights will usually occur during armed conflict or civil strife, the prohibition is not limited to such situations. It also applies in other zones of weak governance and would include, for example, the murder or disappearance of trade unionists.

### 6.9.3 Sample provision: obligation not to commit, be complicit in or benefit from grave violations of human rights

#### Obligation Not to Commit, Be Complicit in or Benefit from Grave Violations of Human Rights

1. Investors of a Party and their investments shall neither commit nor be complicit in grave violations of international human rights or violations of international humanitarian law committed by the other Party or by a non-state actor in the territory of the other Party. Such violations include, but are not limited to, genocide, war crimes, crimes against humanity, torture, enforced or involuntary disappearance, forced or compulsory labour, hostage-taking, extra judicial, summary or arbitrary executions, forced displacement or other international crimes against the human person as defined by international law, in particular international criminal law, international human rights law and international humanitarian law.
2. Investors of a Party and their investments shall ensure that their activities in the other Party do not contribute directly or indirectly to international crimes, grave violations of international human rights or violations of international humanitarian law as defined in Section 1 and that they do not benefit from such violations.
3. Investors of a Party and their investments shall ensure that any arrangement for the security of the investor or their investments shall observe international human rights norms on the use of force in the other Party, including the *UN Basic Principles on the Use of Force and Firearms by Law Enforcement Officials*, the *UN Code of Conduct for Law Enforcement Officials* and the laws and professional standards of the other Party.
4. For greater certainty, a security arrangement includes any public or private security force or other means of protecting an investor of a Party or its investment.

## 6.10 Investor obligation to comply with core labour standards

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The imposition on investors by host states of a duty to respect core labour standards has traditionally been viewed as likely to discourage foreign investment.[208] This is because investors might be attracted to a state by its lower labour standards, which may translate into a lower cost of doing business. Contrary to this view, however, empirical studies over the last decade have shown that the maintenance of high labour standards does not in fact discourage foreign investment. As noted by the OECD:

> … any fear on the part of developing countries that better core standards would negatively affect either their economic performance or their competitive position in world markets has no economic rationale. On the contrary, it is conceivable that the observance of core standards would strengthen the long-term economic performance of all countries.[209]

These studies show that the level of local labour standards is not a significant factor in investment decision making.[210] Moreover, it appears that violations of labour rights actually have the effect of *discouraging* foreign investment, even where the host state is a small or poor developing country.[211]

Strong core labour laws are also a central aspect of sustainable development. For example, the reduction and eventual abolition of child labour will enhance a state's development by ensuring that children have the opportunity to go to school and gain

208 R Howse, B Langille and J Burda (2006), 'The World Trade Organization and Labour Rights: Man Bites Dog', in V A Leary and D Warner (eds), *Social Issues, Globalisation and International Institutions*, Martinus Nijoff, Leiden, 157 at 168.

209 OECD (1996), *Trade, Employment and Labour Standards: A Study of Core Workers' Rights and International Trade*, OECD, Paris, at 105.

210 Ibid.

211 M Busse, P Nunnenkamp and M Spatareanu (2011), 'Foreign Direct Investment and Labour Rights: A Panel Analysis of Bilateral FDI Flows', 18 *Applied Economics Letters* 149 (looking at the impact of fundamental labour rights on bilateral FDI flows in 82 developing countries).

the education and skills that will enable them to contribute as adults to economic growth and prosperity.[212]

### 6.10.1 IIA practice

A small but increasing number of IIAs, especially FTAs, now includes some language on labour standards.[213] There are a number of different approaches reflected in IIA practice. References to, or provisions on, labour protection may be included in the preamble or the body of a treaty in a separate provision, or in a side agreement, among other things.

**Language in the preamble:** Preambular language on labour protection does not create binding obligations and is not very protective of labour rights. A preamble sets out the overall goals of the party states in entering the treaty and provides part of the context for interpreting treaty obligations. For example, a preamble may articulate a desire of the parties for the objectives of the treaty to be accomplished in a manner consistent with certain values. The preamble in the US–Uruguay BIT, for instance, lists the protection of health, safety, the environment and international labour rights.[214] The EC–CARIFORUM EPA, on the other hand, articulates the need of the parties 'to promote economic and social progress for their people in a manner consistent with sustainable development by respecting basic labour rights … and by protecting the environment'. A preamble could be drafted to give precedence in the interpretation of the treaty to such non-investment norms. In the absence of a clear specification to this effect, however, it is likely that an interpreter of an IIA will give preference to investment protection and promotion.

**Provisions in the body of the treaty:** Three types of provisions are becoming common in IIAs. The first is a provision acknowledging that it is inappropriate for the parties to encourage investment by lowering domestic labour law standards and requiring parties not to waive or derogate from domestic labour laws and/or not to fail to effectively enforce such laws. This is the approach of the Economic Partnership

212 ILO (2002), 'A Future without Child Labour: Global Report under the Follow-Up to the ILO Declaration on Fundamental Principles and Rights at Work', International Labour Conference, 90th session, ILO, Geneva, at 1.

213 For a comprehensive comparison of the various labour provisions in US and EU agreements, see R Grynberg and V Qalo (2006), 'Labour Standards in US and EU Preferential Trading Arrangements', 40 *Journal of World Trade* 619; see also K Gordon (2008), 'International Investment Agreements: A Survey of Environmental, Labour and Anti-Corruption Issues', in OECD, *International Investment Law: Understanding Concepts and Tracking Innovations*, OECD, Paris, 135; L Bartels (2009), 'Social Issues: Labour, Environment and Human Rights', in S Lester and B Mercurio (eds), *Bilateral and Regional Trade Agreements: Commentary, Analysis and Case Studies*, Cambridge University Press, Cambridge, 342; and for an excellent critique of the concept of 'core labour standards', see P Alston (2004), 'Core Labour Standards and the Transformation of the International Labour Rights Regime', 15 *European Journal of International Law* 457 at 497–506.

214 See, for example, the preamble of the US–Uruguay BIT (2004).

Agreement between the EC and CARIFORUM,[215] the 2012 US model BIT[216] and several US FTAs,[217] the Austrian model BIT[218] and the EU–Korea FTA.[219]

In addition to a requirement not to relax domestic labour standards, some IIAs also contain provisions: (i) affirming the parties' commitments as ILO members and under the 1998 *ILO Declaration on Fundamental Principles and Rights at Work*, (ii) recognising the right of the parties to establish their own labour standards, (iii) requiring the parties to either maintain high levels of labour standards or endeavour to ensure that domestic labour standards are consistent with certain listed international labour standards, and (iv) requiring parties to strive to improve such standards. The listed standards often include the right of association, the right to organise and bargain collectively, prohibition of forced labour, minimum age for the employment of children, the prohibition of the worst forms of child labour, and the right to acceptable conditions of work with respect to minimum wages, hours of work, occupational safety and health.[220]

The EC–CARIFORUM EPA provides a variation of this type of provision. Like the provisions discussed above, it requires parties to ensure that their domestic laws 'provide for and encourage high levels of social and labour standards' in line with listed international labour standards. However, it also recognises the right of the parties 'to regulate in order to establish their own social regulations and labour standards in line with their own social development priorities and to adopt or modify accordingly their relevant laws and policies'.[221]

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215 EC–CARIFORUM EPA (2008), Arts. 73 and 193.

216 Art. 13. See also the Canada–Colombia FTA (2008), Arts. 1601–4. That agreement also references the obligations between the parties set out in the Canada–Colombia Agreement on Labour Cooperation, signed 21 November 2008, in force 15 August 2011.

217 See, for example, Australia–US FTA (2004); United States–Dominican Republic–Central America Free Trade Agreement, signed 5 August 2004, in force 1 January 2009, Art. 16.2; United States–Chile Free Trade Agreement, signed 6 June 2003, in force 1 January 2004, Art. 18.2; United States–Jordan Free Trade Agreement, signed 24 October 2000, in force 17 December 2001, Art. 6; United States–Morocco Free Trade Agreement, signed 15 June 2004, in force 1 January 2006, Art. 16.2.

218 Art 5. See also Art. 5 of both Austria–Tajikistan, Agreement for the Promotion and Protection of Investment between the Republic of Austria and the Republic of Tajikistan, signed 15 December 2010, not yet in force, and the Kosovo–Austria, Agreement between the Government of the Republic of Kosovo and the Republic of Austria on Promotion and Protection of Investments, signed 22 January 2010, not yet in force; as well as Art. 6 of Belgium–Luxembourg–Ethiopia, Agreement between the Belgium–Luxembourg Economic Union on the one hand, and the Federal Democratic Republic of Ethiopia, on the other hand, on the Reciprocal Promotion and Protection of Investments, signed 26 October 2006, not yet in force.

219 Arts. 13.4, 13.7.

220 Belgium–Luxembourg–Ethiopia BIT (2006), Arts. 6 and 1(6); US Model BIT, Art. 13; Australia–US FTA (2004) Arts. 18.1 and 18.7; US–CAFTA FTA (2004), Arts. 16.1 and 16.8; US–Chile FTA (2003), Arts. 18.1 and 18.8; US–Jordan FTA (2000), Art 6; and US–Morocco FTA (2004), Art. 16.1 and 16.7. The European Union–South Korea Free Trade Agreement, signed 15 October 2009, in force 1 July 2011, Art. 13.4, goes slightly further than the US Model BIT and other US FTAs and BITs by recognising the parties' commitments to the 2006 Ministerial Declaration of the UN Economic and Social Council on Full Employment and Decent Work and the importance of 'full and productive employment and decent work for all' for sustainable development.

221 Arts. 192 and 191.

The main aim of these various provisions is to prevent competition between states that will lead to a 'race to the bottom' of labour standards, rather than to ratchet up the level of labour protection. These types of provisions do not oblige party states to ensure minimum standards are met in their domestic law in compliance with their international labour obligations, and they target investor behaviour only indirectly and weakly.

**Side accord:** Another method states have adopted to address the problem of a 'race to the bottom' is to negotiate a side accord to an FTA. These side accords are generally based on the *North American Agreement on Labor Cooperation* (NAALC), the side accord to NAFTA. In that agreement, the parties are obliged to maintain high domestic labour standards and to strive to improve such standards.[222] In addition, party states are required to facilitate compliance with and enforce their labour laws through appropriate government measures and to ensure that judicial and non-judicial mechanisms and other procedures are available to individuals to enforce such laws.[223] These side agreements essentially do the same thing as IIAs with provisions requiring parties to enforce their labour laws.[224] Under the NAALC, states do not commit to upholding international core labour standards. Rather they agree to promote a list of principles,[225] subject to their respective law and with the proviso that such principles do not set common minimum standards.

**Compliance mechanisms:** Some IIAs, FTAs and side accords, such as the NAALC and the side accords to the Canada–Chile, Canada–Costa Rica and Canada–Colombia FTAs, incorporate compliance mechanisms and complaint mechanisms to ensure that states comply with their domestic labour standards or certain specified international labour standards. The NAALC, the Canadian agreements and some US FTAs establish a compliance system that includes a means for individuals to make complaints about a party's failure to enforce its labour laws and regulations.[226] These systems are primarily diplomatic, although in principle, under some side agreements

222 Canada–Mexico–United States, North American Agreement on Labour Cooperation, signed 14 September 1993, in force 1 January 1994, Art. 2.

223 NAALC (1993), Arts. 2 and 3.

224 One difference is that the side agreement commitments cannot be the subject of dispute settlement under the treaty. However, even where labour commitments are incorporated directly in an IIA, it is possible to carve these obligations out of the dispute settlement procedures in the treaty.

225 NAALC (1993), Annex 1. The principles are: freedom of association and protection of the right to organize; the right to bargain collectively; the right to strike; prohibition of forced labour; labour protections for children and young persons; minimum employment standards; elimination of employment discrimination; equal pay for women and men; prevention of occupational injuries and illnesses; compensation in cases of occupational injuries and illnesses; and the protection of migrant workers.

226 See Australia–US FTA (2004), Art. 18.4(2); US–CAFTA FTA (2004), Art 16.4(3); US–Chile FTA (2003), Art. 18.4(7): US–Morocco FTA (2004), Art. 18.4(1); United States–Singapore Free Trade Agreement, signed 6 May 2003, in force 1 January 2004, Art. 17.4(5).

and FTAs, certain disputes over labour issues could lead to the imposition of fines[227] or, in some cases, even sanctions.[228] The NAALC compliance procedure is discussed in more detail below in the section on minimum standards of human rights, labour rights, indigenous peoples' rights, and environmental protection and standards to address corruption.[229]

These types of provisions do not directly target investor behaviour and the IISD has observed that there is little evidence that these compliance mechanisms (including the complaint processes) have been effective in ensuring that states enforce their domestic labour laws and regulations against foreign investors.[230]

**Exceptions:** A few IIAs also include exception clauses that are aimed at ensuring that a state's labour laws will not be subject to investor challenge in investor–state arbitration. The US–Uruguay BIT includes a provision stating that:

> [n]othing in this Treaty shall be construed to prevent a Party from adopting or maintaining, or enforcing any measure *otherwise consistent with this Treaty* that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to labor concerns.[231] (Emphasis added.)

This provision, however, is likely to have limited legal effect since it requires any regulation on labour issues to be consistent with the core investor protections in the BIT. The section in the Guide on reservations and exceptions discusses this problem further and provides a discussion of approaches to using exceptions to carve out policy areas from the application of an IIA more effectively.[232]

**Co-operation between parties on labour issues:** Another approach states have taken in FTAs and side accords is to establish a mechanism to enhance co-operation between the party states on labour issues. The US FTAs discussed above, for example, all require the parties to designate a contact point within their ministry of labour and

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227 See, for example, the Canada–Colombia Agreement on Labour Cooperation (2008), Art. 20; it allows for a Review Panel to determine whether a party has demonstrated a persistent pattern of failure to enforce its domestic laws, among other things, to impose a fine on the party to be paid into a fund and spent on appropriate labour-related initiatives in the territory of such a party. The annual amount of any such fines may not exceed US $15 million (see Annex 4). See also NAALC, Art. 39(4)(2) and Annex 39; Canada–Chile Agreement on Labour Cooperation, signed 6 February 1997, in force 5 July 1997, Art. 35(4)(b) and Art. 37, under which the parties may eventually seek enforcement and collection of fines through the domestic courts of the offending party state. The US FTAs discussed above provide for fines.

228 NAALC (2003), Arts. 28 and 29; Australia–US FTA (2004), Art. 21.12; US–CAFTA FTA (2004), Art. 20.17; US–Chile FTA (2003), Art. 18.6(7).

229 See Section 6.12 (Other rights and obligations of party states).

230 N Bernasconi-Osterwalder and L Johnson (2011), 'Commentary to the Austrian Model Investment Treaty', IISD Report at 27.

231 US–Uruguay BIT (2005), Art. 13(3).

232 See Section 5.12 (Reservations and exceptions).

establish an indicative list of co-operative activities on labour and the implementation of co-operative activities.[233] These provisions focus on exchange of information, educational activities and technical co-operation.

The EC–CARIFORUM EPA, on the other hand, requires co-operation on enforcement of labour standards against investors. It imposes an obligation on the party states both to co-operate and to take measures domestically to ensure that investors:

- Comply with the core labour standards set out in the ILO Declaration; and
- Do not manage or operate their investments in a manner that circumvents labour obligations arising from the international obligations of the parties.[234]

This approach is much more protective of labour rights than the other provisions discussed above. First, it goes beyond simply requiring parties to enforce their own domestic law. Second, it specifically requires parties to take action to ensure investor compliance with labour standards that are consistent with international core labour standards. Finally, the obligation of co-operation harnesses the regulatory capacity of the home state in addition to the host state in ensuring investor compliance.

**Obligations on investors to comply with core labour standards:** The most protective approach would be to adopt provisions in an IIA that impose obligations:

- *On parties* to maintain high levels of labour rights protection consistent with the parties' international obligations;
- *On parties* to co-operate and to take measures domestically to prevent investors from operating or managing their investments in a manner that circumvents labour rights consistent with the parties' international obligations; and
- *On investors* requiring them to respect domestic labour laws and to comply with international core labour standards.

None of the IIAs discussed above go this far. The EC–CARIFORUM provision is a step forward in its requirement on party states to ensure investor compliance with such standards. Only the IISD model treaty incorporates a provision that imposes obligations directly on investors to 'act in accordance with core labour standards as required by the *ILO Declaration on Fundamental Principles and Rights of Work, 1998*'.[235]

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233 Australia–US FTA (2004), Art. 18.5; US–CAFTA FTA (2004), Art. 16.5 and Annex 16.5; US–Chile FTA (2003), Art. 18.5 and Annex 18.5: US–Morocco FTA (2004), Art. 16.5 and Annex 16-A; and US–Singapore FTA (2003), Art. 17.5 and Annex 17A. See also NAALC (2003), Arts. 8–19.

234 EU–CARIFORUM EPA (2008), Art. 72(b), and (c).

235 IISD Model IIA, Art. 14(C).

**Box 6.11 Summary of options for investor obligation to comply with core labour standards**

1. *Do not require foreign investors to comply with core labour standards*
2. *Use existing domestic labour laws to regulate investor activity*
3. *Introduce new stronger domestic labour laws, consistent with a state's international labour law obligations*
4. *Integrate language on labour rights into an IIA through:*
   a. Language in the preamble
   b. Provisions in an IIA or side agreement to address the problem of a 'race to the bottom' of labour standards
   c. An exception for labour laws and regulations
   d. An obligation on states to co-operate to ensure investor compliance with international core labour standards
   e. An obligation on investors to comply with core labour standards

### 6.10.2 Discussion of options

1. *Do not require foreign investors to comply with core labour standards*

**It may deter investment:** There are few advantages to not taking action to ensure that investors and their investments comply with domestic labour standards. Studies have shown that the level of local labour standards is not a key factor in investor decision-making about where to invest. In other words, investors will not necessarily choose to invest in a state with lower labour standards. In addition, studies have demonstrated that labour standard violations in the host state may actually discourage foreign investment. Therefore, having domestic laws that are not sufficiently protective of core labour rights and/or failing to enforce those laws may not be an effective strategy for attracting investment.

**States may be in breach of their international labour rights obligations:** Further, states that do not implement their international obligations into domestic law and require foreign investors to comply with such laws may be in breach of their international obligations. Most states have ratified the eight core ILO treaties[236] and therefore have obligations under those treaties to protect such standards under domestic law.

2. *Use existing domestic labour laws to regulate investor activity*

This approach may be attractive for states that have strong labour laws that protect international core labour rights. It would not require any further resources on the part

236 See the list of the ILO core conventions above.

of the state to be dedicated to developing a regulatory framework and enforcement institutions.

However, existing labour laws may not be sufficiently rigorous and/or may not be consistent with a state's international labour law obligations. Moreover, even where states do have a robust labour regulatory framework in place, they may face difficulties in enforcing such laws against foreign investors. All states, even the most economically powerful, confront challenges in regulating the behaviour of transnational business actors,[237] which can restructure or transfer assets out of a state in order to avoid liability.

3. *Introduce new stronger domestic labour laws, consistent with a state's international labour law obligations*

**It is costly to develop a regulatory framework:** As discussed above with respect to investor obligations to respect human rights, developing a robust regulatory framework to protect labour rights can be costly. It will require the host state to dedicate resources to strengthening its labour laws and regulations to meet its international standards.

**It may increase the costs of doing business:** The introduction and enforcement of domestic laws that protect labour rights could:

- Raise wages;
- Require investors to take steps to ensure that the work environment complies with health and safety standards;
- Require investors to have policies and processes in place to protect against discrimination in the workplace;
- Require investors to engage in collective bargaining; and
- Prohibit child labour or the worst forms of child labour.

Investors may feel that such requirements would be too costly for them to comply with and may choose to operate in states with lower standards. However, as noted above, empirical studies have shown that strong labour standards are not a significant factor in investment decision making and may therefore not act as a deterrent to investment.

**Domestic laws can be difficult to enforce against a foreign investor:** As discussed above, even where a state brings its domestic labour laws and regulations into line with its international obligations, it may be difficult to enforce them against foreign investors.

**There is a risk of investor challenge under an IIA:** As with implementing a new obligation on investors to respect human rights and undertake human rights due diligence, introducing more rigorous labour laws and regulations into domestic law

237 Marks, op. cit.

might trigger a challenge by an investor under an existing IIA. The investor might argue that the introduction of such measures is a violation of the FET provisions. Some, but not all, investment tribunals have interpreted FET obligations so broadly that host states may have little room to change the regulatory environment that persuaded the investor to invest.[238] The risk is greatest if a host state's action targets only foreign investors. If the investor is successful in an investor–state arbitration claim, the state will be required to pay compensation.

**It implements the state's international labour law obligations and supports sustainable development:** On the other hand, there are important benefits to introducing new domestic labour laws and regulations or amending existing laws and regulations. First, it allows states the opportunity to bring its laws into compliance, if they are not already, with their international labour law obligations. Creating a rigorous labour law framework will help ensure that investors contribute in a positive way to state development goals by supporting sustainable development in a host state. It will also more effectively protect the labour rights of individuals within the host state.

**It attracts investment including, in particular, socially responsible investment:** In addition, having a strong regulatory framework of labour protections sends a signal to investors, particularly socially responsible investors and investors concerned about their global reputations, that the state has a stable, rights-protective regulatory environment in which to conduct business.

**It helps manage corporate risk:** More and more investors are interested in managing risks related to labour rights issues. Corporations operating in a state with strong labour protections are less likely to face strikes or public protests that may disrupt operations. They are also less likely to be the target of non-governmental organisation (NGO) campaigns that can expose investors to reputational damage, or to be brought before administrative tribunals or courts for violations of labour rights.

4. *Integrate language on labour rights into an IIA*

There are a variety of different ways of incorporating labour rights protections into IIAs to promote conformity with a state's international obligations. The following are some examples.

**Language in the preamble:** The parties could negotiate a general statement in the preamble stating that the IIA is to be interpreted in accordance with the parties' international obligations in regard to labour rights. Such an approach can be stronger or weaker, depending on the wording:[239]

- *Stronger approach (more protective of labour rights)*: The preamble could state that the protection of labour rights is of the same level of importance as the investor protections included in the IIA. This will ensure that labour rights protection

238 See Section 5.5 (Fair and equitable treatment and the minimum standard of treatment).
239 See Section 4.2.1 (The role of preambles in IIAs).

is not subordinated to investment protection considerations in interpreting the treaty.

- *Weaker approach (less protective labour rights)*: The parties could specify that the IIA is to be interpreted in a way that is consistent with international labour rights. Such a statement leaves unspecified the priority of investment protection, compared with labour rights protection, although it may imply that norms relating to investment promotion and protection should be given precedence in interpreting the treaty.

As noted above, preambular language does not create any binding obligations on the parties or on investors and does not on its own provide effective protection of labour rights.

**Provisions in an IIA or side agreement to address the problem of a 'race to the bottom' of labour standards:** States can negotiate provisions in an IIA or in a side agreement that:

- Reaffirm their commitments to international labour law instruments;
- Establish an obligation on the parties not to relax domestic labour laws and regulations in order to attract or retain investment and not to fail to enforce such standards;
- Establish an obligation on the parties to either maintain high levels of labour standards or endeavour to ensure that domestic labour standards are consistent with certain listed international labour standards and require parties to strive to improve such standards.

These types of provisions are becoming more common in IIAs.

*These provisions offer flexibility*. These provisions might be attractive to states because of the latitude they offer. First, they allow states parties to pick and choose the labour standards that (for the purposes of the IIA) they intend to protect under domestic law. Second, they do not require states to ensure that domestic law is consistent with international labour standards and they impose only a 'best endeavours' obligation to improve standards of labour protection.

*There is a risk of investor challenge for states wishing to strengthen labour protections*. An important limitation of these provisions is that they provide no direct protection from an investor challenge under an IIA for states interested in strengthening existing laws and regulations or introducing new labour protection measures. As noted above, an investor could argue that the introduction or strengthening of such measures is a breach of its legitimate expectations under an FET provision in some circumstances.[240] However, the recognition in the IIA that a state should act to protect labour rights in the treaty would undermine an investor's claim that it had a legitimate expectation that a state would not act to provide such protection.

240 See Section 5.5 (Fair and equitable treatment and the minimum standard of treatment).

*They do not allow for treaty-based enforcement mechanisms targeting investor conduct.* Finally, states may have difficulty in ensuring that investors comply with domestic labour laws. Since these types of provisions do not impose specific standards on investor conduct, they do not allow for the use of treaty-based enforcement mechanisms to supplement domestic enforcement mechanisms.

**An exception for labour laws and regulations:** Negotiating an exception for labour measures would provide a clear expression of the parties' intention to carve out labour regulation from the application of investors' protections under an IIA. It would therefore give the host state the policy space to introduce new labour laws and regulations, or to strengthen such measures, without the fear of triggering an arbitral claim against the host state by an investor. A full discussion of the costs and benefits of using exceptions to exclude certain areas of policy making from the purview of an IIA is found in Section 5.12 (Reservations and exceptions).[241]

**An obligation on states to co-operate to ensure investor compliance with international core labour standards:**

*This harnesses home state regulatory capacity and co-operation in regulating investor conduct.* This option, which is the approach taken in the EC–CARIFORUM EPA discussed above, can help states to address some of the challenges to regulating effectively the behaviour of powerful foreign investors by requiring enforcement action on behalf of the home state, in addition to the host state, to ensure that investors do not evade compliance with international core labour standards. It also obliges co-operation between the parties in this regard.

*There is a risk of investor challenge under an IIA.* However, this approach does not avoid the problem, discussed above, faced by states that wish to introduce more rigorous labour laws and regulations, that changes to a state's domestic regime of this kind could potentially be challenged by an investor under the investor-protection provisions in an IIA. To avoid this issue with certainty, a treaty would also need to include provisions that protect the right of states to introduce or strengthen such laws and regulations. As noted above, one way to do this would be to include a general exception for labour laws and regulations. Another is to ensure that this kind of regulation is permitted under the investor protection obligations in the treaty, such as the national treatment, MFN, minimum standard of treatment and expropriation provisions. How states can retain the flexibility to regulate in areas such as labour rights is discussed in relation to each of the Guide's respective sample provisions.[242]

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241 If a state had entered into other IIAs, it would have to determine whether there was a risk that any increase in labour standards for all businesses could be challenged under another treaty.

242 See Section 5.3 (National treatment); Section 5.4 (Most favoured nation); Section 5.5 (Fair and equitable treatment and the minimum standard of treatment); Section 5.6 (Limitations on expropriation and nationalisation); and Section 5.12 (Reservations and exceptions). As previously noted, if a state had entered into other IIAs, it would have to determine whether there was a risk that any increase in labour standards for all businesses could be challenged under another treaty.

**An obligation on investors to comply with core labour standards:** The potential costs and benefits of introducing a provision imposing an obligation directly on investors to comply with certain core labour standards are similar to those identified above regarding the introduction of new labour protection measures or amending existing domestic laws and regulations to strengthen labour rights protection. There are, however, two additional advantages to including such a provision in an IIA rather than simply relying on existing domestic laws or introducing more stringent labour requirements into domestic law.

*Overcomes the problem of a potential investor challenge*. As long as states comply with the core provisions of the IIA in their enforcement of core labour obligations in an IIA, incorporating the labour standards for investors' activities into the treaty would address the risk that the adoption and enforcement of those standards would be challenged through investor–state arbitration. States could also address this risk directly by excluding non-discriminatory labour regulation and enforcement of the identified standards from the purview of the treaty through an exception.[243]

*Access to treaty-based enforcement mechanisms*. The most important benefit of including such a provision in an IIA is that it raises the obligation to comply with core labour standards to the international level.[244] This not only helps balance investor rights with obligations in the treaty, but also allows states, if they wish, to complement domestic laws and enforcement mechanisms with treaty-based enforcement mechanisms. These can include grievance processes,[245] civil liability[246] and state counterclaims in dispute settlement[247] as discussed below.

An IIA could be drafted to provide that treaty-based enforcement mechanisms would apply to the failure by an investor to observe domestic labour standards. The treaty obligation to comply with domestic law discussed above has the effect of doing this.[248] Expressing standards in the treaty itself makes the requirements for investor more transparent.

### 6.10.3 Discussion of sample provision

The Guide includes a sample provision obliging investors to meet core international labour standards. The sample provision does not deal with state obligations. These are considered below in a separate section.[249]

States will have to determine, based on their international obligations, their particular circumstances and the costs and benefits discussed above, whether or not they wish to adopt or strengthen labour legislation and/or incorporate an obligation on investors into an IIA in the manner provided for in the sample provision. The

243 See Section 5.12 (Reservations and exceptions).
244 UNCTAD (2012), *Investment Policy Framework for Sustainable Development*, op. cit., at 12.
245 See Section 6.15 (Grievance procedure and other measures to enforce the management plan produced in the sustainability assessment).
246 See Section 6.16 (Civil liability of investors).
247 See Sections 6.17 (Counterclaims by states in investor–state arbitration) and 7.1.7 (Sample provisions: investor–state dispute settlement, Article [W] (Counterclaims)).
248 See Section 6.7 (Investor obligation to comply with the laws of the host state).
249 See 6.12 (Other rights and obligations of party states).

inclusion of core labour standards in an IIA may be acceptable to host states, investors and their home states for a number of reasons:

- As discussed above, the maintenance of strong core labour standards has been found not to be a deterrent to investment, while violations of labour rights can deter investment.
- Almost all states have accepted the *ILO Declaration*,[250] and the large majority of Commonwealth countries have ratified the key ILO Conventions underlying the principles set out in the *ILO Declaration*.[251]
- Many investors are likely to be familiar with the international standards imposed in this provision. Investors are represented in the tripartite ILO structure, and many large companies list the *ILO Declaration* in their corporate social responsibility policies. In addition, these obligations are all specifically recognised as corporate responsibilities in voluntary codes of conduct for investors such as the *Global Compact*[252] and the *OECD Guidelines for Multinational Enterprises*.[253] Moreover, the revised *Guidelines for International Investment* of the International Chamber of Commerce encourage investors to comply with domestic and international labour laws even where such laws are not enforced.[254] Many investors claim to have adapted their operations to meet these standards. Therefore, compliance with these standards should not be unduly burdensome for them.

The Guide sample provision goes further than the current practice in IIAs and side accords in relation to the protection of labour standards in several ways.

- **Imposes obligations on investors:** The most radical departure from current IIA practice is that it imposes a treaty obligation directly on investors to comply with core labour standards.
- **Lists core labour rights and references the eight core ILO treaties:** The sample provision spells out the core standards set out in the *ILO Declaration*, rather than simply referencing the non-binding *Declaration*. It also links the obligations to the relevant ILO Conventions. This goes some way to addressing one of the criticisms of the regime created by the *ILO Declaration*, namely that it obscures the precise relationship between the principles of the Declaration and the legal rights that are set out in the underlying ILO Conventions.[255]

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250 H Mann, K von Moltke, LE Peterson and A Cosbey (2005), *IISD Model International Agreement on Investment for Sustainable Development*, International Institute for Sustainable Development, Winnipeg, available at: www.iisd.org/pdf/2005/investment_model_int_agreement.pdf (accessed 29 May 2012) at 26.

251 See ILO, Ratifications of the Fundamental Human Rights Conventions by Country, ILOLEX Database of International Labour Standards, available at: www.ilo.org/ilolex/english/docs/declprint.htm (accessed 8 January 2013).

252 UN Global Compact, op. cit.

253 *OECD Guidelines*, op. cit.

254 ICC (2012), 'ICC Guidelines for International Investment', ICC, Paris, available at: www.uscib.org/docs/2012_04_21_icc_investment_guidelines.pdf (accessed 8 January 2013), at 14.

255 For a full discussion of this and other criticisms of the Declaration regime, see Alston, op. cit. These conventions are: ILO Convention No. 29, 87, 98, 100, 105, 111, 138 and 182.

The obligations set out in the Guide provision elaborate on the minimum labour standards to which investors are bound, regardless of whether adherence to such standards is specifically required by domestic law. As a result, the article provides investors with clear benchmarks for conduct alongside domestic requirements. The provisions of the Guide draw extensively on the equivalent provisions in the *Draft UN Norms on the Responsibilities of Transnational Corporations*.[256]

- **Takes into account host state policies to address past discrimination against certain groups:** The obligation on investors and investments to ensure equality of opportunity and treatment in employment by eliminating discrimination is subject to the obligation to comply with host state requirements to hire and promote individuals from certain historically disadvantaged groups.[257]
- **Requires security providers to respect freedom of association:** The obligation to respect the right to freedom of association in the Guide sample provision goes beyond the IISD model treaty by requiring that investors exercise due diligence to ensure that their contractors, including security contractors, respect this right in connection with all work related to, or conducted for, the investment. The aim of this provision is to ensure that investors are not complicit in violations of this right and do not profit from violating it.
- **Protects the right to a healthy and safe work environment:** The Guide sample provision adds to the core labour rights listed in the *ILO Declaration* the obligation to provide a healthy and safe work environment. By doing so, the sample provision addresses a second important critique of the Declaration, that the selection of principles to be included in the Declaration was somewhat arbitrary and diluted by political compromise.[258] Commentators generally agree that the Declaration should have included the right to a healthy and safe work environment.[259]

  The obligation in the sample provision requires investors to comply with the health and safety standards of the home or host state, whichever standards are more rigorous for the particular industry in question. The rationale for choosing these more rigorous standards is that investors should be held to the highest standards of health and safety in all countries in which they operate and should not be able to provide less protection for their workers simply because they are operating in states with less rigorous standards. Ensuring high standards of health and safety in employment, as with other core labour rights, is an important aspect of sustainable development. The requirement to provide a healthy and safe work

256 Draft UN Norms, op.cit.

257 South Africa's Black Economic Empowerment (BEE) policy requires, among other measures, the hiring and promotion into management positions of blacks, Coloureds and Indians. For a critical discussion of the BEE policy and international investment law, see D Schneiderman (2009), 'Promoting Equality, Black Economic Empowerment, and the Future of Investment Rules', 25 *South African Journal on Human Rights* 246.

258 Alston, op. cit., at 485–6.

259 Ibid.

environment is reflected in the *OECD Guidelines* and the *Draft UN Norms*. It is also recognised in the labour side accords to the Canadian FTAs with Chile, Costa Rica and Colombia, in the NAALC, in the Austrian model BIT, in the 2012 US model BIT and in the US FTAs discussed above, as well as the Austrian BITs noted above in this section, all of which impose obligations on party states to enforce their labour laws and regulations.

The prohibition against forced labour is not included in the Guide's core labour provisions because it is specifically dealt with in the sample provision setting out the prohibition against the commission of, or complicity in, grave violations of human rights.[260]

### 6.10.4 Sample provision: obligation to comply with core labour standards

#### Obligation to Comply with Core Labour Standards

In relation to all of their activities in the other Party, investors of a Party and their investments shall:

a. Ensure equality of opportunity and treatment in employment by eliminating discrimination based on race, colour, sex, language, religion, political opinion, national or social origin, social status, indigenous status, disability and age or other status of the individual unrelated to the inherent requirements to perform the job consistent with ILO *Convention (No. 100) concerning Equal Remuneration for Men and Women Workers for Work of Equal Value, 1951*, and ILO *Convention (No. 111) concerning Discrimination in Respect of Employment and Occupation, 1958*, and any other international obligation to which either Party is party on this subject;

b. Notwithstanding the obligations set out in paragraph (a), comply with all measures of the other Party designed to overcome past discrimination against identified groups;

c. Respect the right of individuals to freedom of association consistent with ILO *Convention (No. 87) concerning Freedom of Association and Protection of the Right to Organize, 1948*, and exercise due diligence to ensure that their contractors, including but not limited to their security contractors, respect this right in all work related to, or conducted for, the investor or the investment;

d. Respect the right of workers to organise and collectively bargain consistent with ILO *Convention (No. 98) concerning the Application of the Principles of the Right to Organise and Collective Bargaining, 1949*, not act in such a way as to impede this right and ensure that workers have access to information necessary to give effect to this right;

e. Respect the right of children to be protected from economic exploitation and support the efforts of the other Party to abolish child labour consistent with ILO *Convention (No. 138) concerning Minimum Age for Admission to*

260 See Section 6.9 (Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights).

*Employment 1973*, ILO *Convention (No. 182) concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour 1999*, and the *Convention on the Rights of the Child 1999*;

f. Respect other international obligations of either Party on subjects covered in sections a., c., d. and e.; and

g. Provide employees with a healthy and safe working environment in accordance with national laws of the Party or the other Party, whichever are more rigorous in relation to the investment in question.

## 6.11 Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption

### Cross references


| | | |
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| Section 6.7 | Investor obligation to comply with the laws of the host state | 292 |
| Section 6.8 | Investor obligation to respect internationally recognised human rights and undertake human rights due diligence | 294 |
| Section 6.10 | Investor obligation to comply with core labour standards | 322 |
| Section 6.12 | Other rights and obligations of party states | 345 |
| Section 6.14 | Criminal sanctions | 373 |
| Section 6.15 | Grievance procedure and other measures to enforce the management plan produced in the sustainability assessment | 381 |
| Section 6.16 | Civil liability of investors | 387 |
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Corruption can undermine sustainable development and its goals of environmental protection and the eradication of poverty. It discourages investment and reduces economic growth.[261] It can result in the diversion of aid and loss of tax revenue, directly affecting a state's ability to finance public goods, including education. It can also distort public procurement decisions, which in turn has an impact on the cost-effectiveness and quality of public infrastructure and government services.[262] Corruption can also distort competition, create inefficiencies and lead to human rights abuses and environmental and other damage, where procedures and substantive rules are waived or not enforced as a result of corrupt actions.[263] On the other hand,

261 P Mauro (1996), 'The Effects of Corruption on Growth, Investment, and Government Expenditure', No 96/98 IMF Working Paper at 7–8. See also R S Igwike, M E Hussain and A Noman (2012), 'The Impact of Corruption on Economic Development: A Panel Data Analysis', available at: http://ssrn.com/abstract=2003061, at 5 (accessed 8 January 2013); S Rose-Ackerman (2010), 'The Law and Economics of Bribery and Extortion', 6 *Annual Review of Law and Social Science* 217 at 219 (noting the social costs of bribery); and C R Kumar (2006), 'Corruption as a Human Rights Issue in South Asia: Law, Development and Governance', Paper delivered at Human Rights 2006: The Year in Review Conference, Castan Centre for Human Rights Law, Monash University, available at: www.law.monash.edu.au/castancentre/events/2006/conf-06-kumar-paper.html (accessed 8 January 2013).

262 Mauro, ibid.

263 P Eigen and J Moberg (2007), 'Transparency and Accountability as a Driver for Growth', in *The State of Responsible Competitiveness 2007: Making Sustainable Development Count in Global Markets*, AccountAbility, London, 71 at 71–2. See also L Pellegrini (2011), *Corruption, Development and the Environment*, Springer, Dordrecht, at 149–50.

it has been shown that protecting and realising economic, social and cultural rights, which target poverty and economic inequality, increases the state's ability to control corruption and to operate in a manner that is transparent and consistent with the rule of law, as well as strengthening the ethics of private business behaviour.[264]

Corruption can also have negative impacts on investors. Agreements reached through bribery are legally unenforceable.[265] In addition, an increasing number of states have introduced laws prohibiting individuals and corporations from engaging in bribery and other forms of corruption in other states, and have begun to investigate and prosecute offenders.[266] Allegations of corruption and, especially, prosecution can cause significant reputational damage to corporations, and defending against criminal charges can be costly.

Five Commonwealth countries[267] are parties to the OECD *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*,[268] which imposes obligations on parties to establish criminal sanctions for acts of bribery of foreign public officials. Moreover, 16 Commonwealth states are party to the *African Union Convention on Preventing and Combatting Corruption*[269] and thus have obligations to take steps to eliminate corruption domestically and to exercise jurisdiction over nationals engaging in corrupt activities in another state. In addition, 44 Commonwealth countries[270] are party to the *UN Convention against Corruption*,[271]

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264 D Kaufmann (2005), 'Human Rights and Governance: The Empirical Challenge' in P Alston and M Robinson, (eds), *Human Rights and Development: Towards Mutual Reinforcement*, OUP, Oxford and New York, 352, at 382–383.

265 Pellegrini, op. cit., at 61.

266 See, for example, the UK case of *Corner House Research and Campaign Against Arms Trade v. The Director of the Serious Fraud Office and BAE Systems PLC*, [2008] EWHC 714 (Admin). See also the US cases, *US v. Siemens Aktiengesellschaft*, No 08-367 (DDC Filed Dec 15, 2008); *SEC v. Siemens Aktiengesellschaft*, No 1:08-cv-02167 (DDC Filed Dec 15, 2008); *US v. ABB Inc*, No 4:10-cr-00664 (SD Tex 2010). In Canada, Niko Resources pleaded guilty to charges of corruption in relation to its operations in Bangladesh. See *R v. Niko Resources Ltd*, (23 June 2011) (AB QB) Agreed Statement of Facts, available at: www.osler.com/uploadedFiles/Agreed%20statement%20of%20facts.pdf (accessed 8 January 2013). In addition there is an ongoing investigation of SNC Lavalin for corruption in its operations in Libya and Bangladesh. See Andrew Chung (2012), 'RCMP Raids SNC-Lavalin's Montreal Headquarters', *Toronto Star*, 13 April, available at: www.thestar.com/news/canada/article/1161146–rcmp-raids-snc-lavalin-s-montreal-headquarters (accessed 8 January 2013).

267 Australia, Canada, New Zealand, South Africa and the UK.

268 OECD *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*, adopted 21 November 1997, in force 15 February 1999, OECD Doc DAFFE/IME/BR(97)20. As of 2004, all parties to the OECD Convention had enacted legislation to implement the treaty, see OECD, 'OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, Ratification Status as of April 2012'.

269 *African Union Convention on Preventing and Combatting Corruption*, adopted 11 July 2003, in force 5 August 2006, 43 *International Legal Materials* 5 (2004), Art. 4.

270 Antigua and Barbuda, Australia, The Bahamas, Bangladesh, Brunei Darussalam, Cameroon, Canada, Cyprus, Dominica, Fiji, Ghana, Guyana, India, Jamaica, Kenya, Lesotho, Malawi, Malaysia, Maldives, Malta, Mauritius, Mozambique, Namibia, Nauru, New Zealand, Nigeria, Pakistan, Papua New Guinea, Rwanda, St. Lucia, Samoa, Seychelles, Sierra Leone, Singapore, Solomon Islands, South Africa, Sri Lanka, Swaziland, United Republic of Trinidad and Tobago, Uganda, United Kingdom, United Republic of Tanzania, Vanuatu and Zambia.

271 *UN Convention against Corruption*, adopted 31 October 2003, in force 14 December 2005, GA Res 58/4, UN Doc A/58/422 (2003), 43 *International Legal Materials* 37 (2004).

and 12 are party to the *Inter-American Convention Against Corruption*.[272] Both these latter conventions require states to take measures to address corruption domestically and permit states to exercise jurisdiction over nationals that engage in corruption abroad. Where states have fully implemented their obligations under these treaties, their nationals may have obligations not to engage in acts of corruption, including bribery, in any state in which they operate. In addition, both the *OECD Guidelines for Multinational Enterprises*[273] and the *Global Compact*[274] strongly discourage acts of corruption, including bribery, as a core principle of corporate social responsibility.

### 6.11.1 IIA practice

A few existing IIAs address corruption. The preambles of the Austria–Kosovo BIT and the Austria–Tajikistan BIT, for instance, make reference to 'the necessity for all governments and civil actors alike to adhere to UN and OECD anti-corruption efforts, most notably the UN Convention against Corruption (2003)'.[275]

Other IIAs impose obligations on the states parties to implement legislative and other measures to prohibit and sanction corruption. The EU–Korea FTA, for example, recalls the obligations of the parties under the OECD Convention and requires each party to adopt or maintain appropriate measures to prohibit and punish bribery and corruption in the pharmaceutical and health care sectors, and to bring to the attention of the other party situations of bribery in these sectors.[276]

The EC–CARIFORUM EPA has a provision that is more broadly focused. The parties agree to 'take the necessary legislative and administrative measures to comply with international standards, including those laid down in the United Nations Convention against Corruption' and to co-operate and take domestic measures, including legislation, to prohibit and punish bribery or corruption.[277]

A stronger approach, going beyond imposing obligations on party states to address bribery and other forms of corruption, would be to target investor conduct directly by imposing obligations on investors. The IISD model treaty departs from IIA practice by establishing an obligation on investors to refrain from acts of bribery and corruption. The obligation tracks the wording of the OECD and UN conventions, but it also includes language to ensure that bribes directly given to an official's family or close associates are within the scope of proscribed activity.[278]

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272 *Inter-American Convention Against Corruption*, adopted 29 March 1996, in force 6 March 1997, Art. 7.
273 *OECD Guidelines*, op. cit.
274 *UN Global Compact*, op. cit.
275 See Kosovo–Austria BIT (2010), preamble; Austria–Tajikistan BIT, preamble.
276 See preamble and Annex 2-D, Art. 4, European Union–South Korea Free Trade Agreement, signed 15 October 2009, in force 1 July 2011.
277 EC–CARIFORUM EPA (2008), Arts. 237 and 72.
278 IISD Model Treaty, Art. 13.

**Box 6.12 Summary of options for investor obligations to refrain from acts or complicity in bribery and corruption**

1. *Do not require foreign investors to refrain from acts or complicity in acts of bribery and corruption*
2. *Use existing domestic laws to regulate and sanction bribery and corruption*
3. *Introduce new legislation to prohibit and punish bribery and corruption consistent with a state's international obligations*
4. *Integrate provisions on corruption into an IIA through:*
   a. Language in the preamble
   b. Provisions in the agreement requiring parties to prohibit corruption in a particular industry, enforce appropriate penalties and notify the other party of situations of corruption
   c. An obligation on states to co-operate to ensure investors are prohibited from, and effectively sanctioned for, engaging in corruption
   d. Obligation on investors to refrain from acts or complicity in acts of bribery and corruption

### 6.11.2 Discussion of options

1. *Do not require foreign investors to refrain from acts or complicity in acts of bribery and corruption*

**This may deter investment:** Not taking any action to prevent and punish acts of bribery or corruption is likely to discourage foreign investment. Investors generally prefer to invest in open, stable states with strong, transparent regulatory frameworks.

**It undermines sustainable development:** Corruption can undermine the ability of government to pursue its sustainable development goals. It can result in a loss of government revenues, illegitimate and inefficient government procurement decisions, and distorted competition, as well as leading to human rights and environmental abuses.

**States may be in breach of their international obligations:** Many Commonwealth countries have ratified the *UN Convention against Corruption*, the African Union convention or the *Inter-American Convention against Corruption* and some are parties to the OECD anti-bribery convention. Thus they have obligations under those treaties to prohibit and punish acts of bribery and other forms of corruption. Failure to enact such laws would put them in breach of these obligations.

2. *Use existing domestic laws to regulate and sanction bribery and corruption*

This option may be attractive to states because it would not require any further expenditure of resources on the part of the state. However, existing laws may not be

sufficiently robust or may not target all corrupt activities. In addition, some states may have limited resources to devote to enforcement and many states encounter difficulties in regulating the behaviour of powerful foreign investors.

3. *Introduce new legislation to prohibit and punish bribery and corruption, consistent with a state's international obligations*

**It is costly to develop a regulatory framework:** Adopting new legislation will require states to dedicate resources to developing a robust anti-corruption framework to meet their international obligations. This may require establishing new institutions to enforce the laws and will be onerous for some states.

**Domestic laws can be difficult to enforce against foreign investors:** As noted above,[279] all states face challenges in enforcing domestic laws against powerful business actors. Thus, even where a state enacts or strengthens existing anti-corruption laws, it may be unable to effectively enforce such laws against foreign investors in some cases.

**This implements the states' international obligations and supports sustainable development:** Conversely, there are significant advantages to introducing a strong anti-corruption regulatory framework. It will bring states that have international obligations under the OECD Convention, the UN Convention or other instruments into compliance with such commitments, if they are not already. It will also help ensure that investors and their investments support, rather than undermine, the sustainable development goals of the host state.

**It may decrease the costs of doing business:** Reducing bribery and corrupt activities will increase transparency and predictability regarding the payments investors are required to make to host state governments and in their relations with host state governments generally. This may decrease the cost of doing business in the host state.

**It attracts investment and in particular socially responsible investment:** Studies have shown that corruption deters investment. Having strong anti-corruption laws indicates to potential investors, particularly to socially responsible investors and investors concerned with maintaining their global reputation, that the state has a stable, transparent and predictable regulatory environment.

**It helps manage corporate risk:** Where a contract is concluded through bribery or other corrupt activities, it can be unenforceable. In many situations, investors can be prosecuted under the laws of their home states for engaging in bribery or other forms of corruption in other states. Investors that come under investigation for corruption, even where they are not convicted, can suffer significant reputational damage, which can lead to a decrease in share value. Operating in a state with strong anti-corruption legislation can reduce the risk that investors will get caught up in corrupt activities.

279 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence) and Section 6.10 (Investor obligation to comply with core labour standards).

4. *Integrate provisions on corruption into an IIA*

There are several options for integrating provisions that address bribery and other forms of corruption into an IIA. The following are a few examples.

**Language in the preamble:** As discussed in the preceding section,[280] preambular language does not create binding obligations for party states or investors. The language may be used to interpret states' obligations under the IIA, but will not on its own provide a means of effectively addressing corruption.

**Provisions in the agreement requiring parties to prohibit corruption in a particular industry, enforce appropriate penalties and notify the other party of situations of corruption:** This type of provision is used in the EU–Korea FTA.

*Is less costly*. This option will be less onerous for some host states with scarce resources, allowing them to focus their enforcement measures on a particular industry or on the most corrupt sectors.

*Requires states to share information on corruption*. Requiring parties to exchange information of any corrupt activities in a particular sector may aid states in investigating and prosecuting investors that engage in corrupt practices or activities.

*Does not fully implement states' international obligations*. Focusing on a few industry sectors, however, does not fulfil states' obligations under the OECD, UN, AU or Inter-American conventions. If the commitment is not limited to particular sectors, however, this problem can be avoided.

*May deter investment*. This option may not sufficiently address corrupt activities among investors and may discourage investors that are seeking transparent and predictable business environments.

**An obligation on states to co-operate to ensure investors are prohibited from, and effectively sanctioned for, engaging in corruption.**

*Harnesses home state regulatory capacity and co-operation in regulating investor conduct*. As discussed above with respect to labour rights, this type of provision can also help states to address the challenges of regulating foreign investors that might otherwise be able to evade compliance with domestic law of the host state. It requires both states to take domestic measures and to co-operate in their enforcement to ensure that corruption is prohibited and sanctioned under domestic law.

*Is more cost-intensive*. This approach, which has been adopted in the EC–CARIFORUM EPA, will require more state resources than the preceding option. States will need to develop an effective anti-corruption regulatory and institutional framework and devote resources to co-operative enforcement measures to fulfil such an obligation.

**Obligation on investors to refrain from acts, or complicity in acts, of bribery and corruption:** The potential benefits and drawbacks of incorporating into an IIA an obligation on investors to refrain from acts, or complicity in acts, of bribery and corruption are similar to those identified above with respect to incorporating such an obligation into domestic law.

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280 See Section 6.10 (Investor obligation to comply with core labour standards).

There is, however, an additional significant advantage to including such a provision in an IIA. It makes the obligation to refrain from bribery and corruption a treaty obligation. This means that states can support domestic enforcement mechanisms with treaty-based enforcement mechanisms. These mechanisms could include criminal enforcement in both the host state and the investor's home state, grievance processes (which can reveal information on bribery and corruption), civil liability and state counterclaims in dispute settlement, all of which are considered below.[281]

An IIA could be drafted to provide that treaty-based enforcement mechanisms would apply to the failure by an investor to comply with domestic laws on bribery and corruption. The treaty obligation to comply with domestic law discussed above has the effect of doing this.[282] Expressing standards in the treaty itself makes the requirements for investor more transparent and can help ensure compatibility with international standards.

### 6.11.3 Discussion of sample provision

The aim of the sample provision is to prohibit investors from engaging in corrupt activities directly. States will have to determine, based on their international obligations, their particular circumstances and the costs and benefits discussed above, whether or not they wish to adopt or strengthen anti-corruption legislation and/or incorporate an obligation on investors into an IIA in the manner provided for in the sample provision.

The Guide sample provision departs from current IIA practice and adopts a modified version of the IISD provision imposing direct obligations on investors not to commit, or be complicit in, bribery or other acts of corruption in relation to their investment. It does not address state co-operation because this is addressed in a separate section on state obligations.[283]

It includes the IISD provision's language prohibiting bribery of an 'official's family, business associate or other person in close proximity to an official'. In doing so, it provides a higher standard than in the OECD, UN, AU or Inter-American conventions. Drawing on the UN Convention, the sample provision also includes in the prohibited outcomes of an act of bribery or corruption '[o]btaining or retaining any other business or other undue advantage in relation to such investment'.[284]

In order for the obligation in the sample provision to be fully effective and capable of being addressed in a counterclaim by states, it will need to take effect prior to the investment being approved by the state. Otherwise, bribery and corruption in

281 See Section 6.14 (Criminal sanctions); Section 6.15 (Grievance procedure and other measures to enforce the management plan produced in the sustainability assessment); Section 6.16 (Civil liability of investors); and Sections 6.17 (Counterclaims by states in investor–state arbitration) and 7.1.7 (Sample provisions: investor–state dispute settlement, Article [W] (Counterclaims)).

282 See Section 6.7 (Investor obligation to comply with the laws of the host state).

283 See Section 6.12 (Other rights and obligations of party states).

284 *UN Convention against Corruption*, Art 16.

connection with investment approvals would not be caught. The time for the commencement of investor obligations is discussed above.[285]

Other sample provisions in the Guide impose consequences for investors who breach the obligations relating to corruption. These provisions, if included in an IIA, would require party states to impose criminal sanctions for such behaviour and permit civil actions for relief for injuries that such behaviour may cause.[286] In addition, investors in breach of these obligations may be subject to a counterclaim by states in investor–state arbitration cases that they initiate.[287]

### 6.11.4 Sample provision: obligation to refrain from acts, or complicity in acts, of bribery and corruption

#### Obligation to Refrain from Acts, or Complicity in Acts, of Bribery or Corruption

1. Investors of a Party and their investments shall not, either prior to or after the establishment of an investment, offer, promise, or give any undue pecuniary or other advantage, whether directly or indirectly, to a public official of the other Party, or to a member of such an official's family or such official's business associate or other person in close proximity to such official, in order that the official or third party act or refrain from acting in relation to the performance of official duties, or use his or her influence to:
   a. Obtain any favour in relation to a proposed or actual investment;
   b. Obtain or renew any licences, permits, contracts or other rights in relation to a proposed or actual investment; or
   c. Obtain or retain any other business or other undue advantage in relation to such investment.
2. Investors of a Party and their investments shall not be complicit in any act described in Section 1, including incitement, aiding and abetting, conspiracy to commit or the authorisation of such acts.

## 6.12 Other rights and obligations of party states

**Cross references**


| | | |
|---|---|---|
| Section 2.3 | Links between foreign investment and sustainable development | 18 |
| Section 4.2.1 | The role of preambles in IIAs | 42 |
| Section 5.3 | National treatment | 110 |
| Section 5.4 | Most favoured nation | 124 |
| Section 5.5 | Fair and equitable treatment and the minimum standard treatment | 138 |
| Section 5.6 | Limitations on expropriation and nationalisation | 152 |


285 See Sections 4.4 (Statement of objectives) and 5.2 (Right of establishment).

286 See Section 6.14 (Criminal sanctions) and Section 6.16 (Civil liability of investors).

287 See Sections 6.17 (Counterclaims by states in investor–state arbitration) and 7.1.7 (Sample provisions: investor–state dispute settlement, Article [W] (Counterclaims)).

As discussed above,[288] international human rights law imposes a three-part obligation on states to respect, protect and fulfil human rights[289] with respect to individuals within their territory and subject to their jurisdiction. The *obligation to protect* is an obligation of due diligence.[290] International human rights law requires a state to take measures, such as enacting legislation and adopting administrative practices, to control, regulate, investigate and prosecute actions by non-state actors that violate the human rights of those within the territory, and subject to the jurisdiction, of that state.[291]

States have been found by international human rights treaty monitoring bodies to be in breach of the obligation to protect in a variety of situations, including where corporate actors have violated labour rights,[292] where the activities of companies have polluted both air and land,[293] and for failures by the state to protect indigenous peoples' land from harm caused by business activities or from commercial development.[294]

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288 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence).

289 See, for example, the analysis by the UN Committee on Economic, Social and Cultural Rights in *General Comment No 13: The Right to Education*, UNCESCR, UN Doc E/C.12/1999/10, (1999) at para. 46, where the Committee states: 'The right to education, like all human rights, imposes three types or levels of obligations on states parties: the obligations to respect, protect and fulfill. In turn, the obligation to fulfill incorporates both an obligation to facilitate and an obligation to provide'.

290 See generally A Clapham (1993), *Human Rights in the Private Sphere*, Clarendon Press, Oxford; A Clapham (2001), 'Revisiting Human Rights in the Private Sphere: Using the European Convention on Human Rights to Protect the Right of Access to the Civil Courts', in C Scott (ed.), *Torture as Tort: Comparative Perspectives on the Development of Transnational Human Rights Litigation*, Hart Publishing, Oxford, 513 at 513.

291 See, for example, *Velásquez Rodriguez v. Honduras*, op. cit., 294; *Herra Rubio v. Colombia* (161/1983), (1988) HRC Report, GAOR, 43rd Sess., Supp. 40, 190 [11]; *Ergi v. Turkey* (App. 23818/94) (1998) 32 EHRR 388; *Timurtas v. Turkey* (App. no. 23531/94) (2000) ECHR 13 June 2000; and *A v. UK* (App. no. 25599/94) (1999) 27 EHRR 611.

292 See, for example, *Young, James and Webster v. UK*, (1981) 44 ECHR (Ser A), 4 EHRR 38.

293 See, for example, *Lopez Ostra v. Spain*, (1994) 303C ECHR (Ser A), 20 EHRR 277; *Guerra v. Italy*, (1998) 7 ECHR, 26 EHRR 357. See *Social and Economic Rights Action Centre for Economic and Social Rights v. Nigeria*, (2001) Communication No 155/96 African Commission.

294 See, for example, *Yanomani v. Brazil*, (1985) Inter-Am Ct HR (Ser L) No 12/85; *The Mayagna (Sumo) Awas Tingni Community v. Nicaragua*, (2001) Inter-Am Ct HR (Ser C) No 79; *Hopu and Bessert v. France*, HRC, UN Doc CCPR/C/60/D/549/1993/Rev.1, (1997) at para 10.3; *Saramaka People v. Suriname*, op cit.

An important criticism of current IIAs, which has been discussed in various sections of the Guide, is that they can restrict the capacity of host states to implement laws, regulations and policies to comply with their environmental obligations and their international human rights obligations, including their duties under international labour law and their international obligations with respect to indigenous peoples, as well as their obligations to prevent and punish bribery and corruption.[295] An IIA that aims to promote foreign investment that supports and facilitates sustainable development should not unduly restrict the host state's capacity to comply with these international legal duties. The agreement must therefore protect the state's right to introduce laws and regulations for this purpose. The UN Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and other Business Enterprises (SRSG) has urged states that are in the process of, or considering, reviewing their policy with respect to IIAs 'to ensure that the new model BITs combine robust investor protection with adequate allowances for *bona fide* public interest measures, including human rights, applied in a non-discriminatory manner'.[296]

These concerns are addressed by the sample provisions on investor protection standards, as well as the provisions dealing with reservations and exceptions discussed above.[297] The following section of the Guide addresses states' implementation and enforcement of their international obligations.

In order to realise the overall goal of promoting sustainable development, party states must play an important role in promoting and protecting human rights (including labour rights and indigenous peoples' rights), protecting the environment, and preventing and punishing bribery and corruption, as well as addressing other development priorities. To achieve these goals, states should take the necessary steps to bring their domestic laws into compliance with their international obligations.[298] The obligations on investors set out in the Guide will be most effective if they are supported by host states through legislative, administrative and other measures to ensure that foreign investment supports, rather than undermines, sustainable development. Introducing such domestic laws and regulations is a first and fundamental step in this regard. Negotiating a provision in an IIA requiring states to adopt standards in their domestic law would complement and reinforce such domestic measures.

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295 See UNHRC (2008), 'Protect Respect and Remedy', op. cit.; Sornarajah, op. cit.; Schneiderman, op. cit., and Miles, op. cit.

296 'Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, John Ruggie. Business and Human Rights: Further Steps toward the Operationalization of the "Protect, Respect and Remedy" Framework', UNHRC, UN Doc A/HRC/14/27, (2010) at para 23. See also *UN Guiding Principles on Business and Human Rights*, op. cit., at Principle 9 and commentary.

297 See Section 5.12 (Reservations and exceptions).

298 See, for example, the rights set out the core UN human rights treaties (as well as their optional protocols) including, *ICCPR* and *ICESCR*; *ICERD*; *CAT*; *CEDAW: CRC*; *ICRMW*; *CPED*; *CRPD*. In addition, see the ILO Conventions 29, 87, 98, 100, 105, 111, 138 and 182.

This section builds on the discussion in previous sections by considering in more detail the costs and benefits of introducing new domestic laws setting minimum standards for human rights, labour rights, indigenous peoples' rights, and environmental protection as well as anti-corruption measures as a means to help achieve sustainable development. It also considers a range of alternative a means for states to incorporate an obligation to meet minimum standards for their domestic laws in these areas into an IIA. In the consultations undertaken in developing the Guide some state representatives articulated a strong concern that IIA provisions creating obligations for states with respect to minimum standards in these areas would represent an inappropriate intrusion into state sovereignty. In particular, some were concerned that such provisions would create opportunities for other party states to put pressure on a state with respect to the design and enforcement of its domestic laws in these complex and sensitive areas. In light of the controversial nature of IIA provisions that impose minimum standards in these areas, no sample provision of this kind has been included in the Guide. Nevertheless, there are potential benefits that could flow from this kind of provision from a sustainable development point of view. These benefits as well as the costs are discussed below. For states that wish to consider ways of incorporating such an obligation into an IIA, the discussion of IIA practice in this section makes reference to a range of examples and options that are drawn from state practice.

### 6.12.1 IIA practice

A growing number of IIAs include obligations on states regarding standards to be reflected in their domestic laws. The sections on investor obligations have canvassed IIA practice with respect to human rights, labour rights, and bribery and corruption.[299] This section focuses on obligations relating to environmental protection.

Language on protecting the environment is becoming more commonplace in IIAs, with about 50 per cent of new treaties each year including provisions on environmental protection.[300] States have taken a variety of approaches to addressing environmental concerns associated with foreign investment. Gordon and Pohl, in a survey of 1,623 IIAs, identify a range of provisions that are increasingly found in IIAs.[301] Examples of these different types of provisions are discussed below, together with other types of provisions not identified in that study. Such provisions include language on environmental protection in the preamble, references to environmental standards in

299 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence); Section 6.9 (Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights); Section 6.10 (Investor obligation to comply with core labour standards); Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).

300 K Gordon and J Pohl (2011), 'Environmental Concerns in International Investment Agreements: A Survey', 2011/1 OECD Working Papers on International Investment at 7, available at: www.oecd.org/dataoecd/50/12/48083618.pdf (accessed 8 January 2013).

301 Ibid. at 13–25.

separate provisions in the body of the treaty text or in a side agreement, exceptions, CSR provisions and provisions on co-operation regarding investor compliance with environmental standards.

**Language in the preamble:** Language in the preamble on environmental protection does not create binding obligations on states or, on its own, provide effective protection of the environment. As discussed above,[302] the aim of the preamble is to describe the overall goals of the parties in entering the treaty and to set out the context for interpreting treaty obligations. A preamble might, for instance, express the desire that the objectives of the treaty be accomplished in a manner consistent with certain principles, such as environmental protection or sustainable development. For example, the preamble of the EC–CARIFORUM EPA considers the need of the parties 'to promote economic and social progress for their people in a manner consistent with sustainable development by respecting basic labour rights … and by protecting the environment'.[303] Similarly, the preamble of the US–Morocco FTA expresses the desire of the parties 'to strengthen the development and enforcement of … environmental policies … promote sustainable development, and implement this Agreement in a manner consistent with environmental protection and conservation'.[304] States can draft a preamble so as to give precedence in the interpretation of the treaty to environmental or other non-investment norms. However, if such precedence is not clearly specified in an investment treaty, a person or an investment tribunal interpreting the treaty will be likely to give preference to investment protection and promotion over other norms.

**Obligation not to relax domestic environmental standards to encourage investment:** Some IIAs include a provision recognising that it is inappropriate for parties to lower or waive environmental standards in order to attract investment. The Canadian model FIPA, for example, incorporates a provision in which the parties recognise that it is inappropriate to encourage investment 'by relaxing domestic health, safety or environmental measures.'[305] The Austrian model BIT includes a similarly worded provision, but it also provides for consultations where a party considers that the other party is attempting to encourage investment by lowering such standards.[306] The US model BIT goes somewhat further by specifically prohibiting waiving or derogating from environmental laws so as to lower the protections provided by such laws or consistently failing to apply such laws to encourage investment.[307]

302 Section 4.2.1 (The role of preambles in IIAs).
303 EC–CARIFORUM EPA (2008), preamble.
304 US–Morocco FTA (2004), preamble.
305 Art 11.
306 Austria Model BIT. See also NAFTA (1992), Art. 1114(2);
307 2012 US Model BIT, Art. 12. See also EC–CARICOM EPA (2008), Arts. 73, 188.1(a),(b); EU–Korea FTA (2009), Art. 13.7; US–Chile FTA (2003), Art. 19.2; US–Singapore FTA (2003), Art. 18.2; Australia–US FTA (2004), Art. 19.2.

**Obligation to strengthen domestic laws on environmental protection:** In addition to an obligation not to relax domestic environmental laws and regulations, a few IIAs also contain provisions that:

- Recognise the right of the parties to establish their own environmental standards;
- Oblige the parties to maintain high levels of environmental protection; and
- Require the parties to strive to improve such standards.[308]

Some IIAs, such as the Belgium–Luxemburg model BIT, also reaffirm the parties' international commitments under environmental treaties and impose an obligation on the parties to strive to ensure that these international environmental law obligations are implemented in domestic law.[309]

The EC–CARIFORUM EPA provides a variation of this type of provision. It highlights the need for developing countries to take into account their development priorities and their level of development:

> 1. Recognising the right of the Parties and the Signatory CARIFORUM States to regulate in order to achieve their own level of domestic environmental and public health protection and their own sustainable development priorities, and to adopt or modify accordingly their environmental laws and policies, each Party and Signatory CARIFORUM State shall seek to ensure that its own environmental and public health laws and policies provide for and encourage high levels of environmental and public health protection and shall strive to continue to improve those laws and policies.
> 2. The Parties agree that the special needs and requirements of CARIFORUM States shall be taken into account in the design and implementation of measures aimed at protecting environment and public health that affect trade between the Parties.[310]

The goal of these various types of provisions is not so much to improve the level of environmental protection, but to prevent competition for investment between states that will lead to a 'race to the bottom' of environmental standards. These provisions do not oblige party states to ensure that their domestic laws and regulations reflect minimum environmental standards consistent with their international environmental obligations.

**Side accords:** As with labour rights protections, some states have opted to negotiate side accords to free trade agreements to address the problem of a potential 'race to the bottom' of environmental standards. The North American Agreement on Environmental Cooperation (NAAEC), for example, includes provisions on environmental protection that mirror the NAALC provisions on labour rights protection.[311] The NAAEC recognises the right of parties to establish their own

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308 See Australia–US FTA (2004), Art. 19.1; US–Chile FTA (2003), Art. 19.1; US–Singapore FTA (2003), Art. 18.1.

309 Art. 5(3). See also the Belgium–Luxembourg–Ethiopia BIT (2006), Art. 5(3).

310 EC–CARIFORUM EPA (2008), Art. 184.1

311 See Section 6.10 (Investor obligation to comply with core labour standards).

domestic environmental standards, policies and priorities, and to adopt or modify such laws and regulations. It also requires parties to ensure that their domestic laws and regulations 'provide high levels of environmental protection' and to 'strive' to improve domestic standards.[312]

In addition, party states are required to facilitate compliance with and enforce their environmental laws through appropriate government measures and to ensure that judicial and non-judicial mechanisms and other procedures are available to individuals to enforce such laws.[313] The provisions in the NAAEC aim to accomplish the same thing as the provisions of IIAs, discussed above, which merely require parties to enforce their environmental laws. There is no requirement on the parties to bring their domestic laws into compliance with their international obligations or to continuously improve such standards.

**Compliance mechanisms:** Some IIAs, including FTAs and side accords, incorporate mechanisms intended to ensure that states enforce their domestic environmental standards. The NAAEC and certain US FTAs establish a compliance system that includes a means for individuals and organisations to make complaints about a party's failure to enforce its environmental laws and regulations.[314] These systems are analogues of those in place to enforce labour standards, discussed above.[315] They rely primarily on consultations between the party states.[316] However, in principle, under some side agreements and FTAs, a narrow set of disputes can go on to be settled through arbitration[317] and could lead to the imposition of fines[318] or, in some cases, even sanctions to enforce such fines.[319]

Like the equivalent labour compliance mechanisms, these types of provisions do not directly target investor behaviour. According to the IISD, these compliance mechanisms are relatively new and have not to date played any significant role. In addition, there is little evidence that these compliance mechanisms, together with their complaint processes, have been effective in preventing a 'race to the bottom' by ensuring that states enforce their domestic environmental standards against foreign investors.[320]

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312 Canada–Mexico–United States, North American Agreement on Environmental Cooperation, signed 1 January 1994, in force 1 January 1994, Art. 2.

313 NAAEC, Arts. 4–7.

314 See NAAEC (1994), Art 14. The Australia–US FTA (2004), US–Chile FTA (2003) and US–Singapore FTA (2003) only provide for members of the public to make 'communications' on environmental enforcement. The parties in each case are only under a 'best efforts' obligation 'to respond favorably to requests for consultations by such persons or organizations'. See Arts. 19.5, 19.5, 19.18.5, respectively.

315 See 6.10 (Investor obligation to comply with core labour standards).

316 See NAAEC (1994), Arts. 22–23; US–Australia FTA (2004), Art. 18.7; US–Chile FTA (2003), Art.19.5; and US–Singapore FTA (2003), Art. 18.7.

317 See NAAEC (1994), Arts. 24–36; Australia–US FTA (2004), Chapter 21; US–Chile FTA (2003), Chapter 22; US–Singapore FTA (2003), Chapter 20.

318 See NAAEC (1994), Art. 34(4)(b); Australia FTA–US (2004), Art. 21.11(1); US–Chile FTA (2003), Art. 22.15(1); US–Singapore FTA (2003), Art. 20.6(1).

319 See NAAEC (1994), Art. 36; Australia–US FTA (2004), Art. 21.11(2); US–Chile FTA (2003), Art. 22.15(2); US–Singapore FTA (2003), Art. 20.6(2).

320 Bernasconi-Osterwalder and Johnson, op. cit., at 27.

**General exceptions:** Some IIAs include exceptions with language that relates to environmental protection even where such provisions do not specifically use the terms 'environment' or 'environmental protection'. IIA exception provisions commonly reference 'human, animal and plant life or health, or the protection of natural resources'.[321] The Canadian model treaty includes in its exception provision the right to take measures necessary to protect, among other things, human, animal or plant life or health, and the conservation of living or non-living exhaustible resources.[322] There are a range of problems with how exceptions are commonly worded and how they are interpreted by investment tribunals.

The US–Singapore FTA includes a provision stating that:

> Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure *otherwise consistent with this Chapter* that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.[323] (Emphasis added.)

This type of provision is likely to be quite limited in its legal effect, since it requires any regulation on environmental protection to be consistent with the core investor protection provisions in the FTA. It is more in the nature of a guide to interpretation.

The section of the Guide that deals with reservations and exceptions considers the use of exceptions in more detail and discusses approaches to excluding policy areas from the application of an IIA.[324]

**Exceptions excluding regulation as a basis for claims of indirect expropriation:** A small number of IIAs incorporate provisions that aim to specifically preclude environmental regulation from becoming the basis for an investor to claim that such regulation constitutes indirect expropriation.[325] For instance, Canada's model FIPA includes a provision stating:

> Except in rare circumstances, such as when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith, non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation.[326]

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321 Ibid. at 17.
322 Canadian Model FIPA, Art. 10.
323 US–Singapore FTA (2003), Art. 15.10. See also, the Australia–US FTA (2004), Art. 11.11, for example.
324 See Section 5.12 (Reservations and exceptions).
325 Ibid. at 22.
326 Annex B.13(1)(c).

Similar provisions can be found in the US model BIT,[327] some US FTAs[328] and the Austrian model BIT.[329] The aim of these provisions is to ensure that *bona fide*, non-discriminatory regulation in certain policy areas will not be found by an investment tribunal to indirectly expropriate an investment and thus require the host state to pay compensation. The problem of indirect expropriation is discussed at length in Section 5.6 (Limitations on expropriation and nationalisation).

**Obligation to encourage compliance with voluntary mechanisms on environmental performance:** Some IIAs include general provisions on CSR relating to human rights, the environment and corruption, and they may reference CSR instruments such as the *OECD Guidelines* or the *Global Compact*.[330] These provisions are discussed in more detail above.[331] Certain US FTAs include CSR provisions that specifically target the environment. For example, the Australia–US FTA incorporates an obligation on the parties to promote 'as appropriate' the development of voluntary, market-based mechanisms that 'encourage the protection of natural resources and the environment'.[332] The US–Singapore and the US–Chile FTAs include a non-binding recommendation that parties 'encourage enterprises operating within [their] territory or subject to [their] jurisdiction to voluntarily incorporate sound principles of corporate stewardship in their internal policies, such as those principles or agreements that have been endorsed by the Parties'.[333] While these provisions raise awareness of the need for environmentally responsible conduct by investors, they have no binding effect. They do not impose obligations on states to implement laws or policies on CSR. Nor do they require investors to operate in accordance with internationally accepted CSR norms. Thus, such provisions are not directly protective of the environment.

**Co-operation between parties on environmental issues:** Another approach states have taken in FTAs and side accords is to establish a mechanism to enhance co-operation between the parties on environmental issues. The three US FTAs discussed in this section recognise the importance of capacity building for the purpose of environmental protection and incorporate provisions on the sharing of information relating to the environmental effects of trade agreements and policies.[334] The environmental co-operation provisions in the US–Chile FTA are more expansive and resemble the labour provisions found in some US FTAs, which provide an indicative list of co-operative activities and the implementation of such activities.[335] The US–Chile

327 Annex B, Art. 4(b).

328 See, for example, Australia–US FTA (2004), Annex 11-B, Art 4(b); US–Chile FTA (2003), Annex 10-D, Art. 4(b); US–Morocco FTA (2004), Annex 10-B, Art. 4(b).

329 Art. 7(4).

330 Canada–Colombia FTA (2008), Art. 816; Canada–Peru FTA (2008), Art. 810; Norwegian draft APPI, Art. 32.

331 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence).

332 See Australia–US FTA (2004), Art. 19.4.

333 See US–Singapore FTA (2003), Art. 18.9; US–Chile FTA (2003), Art. 19.10.

334 See the Australia–US FTA (2004), Art. 19.6; US–Singapore FTA (2003), Art. 18.6.

335 See Section 6.10 (Investor obligation to comply with core labour standards).

FTA includes such provisions[336] but goes further to require the parties to pursue certain 'cooperative projects'. These include, for example, developing a public database of chemicals that have been released into the environment, reducing the pollution from mining projects, protecting wildlife and reducing ozone-depleting substances.[337]

In contrast, the EC–CARIFORUM EPA co-operation provision focuses on the enforcement of environmental protection standards against investors. It imposes an obligation on the states parties both to co-operate and to take measures domestically to ensure that investors do not manage or operate their investments in a manner that circumvents international environmental obligations consistent with the international obligations of the parties.[338]

This provision (which is the same provision discussed with respect to labour and bribery and corruption in preceding sections of the Guide)[339] is more protective of the environment than some of the other provisions discussed in this section. First, it goes beyond simply requiring parties not to lower their domestic standards and to enforce their domestic environmental protection laws. Second, it specifically requires both parties to take action to ensure investor compliance with international environmental standards. It thus obliges the *home state* to exercise its regulatory power to ensure investor compliance with environmental norms consistent with the parties' international obligations. Finally, it requires the home state and the host state to co-operate on these issues.

No existing IIA contains specific provisions requiring states to bring their laws into compliance with their international obligations with respect to human rights, labour rights, indigenous peoples' rights, environmental protection, and bribery and corruption, or even requires parties to provide minimum levels of protection in each of these policy areas and to strive to improve such protections.

The IISD model treaty goes the furthest in this regard. It affirms state obligations under international human rights and environmental agreements.[340] According to the IISD, the aim of this provision is to put the parties on notice that these 'obligations are not superseded by the present Agreement'.[341] The IISD model treaty also includes a provision that tracks some of the language from the EC–CARIFORUM EPA. It recognises the right of parties to establish their own levels of environmental protection and requires the parties to establish high levels of human rights, labour rights and environmental protection appropriate to their level of development, to strive to improve such protection, and to bring their labour laws into compliance with international core labour standards as set out in the ILO Declaration.[342]

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336 See the US–Chile FTA (2003), Annex 19.3, Art. 2.
337 US–Chile FTA (2003), Annex 19.3, Art. 1.
338 EC–CARIFORUM EPA (2008), Art. 72(b), (c).
339 See Section 6.10 (Investor obligation to comply with core labour standards); and Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).
340 IISD model treaty, Art. 34.
341 Mann et al., op. cit., at 47.
342 IISD Model Treaty, Art. 21.

**Box 6.13 Summary of options for party state obligations relating to minimum standards of human rights, labour rights, indigenous peoples' rights and environmental protection and standards to address corruption**

1. Do not establish domestic laws and administrative measures to protect human rights, labour rights, indigenous peoples' rights and environmental protection or to address bribery and corruption
2. Use existing laws to protect human rights, labour rights, indigenous peoples' rights and environmental protection and to address bribery and corruption
3. Introduce stronger domestic laws to entrench minimum standards of human rights, labour rights, indigenous peoples' rights and environmental protection and to address bribery and corruption, consistent with a state's international obligations
4. Integrate into an IIA the obligation on states to enact and enforce legislation to protect human rights, labour rights, indigenous peoples' rights and the environment, and to address bribery and corruption by including:
   a. Language in the preamble
   b. Provisions in the body of the treaty or side agreement to address the problem of a 'race to the bottom'
   c. Exceptions for human rights, labour rights, indigenous peoples' rights, anti-corruption and environmental protection measures
   d. Provisions excluding regulation on human rights, labour rights, indigenous peoples' rights, anti-corruption measures and environmental protection as a basis for indirect expropriation
   e. Provisions recommending that the parties encourage investors to comply with voluntary CSR standards
   f. Obligations on states to co-operate to ensure that investors do not circumvent compliance with international human rights, labour rights, indigenous peoples' rights, international environmental protection obligations and anti-corruption obligations

### 6.12.2 Discussion of options

1. *Do not establish domestic laws and administrative measures to protect human rights, labour rights, indigenous peoples' rights and environmental protection or to address bribery and corruption*

**This may deter investment:** As discussed in the investor obligation sections,[343] there are few advantages that flow from failing to enact minimum standards of protection

343 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence); Section 6.9 (Investor obligation to refrain from the

for human rights (including labour rights and indigenous peoples' rights), and to prevent and punish corruption. Studies have shown that violations of labour rights even in small poor developing countries can deter investment, as can corruption.[344] Research has also shown that states with robust human rights protections attract more investment than those with weak protections and that strong human rights protection is beneficial for economic growth and general welfare.[345] This may also be true for environmental standards. Therefore, deciding not to provide such minimum protections or failing to enforce the laws and regulations that exist may not be a helpful strategy for attracting investment.

**States may be in breach of their international obligations:** In addition, states that do not implement their international obligations in domestic law and enforce such laws against foreign investors and other businesses may be in breach of their international obligations. These are discussed in the investor obligation sections[346] and in more detail below.

2. *Use existing laws to protect human rights, labour rights, indigenous peoples' rights and environmental protection and to address bribery and corruption*

**This is less costly for states:** This approach may be attractive for states that already have robust laws and regulations in place to address bribery and corruption, environmental protection and human rights, including labour rights and indigenous peoples' rights. The advantage of this approach is that host states will not have to commit further resources to developing a stronger regulatory framework and establishing or strengthening enforcement institutions.

**Existing laws may not be consistent with states' international obligations:** However, current domestic laws may not be sufficiently rigorous and/or may not be consistent with a state's international obligations. In addition, as discussed in the investor obligation sections, even where states have a strong regulatory framework in place, they may have difficulty enforcing such laws against foreign investors. All states, even those with robust laws and enforcement institutions, can face challenges in regulating the behaviour of transnational businesses. These corporate groups are able to restructure or to transfer assets from one state to another to avoid liability in the host state.

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commission of, or complicity in, grave violations of human rights); Section 6.10 (Investor obligation to comply with core labour standards); and Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).

344 See OECD, Standards, op. cit.; P Busse et al. (February 2008), 'FDI Promotion through Bilateral Investment Treaties: More than a BIT?', Kiel Working Paper No. 1403, Kiel Institute for the World Economy, Kiel.

345 See Blume and Voigt, op. cit.

346 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence); Section 6.9 (Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights); Section 6.10 (Investor obligation to comply with core labour standards); and Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).

3. *Introduce stronger domestic laws to entrench minimum standards of human rights, labour rights, indigenous peoples' rights and environmental protection and to address bribery and corruption consistent with a state's international obligations*

**It is costly to develop a regulatory framework:** As discussed in the preceding sections on investor obligations, developing strong laws, regulations and enforcement institutions can be burdensome for many states. States will need to dedicate what may be scarce resources to strengthening laws, regulations, administrative measures, the judiciary and the court system to meet their international obligations.

**It may increase the costs of doing business and deter investment:** Enacting and enforcing laws consistent with a host state's international obligations with respect to human rights, labour rights, indigenous peoples' rights, environmental protection and corruption may deter some investors. This is especially likely to be true where other states have not given effect to their international obligations in these areas. Investors may feel that it is too costly to comply with such standards.

**Domestic laws can be difficult to enforce against foreign investors:** As noted above in this section, even where states bring domestic laws and regulations into line with their international obligations, they may face significant challenges enforcing them against foreign investors.

**There is a risk of investor challenge under an IIA:** As discussed in the investor obligation sections, the introduction or amendment of laws and regulations on human rights, labour rights, indigenous peoples' rights and environmental protection might expose a host state to a challenge by a foreign investor under an existing IIA. The investor might argue, for example, that the introduction of such measures is a violation of the FET provisions. A number of investment tribunals have interpreted FET obligations so expansively that the capacity of host states to change the regulatory environment that induced the investor to invest may be significantly restricted.[347] The risk of such a challenge is greatest in situations where the action of the host state is directed only at foreign investors. In addition, in some circumstances an investor might argue that the introduction of environmental laws and regulations amounts to indirect expropriation.[348] Where an investor is successful in an investor–state arbitration claim, the state would be required to pay compensation. In some cases, awards of hundreds of millions of dollars have been made.[349]

**It attracts investment and in particular socially responsible investment:** On the other hand, there are important advantages in introducing stronger domestic standards for environmental protection, the protection of human rights, labour rights and indigenous peoples' rights and to address bribery and corruption. Having a robust regulatory framework indicates to investors, particularly investors that have

347 See Section 5.5 (Fair and equitable treatment and the minimum standard of treatment).

348 See Section 5.6 (Limitations on expropriation and nationalisation).

349 JA VanDuzer, P Simons and G Mayeda (2008) 'Modeling International Investment Agreements for Economic Development', in V Qalo (ed) *Bilateralism and Development: Emerging Trade Patterns*, Cameron May, London, 359, at 390.

developed socially responsible business practices, and other investors concerned about protecting their global reputations, that the state has a stable, transparent, rights-protective regulatory environment in which to conduct business. As noted above, in the case of labour rights, studies have shown that strong labour standards are not a significant factor in investment decision making.[350] Corruption can increase business costs unpredictably and has been shown to deter investment.[351] Investors prefer to invest in open stable states with strong, transparent regulatory frameworks.[352]

**It helps manage corporate risk:** Increasingly, investors are concerned with avoiding and managing the risks associated with potential rights violations and environmental impacts. In addition, regulating the human rights and environmental impacts of investors by requiring them to undertake impact assessments and engage in human rights due diligence prior to their investment and to prevent, avoid and mitigate harmful impacts, can reduce costs for investors and the risk of liability. As noted in the section on sustainability assessments, investors that fail to conduct an impact assessment and therefore have no plan in place to deal effectively with future conflicts may face higher and unexpected costs with their operations.[353] The financial costs of conflict between investors and communities can be significant.[354] Foreign investors operating in a state with a robust regulatory environment are less likely to face strikes or public protests that may disrupt operations. They are also less likely to be the target of NGO campaigns that can expose them to reputational damage, or to be the subject of civil or administrative claims for violations of rights or environmental harm. In addition, investors are also increasingly concerned with avoiding corruption in connection with their investments. Not only may contracts procured through bribery and other forms of corruption be unenforceable, but investors also risk being prosecuted in the host state, their home state or both. As discussed in the preceding section,[355] even where investors are not convicted, an investigation and the media attention that accompanies a prosecution can result in reputational damage, which in turn can result in a decrease in share value. Operating in a state with strong anti-corruption legislation can reduce the risk that investors will get caught up in corrupt activities.

**It implements states' international obligations and supports sustainable development:** Introducing new stronger domestic laws and regulations, or amending existing laws and regulations in the areas of human rights (including labour rights and indigenous

350 See OECD, Trade, Employment and Labour Standards, op. cit. See Section 6.10 (Investor obligation to comply with core labour standards).

351 Busse et al. (2008), op. cit.

352 See Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).

353 See Section 6.6 (Sustainability assessments).

354 Davis and Franks, op. cit. See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence).

355 See Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).

peoples' rights), anti-corruption and environmental protection, allows states the opportunity to bring their laws into compliance (where they are not already) with their international obligations. The most widely accepted international obligations in these areas are surveyed below.

### *Anti-corruption and environmental protection obligations*

As discussed in the previous section, most Commonwealth countries are parties to one or more anti-corruption treaties.[356] In addition, most states have ratified the following major international environmental treaties, and may be parties to a range of others, and therefore have obligations under such agreements:

- *Convention on International Trade in Endangered Species of Wild Fauna and Flora*, 1973[357]
- *Framework Convention on Climate Change*, 1992[358]
- *Kyoto Protocol to the Framework Convention on Climate Change*, 1997[359]
- *Convention on Biological Diversity*, 1992[360]
- *Cartagena Protocol on Biosafety*, 2000[361]
- *Vienna Convention for the Protection of the Ozone Layer*, 1988[362]
- *Montreal Protocol on Substances that Deplete the Ozone Layer*, 1987[363]
- *Stockholm Convention on Persistent Organic Pollutants*, 2001[364]

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356 See Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).

357 *Convention on International Trade in Endangered Species of Wild Fauna and Flora*, adopted 3 March 1973, in force 1 July 1975, 27 UST 1087; 993 *United Nations Treaty Series* 243.

358 *United Nations Framework Convention on Climate Change*, adopted 9 May 1992, in force 21 March 1994, 1771 *United Nations Treaty Series* 107, 31 *International Legal Materials* 849 (1992).

359 *Kyoto Protocol to the United Nations Framework Convention on Climate Change*, adopted 11 December 1997, in force 16 February 2005, 2303 *United Nations Treaty Series* 148, 37 *International Legal Materials* 22 (1998).

360 *Convention on Biological Diversity*, adopted 5 June 1992, in force 29 December 1993, 1760 *United Nations Treaty Series* 79, 31 *International Legal Materials* 818 (1992).

361 *Cartagena Protocol on Biosafety to the Convention on Biological Diversity*, adopted 29 January 2000, in force 11 September 2003, 2251 *United Nations Treaty Series* 205, 39 *International Legal Materials* 1027 (2000).

362 *Vienna Convention for the Protection of the Ozone Layer*, adopted 22 March 1985, in force 22 September 1988, 1513 *United Nations Treaty Series* 293, 26 *International Legal Materials* 1516 (1987).

363 *Montreal Protocol on Substances that Deplete the Ozone Layer*, adopted 16 September 1987, in force 1 January 1989, 1522 *United Nations Treaty Series* 3, 26 *International Legal Materials* 1541 (1987).

364 *Stockholm Convention on Persistent Organic Pollutants*, adopted 22 May 2001, in force 17 May 2004, 2256 *United Nations Treaty Series* 119, 40 *International Legal Materials* 532 (2001).

- *Convention on the Law of the Sea*, 1982[365]
- *Convention to Combat Desertification*, 1994[366]

Only three Commonwealth member countries are parties to the Convention on Long-Range Transboundary Air Pollution, 1979,[367] and the Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters, 1998 (Aarhus Convention).[368] However, states may wish to consider the standards set out in these instruments. In particular, the norms set out in the Aarhus Convention are relevant to states interested in pursuing sustainable development. This treaty recognises, among other things, the importance of protecting the environment as necessary for human well-being and the enjoyment of human rights and to protect the interest of future generations.[369] It provides rights and protections regarding access to environmental information,[370] meaningful participation in environmental decision making,[371] and rights to challenge environmental decisions in both judicial and non-judicial fora.[372]

### *Human rights standards*

In determining the adequacy of existing domestic law, states should consider their human rights obligations under customary international law and under the core UN human rights treaties discussed above.[373] They may also wish to refer to the measures proposed in the section on investors' human rights obligations,[374] which if implemented in domestic law would go some way to satisfying the international human rights law obligation to protect human rights.

### *Labour rights standards*

States' labour rights obligations include those entrenched in customary international law and the following obligations:

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365 *United Nations Convention on the Law of the Sea*, adopted 10 December 1982, in force 16 November 1994, 1833 *United Nations Treaty Series* 3, 21 *International Legal Materials* 1261 (1982).

366 *United Nations Convention to Combat Desertification in those Countries Experiencing Serious Drought and/or Desertification, Particularly in Africa*, adopted 14 October 1994, in force 26 December 1996, 1954 *United Nations Treaty Series* 3, 33 *International Legal Materials* 1332 (1994).

367 *Convention on Long-Range Transboundary Air Pollution*, adopted 13 November 1979, in force 16 March 1983, 1302 *United Nations Treaty Series* 217, 18 *International Legal Materials* 1442 (1979).

368 *Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters*, adopted 25 June 1998, in force 30 October 2001, 2161 *United Nations Treaty Series* 447, 38 *International Legal Materials* 517 (1999).

369 Ibid., preamble.

370 Ibid., Arts. 4, 5.

371 Ibid., Arts. 6, 7, 8.

372 Ibid., Art. 9.

373 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence).

374 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence).

- The ILO conventions to which states are parties;[375] and
- Other relevant international instruments, including general human rights treaties which protect labour rights to which states are parties, such as the *ICERD*, *ICCPR*, *ICESCR*, *CEDAW*, *CRC*, *ICRMW*, *CPED and CPRD*.

In addition, the labour protections put in place by states that are members of the ILO[376] should also reflect the principles of ILO Declaration on Social Justice for a Fair Globalization, 2008.[377] Together with the ILO Constitution, 1919, the Philadelphia Declaration, 1944, and the Declaration on Fundamental Principles and Rights at Work, 1998, the *Declaration on Social Justice for a Fair Globalization* provides the basis and method of implementation for the constitutional objectives of the ILO.[378] The 2008 Declaration institutionalises the Decent Work Agenda, and requires that ILO member states 'place full and productive employment and decent work at the centre of economic and social policies' pursuant to four 'inseparable, interrelated and mutually supportive' strategic objectives. These are set out in Box 6.14.

**Box 6.14 Objectives of the ILO Declaration on Social Justice for a Fair Globalization**

i. Promoting employment by creating a sustainable institutional and economic environment in which:
   - Individuals can develop and update the necessary capacities and skills they need to enable them to be productively occupied for their personal fulfilment and the common well-being;
   - All enterprises, public or private, are sustainable to enable growth and the generation of greater employment and income opportunities and prospects for all; and
   - Societies can achieve their goals of economic development, good living standards and social progress;

(Continued)

375 See, for example, the eight core ILO conventions.

376 All Commonwealth member states, except Nauru and Tonga, are members of the ILO.

377 10 June 2008, 97th Session, ILC Conference.

378 ILO, *Director General's Announcement, IGDS No. 36 (Version 1)*, 13 August 2008 at para. 2. According to Maupain, while the Declaration is not a normative instrument, it has a distinct legal nature. Although it does 'not modify or formally interpret the [ILO's] Constitution … [it] nevertheless entails important legal consequences vis-à-vis the Organization and its members … it imparts legal meaning to the concept of "decent work" within the ILO. Its unanimous adoption by all members would make it difficult – if not formally impossible – to challenge the restatement of the ILO's objectives contained therein on grounds of variance with the provisions of the Constitution or the Declaration of Philadelphia' (see F Maupain (2009), 'New Foundation or New Façade? The ILO and the 2008 Declaration on Social Justice for a Fair Globalization', 20 *European Journal of International Law* 823 at 832.

(Continued)

ii. Developing and enhancing measures of social protection – social security and labour protection – which are sustainable and adapted to national circumstances, including:

- The extension of social security to all, including measures to provide basic income to all in need of such protection, and adapting its scope and coverage to meet the new needs and uncertainties generated by the rapidity of technological, societal, demographic and economic changes;
- Healthy and safe working conditions; and
- Policies in regard to wages and earnings, hours and other conditions of work, designed to ensure a just share of the fruits of progress to all and a minimum living wage to all employed and in need of such protection;

iii. Promoting social dialogue and tripartism as the most appropriate methods for:

- Adapting the implementation of the strategic objectives to the needs and circumstances of each country;
- Translating economic development into social progress, and social progress into economic development;
- Facilitating consensus building on relevant national and international policies that impact on employment and decent work strategies and programmes; and
- Making labour law and institutions effective, including in respect of the recognition of the employment relationship, the promotion of good industrial relations and the building of effective labour inspection systems; and

iv. Respecting, promoting and realising the fundamental principles and rights at work, which are of particular significance, as both rights and enabling conditions that are necessary for the full realisation of all of the strategic objectives, noting:

- That freedom of association and the effective recognition of the right to collective bargaining are particularly important to enable the attainment of the four strategic objectives; and
- That the violation of fundamental principles and rights at work cannot be invoked or otherwise used as a legitimate comparative advantage and that labour standards should not be used for protectionist trade purposes.[379]

379 *Declaration on Social Justice for Fair Globalization*, 10 June 2008, 97th Session, ILC Conference at Section I, subsections A and B.

The *Declaration* emphasises that how states attain these objectives is a matter to be determined by each state, taking into account its international obligations and the fundamental principles and rights at work, and in light of international labour standards, a state's circumstances and priorities and the co-operation among ILO member states.[380]

*Rights of indigenous peoples*

No international instrument currently exists that specifically articulates the rights of indigenous peoples and the corresponding responsibilities of states, corporations or individuals in relation to investment. However, relevant rights and their related responsibilities can be extracted from international instruments pertaining to indigenous peoples, including the UN Declaration on the Rights of Indigenous Peoples (UNDRIP) and the ILO Convention (No. 169) Concerning Indigenous and Tribal Peoples in Independent Countries, 1989.[381] To date, 38 Commonwealth countries have endorsed the non-binding UN Declaration, while only two Commonwealth member countries are parties to the ILO Convention.

The primary concern that arises regarding IIAs from the perspective of indigenous peoples is ensuring that none of the state's obligations in relation to investors limits the state's ability to adopt and enforce laws, regulations or policies that implement its international obligations towards indigenous peoples or that secure their rights. In particular, states that have endorsed the UNDRIP have committed to protect the rights set out in Box 6.15 below, among others.

**Box 6.15 Overview of key provisions of the *United Nations Declaration on the Rights of Indigenous Peoples***

- The right to the full enjoyment, as a collective or individuals of all human rights and fundamental freedoms recognised in the UN Charter, the Universal Declaration on Human Rights and international human rights law (Article 1);
- The right to be free from discrimination (Article 2);
- The right to self-determination (Article 3);
- The right to autonomy or self-government in matters relating to their internal and local affairs (Article 4);
- The right to life, physical and mental integrity, liberty and security of the person and the right not to be subjected to any act of genocide or violence (Article 7);

(Continued)

380 Ibid. at Section I, subsection C.

381 *Convention (No. 169) concerning Indigenous and Tribal Peoples in Independent Countries*, adopted 27 June 1989, 7 in force 5 September 1991.

(Continued)

- The right not to be forcibly removed from their lands or territories or relocated without free, prior and informed consent (Article 10);
- The right to restitution of cultural, intellectual, religious and spiritual property taken without their free and informed consent (Article 11);
- The right to practice and revitalise their cultural traditions and customs, including maintaining and protecting past, present and future archaeological and historical sites, artefacts, designs, ceremonies, technologies, visual and performing arts and literature (Article 11);
- The labour rights established in international and national law (Article 17);
- The right to full participation at all levels of decision making in matters that affect them and their rights and to good faith consultation to obtain their free prior and informed consent before adoption and implementation of laws and administrative measures that may affect them (Articles 18 and 19);
- The right to develop their political, economic and social systems or institutions, to be secure in the enjoyment of their own means of subsistence and development, and to engage freely in all their traditional and other economic activities (Article 20);
- The right to determine, develop and administer health, housing and other economic and social programmes affecting them (Article 23);
- The right to protection of traditional medicines and health practices, including the protection of vital medicinal plants, animals and minerals, to access to all social and health services and to the highest standard of physical and mental health (Article 24);
- The right to own, use, develop and control the lands they have traditionally owned or otherwise occupied or used (Article 26);
- The right to conservation and protection of the environment and the productive capacity of their lands or territories and resources (Article 29);
- The right to maintain, control and protect their cultural heritage, traditional knowledge, traditional cultural expressions and their intellectual property over such cultural heritage, traditional knowledge and traditional cultural expressions (Article 31);
- The right to determine and develop priorities and strategies for the development or use of their lands or territories and other resources, and the right to free and informed consent prior to the approval of projects affecting their lands, territories and other resources (Article 32);
- The right to recognition, observance and enforcement of treaties, agreements and other arrangements between states and indigenous peoples (Article 37); and
- The right to access financial and technical assistance in the realisation of these rights (Article 39).

States should be aware that laws, regulations and policies relating to investors and their investments have the potential to affect indigenous populations in their territory. As discussed in the section on investor human rights obligations,[382] states have a duty under international law to seek the free, prior and informed consent of indigenous peoples in certain limited circumstances.[383] These situations include the following:

- Where proposals to remove indigenous communities from their lands and territories are being considered;[384]
- Where the storage and disposal of hazardous waste on indigenous territory is being contemplated;[385]
- Cases where large-scale projects may have a significant impact within indigenous territory.[386]

In all other situations states have, at a minimum, an obligation to consult indigenous peoples. According to the Inter-American Court of Human Rights such consultation must meet the following criteria:

- Be undertaken in good faith;
- Be pursued through culturally appropriate procedures;
- Be undertaken in accordance with the traditions of the particular indigenous group;
- Have the goal of reaching an agreement;
- Provide clear information to the indigenous group of the possible risks of a particular development or investment plan; and
- Result in a plan that is accepted by the indigenous group knowingly and voluntarily.[387]

Moreover, the state should require an independent environmental and social impact assessment and guarantee reasonable benefit sharing[388] where this is appropriate, such as in situations of resource exploration and/or extraction on indigenous lands.

Where investment activity could negatively affect the property rights of indigenous peoples, there is an emerging obligation on states to seek the consent of the indigenous community in question for this activity. In situations where consent is not given, 'there is a strong presumption that the project should not go forward'.[389] If the investment is

382 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence).
383 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence).
384 Perrault et al., op. cit., at 491; Anaya, op. cit., at 17.
385 Perrault et al., ibid. UNDRIP, Art. 29 (2): 'States shall take effective measures to ensure that no storage or disposal of hazardous materials shall take place in the lands or territories of indigenous peoples without their free, prior and informed consent'.
386 *Saramaka v. Suriname*, op. cit., at para. 134.
387 Ibid. at para. 133.
388 Ibid. at para. 129.
389 Anaya, op. cit., at 17.

pursued, the state must take steps to ensure that the indigenous group in question benefits from the investment and it must also take effective measures to mitigate any negative effects.[390] States may also wish to provide a further level of protection to indigenous peoples by requiring that their free and informed consent be obtained before the state enacts any laws or regulations in regard to foreign investment that may affect such groups.

The relationship between foreign investment and sustainable development is discussed earlier in the Guide.[391] For foreign investment to promote sustainable development or even economic development, the inhabitants of the host state must be able to reap some of its benefits. Creating a strong, transparent, rights-protective regulatory framework addressing these important policy areas would help to ensure that investors and their investments make a positive contribution to sustainable development in a host state. It would also better protect the rights of individuals and groups, as well as the host state's environment. States that enact and enforce such laws will contribute substantially to these goals.

4. *Integrate into an IIA the obligation on states to enact and enforce legislation to protect human rights, labour rights, indigenous peoples' rights and the environment, and to address bribery and corruption*

There are a variety of different approaches that could be used in IIAs to promote conformity with international obligations relating to human rights, labour rights, indigenous peoples' rights, environmental protection and anti-corruption standards that impose varying levels of obligation on party states. These approaches were discussed above in relation to human rights, labour rights, anti-corruption and environmental standards and are summarised here.[392]

**Language in the preamble:** The parties could negotiate a general statement in the preamble clarifying that the IIA is to be interpreted in accordance with the parties' international obligations in identified non-investment policy areas. States would want to ensure that in the preamble, human rights, labour rights, indigenous peoples' rights and environmental protection, as well as anti-corruption measures, are described as having the same level of importance as the investor protections included in an IIA. This would ensure that in interpreting the treaty, these norms are not subordinated to investment protection considerations. States that are serious about protecting these areas of policy concern, however, should incorporate other provisions addressing these issues in addition to such language in the preamble since statements in a preamble do not create binding obligations.[393]

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390 Ibid.

391 See Section 2.3 (Links between foreign investment and sustainable development).

392 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence), Section 6.9 (Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights), Section 6.10 (Investor obligation to comply with core labour standards), Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption) and Section 6.12 (Other rights and obligations of party states).

393 It would also be useful to include statements according priority to these policy objectives in a statement of objectives of the agreement. See Section 4.4 (Statement of objectives).

**Provisions in the body of the treaty or side agreement to address the problem of a 'race to the bottom':** States could negotiate provisions in an IIA or in a side agreement that:

- Reaffirm their commitments under international human rights, labour rights, indigenous peoples' rights treaties and other instruments, environmental protection treaties and anti-corruption conventions;
- Establish obligations not to relax domestic laws and regulations for the purpose or attracting or retaining investment, and not to fail to enforce domestic standards;
- Establish an obligation on the parties to strive to maintain high levels of human rights, labour rights, indigenous peoples' rights protection, environmental protection and robust anti-corruption laws, and require parties to strive to improve such standards.

States may prefer to adopt the approach of the EC–CARIFORUM EPA for the latter type of provision. As discussed in the subsection on IIA practice, the EPA qualifies the obligation to establish high levels of domestic protection and to strive to improve such standards by recognising the right of the parties to enact regulation to achieve their own domestic health and environmental standards and sustainable development priorities and to adopt and modify such standards and priorities.[394]

*These types of provisions are increasingly used.* The provisions described above are becoming more common in relation to labour and environmental protection standards.

*These provisions offer flexibility*. Under these types of provisions, states have significant flexibility. The provisions do not require states to bring their domestic laws into compliance with international standards and there is no obligation to raise the level of domestic protection; only a requirement *to strive* to do so.

*There is a risk of investor challenge for states seeking to strengthen their domestic laws*. A key shortcoming of these provisions, of which states should be aware, is that they do not directly protect states that introduce new or amended domestic laws from an investor challenge under an IIA. An investor might claim that the introduction or amendment of domestic laws or regulations is a breach of its legitimate expectations under an FET provision.[395] The risk of such a claim is small, however. It would be hard for an investor to claim that it did not expect a state to act pursuant to the provision expressed in the treaty. This problem could be addressed more directly by introducing a general exception and/or a provision that excluded measures in these areas from the obligations of the treaty.[396]

*A party could potentially use state-to-state dispute resolution to enforce these provisions against another party*. Where the provision is included in the body of the treaty, such as the obligation not to fail to enforce certain domestic laws, a party could potentially

394 EC–CARIFORUM EPA (2008), Art. 184.1.

395 See Section 5.5 (Fair and equitable treatment and the minimum standard of treatment).

396 See Section 5.6 (Limitations on expropriation and nationalisation); and Section 5.12 (Reservations and exceptions).

use the state-to-state dispute settlement process[397] to pressure another party to comply with such obligations. States may see this as a violation of their sovereignty and may not want to create obligations that would allow the IIA to become an indirect mechanism for enforcing standards in complex and sensitive areas such as human rights protection.

One way to deal with this problem is to specifically exclude such obligations from enforcement under the state-to-state dispute settlement process.[398] Another approach, which is the approach used in some US FTAs with respect to labour rights, is to include a provision clarifying and limiting the scope of a party's obligations:

> … each Party retains the right to exercise discretion with respect to investigatory, prosecutorial, regulatory, and compliance matters and to make decisions regarding the allocation of resources to enforcement with respect to other labour matters determined to have higher priorities. Accordingly, the Parties understand that a Party is in compliance with [the obligation not to persistently fail to enforce its labour laws] where a course of action or inaction reflects a reasonable exercise of such discretion, or results from a *bona fide* decision regarding allocation of resources.[399]

Such a provision would probably make it difficult to find a state in breach of its obligation not to persistently fail to enforce its domestic laws in a particular policy area.

**Compliance provisions:** There are a number of options available for states that do wish to provide for some form of mechanism in an IIA to encourage parties to enforce their domestic laws, even if they do not agree to state-to-state dispute settlement in connection with their obligations. Two of these are considered below.

*Complaint mechanism and enforcement mechanism to encourage states to enforce domestic law.* Parties to an IIA could negotiate provisions that provide for a means to receive complaints about non-enforcement of domestic laws and provide a consultative procedure for states to deal with a party's persistent pattern of non-enforcement of human rights, labour rights or indigenous peoples' rights, or environmental or anti-corruption laws.

The *North American Agreement on Labour Cooperation* (NAALC) provides an example of this type of soft enforcement mechanism. Complaints under NAALC regarding non-enforcement of a party state's labour laws are initially dealt with through consultations between National Administrative Offices (NAOs)[400] or government ministers.[401] Where the matter is not resolved through ministerial consultations, a party state may request that an Evaluation Committee of Experts (ECE) be created

397 The Guide provides a discussion of state-to-state dispute settlement. See Section 7.2 (State-to-state dispute settlement).
398 See Section 7.2 (State-to-state dispute settlement).
399 US–Singapore FTA (2003), Art. 17.2(b).
400 *NAALC* (1994), Art. 21.
401 *NAALC* (1994), Art. 22.

to investigate and report on the matter.[402] This latter procedure is restricted to non-enforcement of occupational health and safety laws and 'other technical labor standards'[403] that are trade related and recognised in the laws of both states.[404] Where the issue concerns an 'alleged persistent pattern' of failure to enforce 'occupational health and safety, child labor or minimum wage technical standards' that is not resolved by the ECE, recommendations can, in principle, lead to the creation of an arbitral panel and sanctions, but this is by no means automatic and has never been done.[405]

This type of mechanism has not been very effective in ensuring that states comply with their domestic standards and does not prevent a 'race to the bottom' of labour and environmental standards.[406] Its advantage is that it provides a means for public participation by allowing members of the public to bring complaints and thus to exert some pressure on governments to enforce their domestic laws against foreign investors as well as domestic businesses.

*Ministerial consultations*. Another weaker option is simply to provide for issues of persistent non-enforcement of domestic laws to be addressed through ministerial consultations co-ordinated by a body established by the IIA.[407]

**Exceptions for measures related to human rights, labour rights, indigenous peoples' rights, anti-corruption and environmental protection:** Including an exception for regulatory measures relating to human rights, labour rights, indigenous peoples' rights, anti-corruption and environmental protection would provide a clear expression of the intention of the parties to remove these areas of regulation from the application of the investor protections under an IIA. This means that the host state would retain the flexibility to introduce new regulatory measures or to strengthen existing ones without breaching its investor protection obligations. The advantages and drawbacks

402 *NAALC* (1994), Art. 23(1).
403 *NAALC* (1994), Art. 23(2).
404 *NAALC* (1994), Art. 23(3)(1).
405 See *NAALC* (1994), Arts. 28, 29. Under Art. 29(1) an arbitral panel can be convened by written request of a party state to the Council of the Commission for Labor Cooperation and following a two-thirds vote in the Council in favour of such action.
406 Bernasconi-Osterwalder and Johnson, op. cit., at 27. See also Maquila Solidarity Network (2004), 'NAFTA Ten Years Later: Why the Labour Side Agreement Doesn't Work for Workers', 1 January, available at: http://en.maquilasolidarity.org/issues/trade/nafta/naalc/critique?SESS89c5db41a82abcd7da7c9ac60e04ca5f=unvlgtie, which states that in 2004: 'After 10 years of NAFTA, not one of the 28 complaints made under the NAALC has resulted in any significant improvements in labour law enforcement or in workers' lives. This is not the rosy future Mexican workers were promised by NAFTA's signatories'. On the NAAEC, see L J Allen (2012), 'The North American Agreement on Environmental Cooperation: Has It Fulfilled Its Promises and Potential? An Empirical Study of Policy', 23 *Colorado Journal of International Environmental Law and Policy* 122 at 190, noting that the Commission on Environmental Cooperation 'has been the most effective in facilitating cooperation between the three NAFTA countries, somewhat less effective in improving the enforcement of environmental laws through the citizen submission process, minimally effective in undertaking independent reporting of environmental issues of regional significance, and not effective in integrating trade and environment in support of the goals of NAFTA'.
407 See Section 9.2 (Commission).

of using exceptions to carve out certain areas of regulation from the purview of an IIA are discussed in detail in the section above on reservations and exceptions.[408]

**Provisions excluding from indirect expropriation regulation to promote or protect on human rights, labour rights, indigenous peoples' rights, for environmental protection or to address corruption measures:** These kinds of provisions are an important tool for states in protecting their right to regulate. In removing certain areas of regulation from being considered indirect expropriation, states preserve their policy space and protect themselves from having to compensate investors for introducing new laws and regulations or strengthening existing ones. Approaches to preserving regulatory space in the drafting of substantive investor protection provisions in an IIA are discussed in the sections above on investor protections.[409]

**Provisions recommending that the parties encourage investors to comply with voluntary CSR standards:** These types of provisions recognise the need for investors to operate in a socially responsible manner. On the other hand, they do not require states to implement and enforce laws on CSR. Nor do they require investors to comport themselves in a manner consistent with international CSR standards. On the contrary, investors are left to self-regulate. As discussed in the section on investor human rights obligations,[410] voluntary self-regulation has not consistently prevented investors from violating human rights. Nor has it ensured that investors comply with internationally accepted CSR standards, such as the *OECD Guidelines* or the *Global Compact*.[411]

**Obligations on states to co-operate to ensure that investors do not circumvent compliance with international human rights, labour rights, indigenous peoples' rights, international environmental protection obligations and anti-corruption obligations:** This type of provision has been discussed above in the sections on core labour standards,[412] bribery and corruption,[413] and in the subsection on IIA practice in relation to provisions on environmental protection. The EC–CARIFORUM EPA includes such a provision.

*It harnesses home state regulatory capacity and co-operation in regulating investor conduct*. This option can assist states in addressing some of the difficulties in regulating the behaviour of foreign investors by requiring investors' home state to take domestic measures *to complement* actions by the host state to ensure that investors do not evade compliance with identified international norms consistent with the parties' international obligations. It also requires each party to co-operate with the other by providing assistance with the party's enforcement efforts.

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408 See Section 5.12 (Reservations and exceptions).

409 E.g. Section 5.6 (Limitations on expropriation and nationalisation).

410 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence).

411 See Simons and Macklin, op. cit.

412 See Section 6.10 (Investor obligation to comply with core labour standards).

413 See Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).

*There is a risk of investor challenge under an IIA.* A limitation of this approach is that it does not directly avoid the problem for states that wish to introduce more rigorous domestic laws to promote sustainable development of having such measures challenged by an investor in investment arbitration. As noted above, an investor might claim that the introduction or amendment of domestic laws or regulations is a breach of their legitimate expectations under an FET provision.[414] It would be difficult, however, for an investor to claim that it did not expect a state to act pursuant to the provision expressed in the treaty. This problem could be addressed more directly through a general exception and/or a provision that excluded measures in these areas from the obligations in the treaty.[415] In addition, states could negotiate qualifications to the national treatment, MFN, fair and equitable treatment and other investor protection standards, such as those discussed in the Guide.[416]

### 6.12.3 Summary

As discussed at the beginning of this section, in light of the political sensitivity of these types of provisions, the Guide does not provide a sample provision imposing obligations on party states relating to the implementation and enforcement of minimum standards for human rights, labour rights, indigenous peoples' rights, and environmental protection and standards to address corruption. States will have varying views on the extent to which provisions of this kind are desirable and what form they should take. States' views may also depend on the context in which an IIA is being negotiated. Each state must determine for itself, based on its own particular circumstances and taking into account the costs and benefits of the various options described above, whether it wishes to include provisions in an IIA regarding these areas of regulation and, if so, whether they should be made subject to dispute settlement under the treaty.

However, because these types of provisions can be useful from a sustainable development perspective, some states may wish to incorporate a minimum standards provision into an IIA. The subsection on IIA practice, above, considers a range of different ways in which states have included language or minimum standard obligations on environmental protection. These, and similar provisions on labour rights and anti-corruption measures discussed in earlier sections,[417] can provide guidance for states on the development of more comprehensive minimum standards obligations. In particular, the EC–CARIFORUM EPA provides a useful example of a minimum standards provision that provides states with leeway to enact environmental standards appropriate to their level of development.[418] It also establishes an obligation for party states to co-operate to ensure investor compliance with domestic labour,

414 See Section 5.5 (Fair and equitable treatment and the minimum standard of treatment).

415 See Section 5.6 (Limitations on expropriation and nationalisation); and Section 5.12 (Reservations and exceptions).

416 See Section 5.3 (National treatment); Section 5.4 (Most favoured nation); Section 5.5 (Fair and equitable treatment and the minimum standard of treatment).

417 See Section 6.10 (Investor obligation to comply with core labour standards); and Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).

418 EC–CARIFORUM EPA, Art. 184.1.

environmental and anti-corruption laws.[419] States could adapt this latter provision to address a wider range of concerns such as human rights and indigenous peoples' rights. It is possible to avoid the concern that the IIA could be used as a general mechanism for enforcing domestic law in these sensitive policy areas. Any minimum standards provision could be specifically excluded from enforcement under the state-to-state dispute settlement process.[420]

## 6.13 Enforcement of investor obligations

Many developing country host states face significant challenges in seeking to regulate the activities of foreign investors.[421] This lack of capacity can create a governance gap that undermines the achievement of sustainable development generally. As a result of this gap, investors may remain unaccountable for corrupt practices, for acts that violate human and labour rights or the rights of indigenous peoples or for damage to the environment. Those injured by the acts of investors may be without an effective means of redress.

Few IIAs contain investor obligations or enforcement mechanisms for such obligations. In order to deal with this issue, the Guide includes a variety of sample provisions that provide examples of enforcement mechanisms that correspond to the standards to be met by investors set out in the investor obligation sections above. These sample provisions are designed to ensure investor compliance with IIA obligations and support host states' efforts to regulate them. They include the following:

- Criminal sanctions;
- A grievance procedure;
- A process to deal with non-compliance with a management plan produced as result of a sustainability assessment;
- Civil liability; and
- Counterclaims by states in investor–state arbitration.

Developed states and some developing states have the power, resources and legal capacity to exercise some form of oversight over the transnational activities of their investors. Accordingly, the sample provisions in this section oblige investors' home states to provide for criminal and civil enforcement in their domestic courts of treaty standards in relation to the extraterritorial activities of their investors.[422] These enforcement mechanisms supplement the domestic enforcement mechanisms in the host state.

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419 EC–CARIFORUM EPA, Art. 72 (a)-(c).

420 See Section 7.2 (State-to-state dispute settlement) for discussion of the costs and benefits of excluding certain provisions from the state-to-state dispute settlement process.

421 See M Ssenyonjo (2007), 'Non-State Actors and Economic, Social and Cultural Rights', in M A Baderin and R McCorquodale (eds), *Economic, Social and Cultural Rights in Action*, Oxford University Press, Oxford, 109 at 121–2, who notes that 'states where protection of human rights against violations by [non-state actors] is most needed are often those least able to enforce them against [non-state actors] such as international financial institutions and TNCs – the main driving agents of the global economy, exercising control over global trade, investment and technology transfers – who possess much desired investment capital or technology'.

422 See Section 6.14 (Criminal sanctions); and Section 6.16 (Civil liability of investors).

Other sample provisions in this section require party states to put in place grievance and compliance procedures to support compliance with the sustainability assessment process discussed in Section 6.6 (Sustainability assessments) and the obligation to respect human rights and conduct human rights due diligence discussed in Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence).[423] Finally, states that are the subject of investor claims in investor–state arbitration may counterclaim against investors for injuries suffered as a consequence of the investor not complying with its obligations under the agreement.[424]

The particular scope of these enforcement obligations will be defined by which investor obligations states decide to include in their investment treaties. If all the investor obligations contained in the Guide's sample provisions are not included in an IIA, then the sample provisions on enforcement would have to be adjusted accordingly.

The enforcement mechanisms, like the standards for investors themselves, are novel and untested. They may be onerous for particular states to implement. Because they impose enforcement commitments on investors' home states, they may be especially difficult to negotiate. Further, because they are designed to make investor obligations more effective, they may have the effect of deterring some investment.

On the other hand, including these types of enforcement mechanisms in an IIA will assist the host state in ensuring that foreign investment under the treaty supports sustainable development. Each state must therefore weigh the potential costs and benefits of such provisions, taking into consideration its particular circumstances, and determine whether the enforcement mechanisms discussed are appropriate and, if so, whether they should simply be incorporated into domestic law and/or included in a treaty. If states include these enforcement provisions in an IIA, they will have to decide whether these provisions should be subject to the state-to-state dispute settlement mechanism. The costs and benefits of such a decision are considered below in the section on state-to-state dispute settlement.[425]

## 6.14 Criminal sanctions

### Cross references


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| Section 6.2 | The challenges of regulating foreign investors and holding transnational corporations accountable | 254 |
| Section 6.3 | Different approaches to integrating foreign investment and sustainable development | 257 |
| Section 6.8 | Investor obligation to respect internationally recognised human rights and undertake human rights due diligence | 294 |
| Section 6.9 | Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights | 316 |


423 See Section 6.15 (Grievance procedure and other measures to enforce the management plan produced in the sustainability assessment).

424 See Sections 6.17 (Counterclaims by states in investor–state arbitration) and 7.1.7 (Sample provisions: investor–state dispute settlement, Article [W] (Counterclaims)).

425 See Section 7.2 (State-to-state dispute settlement).

The obligations on investors not to commit or be complicit in grave violations of human rights or to engage in acts of corruption, including bribery, may be supported by corresponding duties on states to criminalise and prosecute such actions. All states have jurisdiction under international law to prosecute those who have committed war crimes, crimes against humanity or genocide. States that have ratified the UN *Convention against Torture* are obliged to criminalise torture and to extradite or prosecute individuals suspected of committing acts of torture.[426] States have obligations under other international human rights treaties to protect human rights. As discussed above,[427] states must therefore exercise due diligence to prevent, and take action with respect to, violations of human rights committed by private actors. States must, in addition to implementing legislative and administrative measures, investigate and prosecute private actors that commit grave violations of human rights that constitute crimes.

In relation to corruption, including bribery, the UN, African Union and Inter-American conventions require party states to establish criminal liability for domestic acts of corruption.[428] In addition, the UN, African Union, OECD and Inter-American conventions require home states to establish criminal liability for acts of bribery of a foreign public official.[429] The UN and OECD treaties specifically oblige states to establish liability for acts committed by both natural and legal persons and require the imposition of effective, appropriate criminal penalties.[430] In addition, the UN convention requires states to impose criminal sanctions for other acts of corruption, including trading in influence, abuse of function, money laundering, concealment

426 *CAT*, Arts. 4 and 7.

427 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence).

428 See *UN Convention against Corruption*, Art. 15; *AU Convention on Preventing and Combatting Corruption*, Art. 5(1). The AU Convention only requires parties to establish 'offences' but does not specify criminal offences and thus could include administrative offences.

429 *UN Convention against Corruption*, Art. 16; *OECD Anti-Bribery Convention*, Art. 1; and the *AU Convention on Preventing and Combatting Corruption*, Arts. 5(1), 13; and *Inter-American Convention against Corruption*, Art. 8. Note that the *UN Convention against Corruption* and *Inter-American Convention against Corruption* only permit but do not require states to assume jurisdiction over acts of their nationals committed outside their territories. See *UN Convention against Corruption*, Art. 42(2)(b); and the *Inter-American Convention against Corruption* Art. 5(2). However, both conventions require states to assume jurisdiction where an alleged offender is present in their territory and the state does not extradite that person to another country because he/she is a national.

430 *UN Convention against Corruption*, Arts. 26, 30; *OECD Anti-Bribery Convention*, Arts. 2, 3.

and obstruction of justice.[431] Finally, all of these treaties mandate co-operation between the party states in the investigation and prosecution of the proscribed acts of corruption.[432]

Grave violations of human rights and bribery and corruption by foreign investors are a transnational issue. To date, home states have not taken effective steps to regulate the transnational activity of their investors with respect to human rights.[433] However, as noted above, they have been relatively more diligent in prosecuting bribery and corruption pursuant to their international treaty obligations.[434]

### 6.14.1 IIA practice

No existing IIA includes an obligation on the parties to prosecute grave violations of human rights and few IIAs specifically oblige parties to prosecute corruption. As discussed above,[435] the EU–Korea FTA obliges party states to adopt or maintain appropriate measures to prohibit and punish bribery and corruption in the pharmaceutical and health care sectors.[436] Also, the EC–CARIFORUM EPA requires the parties to implement their international obligations, including those under the *UN Convention against Corruption*, and to co-operate and take domestic measures, including legislation, to prohibit and punish bribery or corruption.[437] It also obliges states to co-operate and take measures domestically to prevent investors from circumventing labour obligations arising from the international obligations of the parties,[438] including the prohibition against forced labour, which is a *jus cogens* norm.

The IISD model treaty includes a provision requiring the party states to impose criminal sanctions for acts of bribery and other forms of corruption and for complicity in such acts.[439] In addition, it requires investors' home states to ensure that fiscal and

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431 Ibid., Arts. 18, 19, 23–5. See also the *Inter-American Convention against Corruption* and the *AU Convention on Preventing and Combatting Corruption*, which cover certain other acts of corruption.

432 *Inter-American Convention against Corruption*, Art. 16; *AU Convention on Preventing and Combatting Corruption*, Arts. 18, 19; *UN Convention against Corruption*, Arts. 37, 38; and *OECD Anti-Bribery Convention*, Art. 9.

433 To date no state has enacted specific legislation directly regulating the human rights impacts of transnational corporate actors (see P Simons (2012), 'International Law's Invisible Hand and the Future of Corporate Accountability for Human Rights', 3 *Journal of Human Rights and the Environment* 5 at 31). A number of legislatures have considered such legislation. The most recent attempt was the Canadian Bill C-300, dubbed the 'Responsible Mining Bill', that survived to its third reading, but it was defeated by six votes on 27 October 2010. Had it been enacted it would have imposed obligations on Canadian extractive corporations to comply with certain human rights and environmental standards when operating in developing countries (see Bill C-300, *An Act Respecting Corporate Accountability for the Activities of Mining, Oil or Gas in Developing Countries*, 3rd Sess, 40th Parl, 2010–11).

434 See 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).

435 See Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).

436 EU–Korea FTA (2009), Annex 2-D, Art. 4.

437 EC–CARIFORUM EPA (2008), Arts. 72, 172.

438 EC–CARIFORUM EPA (2008), Art. 72(b)(c).

439 IISD model treaty, Arts. 22, 32.

tax laws, regulations and policies do not allow investors to recover or deduct monies paid or benefits given as bribes or obtained through other forms of corruption.[440]

**Box 6.16 Summary of options for criminal sanctions against bribery and corruption and grave violations of human rights**

1. *Do not provide sanctions against bribery and corruption or grave violations of human rights*
2. *Use existing domestic criminal law to address bribery and corruption or grave violations of human rights*
3. *Develop domestic laws and regulations that provide more effective criminal sanctions for bribery and corruption and grave violations of human rights*
4. *Integrate into an IIA an obligation on states to co-operate and to provide for criminal enforcement of prohibitions on bribery and corruption and grave violations of human rights and to co-operate with respect to enforcement*

### 6.14.2 Discussion of options

1. *Do not provide sanctions against bribery and corruption or grave violations of human rights*

**States may be in breach of their international obligations:** States that do not have effective laws and institutions in place to prohibit and prosecute grave violations of human rights or bribery and other forms of corruption will be in violation of their international human rights obligations and their obligations under the anti-corruption treaties to which they are parties. As noted above, the international human rights obligation to protect requires states not only to take legislative and administrative measures to ensure that private actors, including investors, do not violate the human rights of others, but also to investigate and punish such violations. Equally, the UN and OECD conventions require states to introduce appropriate criminal sanctions and to investigate and punish actors that engage in corruption.

**This may deter investment:** Empirical studies have shown that corruption deters investment. Investors prefer to invest in states with stable, transparent regulatory environments. Creating a robust legislative framework to impose criminal sanctions on those actors that engage in grave violations of human rights or corruption sends a clear signal to investors that the host state supports the rule of law.

2. *Use existing domestic criminal law to address bribery and corruption or grave violations of human rights*

There are costs and benefits to using existing domestic laws to sanction these acts.

440 IISD model treaty, Art. 32(B).

**It is a low-cost option:** Using existing law may be attractive to states, as they will not have to develop new laws or institutions to sanction bribery and corruption or grave violations of human rights. Enforcement resources may be limited. However, even though a state has international obligations in these areas, in some cases its existing laws may not be well adapted to address bribery and corruption or grave violations of human rights.

**It may be difficult to prosecute foreign investors:** As discussed above,[441] all states can face difficulties in enforcing domestic law against powerful foreign investors. These entities are often able to restructure to avoid liability or to transfer assets outside the host state to avoid criminal fines.

3. *Develop domestic laws and regulations that provide more effective criminal sanctions for bribery and corruption and grave violations of human rights*

**It is costly to develop a regulatory framework:** A potential disadvantage of this option is the cost. States would need to dedicate resources to developing robust criminal law sanctions, enforcement mechanisms and institutions to meet their international obligations.

**It may be difficult to prosecute foreign investors:** Even where states have robust criminal laws and institutions in place, they may still face challenges in enforcing such laws against foreign investors, particularly powerful transnational business actors.

**It implements states' international obligations and supports sustainable development:** On the positive side, creating strong criminal sanctions and institutions to deal with grave violations of human rights and corruption brings states into compliance with their international obligations. It would also help to ensure that investors and their investments support sustainable development in a host state.

**It may decrease the costs of doing business:** Another potential benefit of introducing criminal sanctions is that it may deter bribery and other corrupt activities. This will increase transparency and predictability in commercial transactions and dealings with government. Having robust anti-corruption laws can potentially decrease the cost of doing business for both domestic and foreign businesses.

**It attracts investment and in particular socially responsible investment:** Studies have shown that corruption deters investment. It may also be true that incidents of egregious violations of human rights that go unpunished will deter investment. Establishing and enforcing criminal laws targeting corruption and grave violations of human rights indicates to socially responsible investors and investors wishing to maintain their global reputations that the state has a stable, transparent, rights-protective and lower-risk regulatory environment in which to conduct business.

**It helps manage corporate risk:** As discussed above,[442] in many situations investors can be prosecuted under the laws of their home states for engaging in bribery or other

441 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence).

442 See Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).

forms of corruption in other states. Many states also have laws in place to prosecute investors for extraterritorial commission of or complicity in egregious human rights abuses.[443] Operating in a state that prosecutes such activities can reduce the incidence of such crimes and decrease the risk that investors will get caught up in corrupt or human rights-violating behaviour. This also means that investors will be less likely to be the subject of NGO campaigns and that institutional investors, concerned about the behaviour of the businesses in which they invest, will be less likely to withdraw their investments.

4. *Integrate into an IIA an obligation on states to provide for criminal enforcement of prohibitions on bribery and corruption and grave violations of human rights and to co-operate with respect to enforcement*

The potential costs and benefits of integrating into an IIA an obligation on states to criminalise such behaviour and prosecute investors engaged in such activities are similar to those identified above with respect to incorporating the obligation into domestic law.

There are, however, other significant benefits to including such a provision in an IIA, rather than simply relying on existing domestic laws or introducing more stringent anti-corruption legislation and other measures.

**Host state criminal enforcement is complemented by criminal enforcement in the investor's home state and by state co-operation:** Perhaps the most important benefit of including such a provision in an IIA is that it requires *both* parties, home and host state, to create criminal sanctions and to co-operate with respect to their enforcement. Home state actions would complement and supplement host state efforts to investigate and prosecute this type of behaviour. Home state assistance and home state prosecution will help to address some of the difficulties faced by host states in holding foreign investors accountable for egregious acts.

**Supported by other treaty-based enforcement mechanisms:** Criminal sanctions for investor complicity in bribery and corruption and grave violations of human rights criminal liability of investors, whether required in an IIA or not, can be complemented by several other kinds of IIA enforcement commitments that are discussed below. One is a grievance procedure that has the potential to produce information that could provide the basis for a criminal investigation.[444] The sample provisions also provide an example of a requirement for both parties to establish civil liability for, among other things, harms arising from grave abuses of human rights and corrupt activities.[445] Criminal responsibility can also be complemented by a

443 Ramasastry and Thompson, op. cit.

444 See Section 6.15 (Grievance procedure and other measures to enforce the management plan produced in the sustainability assessment).

445 See Section 6.16 (Civil liability of investors).

counterclaim mechanism, which allows host states to counterclaim in investor–state proceedings where the investor has violated its obligations under the treaty.[446]

Including an obligation to provide for criminal enforcement in an IIA also means that, unless excluded from state-to-state dispute settlement, one state could initiate this process for the purpose of ensuring that the other state was in compliance with its enforcement obligations. Access to such a process may assist host states to have home states act on their commitments with respect to enforcement. It could also be used by home states to put pressure on host states to take more rigorous enforcement action.

### 6.14.3 Discussion of sample provision

The aim of the Guide sample provision is to require party states to criminalise and punish grave abuses of human rights and corruption. The sample provision obliges party states to impose criminal sanctions on:

- Investors to punish them for committing, or being complicit in, grave violations of human rights and corruption, including bribery;
- Public officials for soliciting bribes or other undue advantage for the purpose of performing or not performing an official duty, or for the purpose of using influence to obtain a favour, licence or other undue advantage in order to obtain or retain an investment; and
- Investors for complicity in such acts of corruption by a public official.

**Requires effective and dissuasive enforcements and sanctions:** The sample provision also obliges parties to implement appropriate enforcement measures and sanctions for these acts.

**Targets both legal and natural persons:** Concerns have been raised by the OECD Working Group on Bribery regarding the lack of liability of *legal* persons for acts of bribery in domestic legal systems, which, as mentioned above,[447] is required by both the OECD and UN conventions.[448] Accordingly, the Guide sample provision specifically provides for the criminal liability of legal persons for acts of bribery and corruption and, drawing on the language of the UN Convention, provides for the prosecution of natural and legal persons for the same act.

**Requires parties to make every effort to prosecute:** The provision imposes a 'best endeavours' obligation on parties to prosecute grave violations of human rights and corrupt activities related to investment in order to encourage state action on these commitments.

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446 See Sections 6.17 (Counterclaims by states in investor–state arbitration) and 7.1.7 (Sample provisions: investor–state dispute settlement, Article [W] (Counterclaims)).

447 See Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).

448 OECD (2008), 'OECD Working Group on Bribery Annual Report 2007', available at: www.oecd.org/dataoecd/21/15/40896091.pdf (accessed 8 January 2013).

**Obligates parties to co-operate in enforcement:** Finally, the sample provision requires states to co-operate with each other in the enforcement of criminal laws prohibiting investors from committing, or being complicit, in grave violations of human rights and acts of bribery or corruption.

### 6.14.4 Sample provision: obligation to provide criminal offences, enforcement and sanctions for grave violations of human rights and corruption

#### Obligation to Provide Criminal Offences, Enforcement and Sanctions for Grave Violations of Human Rights and Corruption

1. Each Party shall make it a criminal offence:
    a. For an investor of the other Party or its investment to violate the obligations set out in [Guide sample provision in Section 6.9 (Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights)] and [Guide sample provision in Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption)];
    b. For a public official to solicit or accept any pecuniary or other undue advantage, directly or indirectly, whether on his or her own behalf or on behalf of a third party, in order that the official or third party perform or refrain from performing an official duty or use his or her influence for the purpose of obtaining or retaining for the investor or investment
        i. a favour in relation to a proposed or actual investment,
        ii. a licence, permit, contract, or other rights in relation to a proposed or actual investment, or
        iii. any other business or other undue advantage in relation to such investment;
    c. For an investor or its investment to be complicit in any act described in subsection b., including incitement, aiding and abetting, conspiracy to commit or authorisation of such an act.
2. The offences created under Section 1, whether committed by a natural person or an enterprise or both, shall include provision for appropriate, effective, proportionate and dissuasive criminal enforcement of and sanctions for commission of those offences.
3. The criminal liability of enterprises in relation to the offences created under Section 1 shall be without prejudice to the criminal liability of the natural persons who have committed an offence.
4. Each Party shall make every effort to prosecute the offences created under Section 1 in accordance with its domestic law.
5. Each Party shall co-operate with the other Party in measures taken by the other Party to enforce the criminal offences created under Section 1.

## 6.15 Grievance procedure and other measures to enforce the management plan produced in the sustainability assessment

### Cross references


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| Section 2.3 | Links between foreign investment and sustainable development | 18 |
| Section 6.6 | Sustainability assessments | 267 |
| Section 6.8 | Investor obligation to respect internationally recognised human rights and undertake human rights due diligence | 294 |
| Section 6.14 | Criminal sanctions | 373 |
| Section 6.16 | Civil liability of investors | 386 |
| Section 6.17 | Counterclaims by states in investor–state arbitrations | 401 |
| Section 7.1.7 | Sample provisions: investor–state dispute settlement, Article [W] (Counterclaims) | 478 |


The UN Guiding Principles on Business and Human Rights recommend that states 'provide effective and appropriate non-judicial grievance mechanisms, alongside judicial mechanisms, as part of a comprehensive State-based system for the remedy of business-related human rights abuse'.[449] According to the UN Special Representative on Business and Human Rights (SRSG), such mechanisms are crucial to supplement judicial mechanisms, which are unable to deal with all human rights-related complaints.[450] This is similarly true with respect to complaints about an investment relating to labour rights, indigenous peoples' rights or environmental abuses. The court system of the host state will not be able to address all such concerns. Many complaints will not translate into legally actionable issues. In addition, courts may be inaccessible to many individuals in the host state because of factors such as cost, distance, lack of knowledge, cultural barriers or lack of legal aid programmes.

One of the key functions of a grievance procedure is to provide information about harms caused by an investment's activities, including, but not limited to, harms caused by the failure of the investor to comply with its obligations. A grievance procedure provides a means through which affected individuals and communities can bring complaints about the harms caused by the investment that they may have suffered. It can serve as a forum for settling disputes and providing adequate reparations.

Non-judicial grievance mechanisms can function as alternative dispute resolution (ADR) processes providing mediation and/or adjudication and should be conceived so as to be culturally appropriate, and able to deal with rights-related issues[451] and environmental complaints. The UN Guiding Principles on Business and Human Rights suggest that such grievance mechanisms should be based on principles of legitimacy, accessibility, predictability, equity and transparency, and that they should be rights-compatible and a source of continuous learning.[452]

449 UN Guiding Principles on Business and Human Rights, op. cit., at Principle 27.
450 Ibid., at Principle 27, commentary.
451 Ibid.
452 Ibid., at Principle 31.

The Guide contains sample provisions that contemplate that:

- States will establish a sustainability assessment process;[453]
- Investors will undertake a pre-establishment sustainability assessment and develop a management plan to implement the assessment and outline how the investor will prevent, avoid, minimise, mitigate or compensate for their adverse impacts and, in appropriate circumstances, provide for benefit sharing with indigenous peoples;[454] and
- States will establish a consultative process for dealing in the first instance with non-compliance with the management plan by an investor.

A grievance procedure may be used to ensure that the benefits of a management plan are realised and, more generally, to address harms caused by the investment.

**Box 6.17 Summary of options for grievance mechanism and other measures to enforce the management plan**

1. *Do not create a grievance mechanism or other measures to enforce a management plan*
2. *Enact a domestic law establishing a grievance mechanism and process for enforcing a management plan*
3. *Integrate into an IIA an obligation on party states to establish a grievance mechanism and a compliance process for a management plan*

### 6.15.1 Discussion of options

1. *Do not create a grievance mechanism or other measures to enforce a management plan*

**Low-cost option:** This may be attractive to states with few resources to dedicate to such an endeavour. Financial and human resources will be needed to develop and operate a grievance mechanism. If it is to be effective, additional resources will probably be required to ensure that affected communities are aware of the mechanism and know how to make use of it. In addition, it could be costly to ensure that the mechanism is culturally appropriate where the affected individuals and community are, for example, indigenous peoples or minority groups.

**No forum for victims and no compliance procedure for a management plan:** If states do not create a grievance mechanism for investment-related disputes, many individuals and communities affected by the investment will have no access to a non-judicial forum for bringing complaints about alleged harms caused by an investor or its investment, and to seek redress or settle disputes related to the investor or investment in a non-adversarial and cost-effective manner.

453 See Section 6.6 (Sustainability assessments).
454 See Section 6.6 (Sustainability assessments).

In terms of compliance with the management plan, the state will have no procedure in place that provides clear expectations as to how it will deal with non-compliance by the investor. Further, there will be no consultative process to bring the investor into compliance before ratcheting up sanctions to more adversarial forms of enforcement, such as civil actions in domestic courts and counterclaims in investor–state dispute settlement. This could lead to a breakdown in the relationship between the investor and the host state.

2. *Enact a domestic law establishing a grievance mechanism and process for enforcing a management plan*

**May be onerous for some states to establish and resource these mechanisms:** A potential disadvantage of this option is that states will have to dedicate financial and human resources to develop and administer a grievance mechanism. A less costly option would be to require the establishment of a grievance mechanism only for investments in the extractive industry and other similar sectors, where there is the greatest potential for significant impacts on human rights, labour rights, indigenous peoples' rights and the environment.

**May discourage investment:** The grievance process could create a repository of information accessible to the public and media. Such information could be damaging to some investors or even to the state. It could be used by the media and NGOs to target both the state and investor conduct and to provide the basis for claims by affected stakeholders against an investor for relief. Some investors may consequently be discouraged from investing.

**Implements the state's international obligations and supports sustainable development:** On the other hand, establishing this type of complaint mechanism and process to enforce a management plan would demonstrate that a state is complying with its international obligations to protect human rights, labour rights, indigenous peoples' rights and the environment. As discussed above, states have obligations to protect human rights by taking administrative, legislative and enforcement measures to ensure that investors do not violate the human rights of individuals and certain groups within the territory or subject to the jurisdiction of the state. Providing a non-judicial complaint mechanism for settling disputes and addressing harms of those affected by an investment helps to fulfil the obligation to protect human rights. Equally, providing a process to help bring an investor back into compliance with a management plan which deals with prevention, avoidance and mitigation of, and reparation for, human rights violations also fulfils a component of this duty.

**May decrease the costs of doing business and promote goodwill:** As noted above, clashes between investors and the local community can result in significant costs to the investor through disrupted production, delayed operations, loss of property value, property damage, injuries to employees or worse.[455] A non-judicial grievance

455 Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence). See Davis and Franks, op. cit., at 3–8.

mechanism under which problems can be aired, disputes settled and reparations made could diffuse tensions, help to protect the investor's social licence to operate and save companies millions of dollars.

In addition, dealing with complaints about an investment outside the court system is less expensive and may reduce the investor's cost of doing business in the host state. Similarly, having a non-judicial, non-adversarial process for initially dealing with investor non-compliance with a management plan will be less expensive for both the investor and the state, and will facilitate the maintenance of a good relationship between them.

**Helps manage corporate risk:** Where investors participate in a non-judicial grievance process in good faith and provide adequate reparations for harm, they are less likely to be sued in either the host or the home state for harms caused by the investment. They are also less likely to be targeted by NGOs for unethical and rights-violating behaviour or to become the subject of a divestment campaign.

**Supports sustainable development:** As discussed above in the section on the relationship between investment and sustainable development,[456] foreign investment will be successful in promoting sustainable development – even a concept of sustainable development restricted to economic development – only if citizens of the host state benefit from such investment. Creating a low-cost, non-judicial grievance mechanism will provide an accessible, culturally appropriate forum to deal with adverse impacts in a rights-protective manner and ensure that any necessary reparations are made to affected individuals and communities. In this way, it will help to ensure that investors and their investments play a part in achieving sustainable development in a host state. Likewise, states and individuals will benefit from a consultative process between the state and investor to bring the investor back into compliance with the management plan, which aims to prevent or reduce adverse impacts on human rights and the environment.

3. *Integrate into an IIA an obligation on party states to establish a grievance mechanism and a compliance process for a management plan*

The potential benefits and drawbacks of integrating into an IIA an obligation on states to establish a grievance mechanism and a process to enforce a management plan are similar to those canvassed above with respect to establishing such a mechanism and process through domestic law. There is, however, an important added benefit of including such a provision in an IIA. A grievance mechanism and management plan enforcement process can be complemented by other treaty-based enforcement mechanisms, including criminal[457] and civil liability[458] and counterclaims in dispute settlement.[459]

456 See Section 2.3 (Links between foreign investment and sustainable development).

457 See Section 6.14 (Criminal sanctions).

458 See Section 6.16 (Civil liability of investors).

459 See Sections 6.17 (Counterclaims by states in investor–state arbitration) and 7.1.7 (Sample provisions: investor–state dispute settlement, Article [W] (Counterclaims)).

### 6.15.2 Discussion of sample provisions

Based on the discussion of costs and benefits above, a state may decide to include a grievance mechanism in its IIAs. The sample provisions discussed below provide examples of how this could be done.

**Grievance mechanism:** The first sample provision below imposes an obligation on states to establish a non-judicial grievance mechanism. It must be available to individuals or groups of individuals who allege that they have suffered violations of their human rights, labour rights or indigenous peoples' rights or harmful environmental impacts caused by the investment. It also sets out the principles on which the procedure is to be based.

In the context of investment, this type of grievance mechanism could be used by individuals or communities in the host state or by host state civil society groups to:

- Raise concerns regarding the impact of a foreign investment on their health, safety or social welfare;
- Report instances of unacceptable environmental degradation resulting from the investment;
- Report instances of a failure by the investor or investment to respect human rights, labour rights or indigenous peoples' rights;
- Report instances of the host state's failure to protect the environment affected by the investment;
- Report and address an investors' failure to abide by the management plan developed through the sustainability assessment process; or
- Seek reparation for abuses or harm caused by the investment.

**Procedure to ensure investor compliance with a management plan:** In the case of an alleged failure to comply with a management plan, a separate sample provision creates a process to deal with such non-compliance as follows:

- The host state notifies the investor of such failure;
- The investor then has six months to remedy its non-compliance in consultation with the host state and persons of the host state who are affected by the investor's non-compliance;
- Where the investor has not complied with the management plan within six months, consultations involving the investor, the host state and the investor's home state are required;
- Where consultations fail, a host state, private person or organisation may commence an action against the investor in the domestic courts of the host state or the home state to seek an order directing compliance with the management plan and/or to obtain compensation for losses suffered as a result of non-compliance; [460] and

460 See 6.16 (Civil liability of investors).

- A state may also bring a counterclaim in any investor–state arbitration initiated by the investor where consultations have not resulted in compliance or in an agreement for a reasonable and appropriate modification of the plan.[461]

### 6.15.3 Sample provision: obligation to establish a grievance procedure

#### Obligation to Establish a Grievance Procedure

1. Each Party, in consultation with anyone potentially affected by investments of investors of the other Party, shall establish an effective grievance procedure for individuals and groups of individuals who claim that their human rights, labour rights, rights as indigenous peoples, or health, safety or social welfare are affected by an investor of the other Party or its investment, or who wish to report instances of unacceptable environmental degradation resulting from the investment or from the Party's failure to protect the environment affected by the investment. Such grievance procedure must be legitimate, accessible, predictable, equitable, transparent and compatible with the rights and interests sought to be protected.
2. Where it is determined that the investment has affected the rights of such individuals or groups of individuals or caused environmental damage, the investor shall make reparations to such persons and groups commensurate with the severity of the violations or damage caused.
3. For greater certainty, reparations under Section 2 shall include restitution, compensation and satisfaction.

### 6.15.4 Sample provision: compliance with management plan

#### Compliance with Management Plan

1. If an investor of a Party or its investment fails to implement a management plan developed in accordance with [see Guide sample provision in Section 6.6 (Sustainability assessments)] relating to an investment in the other Party, the other Party shall give notice to the investor or investment of such non-compliance. The investor or investment shall re-establish compliance with the plan in a timely manner having regard to the harms resulting from non-compliance. In the process of doing so, the investor or investment shall consult in good faith with the other Party and with persons affected by the failure to comply.
2. Failure of the investor or investment to comply with the management plan within 180 days of notice having been given under Section 1 shall result in consultation between the other Party, the investor and affected persons in order to re-establish compliance or modify the management plan in a reasonable and appropriate way and in a timely manner having regard to the harms resulting from non-compliance.

461 See 6.17 (Counterclaims by states in investor–state arbitration).

## 6.16 Civil liability of investors

### Cross references


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Imposing civil liability on investors and their investments for breaches of their treaty obligations is another way to facilitate compliance in the host state with standards set out in the treaty. Civil suits brought against corporate actors for their acts or complicity in acts that violate human rights, labour rights and indigenous peoples' rights, or for harm caused by corruption or environmental damage may provide the sole avenue for redress for victims, given the current lack of other mechanisms and processes for addressing the adverse impacts of investment. Litigation can expose unscrupulous investor conduct and investors may have to expend significant amounts in legal fees, even where such litigation is unsuccessful. Given this, the potential high reputational and financial costs of even an unsuccessful suit may deter similar future conduct by investors.[462] In addition, a decision in favour of the plaintiffs would help to deter future abusive conduct on behalf of investors operating in host states. However, there are a number of significant jurisdictional, procedural, evidentiary and other legal hurdles to bringing successful civil suits against an investor in the host state and the investor's home state. Three important ones are discussed below.

**No legal cause of action in the home state:** In many common law jurisdictions such as Australia, Canada and the UK there is no specific cause of action for violations of human rights, labour rights or indigenous peoples' rights that may result from an investment in other countries. Such claims must be framed as torts, such as

462 See B Stephens (2007), 'U.S. Litigation against Corporations for Gross Violation of Human Rights', written for the ICJ Expert Legal Panel on Corporate Complicity in International Crimes, at 23 (copy on file with the authors), who notes that '[t]o the extent that well-publicized cases influence the many corporations that learn about them and fear becoming targets, the cases can have an impact on corporate culture and business practices'.

assault, battery, false imprisonment, intentional or negligent infliction of emotional distress, wrongful death or negligence, and then proved according to the tort laws of the particular jurisdiction. The USA, on the other hand, has specific legislation that facilitates suits for egregious extraterritorial violations of certain human rights. In addition to claims made under ordinary tort laws, plaintiffs are able to file such claims under the *Alien Torts Claims Act* (ATCA),[463] and a number of other statutes. However, some US courts have ruled that corporations can no longer be sued under the ATCA in certain US jurisdictions and one such decision has been appealed to the US Supreme Court.[464] The Supreme Court decision will probably determine once and for all whether corporate liability is actionable under the ATCA.

**Home state judicial doctrines such as *forum non conveniens*:** One of the challenges to bringing a claim in an investor's home state for acts committed by the investor or its investment in a host state is the domestic judicial doctrine of *forum non conveniens*. This, and other doctrines relating to jurisdiction, may discourage a home state court from hearing a matter if an investor objects to the jurisdiction of the court on the basis that it would be more convenient to hear the matter elsewhere. Some national courts are unwilling to assert jurisdiction over actions that take place outside a state's borders on this basis. The application of these kinds of judicial doctrines to refuse to hear the case severely undermines the effectiveness of requiring civil liability in home states, since the subject matter of the claim in each case will relate to actions in the host state.[465]

**Complex organisation of transnational businesses:** Another problem faced by plaintiffs suing investors in the investor's home state (and by home states seeking to criminally prosecute investors)[466] for acts committed in the host state is the separate legal personality of the different entities that make up many transnational businesses. Many investors are organised as corporate groups composed of multiple related legal entities. An investor that is a legal person may legitimately use a subsidiary incorporated in the host state that it controls to carry on its operations there or use other arrangements that shelter the parent company and other members of a corporate group from liability for activities carried out for the benefit of the group.[467] Courts are reticent to 'pierce the veil' of corporate groups to impose liability on parent companies

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463 27 USC, §1350.

464 Petition for Writ of Certiorari, *Kiobel v. Royal Dutch Petroleum*, (2011) 565 US (No 10–1491). In *Mohamad v. Palestinian Authority*, no 11–88 (18 April 2012), affd 634 F 3d 604 (DC Cir 2011), available at: www.supremecourt.gov/opinions/11pdf/11-88.pdf (accessed 8 January 2013), the US Supreme Court confirmed that the *Torture Victim Protection Act* applies only to natural persons and does not therefore impose liability on organisations.

465 For a full discussion of the barriers to bringing these types of claims, see International Commission of Jurists (2008), 'Corporate Complicity and Legal Accountability: Volume 3 – Civil Remedies: Report of the International Commission of Jurists Expert Legal Panel on Corporate Complicity in International Crimes', International Commission of Jurists, available at: www.icjcanada.org/fr/document/doc_2008-10_vol3.pdf (accessed 8 January 2013).

466 See Section 6.14 (Criminal sanctions).

467 R Nicolson and E Howie (2008), 'The Impact of the Corporate Form on Corporate Liability for International Crimes: Separate Legal Personality, Limited Liability and the Corporate Veil – An Australian Law Perspective', Paper written for the ICJ Expert Legal Panel on Corporate Complicity in International Crimes at 11, available at: www.hrlrc.org.au/files/icj-paper-e-howie-and-r-nicolson-final-0207.pdf (accessed 8 January 2013).

for acts of their subsidiaries.[468] Home state courts will be more reluctant to assume jurisdiction over a claim that can be pursued only against a subsidiary incorporated and operating in a the host state.

Attaching liability to the appropriate entity becomes more problematic when a number of subsidiaries incorporated in a variety of states are interposed between the parent and the subsidiary that committed the impugned acts in the host state, and where the local subsidiary has insufficient assets to satisfy claims for injuries caused. In such a case, liability of the subsidiary in the host state will not result in relief being provided. The challenge is to hold liable an appropriate entity in a corporate group that has sufficient assets. This challenge is often further complicated by the wide variety of ownership and contractual relationships that can exist between members of a related group that together make up a transnational business.

There are a number of ways to attempt to address this issue, including:

- States can establish *enterprise liability* for investors and their investments;
- States can impose an obligation on investors to take out liability insurance for violations of human rights, labour rights, indigenous peoples' rights and environmental damage, as a condition of permitting the investment; and
- States can impose an obligation on investors to post a bond as a condition of permitting the investment to supplement liability insurance for potential liabilities in the host state. Such a requirement could be restricted to investments that are more likely to have significant unforeseen harmful social and environmental impacts.

### 6.16.1 Enterprise liability

To date, no generally accepted solution has been found for the problem of establishing liability of appropriate legal persons in complex transnational businesses composed of multiple distinct legal entities. As discussed above, the traditional approach of states has been to treat parent, subsidiaries, affiliates, joint venture partners and other entities in a transnational business (or corporate group) as separate legal entities with liability attaching only to the entity whose agents directly participated in the action giving rise to liability.

Some states have, however, employed enterprise law – treating corporate groups as a single juridical unit[469] – in areas of tax law, competition law, bankruptcy law, labour law, administrative law and discrimination law. Under corporate law in most jurisdictions, courts may 'pierce the corporate veil' (look behind the separate legal existence) of a corporation in certain limited circumstances to impose liability on shareholders, including parent corporations. Enterprise law goes beyond the piercing of the corporate veil, in that it allows a court not only to find a parent corporation liable for the acts of a subsidiary, but also to find a sister subsidiary (a corporation that

468 Subsidiary means a corporation under the control of a parent corporation through the parent's ownership of all or a majority of the voting shares of the subsidiary.

469 G Wright (2010), 'Risky Business: The Case for Enterprise Analysis at the Intersection of Corporate Groups and Torts', available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1966777, at 5. (accessed 8 January 2013).

is under the common control of the parent) liable, because the entire corporate group is regarded as a single entity.[470]

The application of enterprise liability in the case of third party victims of actions by an undercapitalised entity within a corporate group can be justified on two grounds. It reflects the economic reality of transnational business groups, which often operate as an integrated whole; and it reallocates the liability risk to the business group, which has the choice to refrain from the activities that would cause harm or to ensure that the entity directly responsible for the harmful acts has sufficient assets to compensate people injured by those activities.[471]

A range of countries, including the USA, Germany, India and Albania, has developed laws that impose enterprise liability in certain circumstances. These laws employ some form of legal or factual test (or both) for control to determine whether two entities are affiliated. Dine argues that Albanian company law contains state-of-the-art provisions on enterprise liability that go beyond the laws in other jurisdictions. For example, it focuses on the flow of money, rather than legal control, and in so doing, it creates the prospect of attaching liability to the whole corporate group and not simply the parent company.[472] According to Dine this 'concept is also broad enough … to include relationships such as franchising or other kinds of supply or distribution, outsourcing of certain enterprise functions or quality-assurance systems'.[473] Box 6.18 reproduces the provisions of the Albanian law related to parents and subsidiaries.

**Box 6.18** ***Law No. 9901, 14 April 2008, on Entrepreneurs and Companies***

Article 207 Parents and Subsidiaries

1. A parent–subsidiary relationship shall be deemed to exist where one company regularly behaves and acts subject to the directions or instructions of another company. That control shall be called [the] control group.
2. If a company, based on its capital share in another company or based on an agreement with that company, has the right to appoint at least 30 per cent of members of the Board of Administration or Supervisory Board or of the administrators of that company, or if it has at least 30 per cent of votes at the General Meeting, it shall be considered a parent of the other company and the other company as its subsidiary. That control shall be called an equity group.
3. The parent's rights over the subsidiary as specified in Paragraph 2 of the present Article shall be considered such even where those rights are exercised

(Continued)

470 Ibid. at 5.
471 Ibid. at 10.
472 J Dine (2012), 'Jurisdictional Arbitrage by Multinational Companies: A National Law Solution?', 3 *Journal of Human Rights and the Environment* 44 at 66–67.
473 Ibid.

(Continued)

through another company, controlled by the parent or a third party acting on account of that other company or the parent itself.

Article 208 Legal Consequences of Control Group

1. Where there is a parent–subsidiary relationship as defined in Article 207 Paragraph 1 of the present Law, the parent shall have a duty to compensate the subsidiary for its annual losses.
2. …
3. Creditors of the subsidiary shall at any time have the right to require the parent to offer adequate security for their claims owed by the subsidiary.
4. Creditors of the subsidiary shall include persons who have incurred damage due to a subsidiary's actions wherever the subsidiary is registered.[474]

Albanian company law could provide a useful template for ensuring enterprise liability for victims of investor abuses of human rights, core labour rights and indigenous peoples' rights and environmental harm or harm caused by bribery or other forms of corruption. It provides a basis for such victims to enforce any judgment in their favour against the parent of a corporate group. It also defines such victims as creditors of the corporate group. Dine notes, however, that these provisions need further refinement and development, in particular with respect to the concept of control and in order to address partnerships, which are another business form commonly used by transnational businesses.[475]

In the transnational context, the use of enterprise liability with respect to a transnational business can be problematic since it can lead to a conflict between the domestic laws of two states.[476] The imposition of enterprise liability by one state on an investor that affects an affiliated entity in another state could also be viewed by the other state as a violation of sovereignty. An agreement in an IIA to the imposition of enterprise liability would address this sovereignty concern.

### 6.16.2 Liability insurance

Liability insurance is a less challenging tool that might be used to address the problem of a foreign investor evading civil liability for the acts of its subsidiary, affiliate or joint venture partnership in the host state in some cases. For example, in addition to establishing civil liability for investors, a state could require the foreign investor to

474 Ibid. at 62–4.
475 Ibid. at 67.
476 P I Blumberg (1993), *The Multinational Challenge to Corporation Law: The Search for a New Corporate Personality*, Oxford University Press, New York, at 153–4.

obtain third party liability insurance for its activities in the host state as a condition of being allowed to establish its investment.

Investors routinely take out political risk insurance from export credit agencies and other financial institutions for operations in jurisdictions deemed to be politically unstable. Such insurance provides protection from the risk of actions by the state, such as a breach of contract, expropriation, political violence, restrictions on currency conversion or transfer, repossession of physical assets, and non-payment by a government of loans or a financial guarantee.[477] Third party liability insurance could cover investor liability for some kinds of negligent acts that may violate the human rights, labour rights, indigenous peoples' rights or cause environmental damage.

The amount of insurance required could be determined having regard to the outcome of a sustainability assessment. The insurance would need to be purchased by the investor for the benefit of the subsidiary, joint venture partner or other legal entity through which the investor is operating the investment in the host state. The proceeds of the insurance would form a pool of money held by the subsidiary that could be used for the purpose of satisfying any judgments against the subsidiary or other entity in a civil claim or in counterclaim in investor–state dispute settlement or to satisfy any reparations that are determined to be required through a grievance process. Alternatively, the host state itself could be made the beneficiary of such insurance.

### 6.16.3 Posting a bond or guarantee

A further option to address the problem of transnational businesses evading civil liability for adverse impacts is to require the investor to post a bond or obtain a guarantee from either a public or private financial institution for such liability that may arise in the host state. Bonds and guarantees are a routine part of international business transactions and the International Chamber of Commerce has developed a widely used set of rules for bonds and guarantees that could be adapted for this purpose.[478] The bond would have to be posted or the guarantee would have to be made for the benefit of the host state. The host state would then be responsible for distributing the proceeds to individuals with claims against the investor.

### 6.16.4 IIA practice

There appear to be no existing IIAs that include provisions requiring parties to establish civil liability for investor violations of human rights, labour rights or indigenous peoples' rights, for environmental damage or for harm caused by corruption. The IISD model treaty contemplates such a provision. It provides a right for host states, individuals and organisations to bring a civil action in the host state and recover damages for breach by an investor or investment of their obligations under the IISD model treaty.[479]

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477 See, for example, Export Development Canada, 'Political Risk Insurance', available at: www.edc.ca/EN/Our-Solutions/Insurance/Pages/political-risk-insurance.aspx (accessed 8 January 2013).

478 ICC (1978), *ICC Uniform Rules for Contract Guarantees*, International Chamber of Commerce, Paris.

479 IISD model treaty, Art. 17.

The IISD model treaty also provides that investors may be held civilly liable in the investors' home state.[480] This provision creates an additional means of redress for those whose rights have been violated or who have suffered harm caused by an investor or its investment in situations where remedies within the host state may be limited or ineffective. It also allows victims in the host state to pursue a claim in the state where the investor is likely to hold more assets, such as the home state.

Finally, the IISD model treaty further attempts to address the jurisdictional obstacles of bringing a claim in the home state for acts that were perpetrated in the host state. It imposes an obligation on home states to ensure that bringing such actions is not prevented just because the impugned acts occurred in the host state. This means that a claim for compensation is more likely to be heard and an award of damages has more chance of being effectively enforced. The IISD provision does not address the problem posed by separate legal personality of the different entities in a corporate group with different nationalities.

**Box 6.19 Summary of options for obligation on states to establish civil liability for investors**

1. Do not establish civil liability for harm caused by investors
2. Use existing domestic law in relation to civil liability for harm caused by investors
3. Enact a domestic law establishing civil liability for investors
4. Integrate into an IIA an obligation on both party states to establish civil liability for investors

### 6.16.5 Discussion of options

1. *Do not establish civil liability for harm caused by investors*

**States may not be in compliance with their international human rights obligations:** As discussed above, states have an obligation to protect human rights. This means they must take action through legislative, administrative and other measures to protect individuals from violations of human rights caused by private actors, including investors. Providing a means for victims of human rights abuses to bring a claim for such harm is one way of fulfilling this duty. In addition, the right to an effective remedy is a fundamental human right that is explicitly protected under a range of human rights treaties, including most of the core UN human rights treaties discussed above,[481] as well as regional instruments. The majority of international universal

480 IISD model treaty, Art 31.

481 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence). See *ICERD*, Art. 6; *ICCPR*, Art 2(3); *CEDAW*, Art 2(c); *CAT*, Art. 14; *ICRMW*, Art. 83; *CPED*, Arts. 8(2), 20(2).

and regional human rights instruments require 'both the procedural right of effective access to a fair hearing and the substantive right to a remedy'.[482]

**This can undermine the rule of law and deter investment:** Remedies are a key feature of the rule of law. They can deter future violations of human rights and they provide redress to victims of such abuses.[483] Failing to provide for effective remedies for abuses of human rights, labour rights, indigenous peoples' rights and environmental damage and harm caused by corrupt practices could weaken the rule of law in the host state. This in turn may discourage investment.

2. *Use existing domestic law in relation to civil liability for harm caused by investors*

**Low-cost option:** This option may be attractive to states with few resources to dedicate to developing new judicial remedies and the institutions necessary to make them effective. Many host states will already have in place a means through which individuals and communities adversely affected by an investment can sue the investor in domestic courts.

**No specific cause of action for violations of human rights, labour rights, indigenous peoples' rights, environmental harm or corruption:** Existing laws in a host state may not provide a specific legal basis for claims regarding violations of human rights, labour rights or indigenous peoples' rights, environmental damage or injuries resulting from corrupt activities. This means such abuses will have to be based on other legal grounds, which may not properly address the harms caused. It may also be the case that certain abuses will not be actionable.

**Possible difficulty in enforcing a judgment against a foreign investor:** As discussed in the sections above,[484] states may have difficulty in enforcing domestic laws against foreign investors, including judgments. Foreign investors can structure themselves so as to avoid exposure to liability. Investors may purposely undercapitalise the subsidiary, affiliate or joint venture partner through which they are operating in the host state or transfer assets to another entity within the corporate group to avoid successful enforcement of any judgment against it.

3. *Enact a domestic law establishing civil liability for investors*

States could implement legislation specifically establishing civil liability for violations of human rights, labour rights, indigenous peoples' rights and environmental damage caused, or contributed to, by foreign investors, as well as for harms caused by corrupt activities of foreign investors.

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482 D Shelton (2005), *Remedies in International Human Rights Law*, 2d ed, Oxford University Press, Oxford, at 115.

483 Ibid.

484 See, for example, Section 6.2 (The challenges of regulating foreign investors and holding transnational corporations accountable); Section 6.3 (Different approaches to integrating foreign investment and sustainable development); Section 6.7 (Investor obligation to comply with the laws of the host state); and Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence).

**It may be onerous for some states to establish a new basis for a civil claim:** The development of a new cause of action for violations of human rights, labour rights, indigenous peoples' rights, environmental damage caused by foreign investors or for harm resulting from corrupt practices will require financial and human resources. It may be necessary to engage in consultations with experts and previously affected communities in developing such a law. States will need to ensure that the judiciary and the legal profession, among others, are sufficiently informed and trained on the international law standards underlying such a cause of action.

**Investors may challenge a new law under existing IIAs:** Investors could potentially challenge such a new law, or even a claim brought under such a new law, as a violation of FET under an existing IIA. This is particularly true where such a new law allows for the host state to address harms caused by the investor. Some investment tribunals have interpreted FET so broadly as to significantly restrict the capacity of states to change the regulatory environment that existed at the time the investment was established.[485] The risk of these types of investor–state claims is greater where the host state acts to permit suits against only foreign, and not domestic, investors. If the investor is successful in an investor–state arbitration claim, the host state could be required to pay significant damages.

**It may be difficult to enforce a judgment against a foreign investor:** As noted above with respect to using existing domestic law, investors may be able to avoid liability for damages awarded against them in a civil case under any new law.

**It implements the state's international obligations and supports sustainable development:** On the other hand, establishing such a cause of action would demonstrate that a state has taken steps, in compliance with its international obligations, to protect human rights (including the right to an effective remedy), labour rights, indigenous peoples' rights, and the environment and to address corruption. Creating civil liability for such adverse impacts of foreign investment may deter egregious investor conduct and allow for redress for victims and the host state. This will help to ensure that investors and their investments play a positive role and contribute to sustainable development in a host state.

**It may deter investors from engaging in hazardous activities or incentivise investors to prevent and mitigate adverse impacts:** The creation of civil liability for adverse impacts on human rights, labour rights, indigenous peoples' rights and for environmental damages may push investors to more thoroughly assess their potential impacts, seek to prevent the most severe effects and mitigate others in compliance with a management plan developed as a result of such an assessment. Investors may also have an incentive to deal with complaints arising from their activities through a non-judicial grievance process and to provide adequate reparations where necessary to avoid drawn-out and costly legal proceedings.

**It reallocates risk:** Providing civil liability for violations of human rights (including labour rights and indigenous peoples' rights) and environmental damage by foreign investors

485 See Section 5.5 (Fair and equitable treatment and the minimum standard of treatment).

and their investments, as well as harm caused by corrupt practices, can help to reallocate risk. If individuals have no access to effective judicial remedies where non-judicial remedies fail to provide effective redress, they bear the risk of such harms. Similarly, if a host state cannot take legal action against an investor for adverse impacts of the investment, then it also bears the social and financial risk of harm. For example, abuses of human rights can lead to increased levels of discrimination, greater marginalisation of certain groups, increased poverty[486] and even conflict.[487] Environmental damage can lead to problems such as the pollution of water supplies and arable land, and the consequent social impacts on health and quality of life. Civil liability is a mechanism to allocate the risks of these losses to the investor who caused them.

4. *Integrate into an IIA an obligation on both party states to establish civil liability for investors*

The potential benefits and drawbacks of integrating into an IIA an obligation on states to establish civil liability for investors are similar to those identified above with respect to developing and implementing a new domestic law allowing for such claims. However, including an obligation in an IIA requiring party states to establish civil liability for investors has several additional important advantages.

**It helps to overcome the problem of a potential investor challenge to domestic law implementing such a cause of action:** Including such a provision in an IIA diminishes the likelihood of investor challenge. As long as states comply with the core investor protections in an IIA in bringing such claims, and do not solely target foreign investors, investor claims based on the introduction and use of a civil liability regime are unlikely to be successful. An express exception for civil liability measures could also be included.

**It harnesses the regulatory capacity of the home state:** Requiring the home state to establish a civil liability regime under an IIA can complement civil liability in the host state. Home state civil actions allow victims of abuse to bring a claim in the jurisdiction in which the investor is likely to hold its assets and which may have more plaintiff-friendly laws, such as laws that permit class actions, provide legal aid to poor claimants or allow fee-paying arrangements where lawyers representing claimants can agree that they will be paid only if the claim is successful.[488]

**Investors can be required to obtain liability insurance and/or post a bond:** An obligation could also be imposed on an investor to obtain insurance for the benefit of the entity through which it is operating in the host state for the sole purpose of satisfying any judgment in a civil claim. This would ensure that the investor could not evade liability by transferring assets out of, or undercapitalising, the entity. Another option is to oblige investors, particularly those engaged in hazardous activities, such as extractive and major infrastructure projects, to post a bond in favour of the host state. This addresses the higher risk of major unanticipated liability typical of these

486 See Sepúlveda and Nyst, op. cit.
487 See Thoms and Ron, op. cit.
488 This is sometimes referred to as a 'contingency fee' payment arrangement.

kinds of investments. It would ensure that insurance coverage could be supplemented where it would be insufficient to cover a judgment for harm caused in violation of the investor obligations.

**It can be complemented with other treaty-based enforcement mechanisms:** Establishing civil remedies for investor violations of human rights, labour rights, indigenous peoples' rights, environmental harm, complicity in bribery and corruption, failure to comply with a management plan resulting from a sustainability assessment and any obligation under domestic law can be complemented by several other kinds of IIA enforcement commitments discussed in the Guide. A grievance procedure required under an IIA could produce information that may provide the basis for a civil claim.[489] An IIA requirement to provide for the criminal prosecution of investors complicit in corruption or grave violations of human rights may lead to criminal prosecutions that could also provide information and decisions that could be useful in a civil claim.[490] Civil responsibility is also complemented by a counterclaim mechanism, which allows host states to counterclaim in investor–state proceedings where the investor has allegedly violated its obligations under the treaty.[491]

Including an obligation in an IIA to provide for civil enforcement also means that, unless this is excluded from state-to-state dispute settlement, one state could initiate this process for the purpose of ensuring that the other state was in compliance with its obligations to provide for civil liability. Access to such a process may assist host states in ensuring that home states act on their commitments with respect to civil liability. It could also be used by home states to pressure host states to take action with respect to the IIA requirements for the host state's civil liability regime.

### 6.16.6 Discussion of sample provision

The Guide sample provision requires both the host state and the investor's home state to create a regime permitting individuals and the host state to sue for civil relief for acts, decisions or omissions of the investor or its investment that violate the investor obligations in the IIA between the home and host state.[492] The sample provision has the following additional features.

**Imposes civil liability for failure to comply with a management plan after six months:** Civil liability is imposed where the consultative process to ensure the investor is brought back into compliance with a management plan (developed pursuant to a

489 See Section 6.15 (Grievance procedure and other measures to enforce the management plan produced in the sustainability assessment).

490 See Section 6.14 (Criminal sanctions).

491 See Sections 6.17 (Counterclaims by states in investor–state arbitration) and 7.1.7 (Sample provisions: investor–state dispute settlement, Article [W] (Counterclaims)).

492 See Section 6.7 (Investor obligation to comply with the laws of the host state); Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence); Section 6.9 (Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights); Section 6.10 (Investor obligation to comply with core labour standards); and Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).

sustainability assessment) has failed to yield such compliance.[493] No civil liability or other recourse is available in circumstances where a management plan itself does not conform to the criteria identified in Section 6.6 (Sustainability assessments). In some cases, however, such non-conformity may be a violation of some other obligation in the investment treaty for which civil liability or other remedies are provided.

**Requires states to remove jurisdictional barriers to transnational claims:** In order to minimise the impact of domestic judicial doctrines, such as *forum non conveniens*, the Guide sample provision imposes an obligation on each party state to remove these kinds of barriers to civil actions.[494] If states include such a provision in their treaty, concerns sometimes expressed by home states and their courts about avoiding extraterritorial application of their laws and encroaching on the sovereignty of the host state are avoided. By including this type of provision, the host state is agreeing to the home state's assertion of jurisdiction in these kinds of cases.

**Addresses problems of enforcement against transnational businesses:** The sample provision aims to address the problem of transnational business groups being able to structure themselves so as to avoid liability in the host state by under capitalising the subsidiary, affiliate or joint venture partner through which the investor operates the investment in the host state or transferring assets out of the host state to another entity within the corporate group in another state to avoid paying any judgment against its entity operating in the host state. The sample provision does not require party states to create enterprise liability for investors since it is not apparent that a single solution would work in every jurisdiction, given the range of different legal constructs and liabilities.

Instead, the sample provision imposes an obligation on party states to require investors, as a condition of the investment to do the following:

- To purchase liability insurance on behalf of the subsidiary, affiliate or joint venture partner. The amount of the insurance will be determined through the sustainability assessment process.[495]
- To post a bond in favour of the host state in situations where the sustainability assessment reveals that potential adverse impacts on human rights, labour rights, indigenous peoples' rights or the environment are sufficiently serious to require extra funds to satisfy any judgment against the investor for breach of the investor's obligations under the treaty. The amount of the bond will be determined through the sustainability assessment process.[496] The aim of the bond is to supplement liability insurance that may be insufficient or unavailable. It will be required

493 See Section 6.6 (Sustainability assessments).

494 While such jurisdictional hurdles exist mainly in common law states, the courts of European states parties to the Brussels Convention are now prevented from objecting to the jurisdiction of a claim relating to acts that occurred in another state. See *Group Josi Reinsurance Company SA v. Universal General Insurance Company*, C-412/98, [2000] ECR I-5925; *Owusu v. Jackson*, C-281/02, [2005] ECR I–1383.

495 See Section 6.6 (Sustainability assessments).

496 See Section 6.6 (Sustainability assessments).

only in situations where the investment poses a risk of significant harms, such as extractive industry activities or large infrastructure projects.

**Limitation to breaches that cause a loss to the party state or persons of the party state:** Civil liability arises only where a violation by an investor of a treaty obligation causes a loss or injury to a party state or a person of a party state. This should help to limit the use of civil actions to harass investors on the basis of trivial violations of treaty standards. The risk of such actions may be most significant in relation to an obligation of an investor to comply with domestic law in the host state as is discussed above.[497] With such an obligation, there is a risk that civil liability would be imposed even for relatively minor or technical violations by the investor. It would be possible to limit civil claims based on violations of domestic law by establishing a minimum threshold of seriousness for an investor's liability. An IIA could provide that only breaches that are 'substantial' or 'material' could be the basis of a civil claim. In the absence of such qualifying language, it would be up to the court hearing the case to determine whether to hold an investor liable for a minor or technical violation, and if so, what should be the appropriate level of damages for such violations. Since the sample provision contemplates civil liability only where a loss or injury has been suffered as a result of the breach and domestic courts typically have the power to deal with any abuse of their civil process, no such limitation has been included in the sample provision.

### 6.16.7 Sample provision: obligation to provide for civil liability of investors

#### Obligation to Provide for Civil Liability of Investors

1. Each Party shall take such measures as may be necessary to permit the Party or a person of the Party to initiate an action against an investor of the other Party or its investment in the first Party's domestic courts for compensation for losses of or injuries to the Party or a person of the Party arising from an alleged breach by the investor or its investment of the standards set out in:
    a. [see Guide sample provision in Section 6.7 (Investor obligation to comply with the laws of the host state)];
    b. [see Guide sample provision in Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence)];
    c. [see Guide sample provision in Section 6.9 (Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights)];
    d. [see Guide sample provision in Section 6.10 (Investor obligation to comply with core labour standards)]; and
    e. [see Guide sample provision in Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption)]

of this Agreement.

497 See Section 6.7 (Investor obligation to comply with the laws of the host state).

2. Each Party shall take such measures as may be necessary to permit the Party or a person of the Party to initiate an action against an investor of the other Party or its investment in the first Party's domestic courts for compensation for losses of or injury to the Party or a person of the Party arising from non-compliance with an management plan in relation to the investor's investment, where consultation has not resulted in compliance with the management plan or the reasonable and appropriate modification of the plan in accordance with [see Guide sample provision in Section 6.15 (Grievance procedure and other measures to enforce the management plan produced in the sustainability assessment)] within 180 days of the commencement of such consultations.

3. Each Party shall take such measures as may be necessary to permit the other Party or a person of the other Party to initiate an action against an investor of the Party or its investment in the Party's domestic courts for damages arising from an alleged breach by the investor or its investment of the obligations listed in Sections 1 and 2.

4. Each Party shall take such measures as may be necessary to ensure that its domestic courts have jurisdiction to hear actions contemplated under this Article, notwithstanding that the non-compliance complained of may occur partially or wholly outside the Party. For greater certainty, each Party shall ensure that its domestic courts shall not decline to hear such actions based on *forum non conveniens* or any similar judicial or statutory rule in the Party.

5. In connection with any action against an investor or other persons in the circumstances contemplated in this Article, each Party shall empower its domestic courts to order that the investor or other person shall comply with their obligations under this Agreement and that damages be paid in accordance with its domestic law to the injured Party or person where the investor or other person is found not to be in compliance with its obligations under this Agreement.

6. Each Party shall require an investor to obtain liability insurance as a condition of making an investment as determined to be appropriate in accordance with the results of the sustainability assessment conducted in accordance with [see Guide sample provision in Section 6.6 (Sustainability assessments)].

7. Each Party shall require an investor to post a bond in favour of the Party in which it is making investment where the sustainability assessment process conducted in accordance with [Guide sample provision in Section 6.6 (Sustainability assessments)] determines that the potential adverse impacts of the investment on human rights, labour rights, indigenous peoples' rights or the environment are sufficiently severe to require such a bond to be posted.

8. For greater certainty:

    a. The requirement to post a bond shall be in addition to the requirement to obtain liability insurance;

    b. The amount of such a bond shall be determined by the Party in which the investment is to be made on the basis of the results of the sustainability

assessment conducted in accordance with [Guide sample provision in Section 6.6 (Sustainability assessments)];

c. The proceeds of any bond posted in favour of the Party in which the investment is made shall be distributed to:

i. the individuals affected by the investment, or

ii. a Party, where such Party has brought a civil action for breach of an investor obligation,

Pursuant to a judgment of the court of a Party awarding damages in favour of such individuals or the Party on the basis of a breach by the investor or its investment of obligations listed in Section 1 or 2.

9. For greater certainty, any bond posted in favour of a Party shall be distributed only where the liability insurance referred to in Section 6 is insufficient to cover the full amount awarded in the judgment referred to in Subsection 8c.

## 6.17 Counterclaims by states in investor–state arbitration

### Cross references


| | | |
|---|---|---|
| Section 6.7 | Investor obligation to comply with the laws of the host state | 292 |
| Section 6.8 | Investor obligation to respect internationally recognised human rights and undertake human rights due diligence | 294 |
| Section 6.9 | Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights | 316 |
| Section 6.10 | Investor obligation to comply with core labour standards | 322 |
| Section 6.11 | Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption | 338 |
| Section 6.15 | Grievance procedure and other measures to enforce the management plan produced in the sustainability assessment | 381 |
| Section 6.16 | Civil liability of investors | 387 |
| Section 7.1 | Investor–state dispute settlement | 408 |


Another means of enforcing investor obligations under an IIA is through the establishment of a counterclaim mechanism. A counterclaim would allow a host state to bring a claim in investor–state arbitration proceedings for violations of investor obligations under the treaty. If such a claim were successful, the state would be able to offset any award in favour of the investor by the amount of any award in favour of the state for investor misconduct, or, if the investor's claim is unsuccessful, the state would be entitled to an award of damages enforceable against the investor.

### 6.17.1 IIA practice

Both the arbitration rules under the ICSID Convention and the UNCITRAL Arbitration Rules provide for counterclaims. These are the arbitral rules applicable to most investor–state arbitrations. However, under the ICSID rules, counterclaims must arise 'directly out of the subject matter of dispute' that is the basis of the claim

brought by the investor.[498] No counterclaim would be permitted that arose out of facts unrelated to the investor's claim. Also, in order for an ICSID tribunal to have jurisdiction the counterclaim must relate to a 'legal dispute arising directly out of an investment.'[499] The UNCITRAL rules in place prior to 2010 permitted counterclaims in an even narrower set of circumstances. A counterclaim could be made only if it arose 'out of the same contract' that was the subject of the investor's claim.[500]

Not surprisingly, under these strict requirements counterclaims have been rare in investor–state arbitration and typically not successful. ICSID tribunals have determined that counterclaims must have a close connection to the investor's claim in order for jurisdiction to be established.[501] For example, in an arbitration involving an investor's claim regarding a state's actions in reorganising its banking sector that resulted in the forced administration of a financial institution owned by the investor, the tribunal decided that the state's counterclaims for taxes owed by the investor and for violations of the state's domestic commercial and banking laws were not within its jurisdiction.[502] In one case, a state's counterclaim was allowed where it was based on one of three contracts that together were an 'indivisible whole' of the investment transaction.[503]

In 2010, the UNCITRAL rules were amended to provide that a counterclaim is permitted any time the tribunal has jurisdiction over it.[504] This change expands the circumstances in which counterclaims may be made. In each case, however, counterclaims are available only if they are within the consent of the parties, which defines the tribunal's jurisdiction.[505] Consent to counterclaims in accordance with the ICSID or some other arbitral rules applicable to the dispute may be found in the parties' consent to arbitrate under these rules in the IIA. However, the IIA itself may impose limitations on the tribunal's jurisdiction. For example, if the treaty provides that only breaches of the investor protection obligations in the treaty may be the subject of a claim, a state's counterclaim based on domestic law would be precluded as outside the parties' consent.[506] If a treaty provided for obligations on investors related to areas such as

498 ICSID Convention, Art. 46.

499 ICSID Convention, Art. 25(1) defining the jurisdiction of ICSID arbitration tribunals.

500 UNCITRAL Arbitration Rules, Art. 19.3.

501 *Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v. Mongolia*, UNCITRAL, Award on Jurisdiction and Liability of 28 April 2011 (no jurisdiction over any of the counterclaims).

502 *Saluka Investments BV v. Czech Republic*, Decision in Jurisdiction over the Czech Republic's Counterclaim, PCA IIC, 7 May 2004 (Respondent state's counterclaim based on violations of domestic tax law rejected). See Y Kryvoi (2011), 'Counterclaims in Investor–state Arbitration', 8/2011 LSE Working Papers, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1891935 (accessed 8 January 2013), at 11.

503 *Klochner v. Cameroon*, ICSID Reports, vol. 2, Award, 21 October 1983. This was an arbitration related to a contract not an alleged breach of an investment treaty.

504 UNCITRAL Arbitration Rules, Art. 21.3.

505 This is expressly provided for in ICSID Convention, Art. 46.

506 *Spyridon Roussalis v. Romania*, ICSID Case No. ARB/06/1, Decision on Respondent's Counterclaim (not public), 31 March 2009. If there is a governing law clause in the treaty, it may limit the jurisdiction of the tribunal with respect to counterclaims.

human rights labour rights and anti-corruption, as discussed in the Guide counterclaims based on these obligations would have to be made the subject of the parties, consent to arbitrate for them to be the basis of a counterclaim. Such a consent would likely satisfy the requirement under the UNCITRAL rules that the counterclaim be within the jurisdiction of the tribunal. Even with a consent in the IIA, the counterclaim might not be permitted in an arbitration under the ICSID rules if it did not relate to an investment and arise 'directly out of the subject matter of dispute'.[507]

Few existing IIAs explicitly address the right of counterclaim by the host state. The COMESA Investment Agreement permits a state to bring a counterclaim for breaches of the investor obligations contemplated in that treaty, and permits a state to raise non-fulfilment by the investor of its obligations as a defence or set-off.[508] The IISD model treaty also provides for a right of counterclaim[509] and a right of a set-off where an investor persistently fails to comply with certain investor obligations under the treaty and the breach is determined to be materially relevant to the issues before the arbitral panel.[510] A counterclaim or set-off under these treaty provisions would allow a state to bring a claim in investor–state arbitration against the investor that is independent of the claim made by the investor against the state based on the failure by the investor to comply with its treaty obligations.

There are several important distinctions between a set-off and a counterclaim. A set-off is a form of defence. In investor–state arbitration, a set-off would be an argument by the state that any amount to be paid on the investor's claim should be reduced based on some claim to compensation that is owed by the investor to the state. A set-off defence is linked to the investor's claim in that it can only reduce the amount of any award in favour of the investor. If the investor's claim is unsuccessful for any reason, nothing can be awarded to the state as a set-off. For example, if a state was held responsible for expropriating an investor's assets, the state might claim a set-off based on a claim that the investor had breached an obligation to the state that caused the state to expropriate the investor. The set-off claim might relate to expenses the state had incurred. In contrast, any award under a counterclaim can be applied against any award in favour of the investor. Also, unlike a set-off defence, if the amount of the award to the investor is less than the amount of the counterclaim, the investor would be responsible for paying the difference to the state. If the investor were unsuccessful in its claim, it would still be responsible for paying the award in favour of the state under the counterclaim.[511]

507 A counterclaim based on the investment authorisation that was the basis of the investor's claim was allowed in *Goetz v. Burundi*, ICSID Case No. ARB/01/2, Award, 21 June 2012.

508 COMESA Investment Agreement (2007), Art. 28.9.

509 IISD model treaty, Art. 18(E).

510 IISD model treaty, Art. 18(D).

511 V Pavic (2006), 'Counterclaim and Set-off in International Commercial Arbitration', *1 Annals of the Faculty of Law in Belgrade - Belgrade Law Review, International Edition, 101.*

**Box 6.20 Summary of options for a counterclaim in investor–state arbitration**

1. *Do not introduce counterclaim mechanism into an IIA*
2. *Deny investors the right to pursue an investor–state claim where they have failed to comply with their obligations under an IIA*
3. *Integrate the right of counterclaim for party states into an IIA*

### 6.17.2 Discussion of options

1. *Do not introduce counterclaim mechanism in an IIA*

**Maintains the status quo:** Having no right to counterclaim in an IIA maintains the existing state of affairs in which the host state may only defend itself against a claim brought by the investor, but has no explicit basis within the context of investor–state arbitral proceedings to bring a separate claim against an investor for investor misconduct, apart from the limited rights that may be available under the applicable arbitral rules as discussed above.

2. *Deny investors the right to pursue an investor–state claim where they have failed to comply with their obligations under an IIA*

**Provides no basis for relief for host state and denies investor the right to make an otherwise valid claim:** An alternative to providing for a counterclaim would be to limit access to investor–state arbitration where investors are not in compliance with the standards set in the treaty. While permitting host states to avoid liability in this way would undoubtedly create an additional incentive for investors to comply, an investor would inevitably challenge a state's assertion that the investor was not in compliance, and the result would be that the issue of the investor's compliance would have to be adjudicated before the tribunal. In these circumstances, substantial costs would be incurred without any compensation being payable to the state for losses suffered. In addition, the state would be relieved of liability for a possibly unrelated breach of its obligations under the treaty. On balance, it seems appropriate to permit a state to claim compensation for losses caused by the investor's non-compliance through a counterclaim, as well as to bear responsibility for a breach of its own obligations.

3. *Integrate the right of counterclaim for party states into an IIA*

**This redresses the balance of power in investor–state arbitration:** Where the investor has caused harm to individuals, communities or the environment or engaged in corruption or breached obligations to the state, such as failing to perform a contract or pay taxes, having the right of counterclaim for any losses caused helps to balance the power in investor–state proceedings more equitably between the host state and the foreign investor. Where investor obligations are included in an IIA, the availability of a counterclaim is particularly important because, in some circumstances, there may be no other forum in which a state could make its claim. For example, a state may not

provide a civil right of action in its domestic law that could be used to seek damage awards for breaches of human rights standards, corrupt activities or environmental degradation. Having an effective right of counterclaim enhances the effectiveness of any investor obligations in an IIA. Also, the possibility to resolve both the investor's claim and the state's counterclaim in one proceeding is more efficient than having two separate proceedings, especially where the claims are related, such as because they arise out of the same facts.

**It may deter investment:** Investors may be deterred from investing in a state where that state has the capacity to seek relief from investor conduct within investor–state proceedings. One of the important benefits of an IIA has been the right of investors to bring states to binding international arbitration for violation of the investor protection provisions of the treaty. Under existing IIAs, states have no way of challenging investor misconduct. The introduction of a counterclaim mechanism may be viewed by investors as too great a limitation of these traditional benefits of investment treaties.

**Counterclaim awards may be more easily enforced than court judgments:** An award of damages by counterclaim will be enforceable by the host state as an arbitral award. By virtue of several international treaties, arbitral awards are readily enforced in most countries in the world.[512] By contrast, court judgments of one country are often not enforceable outside that country.

**It may deter investors from bringing or threatening investor–state claims:** Another important advantage of the right of counterclaim is that it may provide a disincentive for investors to resort to investor–state arbitration or to threaten investor–state arbitration in situations where such investors do not come to the dispute settlement process with clean hands, in the sense that they have breached obligations to the state under domestic law or standards set out in the treaty.

**It reallocates risk and supports sustainable development:** Providing the right of counterclaim in an IIA can help to reallocate the risks of the investment to the investors, rather than allowing the risks to be borne by the host state and the individuals residing in that state. Where investor obligations are included in an IIA, the availability of a counterclaim empowers the state to hold investors accountable for violations of human rights or labour rights or indigenous peoples' rights, environmental damage and harm caused by corrupt practices and to offset any amount awarded by such a counterclaim against any damages awarded in favour of the investor. In doing so, it can help to ensure that foreign investment contributes to sustainable development.

**It may discourage investors from engaging in hazardous activities and incentivise investors to prevent and mitigate adverse impacts:** The introduction of a state right of counterclaim into an IIA for breaches by the investor of its obligations under the treaty with respect to human rights, labour rights, indigenous peoples' rights and for environmental damage or breaches of its obligation to refrain from acts of corruptions may provide a strong incentive for investors to assess their potential impacts in these

512 These treaties are discussed in Section 7.1 (Investor–state dispute settlement).

areas more thoroughly, prior to making their investment, to seek to prevent the most severe effects and to mitigate others in compliance with a management plan. Investors may be more motivated to deal with complaints arising from their impacts through a non-judicial grievance process and to provide adequate reparations where necessary to avoid a counterclaim.

**Right to counterclaim can be complementary to other treaty-based enforcement mechanisms:** The right to counterclaim can supplement other enforcement mechanisms mandated by an investment treaty. As discussed above, the preceding sample provision contemplates that states can sue investors civilly both in their domestic courts and in the courts of the investor's home state where the investor has breached a domestic law obligation in the host state.[513] A counterclaim can be used like civil liability as a last resort where consultation and grievance processes fail. It may provide an incentive to the investor to ensure that consultations and grievance processes are successful.[514]

**Transnational businesses have complex structures:** States bringing a counterclaim will encounter the same problems with enforcing any award against an investor discussed in the preceding section on civil liability, though, as noted, international arbitration awards are typically more easily enforced than domestic court judgments.[515] Many foreign investors are able to restructure or to transfer assets out of the host state to avoid liability. As discussed above, one way to address this problem is to require investors to take out liability insurance for the benefit of the entity through which it is operating in the host state to ensure that sufficient funds are available to satisfy a counterclaim award. Where the investor proposes to engage in hazardous activities in the host state, the host state may also wish to request that the investor post a bond or obtain a guarantee from a financial institution, or even from the home state, to satisfy any excess liability that the insurance will not cover. This will help to ensure that the host state will not be left without the ability to enforce its counterclaim for significant social and financial costs due to severe abuse of rights, environmental damage or harm caused by corrupt practices of the investor in violation of investor obligations.

### 6.17.3 Discussion of sample provision

The Guide sample provision, which is found in the section on dispute settlement,[516] creates a right on the part of the host state to bring an independent claim against an investor in the context of investor–state arbitral proceedings. Thus, if an investor brings an investor–state claim against the host state on the basis that the state has violated its obligations under the agreement or domestic law, the host state may counterclaim for damages that it or its nationals have suffered on the basis that:

513 See Section 6.16 (Civil liability of investors).

514 See Section 6.15 (Grievance procedure and other measures to enforce the management plan produced in the sustainability assessment).

515 See Section 6.16 (Civil liability of investors).

516 See 7.1.7 (Sample provisions: investor–state dispute settlement, Article [W] (Counterclaims)).

i. The investor has failed to comply with the management plan resulting from the sustainability assessment and review;[517]

ii. The investor has failed to comply with any other standard for investor behaviour in the investment treaty;[518] or

iii. The investor is liable to the state for any other reason.

The sample provisions expressly provide that, in submitting its claim, the investor consents to counterclaims based on investor obligations under domestic law or the treaty. An issue that may arise in practice is whether a counterclaim should be available even for relatively minor or technical violations by the investor. As discussed above in the section on civil liability, it would be possible to qualify an investor's liability by establishing a minimum threshold of seriousness. An IIA could provide that only violations that are 'substantial' or 'material' could be the basis of a counterclaim. In the absence of such qualifying language, it would be up to the tribunal to determine whether to hold an investor liable for a minor or technical violation, and if so, what should be the appropriate level of damages. In some investor–state cases, arbitral tribunals have required such a minimum threshold for investor claims based on fair and equitable treatment.[519] In the interests of certainty and to ensure that the counterclaim mechanism is not used for insignificant breaches of domestic law, the sample provision restricts counterclaims to violations of domestic law by the investor that the Tribunal determines are sufficiently serious to justify an award of damages. This language parallels language that imposes an identical limit on the award of damages to investors.[520]

The sample provision also expressly permits the tribunal hearing a case to award damages to the host state where the investor's claim is unsuccessful or results in an award of damages that is less than the award of damages to the host state under the counterclaim.

**Note: The sample counterclaim provision is set out in Section 7.1.7 (Sample provisions: investor–state dispute settlement, Article [W] (Counterclaims)).**

517 See Section 6.6 (Sustainability assessments).

518 See Section 6.7 (Investor obligation to comply with the laws of the host state); Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence); Section 6.9 (Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights); Section 6.10 (Investor obligation to comply with core labour standards); and Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).

519 See Section 5.5 (Fair and equitable treatment and the minimum standard of treatment).

520 See Section 7.1.7 (Sample provisions: investor–state dispute settlement), Article [V] (Final Award)).