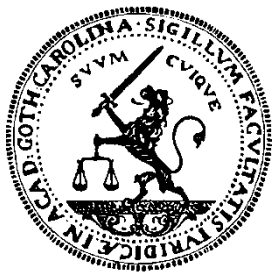

FACULTY OF LAW
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A Rebalancing Act?

Human Rights and Environmental Counterclaims in International Investment Arbitration

JURM02 Graduate Thesis

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Contents

Summary

International investment law (IIL) is a highly complex area of law that consists of around 3000 international investment agreements (IIAs) that aim to promote and protect foreign investment. They provide for investor-State dispute settlement (ISDS) which gives investors the right to sue host States directly through international arbitral tribunals. During the last decade, this system has received significant criticism for being asymmetric as it affords only rights to investors and consequently only obligations for host States. IIL is at the same time becoming increasingly connected to issues of environmental protection and human rights as investors have used the ISDS mechanism to challenge host State's public policy measures in these fields and often been successful in doing so. This has generated further criticism and concerns that the IIL regime is obstructing much needed State efforts to address such non-economic issues. Furthermore, transnational corporations (TNCs) can often avoid liability for environmental destruction and human rights violations when operating abroad due to the lack of a mechanism at the international level that can impose responsibility on such actors.

Reform efforts to rebalance this asymmetry have been made at international level, primarily within the UNCITRAL Working Group III but also at domestic level by renegotiating and reforming IIAs. The increasing significance afforded to the non-economic issues that are implicated in investment law and ISDS can be seen in this progress as well as in arbitral awards in which arbitrators are to a greater extent dealing with such issues. A mechanism that has been presented as a potential tool to further this reform, and rebalance the IIL regime, is counterclaims. States have traditionally rarely raised counterclaims in ISDS but over the last years they have become increasingly common.

This thesis examines the legal framework of counterclaims in ISDS and how such counterclaims have been received by investment tribunals. The

questions that are asked are how counterclaims could support the ongoing reform efforts and how they can be used to promote accountability for TNCs for environmental harm and human rights violations. It draws the conclusion that counterclaims do in fact have great potential to rebalance the system but that the current framework must be improved in order to allow counterclaims by host States to a higher degree. The need for reform of IIAs is discussed as well as the possibilities to interpret existing IIAs in a way that is more open to counterclaims despite their asymmetry. The thesis further concludes that ISDS could become a venue in which TNCs can be held accountable for environmental harm and human rights violations, something that is much needed. However, it also discusses concerns of allocation of authority between arbitral tribunals and domestic courts as well the appropriateness of dealing with such non-economic issues closely related to public policy in *ad hoc* tribunals.

Sammanfattning

Internationell investeringsrätt är ett mycket komplext rättsområde som består av cirka 3000 internationella investeringsavtal som syftar till att främja och skydda utländska investeringar. De tillhandahåller en tvistlösningsmekanism kallad investor-state dispute settlement (ISDS) mellan investerare och stater som ger investerare rätt att stämma värdstater direkt inför internationella skiljedomstolar. Under det senaste decenniet har detta system fått betydande kritik för att vara asymmetriskt eftersom det endast ger investerare rättigheter och följaktligen endast skyldigheter för värdstater. Internationell investeringsrätt blir samtidigt allt mer kopplat till frågor om miljöskydd och mänskliga rättigheter eftersom investerare har använt denna tvistlösningsmekanism för att utmana värdstaters åtgärder på dessa områden och ofta varit framgångsrika med det. Detta har genererat ytterligare kritik och oro för att regelverket hindrar välbehövliga statliga ansträngningar för att ta itu med sådana icke-ekonomiska frågor. Dessutom kan transnationella företag ofta undvika ansvar för miljöförstöring och brott mot mänskliga rättigheter när de verkar utomlands på grund av avsaknaden av en mekanism på internationell nivå som kan ålägga sådana aktörer ansvar.

Reformansträngningar för att balansera denna asymmetri har gjorts på internationell nivå, främst inom UNCITRAL Working Group III men också på nationell nivå genom att omförhandla och reformera internationella investeringsavtal. Den ökande betydelsen av icke-ekonomiska frågor som blir påverkade av internationell investeringsrätt kan ses i dessa ansträngningar såväl som i skiljedomar där skiljemän i större utsträckning tar hänsyn till sådana frågor. En mekanism som har presenterats som ett potentiellt verktyg för att främja denna reform, och balansera systemet, är genstämningar. Stater har traditionellt sällan fört fram genstämningar i tvister gentemot investerare men under de senaste åren har de blivit allt vanligare.

Denna uppsats undersöker rättsläget runt genstämningar i ISDS och hur sådana genstämningar har mottagits av internationella skiljedomstolar. Frågorna som ställs är hur genstämningar kan stödja det pågående reformarbetet och hur de kan användas för att främja ansvarsskyldighet för transnationella företag för miljöskador och brott mot mänskliga rättigheter. Uppsatsen drar slutsatsen att genstämningar faktiskt har stor potential att balansera systemet men att det nuvarande regelverket måste förbättras för att tillåta genstämningar från värdstater i högre grad. Behovet av reformering av internationella investeringsavtal diskuteras liksom möjligheterna att tolka befintliga investeringsavtal på ett sätt som är mer öppet för genstämningar trots deras asymmetri. Vidare dras slutsatsen att ISDS skulle kunna användas för att hålla företag ansvariga för miljöskador och kränkningar av mänskliga rättigheter, något som är välbehövligt. Uppsatsen diskuterar emellertid också frågor om fördelning av befogenheter mellan internationella skiljedomstolar och inhemska domstolar samt lämpligheten av att behandla sådana icke-ekonomiska frågor som är av stort allmänt intresse i temporära internationella skiljedomstolar.

Preface

I would like to thank my supervisor Daria Davitti for valuable input and support throughout this thesis. I also want to thank the librarians at the law faculty's library for helping in the best way possible with whatever I have needed.

Lastly, I want to thank my wonderful family and friends for always believing in me and supporting me, both during the work with this thesis as well as throughout my studies.

Lund, May 2022
Ellen Bisting

Abbreviations

BIT	Bilateral Investment Treaty
COP26	26th United Nations Climate Change Conference of the Parties
CSR	Corporate Social Responsibility
ECT	Energy Charter Treaty
FET	Fair and equitable treatment
ICC	International Chamber of Commerce
ICSID	International Centre for Settlement of Investment Disputes
IIA	International investment agreement
IIL	International investment law
ISDS	Investor-state dispute settlement
OECD	Organisation for Economic Co-operation and Development
OIC Agreement	Organisation of Islamic Cooperation Investment Agreement
PCIJ	Permanent Court of International Justice
SCC	Stockholm Chamber of Commerce
TNC	Transnational corporation
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNCITRAL	United Nations Commission on International Trade Law
UNGPs	United Nations Guiding Principles on Business and Human Rights

1 Introduction

1.1 Background

The adverse effect of human activity on the environment is a concern that over the last few decades has become one of the most prominent issues at the international level. A large number of international instruments aiming to protect the environment and mitigating such adverse effects have been established and, progressively, responsibility has not been put solely on States but also on private actors. Furthermore, the link between environmental protection and human rights has been acknowledged to a higher degree and in 2021 the right to a healthy environment was recognised as a fundamental human right in a resolution adopted by the United Nations Human Rights Council.[1] Initiatives aiming to increase the responsibility of transnational corporations for their harmful activities concerning both the environment and human rights have been developed, with varying degrees of success and in varying forms ranging from soft-law mechanisms to national legislation and NGO-driven advocacy campaigns.[2] But several judicial obstacles lie in the way when it comes to holding TNCs accountable for damage to the environment that they have caused within their operations, such as the difficulties with piercing the corporate veil and the fact that corporations are not considered subjects under international law and

[1] United Nations, UNGA Res 48/13 (18 October 2021) UN Doc A/HRC/RES/48/13.
[2] One of the most noteworthy initiatives have been the United Nations Guiding Principles on Business and Human Rights (UNGPs), developed by then UN Special Representative on business and human rights John Ruggie, see: United Nations, *Guiding Principles on Business and Human Rigths: Implementing the United Nations "Protect, Respect and Remedy" Framework* (2011). A previous soft-law instrument that have gained large recognition is the OECD Guidelines for Multinational Enterprises, see: Organisation for Economic Cooperation and Development (OECD), *OECD Guidelines for Multinational Enterprises* (2011). Other large initiatives that partly address corporate responsibility for mitigating environmental harm also include the UN Global Compact, see <www.unglobalcompact.org> accessed 12 May 2022, the UN Sustainable Development Goals, see <https://sdgs.un.org> accessed 12 May 2022, and the European Green Deal, see <https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal/> accessed 12 May 2022.

therefore do not have obligations under it.[3] However, transnational corporations are more than ever being pushed to take responsibility and remedy the effects of their operations abroad.

This shift is not least noticeable in the area of international investment law. Since the 1960's, several thousand international investment agreements have been concluded between States and since the 1990's, the primary fora for disputes between investors and host States have been international arbitration tribunals. The IIL regime's primary purpose have always been to promote and protect foreign direct investments and the investors providing these in order to encourage economic development.[4] As awareness has increased regarding the need for environmental and human rights protection, the IIL regime, and especially the investor-State dispute settlement mechanism, have been criticised for impeding such protection by States and calls for sustainability within the IIL regime have been made.[5] Regulations and measures put in place by host States in order to protect the environment, limit pollution and ensure the enjoyment of human rights are to a large extent challenged by investors in ISDS, and the number of ISDS cases with such non-economic components have significantly increased in recent years.[6]

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[3] Elisa Morgera, *Corporate Environmental Accountability in International Law* (Oxford University Press 2020) 26-27; Merja Pentikäinen, 'Changing International 'Subjectivity' and Rights and Obligations under International Law – Status of Corporations' (2012) 8(1) *Utrecht Law Review* 145, 147-149.

[4] See, e.g., Barnali Choudbury, 'International Investment Law and Noneconomic Issues' (2020) 53(1) *Vanderbilt Journal of Transnational Law* 1, 2-3; Howard Mann, 'Reconceptualizing International Investment Law: Its Role in Sustainable Development' (2013) 17(2) *Lewis & Clark Law Review* 521, 524.

[5] See, e.g., Arnaud de Nanteuil, *International Investment Law* (Edward Elgar 2020) 372; UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 10; Barnali Choudbury, 'International Investment Law and Noneconomic Issues' (2020) 53(1) *Vanderbilt Journal of Transnational Law* 1, 4; Rosalien Diepeveen and Yulia Levashova and Tineke Lambooy, '"Bridging the Gap between International Investment Law and the Environment", 4th and 5th November, The Hague, The Netherlands' (2014) 30(78) *Utrecht Journal of International and European Law* 145, 146-147.

[6] See, e.g., Howard Mann, 'Reconceptualizing International Investment Law: Its Role in Sustainable Development' (2013) 17(2) *Lewis & Clark Law Review* 521, 533; Jorge E. Viñuales, 'Foreign investment and the environment in international law: current trends' in Kate Miles (ed), *Research Handbook on Environment and Investment Law* (Edward Elgar 2019) 29-31.

One reason for the criticism against the IIL regime is connected to the fact that international investment agreements are seen as asymmetrical in the sense that they only place obligations on the part of the host State and consequently only rights for foreign investors.[7] This is just one part of the legitimacy crisis the system is facing at the moment, and reform work is being made at national, regional and global level.[8]

A mechanism that at times has been presented as a potential tool to rebalance this asymmetry of investment law is counterclaims. When in 2016, an investment tribunal allowed a host State counterclaim based in international human rights law in the award of *Urbaser v. Argentina*[9] for the first time in history, the debate concerning the handling of counterclaims by investment tribunals intensified. The award was seen by some as a fundamental change of international investment law which had the potential of helping to bridge the divide between the investment law regime and human rights law, whereas others doubted the potential of the award and host State counterclaims in general to provide for a rebalancing of the ISDS system and the IIL regime.[10]

The filing of counterclaims by host States in international investment arbitration is not a new phenomenon but has increased dramatically in

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[7] See e.g., Alessandra Arcuri and Francesco Montanaro, 'Justice for All? Protecting the Public Interest in Investment Treaties' (2018) 59(8) *Boston College Law Review* 2791, 2793; Garcia and others, 'Reforming the International Investment Regime: Lessons from International Trade Law' (2015) 18(4) *Journal of International Economic Law* 861, 870-871.

[8] See e.g., Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 13–14.

[9] *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. Argentina* (ICSID Case No. ARB/07/26) Award, 8 December 2016 (*Urbaser v. Argentina*).

[10] See, e.g., Patrick Abel, 'Counterclaims Based on International Human Rights Obligations of Investors in International Investment Arbitration' (2018) *Brill Open Law* 1, 61-90, 89 <https://doi.org/10.1163/23527072-00101003> accessed 12 May 2022; Yulia Levashova, 'The Right of Access to Water in the Context of Investment Disputes in Argentina: Urbaser and beyond' (2020) 16(2) *Utrecht Law Review* 110, 123; Kevin Crow and Lina Lorenzoni Escobar, 'International Corporate Obligations, Human Rights, and the Urbaser Standard: Breaking New Ground' (2018) 36(1) *Boston University International Law Journal* 87, 116-117; Sujoy Sur, 'Urbaser v. Argentina: Analysing the Expanding Scope of Investment Arbitration in Light of Human Rights Obligations' (*EFILA Blog*, 2 May 2017) <https://efilablog.org/2017/05/02/urbaser-v-argentina-analysing-the-expanding-scope-of-investment-arbitration-in-light-of-human-rights-obligations/> accessed 12 May 2022.

recent years. Still, the cases in which a counterclaim has been presented are rather few, and the cases where a counterclaim has been allowed to proceed to a decision on the merits are even fewer. In only two cases, *Burlington v. Ecuador*[11] and *Perenco v. Ecuador*[12], which concerned the same project, did the host State's counterclaim actually succeed and the host State was awarded damages for environmental harm caused by the investor.

These, albeit few, cases raise the question of the potential of counterclaims in investment arbitration to support the reform of international investment law and the ISDS system as well as providing a venue in which transnational corporations can be held accountable for human rights violations and environmental destruction.

1.2 Purpose and research questions

The aim of this thesis is to present some of the current issues that have emerged as international investment law, environmental protection and human rights are becoming increasingly interconnected. More specifically, the purpose is to research how counterclaims can and have been used in ISDS and how they can contribute to promote a more sustainable IIL regime, rebalance the current asymmetry of the ISDS mechanism and increase accountability for TNCs when they operate abroad and cause environmental harm and/or violate human rights. In order to reach this purpose, the thesis aims to answer the following research questions:

- Can human rights and environmental counterclaims serve to rebalance the international investment arbitration system and align it with considerations of issues of human rights and environmental protection?

[11] *Burlington Resources Inc.* v. *Republic of Ecuador* (ICSID Case No. ARB/08/5), Decision on Ecuador's Counterclaims, 7 February 2017 (*Burlington v. Ecuador*).
[12] *Perenco Ecuador Ltd*. v. *Republic of Ecuador and Empresa Estatal Petróleos del Ecuador* (ICSID Case No. ARB/08/6), Award, 27 September 2019 (*Perenco v. Ecuador*).

    - How can host State's counterclaims contribute to the current strive for IIL reform?
    - Can counterclaims be considered an effective tool for investment arbitration reform?
- How can counterclaims in ISDS promote accountability for TNCs for environmental harm and human rights violations?

To be able to answer these questions, and to put the subject of counterclaims in sufficient context, the thesis will also provide an overview of the IIL regime and the ISDS system as they stand today and a historical background of their development as well as present the reasons why the regime has received extensive criticism which have led to calls of reform. Furthermore, the legal framework of counterclaims in investment arbitration will be examined before discussing the role of counterclaims in the ongoing reform of the system.

1.3 Method and materials

In order to answer the research questions presented and achieve the purpose of this thesis, a traditional legal method will be used in the sense that the first part of the thesis will be doctrinal and descriptive to present the issues at hand through a *de lege lata* analysis before examining the problems identified and discuss how the law can be improved and therefore a *de lege ferenda* analysis. A critical perspective will be applied in order to evaluate if and how the use of counterclaims can contribute to the reform of the IIL regime and align it with issues of human rights and environmental protection.

The framework of international investment law is highly complex and fragmented as it consists of around 3000 international investment agreements in the form of mainly bilateral investment treaties (BITs) but

also a smaller number of sectoral and multilateral investment treaties as well as inclusions of investment provisions in free trade agreements.[13] Because of this vast number of legal sources, the work of scholars and academics in the field of international investment law has been used to a large extent in order to present the issues at hand as well as the needed context of them.

A selection of international investment agreements and model BITs has also been used to showcase both the IIL regime as it stands today including provisions commonly found in such agreements as well as progressive developments that have been made in recent years to reform IIL and the ISDS mechanism.

Arbitral awards have also to a large extent been used to research both how issues of environmental protection and human rights have been dealt with by investment tribunals and especially how the submission of counterclaims by host States have been received and reviewed by tribunals in regards to both procedural aspects as well as awards on the merits. Despite the fact that there is no rule of precedent in international investment arbitration, the case law is important when analysing the trends and developments in the area, especially as tribunals often refer to and follow previous awards even though they are only formally binding on the parties to the dispute.

Different types of material from international organisations that have engaged in reform work of IIL and ISDS, such as reports and websites, have provided information about the ongoing efforts at the international level and viewpoints on the underlying issues that have prompted the different efforts to reform and remedy this area of international law.

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[13] Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 15-21.

1.4 Previous research

The implications of international investment law on human rights and the environment is a subject that in recent years has been examined by legal researchers to a rather large extent.[14] However, this research has primarily focused on the potential repercussions of traditional treaty standards on issues of environmental and human rights protection and the tension between the protection of investments, the economic interests of investors and the State right to regulate and enact measures relating to non-economic issues. The notion of counterclaims in ISDS has not been a primary focus and the potential effect the use of counterclaims can have and how this specific area of international investment law has and could evolve is relatively underexplored, even though scholars have increasingly started to devote more attention to it. Various academic articles published in recent years have been of great use in this thesis, both in order to chart the legal framework of counterclaims as well as the potential effect on IIL and ISDS reform.[15]

1.5 Delimitations

Due to the limited scope of this thesis and the highly complex and fragmented nature of international investment law, many features and issues of the IIL regime that are still very relevant to the interconnection between human rights, environmental protection and investment law will have to be left out or only briefly mentioned without thorough analysis. The overview

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[14] See, e.g., Yannick Radi (ed), *Research Handbook on Human Rights and Investment* (Edward Elgar 2018); Kate Miles (ed), *Research Handbook on Environment and Investment Law* (Edward Elgar 2019).

[15] See, e.g., Ted Gleason, 'Examining host-State counterclaims for environmental damage in investor-State dispute settlement from human rights and transnational public policy perspectives' (2021) 21 *International Environmental Agreements: Politics, Law and Economics* 427; Tomoko Ishikawa, 'Counterclaims and the Rule of Law in Investment Arbitration' (2019) 113 *AJIL Unbound* 33; Maxi Scherer, Stuart Bruce and Juliane Reschke, 'Environmental Counterclaims in Investment Treaty Arbitration' (2021) 36(2) *ICSID Review* 413; Xuan Shao, 'Environmental and Human Rights Counterclaims in International Investment Arbitration: at the Crossroads of Domestic and International Law' (2021) 24 *Journal of International Economic Law* 157.

of the IIL regime and its historical development presented in chapter 2 does not nearly discuss all the different parts of international investment law and its history but only aims to provide the reader with enough context to gain a general understanding of the subject. The IIL regime and the ISDS system have also been highly criticised for many years and some of this criticism will be discussed primarily in chapter 3, namely the criticism that is related to growing interference of investment law in the areas of human rights and environmental protection. Criticism relating to other areas such as issues of inconsistency, transparency and to a large degree legitimacy and efficiency concerns will not be thoroughly explored and analysed.
Furthermore, the thesis main focus is on the possibility to submit counterclaims in disputes under investment treaties and largely leaves out discussions about counterclaims founded on investment contracts as it is difficult to draw general conclusions from disputes based on such contracts and as contract-based arbitral awards are often not publicly available.

1.6 Outline

The thesis will begin with an introductory overview of international investment law as well as its historical developments in chapter 2. As already mentioned, the chapter does not aim to provide a full presentation of all aspects of international investment law as that is simply not possible with such a limited scope. The chapter will lay out some of the major events that have led to the development of the current regime. It will also discuss some of the most common substantive provisions in investment treaties that have often been the basis of investor disputes in which an investor has challenged a host State's measures regarding environmental protection and human rights. The chapter will further discuss the procedural protection of investors in IIAs and the foundations of the ISDS system.

Chapter 3 will examine the interaction between environmental protection, human rights and international investment law and focuses on the criticism the regime has received in this area as well the consequences and reform

efforts that have been made in response to it. It will discuss both reform work of international organisations, the renegotiation and modifications of IIAs as well as how investment tribunals have handled implicated non-economic issues in awards.

In the following chapter 4, the notion of counterclaims will be studied. This chapter aims to present the legal framework of counterclaims which is a complex and uncertain area of investment law. The chapter sets out the procedural hurdles that must be overcome in order for a counterclaim to be accepted and focuses to a large extent on case law as investment tribunals have interpreted the issues differently and as the specific wording of the underlying investment treaty is of great importance. The chapter will also discuss investor obligations which are subject to debate as IIAs are traditionally asymmetrical in that they only impose direct obligations on the host State and not on the investor.

Chapter 5 will analyse how counterclaims can be used as a tool for IIL reform and discusses both potential positive effects as well as drawbacks. It will also examine the trends and developments that can be seen regarding the question of counterclaims in ISDS and how this area of law could progress.

Chapter 6 will then analyse the findings that have been made and draw conclusions from it in order to answer the research questions posed. The last chapter will provide some final remarks.

2 Overview of international investment law and the ISDS system

International investment law is a unique sub-field of international law with a number of specific characteristics that sets it apart from other areas of public international law. Perhaps the most distinct feature is that the IIL regime is exceptionally decentralised and does not have a multilateral treaty or an international organisation that it is centred around but instead consists of a myriad of treaties on bilateral, regional and multilateral level, whilst also incorporating customary international law, national law and various forms of contracts. Furthermore, the ISDS mechanism is not a coherent system with one dispute settlement institution but encompasses a variety of arbitral institutions, ad hoc arbitration tribunals and domestic courts.[16]

2.1 History and development

The IIL regime have a long history that cannot be described in detail in this thesis. But in order to give the reader necessary context to understand how this complex field of law have emerged and taken the form it has today, a very brief and general description of the historical developments of international investment law and investment arbitration will be given in this chapter. Some of the issues raised here will be discussed in more depth throughout the thesis.

[16] Joost Pauwelyn, 'Rational Design or Accidental Evolution? The Emergence of International Investment Law' in Zachary Douglas, Joost Pauwelyn and Jorge E. Viñuales (eds), *The Foundations of International Investment Law: Bringing Theory into Practice* (Oxford University Press 2014) 14.

Early developments

The foundation of international investment law stems from the protection by States of their citizens abroad, which have been an important question especially to western States.[17] During the eighteenth and nineteenth centuries, States protected their nationals and their property abroad through diplomatic protection and utilised both economic and political measures as well as military intervention, known as 'gunboat diplomacy'. Home States asserted the right to do so on the claim that injury to a national abroad (or their property) equated an injury to the home State itself.[18] It is important to note that this early development of IIL was set in a time of western colonialism and economic imperialism, and European States and the United States regularly employed threat or use of force to uphold their diplomatic protection claims.[19]

Despite the fact that this western notion of the rights of their nationals abroad was challenged by a number of other standpoints from mainly Latin American countries, most notably the Calvo doctrine[20], by the beginning of the 20th century, a prevalent understanding was reached that foreigners were entitled to a minimum standard of treatment by their host State under customary international law.[21]

After WWII

With the decolonisation that followed after the end of the Second World War, a number of newly independent States emerged which led to an

[17] Arnaud de Nanteuil, *International Investment Law* (Edward Elgar 2020) 2.
[18] Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 2.
[19] Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International 2009) 9-10.
[20] Proposed by the Argentinian jurist Carlos Calvo. A more in-depth analysis of the Calvo doctrine is not possible here due to the limitations of this thesis, but for further details see e.g., Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 3.
[21] Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 4-5.

increase in disputes between these new, developing states and capital-exporting States. This was a time of major political and economic changes and calls for a 'New International Economic Order' was made which created an uncertainty regarding the rules on foreign investment.[22] A number of attempts at creating a multilateral framework for foreign investments were made without success whilst at the same time resort to international arbitration to settle investment disputes increased, which was facilitated by the 1958 New York Convention on the Recognition of Foreign Arbitral Awards. Several States also entered into bilateral treaties with features of investment protection. Furthermore, in 1965, the International Centre for Settlement of Investment Disputes (ICSID) was established which provided an organisational framework for investment arbitration, but consensus on the content of substantial standards for investment protection could still not be reached.[23]

Capital-exporting States were however concerned with constructing an international regime for investment protection to ensure that their national investors were not subjected to arbitrary measures of the host State. These States therefore resorted to bilateral investment treaties, negotiated only by the two parties, when the attempts for a multilateral regime did not succeed.[24] These first BITs were therefore almost exclusively concluded between capital-exporting, developed States and capital-importing, developing (and often newly independent) States with an asymmetrical economic and political relationship.[25] Being drafted by the capital-exporting States, these BITs upheld the strict investor protection standards favoured by these States and although these standards were drafted as reciprocal

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[22] Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 6-7.
[23] Convention on the Settlement of Investment Disputes between States and Nationals of other States, opened for signature 18 March 1965, 575 UNTS 159 (entered into force 14 October 1966) (ISCID Convention); Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International 2009) 20-29.
[24] Kate Miles, *The Origins of International Investment Law* (Cambridge University Press 2013) 84-85.
[25] Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International 2009) 43-44.

obligations, because of the economic inequality between the parties it can be argued that they in practice would only create obligations for the capital-importing States.[26]

After the Cold War

Although BITs had been concluded since the 1960's, and other forms of treaties containing features of investment protection existed even earlier, it was not until the 1990's that the conclusion of BITs really took off. Compared to the 386 investment agreements that were concluded in 1959-1989, almost 2000 BITs were in force by the end of the 1990's.[27] This can be explained by the fact that economic liberalisation and the free market ideology now became seen as the superior political philosophy partly as a result of the exponential growth of several Asian economies with considerable private investment, the fall of the Soviet Union and declining credit flows to developing countries through other alternatives than foreign investment.[28]

This vast increase of international investment treaties also contributed to a surge in investor-state arbitration, especially within the ICSID framework.[29] The ICSID Convention recognised that States could consent to arbitration for future disputes directly in an investment treaty, so called 'arbitration without privity' and already in 1969, the Chad-Italy BIT provided for investor-State arbitration which therefore was the first BIT that both

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[26] Kate Miles, *The Origins of International Investment Law* (Cambridge University Press 2013) 88-89.
[27] Kenneth J. Vandevelde, 'A Brief History of International Investment Agreements' in Karl P. Sauvant and Lisa E. Sachs (eds), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (Oxford University Press 2009) 16; Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International 2009) 48-49.
[28] Kenneth J. Vandevelde, 'A Brief History of International Investment Agreements' in Karl P. Sauvant and Lisa E. Sachs (eds), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (Oxford University Press 2009) 21-22.
[29] Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 13.

contained substantive protection standards and procedural protection in the form of binding investor-State arbitration.[30] However, it took until 1990 before an ICSID tribunal confirmed such 'arbitration without privity', and based its jurisdiction on the consent given by the host State (Sri Lanka) in the UK-Sri Lanka BIT.[31]

This development has led to the current IIL regime consisting of around 3000 IIAs, not only between developed and developing states as was the norm for the first BITs but all across the globe, creating an overlapping network of agreements protecting foreign investment and leading to an abundance of investment arbitration cases.[32]

2.2 Substantive protection standards in international investment agreements

Despite the fragmentation and decentralisation of international investment law, great similarities can be found in most BITs which tend to include a number of common substantive protection standards, albeit with varying stipulations.[33] In cases where an investor challenges measures by the host State for environmental and human rights protection, the standards of fair and equitable treatment (FET) and expropriation, especially in the form of indirect expropriation, are commonly used by investors to claim a breach of the investment treaty, and therefore these standards will be further examined in this section.

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[30] Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International 2009) 45-46.
[31] See further section 2.3; Joost Pauwelyn, 'Rational Design or Accidental Evolution? The Emergence of International Investment Law' in Zachary Douglas, Joost Pauwelyn and Jorge E. Viñuales (eds), *The Foundations of International Investment Law: Bringing Theory into Practice* (Oxford University Press 2014) 31.
[32] UNCTAD, Investment Policy Hub, International Investment Agreements Navigator <https://investmentpolicy.unctad.org/international-investment-agreements> accessed 12 May 2022; Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International 2009) 58-60; Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 13.
[33] Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 16.

2.2.1 Fair and equitable treatment

One of the core substantive protection standards that is commonly found in IIAs is the obligation of the host State to afford foreign investors fair and equitable treatment and it is also the most frequently invoked standard in investment arbitration.[34] This obligation stems from the previously mentioned minimum standard of treatment under customary international law and it is a still contested issue whether the two standards are indistinguishable or not.[35] The practice by tribunals to distinguish the FET standard from that of the minimum standard of treatment and customary international law when no reference to either is made in the treaty they are to interpret, and instead establish it as an independent treaty obligation, has expanded its scope as the term fair and equitable treatment is vague and allows for broad interpretations in lack of a clear definition.[36] Additionally, even if the parties to the investment treaty explicitly declare that fair and equitable treatment is not to be interpretated as going beyond the minimum standard of treatment in customary international law, as was done by the parties to the North American Free Trade Agreement (NAFTA) when the NAFTA Free Trade Commission issued a binding interpretative note in 2001, tribunals have held that also the minimum standard of treatment is part of an evolving customary international law and not limited to the law as it was in the 19th or early 20th century.[37]

One such expansion of the FET standard which have caused a great deal of controversy is the incorporation of the investor's legitimate expectations of which a violation by the host State can amount to a breach of FET. This has

[34] Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 186.
[35] Chester Brown and Domenico Cucinotta, 'Treatment standards in environment-related investor-state disputes' in Kate Miles (ed), *Research Handbook on Environment and Investment Law* (Edward Elgar 2019) 180-181.
[36] Christophe Bondy, 'Fair and Equitable Treatment – Ten Years On' in Jean Engelmayer Kalicki and Mohamed Abdel Raouf (eds), *Evolution and Adaptation; The Future of International Arbitration* (Kluwer Law International 2019) 205-207.
[37] NAFTA Free Trade Commission, *Notes of Interpretation of Certain Chapter Eleven Provisions*, 31 July 2001, at B; Katia Yannaca-Small, 'Fair and Equitable Treatment Standard: Recent Developments' in August Reinisch (ed), *Standards of Investment Protection* (Oxford University Press 2008) 113-115.

further been linked to an obligation of the host State to provide a stable legal and business environment for the investment.[38] One of the most cited arbitral awards regarding this broadening of the standard is *Tecmed v. Mexico*[39] in which the tribunal, when interpreting the FET standard of the Spain-Mexico BIT, related the standard to the *bona fide* principle recognised in international law but also stated that it is not required that the host State acts in bad faith.[40] Drawing from this, the tribunal held that:

> "[…] this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations."[41]

This broad interpretation of the FET standard is certainly setting a very high standard for the host State to comply with, and as a result may deter host States from implementing regulatory measures for the protection of the environment and human rights.[42]

2.2.2 Expropriation

Expropriation is not in itself prohibited in international investment law, on the contrary, expropriation is a right of States recognised in both national law and international law provided that certain requirements for lawfulness are met, such as that the measure serves a public purpose, the payment of

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[38] Chin Leng Lim, Jean Ho and Martins Paparinskins, *International Investment Law and Arbitration: Commentary, Awards and other Materials* (Cambridge University Press 2018) 268.
[39] *Tecnicas Medioambientales Tecmed SA* v. *Mexico* (ICSID Case No. ARB(AF)/00/2), Award, 29 May 2003 (*Tecmed v. Mexico*).
[40] *Tecmed v. Mexico*, para. 153.
[41] *Tecmed v. Mexico*, para. 154.
[42] Kate Miles, *The Origins of International Investment Law* (Cambridge University Press 2013) 169. This issue will be further discussed in chapter 3.

compensation and adherence to due process (including non-discrimination).[43]

As with the FET standard, expropriation clauses in IIAs tend to be constructed vaguely and without specifications of what measures constitute expropriation. The economic interests that are protected under IIAs are also usually abundant, as the definition of 'investment' is often very broad.[44] As well as tangible property, non-property rights such as shareholder rights and contract rights are protected under IIAs as they fall under an extensive definition of 'investment'.[45]

International law distinguishes between direct and indirect expropriation, that is to say when the State deliberately seizes property and transfers the title of private property to itself and when government measures have the effect of depriving the investor of its property despite that not being the aim of the measure.[46] Direct expropriations are today quite uncommon whereas claims of indirect expropriation have gained prominence and are frequently presented in investment arbitration.[47] Furthermore, they often challenge regulatory measures by the host State for the protection of the environment and other public interests. Two different approaches have been taken by arbitration tribunals when assessing claims of indirect expropriation that challenge such regulatory measure, the 'sole effect' doctrine and the 'police powers' doctrine.[48] The 'police powers' doctrine takes into account the

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[43] Chin Leng Lim, Jean Ho and Martins Paparinskins, *International Investment Law and Arbitration: Commentary, Awards and other Materials* (Cambridge University Press 2018) 323.
[44] Chin Leng Lim, Jean Ho and Martins Paparinskins, *International Investment Law and Arbitration: Commentary, Awards and other Materials* (Cambridge University Press 2018) 323-325.
[45] Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 147-148.
[46] Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International 2009) 323;
[47] Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 153.
[48] Ying Zhu, 'Do Clarified Indirect Expropriation Clauses in International Investment Treaties Preserve Environmental Regulatory Space?' (2019) 60(2) *Harvard International Law Journal* 377, 382.

public interest purpose of the host State's regulatory measure when assessing whether the measure amounts to an indirect expropriation or not, as a State's legitimate exercise of police powers do not amount to an expropriation.[49] However, whether a measure falls into a State's accepted police powers or not (and therefore is an indirect expropriation that requires compensation) is seldom easy to distinguish.[50] The 'sole effect' doctrine on the other hand takes investment protection even further, claiming that the effect of the measure on the investment is the only relevant criterion when determining if an expropriation is at hand or not. This creates an obligation for the State to compensate the investor regardless of the purposes behind the measure. The doctrine has been used in a large number of cases, either explicitly or without actually referencing the doctrine but still only giving relevance to the effects of the measure when assessing a claim of expropriation.[51] A well-cited case is the award in *Santa Elena v. Costa Rica*[52] where the tribunal held that:

"While an expropriation or taking for environmental reasons may be classified as a taking for a public purpose, and thus may be legitimate, the fact that the Property was taken for this reason does not affect either the nature or the measure of the compensation to be paid for the taking. That is, the purpose of protecting the environment for which the Property was taken does not alter the legal character of the taking for which adequate compensation must be paid. The international source of the obligation to protect the environment makes no difference."[53]

The case did not concern *whether* Costa Rica had expropriated the investor's property, only the compensation to be paid, but it showcases the way tribunals have often disregarded the reasons behind State measures and only paid attention to the effects of these on the investor.

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[49] Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International 2009) 359.
[50] Ying Zhu, 'Do Clarified Indirect Expropriation Clauses in International Investment Treaties Preserve Environmental Regulatory Space?' (2019) 60(2) *Harvard International Law Journal* 377, 386.
[51] Arnaud de Nanteuil, *International Investment Law* (Edward Elgar 2020) 320-321.
[52] *Compania del Desarrollo de Santa Elena S.A.* v. *The Republic of Costa Rica* (ICSID Case No. ARB/96/1), Award, 17 February 2000 (*Santa Elena v. Costa Rica*).
[53] *Santa Elena v. Costa Rica,* para. 71 (footnote omitted).

2.3 ISDS system and procedural protection of foreign investment

As previously mentioned, investment arbitration between an investor and the host State is not the only way of settling investment disputes, but it has become by far the most used method today.[54] The use of diplomatic protection and domestic courts, which were the primary means of settling investment disputes before investor-State arbitration gained prominence, proved to have their limitations and were not an attractive solution for foreign investors due to potential partiality by the host State's courts and the fact that diplomatic protection is up to the political discretion of the home State government.[55]

The conclusion of the ICSID Convention in 1965 provided an alternative mechanism for investment disputes and the BITs concluded from the 1960's an onwards started offering arbitration not only within the ICSID framework but also other fora, for example the United Nations Commission on International Trade Law (UNCITRAL), the International Chamber of Commerce (ICC), or the Stockholm Chamber of Commerce (SCC). But the first case that recognised jurisdiction on the basis of an offer of arbitration in an investment treaty, not requiring subsequent consent to arbitration by the host State, was the award in *AAPL v. Sri Lanka*[56] in 1990.[57] This decision commenced the broadening of procedural protection for investors, perhaps beyond what was imagined at the conclusion of the ICSID convention and by States when concluding BITs. From now on, investors had the possibility to sue the host State directly in front of an arbitral tribunal, without explicit consent from the host State regarding the specific dispute, as an arbitration

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[54] Chin Leng Lim, Jean Ho and Martins Paparinskins, *International Investment Law and Arbitration: Commentary, Awards and other Materials* (Cambridge University Press 2018) 86-87.
[55] Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 335, 339.
[56] *Asian Agricultural Products Ltd* v. *Sri Lanka* (ICSID Case No. ARB/87/3), Award, 27 June 1990 (*AAPL v. Sri Lanka*).
[57] *AAPL v. Sri Lanka,* para. 18; Gabrielle Kaufmann-Kohler and Michele Potestà, *Investor-State Dispute Settlement and National Courts* (Springer Nature 2020) 11-13.

clause in a BIT was interpreted as an *ex-ante* offer to arbitrate any dispute arising between the State party and a foreign investor, who gives its consent by initiating arbitration. Furthermore, a foreign investor could now invoke rights contained in the BIT directly, despite not being a party to it.[58]

This contributed to the great influx of investment arbitration cases that started in the 1990's. The granting of ISDS in IIAs was seen as attracting and promoting flows of investment, de-politicising investment disputes that were previously dealt with through diplomatic protection and providing investors with international remedies and an alternative to domestic courts.[59]

A novelty of international investment arbitration is also its hybrid nature and the fragmented sources that constitute international investment law. Aspects of both public and private law, international and domestic law are incorporated in the IIL regime, in which arbitrators must navigate when settling investment disputes.[60] Adding to this, decisions by investment tribunals do not have binding effect on other tribunals as there is no rule of precedent in investment arbitration, but tribunals do in fact regularly rely on previous decisions by other tribunals.[61] Considering the vague and undefined standards of protection often invoked in investment disputes, previous awards become an important source of law, and arbitrators can therefore be said to shape the law and act as law-makers.[62]

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[58] Joost Pauwelyn, 'Rational Design or Accidental Evolution? The Emergence of International Investment Law' in Zachary Douglas, Joost Pauwelyn and Jorge E. Viñuales (eds), *The Foundations of International Investment Law: Bringing Theory into Practice* (Oxford University Press 2014) 31-33.
[59] Gabrielle Kaufmann-Kohler and Michele Potestà, *Investor-State Dispute Settlement and National Courts* (Springer Nature 2020) 13.
[60] Zachary Douglas, 'The Hybrid Foundations of Investment Treaty Arbitration' (2003) 74(1) *The British Year Book of International Law* 151, 152-153; Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 15.
[61] Florian Grisel, 'The Sources of Foreign Investment Law' in Zachary Douglas, Joost Pauwelyn and Jorge E. Viñuales (eds), *The Foundations of International Investment Law: Bringing Theory into Practice* (Oxford University Press 2014) 224.
[62] Nicolás M. Perrone, *Investment Treaties and the Legal Imagination: How Foreign Investors Play By Their Own Rules* (Oxford University Press 2021) 109-110.

Several of the characteristic of ISDS that have been presented have led to criticism of the mechanism by various actors such as States, academics and civil society. This backlash has given rise to a growing legitimacy crisis for over a decade, with withdrawals by States from both the ICSID convention and BITs as well as proposals for reform and alternatives to investment arbitration.[63] The causes of this crisis will be further analysed in the following chapter.

[63] Gabrielle Kaufmann-Kohler and Michele Potestà, *Investor-State Dispute Settlement and National Courts* (Springer Nature 2020) 8; Frank J. Garcia and others, 'Reforming the International Investment Regime: Lessons from International Trade Law' (2015) 18 *Journal of International Economic Law* 861, 861-862; Chin Leng Lim, Jean Ho and Martins Paparinskins, *International Investment Law and Arbitration: Commentary, Awards and other Materials* (Cambridge University Press 2018) 477-479.

3 Environmental protection, human rights and IIL

The nexus of international investment law, environmental protection and human rights is an issue that is gaining increasing attention but at the same time, it is not a new concern. Ever since arbitration tribunals started dealing with growing investor-State disputes that involved human rights and environmental issues, the potential effects of IIL on these non-economic concerns have been controversial.[64] Critique concerning potential harm of investment projects to human rights of local populations and the environment of the host-State, the lack of consideration for these issues in ISDS and the use of IIAs to impede regulations aiming to strengthen human rights and environmental protection is continuously being raised.[65] These issues contribute to the backlash against the IIL regime and ISDS mechanisms that is currently undergoing and which has led to denunciation of the system as well as initiatives to amend it. Proposals to reform the IIL system and integrate sustainable development into it have been presented and reform work is being done at various levels, both in intergovernmental organisations and at national level.[66]

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[64] Kate Miles, 'Introduction' in Kate Miles (ed), *Research Handbook on Environment and Investment Law* (Edward Elgar 2019) 1.
[65] Yannick Radi, 'Introduction: taking stock of the societal and legal interplay between human rights and investment' in Yannick Radi (ed), *Research Handbook on Human Rights and Investment* (Edward Elgar 2018) 5-6; Kate Miles, *The Origins of International Investment Law* (Cambridge University Press 2013) 130-133.
[66] Vanina Sucharitkul, 'Backlash in Investment Arbitration', (Jus Mundi, 2022) <https://jusmundi.com/en/document/wiki/en-backlash-in-investment-arbitration> accessed 12 May 2022; Manjiao Chi, *Integrating Sustinable Development in International Investment Law: Normative Incompatibility, System Integration and Governance Implications* (Routledge 2018) 18-19; Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 13-14.

3.1 Criticism of IIL and ISDS

3.1.1 Asymmetry of IIL and ISDS

The need to protect foreign investments (and investors) is rooted in the previous legal regime of diplomatic protection, potentially biased domestic courts and insufficient national law that generated an imbalance to the detriment of foreign investors as compared to host-States. Capital-exporting States required higher protection for their nationals and from this, the current IIL-regime, including the BIT-network and ISDS mechanism developed, to counter this initial imbalance.[67] This development, however, has seen the position of the foreign investor so strengthened that the system has become asymmetrical in favour of investors over host-States.[68] Foreign investors can be said to have gained a privileged status both in relation to the host-State in which they operate and the host-State's domestic investors that do not benefit from the same protection paradigm.[69] Substantive provisions in BITs generally only place obligations on the State, they protect the rights of investors but do not impose obligations on investors to not impose on human rights of a host State's population, which leads to this asymmetry.[70] Furthermore, the right to bring claims under investment arbitration is a right solely given to investors, leaving the host-States, and potentially affected populations in the host-States, with very limited means to challenge investors and invoke their rights in ISDS.[71] Arbitrators have

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[67] For a more critical approach see, e.g., John Linarelli, Margot E. Salomon and Muthucumaraswamy Sornarajah, *The Misery of International Law: Confrontations with Injustice in the Global Economy* (Oxford University Press 2018).
[68] Frank J. Garcia and others, 'Reforming the International Investment Regime: Lessons from International Trade Law' (2015) 18 *Journal of International Economic Law* 861, 869-870.
[69] Mattias Kumm, 'An Empire of Capital? Transatlantic Investment Protection as the Institutionalization of Unjustified Privilege' (2015) 4(3) *ESIL Reflection* <https://esil-sedi.eu/post_name-130/> accessed 12 May 2022, 3-4; Gabrielle Kaufmann-Kohler and Michele Potestà, *Investor-State Dispute Settlement and National Courts* (Springer Nature 2020) 8.
[70] Barnali Choudbury, 'Investor Obligations for Human Rights' (2020) 35(1-2) *ICSID Review* 82, 83.
[71] Alessandra Arcuri and Francesco Montanaro, 'Justice for All? Protecting the Public Interest in Investment Treaties' (2018) 59(8) *Boston College Law Review* 2791, 2798; UN, *Right of everyone to the enjoyment of the highest attainable standard of physical and mental health*, Note by the Secretary-General (11 August 2014) UN Doc A/69/299.

also been accused of being overly investor-friendly and interpreting the vague standards of protection in a way that favour investors, which could be explained by the fact that only investors can initiate arbitration, and therefore arbitrators can be said to be dependent on investors for their employment.[72] Adding to this, the majority of IIAs are limited in their scope, concerning only the investment itself and do not offer any guidance on how to solve conflicts between investment protection and other, non-economic, issues which further explains why tribunals are reluctant to give weight to questions of human rights and environmental protection as their jurisdiction is most often bound to a BIT on which the claim is founded.[73]

3.1.2 Spill-over effects and regulatory chill

The increase of investment disputes implicating social issues and questions of public policy have generated a backlash as investment arbitration is seen as creating spill-over effects in the areas of human rights and environment.[74] The question has been raised whether ISDS has the capacity to deal with such issues of public interest in an appropriate way and balance these with the protection of investments in a way that does not counteract sustainable development, environmental protection and the advancement of human rights.[75]

There is no lack of accounts of large transnational corporations' negative impact on human rights and the environment with tragedies such as the

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[72] Lone Wandahl Mouyal, *International Investment Law and the Right to Regulate: A Human Rights Perspective* (Routledge 2016) 16-17.
[73] Crina Baltag and Ylli Dautaj, 'Promoting, Regulating and Enforcing Human Rights through International Investment Law and ISDS' (2021) 45(1) *Fordham International Law Journal* 1, 23.
[74] Frank J. Garcia and others, 'Reforming the International Investment Regime: Lessons from International Trade Law' (2015) 18 *Journal of International Economic Law* 861, 862-863, 867-869.
[75] Crina Baltag and Ylli Dautaj, 'Promoting, Regulating and Enforcing Human Rights through International Investment Law and ISDS' (2021) 45(1) *Fordham International Law Journal* 1, 30; Frank J. Garcia and others, 'Reforming the International Investment Regime: Lessons from International Trade Law' (2015) 18 *Journal of International Economic Law* 861, 868.

Bhopal disaster, use of child and slave labour in a number of industries and the fossil fuel industry's adverse effects on climate change. The need for regulations to stifle such issues is largely recognised at the international level but when such regulations can be used by investors to invoke treaty violations by host-States, the threat of lawsuits and multimillion-dollar sanctions can thwart States' endeavours to implement policies in these areas and create a so-called 'regulatory chill'.[76] Although the existence of a 'regulatory chill' is somewhat contested[77], several cases can be discerned in which a tribunal's decision, or merely the threat of lawsuits, have led to the host-State changing or repealing regulations concerning environmental protection and protection of public health. One such case is the *Ethyl Corporation v. Canada*[78]-award in which Canada had banned the import of a specific fuel additive in a legislative act, which the claimant alleged breached Canada's obligations in NAFTA's chapter 11.[79] The reason for the ban was that Canada considered the fuel additive to be a considerable risk to human health and Canada objected to the jurisdiction of the tribunal.[80] The tribunal however found that it had jurisdiction and following this, Canada settled the case with the claimant for a significant amount and repealed the ban.[81] Another example is the Indonesian government exempting foreign

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[76] Lone Wandahl Mouyal, *International Investment Law and the Right to Regulate: A Human Rights Perspective* (Routledge 2016) 67-68; Kate Miles, *The Origins of International Investment Law* (Cambridge University Press 2013) 154-155; Barnali Choudbury, 'Investor Obligations for Human Rights' (2020) 35(1-2) *ICSID Review* 82, 87.
[77] See, e.g., Kyla Tienhaara, 'Regulatory Chill and the Threat of Arbitration: A View from Political Science' in Chester Brown and Kate Miles (eds), *Evolution in Investment Law and Arnitration* (Cambridge University Press 2011); George K. Foster, 'Investors, States, and Stakeholders: Power Asymmetries in International Investment and the Stabilizing Potential of International Investment Treaties' (2013) 17(2) *Lewis & Clark Law Review* 361; Joachim Pohl, 'Societal Benefits and Costs of International Investment Agreements: A Critical Review Of Aspects and Available Empirical Evidence'(2018) 65 *OECD Working Paper on International Investment* 2018/01, 61-65.
[78] *Ethyl Corporation* v. *The Government of Canada* (UNCITRAL), Award on Jurisdiction, 24 June 1998 (*Ethyl Corporation v. Canada*).
[79] *Ethyl Corporation v. Canada*, para. 3-7.
[80] *Ethyl Corporation v. Canada,* para. 9; Lone Wandahl Mouyal, *International Investment Law and the Right to Regulate: A Human Rights Perspective* (Routledge 2016) 69.
[81] *Ethyl Corporation v. Canada,* para. 96; Lone Wandahl Mouyal, *International Investment Law and the Right to Regulate: A Human Rights Perspective* (Routledge 2016) 69.

investors from a ban on open-pit mining for environmental reasons when faced with threats of lawsuits from a large number of investors.[82]

With climate change becoming a more and more pressing issue at the international level, pledges from States to reduce their emissions and phase out fossil fuel are being made at an increasing rate such as during the 26th United Nations Climate Change Conference of the Parties (COP26) in Glasgow last year. But IIAs protecting investments in this area, especially the much-criticised Energy Charter Treaty (ECT), which despite long-running efforts has not been amended to suit States' climate agendas, could deter such pledges from becoming practical realities as the threat of lawsuits from investors is great.[83] The fossil fuel industry is the most litigious industry in the ISDS system and it is not uncommon to see multiple arbitrations with different claimants regarding the same project and the same investor raising claims over the same investment over time. Tribunals have also been shown to not take into account the underlying reasons for State measures being implemented when awarding compensation to investors.[84] Adding to this, the costs of arbitration are high in themselves, and not always covered by the cost awards granted by tribunals even if the State is not found to have breached the investment treaty.[85] All this can amount to a significant deterrent for the adoption of climate measures, especially for developing and low/middle-income countries.[86]

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[82] Stuart G. Gross, 'Inordinate Chill: BITS, Non-NAFTA MITS, and Host-State Regulatory Freedom – An Indonesian Case Study' (2003) 24 *Michigan Journal of International Law* 893.
[83] Lukas Shaugg and Greg Muttitt, 'How the Energy Charter Treaty risks undermining the outcomes of COP26' (2022) *Investment Treaty News* <www.iisd.org/itn/en/2022/03/01/how-the-energy-charter-treaty-risks-undermining-the-outcomes-of-cop-26/> accessed 12 May 2022.
[84] Lea Di Salvatore, 'Investor-State Disputes in the Fossil Fuel Industry', (2021) *IISD Report*, available at: <www.iisd.org/publications/report/investor-state-disputes-fossil-fuel-industry> accessed 12 May 2022.
[85] Barnali Choudbury, 'International Investment Law and Noneconomic Issues' (2020) 53(1) *Vanderbilt Journal of Transnational Law* 1, 35-36.
[86] Lea Di Salvatore, 'Investor-State Disputes in the Fossil Fuel Industry', (2021) *IISD Report*, available at: <www.iisd.org/publications/report/investor-state-disputes-fossil-fuel-industry> accessed 12 May 2022.

3.1.3 Lack of accountability for TNCs

Another issue, which has already been touched upon as it is closely related to other forms of criticism of IIL, is how the regime correlates with the general lack of accountability for TNCs for human rights abuses and environmental harm in international law.[87] This lack of accountability stems from the traditional approach in international law where only States are subjects and therefore have direct obligations, together with the changing roles of corporations that due to globalisation and privatisation have an increasingly larger role on the international scene and in areas that traditionally have belonged to the State and are closely related to public policy. Despite efforts to increase accountability for TNCs under international law such as through soft-law instruments and an increase in domestic regulations creating obligations on corporations to respect human rights, no internationally binding instruments that creates such obligations exists.[88]

The IIL regime contributes to this impunity for TNCs in different ways. This can be illustrated by the Texaco/Chevron case in which the US corporation Texaco (which was later acquired by Chevron) caused massive environmental harm in Ecuador which adversely impacted the local population. A civil lawsuit against the company was initiated, which eventually led to a decision of the Ecuadorian National Court of Justice in 2013 in which the company had to pay approximately 9.5 billion USD in compensation. However, the company (now Chevron) refused to do so and because the company no longer had any assets in Ecuador, such funds could not be accessed. Furthermore, in 2009 the company initiated arbitration under the Ecuador-United States BIT (which only came into force after the company had seized its activities in Ecuador, something that did not hinder

[87] Yannick Radi, 'Introduction: taking stock of the societal and legal interplay between human rights and investment' in Yannick Radi (ed), *Research Handbook on Human Rights and Investment* (Edward Elgar 2018) 5-6.
[88] Eric De Brabandere and Maryse Hazelzet, 'Corporate Responsibility and human rights: navigating between international, domestic and self-regulation' in Yannick Radi (ed), *Research Handbook on Human Rights and Investment* (Edward Elgar 2018).

a binding arbitration award), which in 2018 resulted in an award where the tribunal ordered Ecuador to render the decision from 2013 unenforceable due to denial of justice.[89] This case shows how the ISDS mechanism can be used by large, multinational corporation to avoid liability when operating abroad, and it is not the only example.[90]

3.2 Consequences and reform

The criticism presented in the previous section, together with concerns about transparency, legitimacy and consistency, grew into a backlash that started already in the 2000's with attempts to rebalance the NAFTA chapter 11 which had received criticism of overly broad interpretations of the expropriation clause by tribunals. This backlash then grew and resulted in numerous reactions both by States, international organisations, and tribunals.[91]

3.2.1 Denunciations of the system

Starting in 2007, three Latin American States denounced the ICSID convention after having faced a large number of claims from foreign investors, namely Bolivia in 2007, Ecuador in 2009[92], and Venezuela in 2012. This was then followed by unilateral terminations of BITs by these

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[89] *Chevron Corporation and Texaco Petroleum Corporation* v. *Ecuador* (UNCITRAL), Second Partial Award on Track II, 30 August 2018; Lorenzo Pellegrini and others, 'International Investment Agreements, Human Rights, and Environmental Justice: The Texaco/Chevron Case From the Ecuadorian Amazon' (2020) 23 *Journal of International Economic Law* 455, 458-464.

[90] Lorenzo Pellegrini and others, 'International Investment Agreements, Human Rights, and Environmental Justice: The Texaco/Chevron Case From the Ecuadorian Amazon' (2020) 23 *Journal of International Economic Law* 455; Lora Verheecke and others, 'Red Carpet Courts' (Friends of the Earth Europe and International, the Transnational Institute (TNI) and Corporate Europe Observatory (CEO), 2019) <www.tni.org/files/publication-downloads/red-carpet-courts-web.pdf> accessed 12 May 2022.

[91] Chin Leng Lim, Jean Ho and Martins Paparinskins, *International Investment Law and Arbitration: Commentary, Awards and other Materials* (Cambridge University Press 2018), 477-478.

[92] However, Ecuador re-signed the convention in 2021, see: <https://icsid.worldbank.org/news-and-events/news-releases/ecuador-signs-icsid-convention> accessed 12 May 2022.

countries as well as other States such as South Africa, Indonesia, and India.[93] South Africa terminated BITs with several European countries along with Australia during the years 2013-2014, and after facing increasing numbers of ISDS claims, Indonesia followed suit.[94]

However, the effects of both denunciation of the ICSID Convention and the unilateral termination of BITs does not mean that these States were suddenly excluded from the IIL regime and the ISDS mechanism. The effects of a denunciation of the ICSID convention are not entirely clear, but even when that renders ICSID arbitration impossible, many BITs provide for investor-State arbitration under different fora.[95] Arbitration cases also tend to last numerous years, so States can be involved in ISDS long after their withdrawal of consent to arbitration. Furthermore, both BITs and sectoral investment treaties such as the ECT tend to include minimum periods of application and so-called 'survival' (or 'sunset') clauses which prolong the effects of the treaty even after its termination, usually for a decade but for some, even up to 20 years.[96]

3.2.2 Reform of IIAs

A more common approach of States to the backlash against the IIL regime is however the reform of investment treaties, both regarding the substantive rules as well as the procedural protection.[97] Renegotiations of BITs have led

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[93] Vanina Sucharitkul, 'Backlash in Investment Arbitration', (Jus Mundi, 2022) <https://jusmundi.com/en/document/wiki/en-backlash-in-investment-arbitration> accessed 12 May 2022.
[94] Tania Voon and Andrew D. Mitchell, 'Denunciation, Termination and Survival: The Interplay of Treaty Law and International Investment Law' (2016) 31(2) *ICSID Review* 413, 424-425.
[95] Tania Voon and Andrew D. Mitchell, 'Denunciation, Termination and Survival: The Interplay of Treaty Law and International Investment Law' (2016) 31(2) *ICSID Review* 413, 416-419.
[96] James Harrison, 'The Life and Death of BITs: Legal Issues Concerning Survival Clauses and the Termination of Investment Treaties' (2012) 13(6) *The Journal of World Investment & Trade* 928, 933-937.
[97] Chin Leng Lim, Jean Ho and Martins Paparinskins, *International Investment Law and Arbitration: Commentary, Awards and other Materials* (Cambridge University Press 2018), 495.

to the inclusion of other objects and purposes in preambular provisions apart from the traditional, economic objectives of older IIAs.[98] For example, the 2008 United States-Rwanda BIT asserts in its preambular:

"[…] Desiring to achieve these objectives in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labor rights; […] Have agreed as follows:"[99]

Incorporating non-economic objectives in the preambles of BITs has now become a standard rather than an exception, which can be seen in the model BITs that have been adopted in recent years.[100] The preambles of investment treaties can guide tribunals as they set out the objectives and purposes of the treaties, which can affect how other provisions should be interpreted, and arbitral tribunals often refer to the preambles in awards.[101]

IIAs are also increasingly integrating operational clauses relating to the protection of the environment and human rights by, for example, requiring that environmental and social impact assessments be made prior to initiating a project, set out obligations for investors to respect human rights, oblige States to not derogate from environmental and human rights standards to attract investment, or referring to corporate social responsibility (CSR).[102] For example, the 2016 Morocco-Nigerian BIT contains obligations for the

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[98] Laurence Boisson de Chazournes,'Environmental Protection and Investment Arbitration: Yin and Yang?' (2017) 10 *Anuario Colombiano de Derecho Internacional* 371, 380-381.
[99] Preamble, Treaty between the Government of the United States of America and the Government of the Republic of Rwanda Concerning the Encouragement and Reciprocal Protection of Investment, 19 February 2008.
[100] All model BITs available at the UNCTAD Investment Policy Hub adopted in 2017-2021 contain reference to either sustainable development, human rights, environment, other socio-economic matters, or several of these, see <https://investmentpolicy.unctad.org/international-investment-agreements/model-agreements> accessed 12 May 2022. These include the Canada Model BIT (2021), Italy Model Bit (2021), Morocco Model BIT (2019), Belgium-Luxembourg Economic Union Model Bit (2019), The Netherlands Model BIT (2019), Slovakia Model BIT (2019) and Colombia Model BIT (2017).
[101] Manjiao Chi, *Integrating Sustinable Development in International Investment Law: Normative Incompatibility, System Integration and Governance Implications* (Routledge 2018) 20.
[102] Jason Rudall, 'Green Shoots in a Barren World: Recent Developments in International Investment Law' (2020) 67 *Netherlands International Law Review* 453, 455-457; Barnali Choudbury, 'Investor Obligations for Human Rights' (2020) 35(1-2) *ICSID Review* 82, 88.

investor to conduct environmental impact assessments and apply the precautionary principle when doing so.[103] It also requires that investments shall maintain an environmental management system, uphold human rights in the host State and act in accordance with core labour standards.[104]

States are also beginning to narrow the substantive protection standards that traditionally have given way for broad interpretations by arbitral tribunals that have had a negative impact on States' environmental and human rights protections. The 2021 Canadian Model BIT have even removed the FET standard and more clearly defined what constitutes a breach of the minimum standard of treatment.[105] It also contains a specific provision on the right to regulate in areas such as protection of the environment, health, safety, and rights of Indigenous peoples as well as excluding non-discriminatory measures for public purposes from amounting to an indirect expropriation, even if such measures have an effect equivalent to direct expropriation.[106]

3.2.3 Increased importance of human rights and environmental issues in ISDS

There seems to be a trend also amongst investment tribunals to afford greater engagement to issues of human rights and the environment implicated in investment disputes.[107] Tribunals appear to progressively abandon the traditional stance that environmental measures are secondary to investment law as contained in treaties as such measures stems from domestic environmental law and not international law, and are instead giving more room to environmental considerations in a more clear way,

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[103] Article 14, Reciprocal Investment Promotion and Protection Agreement Between the Government of the Kingdom of Morocco and the Government of the Federal Republic of Nigeria, 3 December 2016.
[104] Article 18, Reciprocal Investment Promotion and Protection Agreement Between the Government of the Kingdom of Morocco and the Government of the Federal Republic of Nigeria, 3 December 2016.
[105] Article 8, Canada Model BIT (2021); The FET standard was previously contained in Article 5 of the Canada Model BIT (2004).
[106] Article 3 and 9(3), Canada Model BIT (2021).
[107] Barnali Choudbury, 'International Investment Law and Noneconomic Issues' (2020) 53(1) *Vanderbilt Journal of Transnational Law* 1, 16.

even when such measures are found to be in breach in of investment treaties.[108] For example, in *Unglaube v. Costa Rica*[109] the tribunal took into account environmental considerations when assessing the compensation owed for expropriation and stated that the highest and best use of the property should refer to a "usage appropriate to the environmentally-sensitive surroundings".[110] This reasoning is in stark contrast to previous awards in which tribunals have explicitly ignored environmental considerations in the assessment of compensation, such as the previously mentioned *Santa Elena v. Costa Rica*.[111]

The two cases *Bear Creek v. Peru*[112] and *Bilcon v. Canada*[113], both include dissenting opinions by arbitrators that give greater weight to issues of human rights and environmental protection. In *Bear Creek v. Peru*, the dissenting arbitrator Philippe Sands argued that the conduct of the investor, which led to social unrest amongst the local population, should have been taken into account when deciding the compensation owed to the investor and that the ILO Convention 169[114] concerning rights of indigenous peoples, despite not imposing obligations directly on private investors, is not without significance or legal effects for them.[115] In *Bilcon v. Canada*, the dissenting arbitrator Donald McRae for one holds that the threshold for a breach of NAFTA Article 1105 (concerning the minimum standard of treatment, including fair and equitable treatment and full protection and security) was not reached in the present case (which was held by the majority) and elaborates on potential implications of the case for the

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[108] Jorge E. Viñuales, 'Foreign investment and the environment in international law: current trends' in Kate Miles (ed), *Research Handbook on Environment and Investment Law* (Edward Elgar 2019) 27-28.
[109] *Marion Unglaube* v. *Republic of Costa Rica* (ICSID Case No. ARB/08/1), Award, 16 May 2012 (*Unglaube v. Costa Rica*).
[110] *Unglaube v. Costa Rica*, para. 309.
[111] *Santa Elena v. Costa Rica,* para. 71.
[112] *Bear Creek Mining Corporation* v. *Republic of Peru* (ICSID Case No. ARB/14/21), Award, 30 November 2017 (*Bear Creek v. Peru*).
[113] *Bilcon of Delaware et al* v. *Government of Canada* (PCA Case No. 2009-04), Award on Jurisdiction and Liability, 17 March 2015 (*Bilcon v. Canada*).
[114] International Labour Organization (ILO), *Indigenous and Tribal Peoples Convention*, *C169*, 27 June 1989.
[115] *Bear Creek v. Peru*, Partial Dissenting Opinion of Professor Philippe Sands, paras. 4-10.

application of environmental laws for the NAFTA parties.[116] He suggests that the award can have a chilling effect on environmental review panels and that it will be seen as a remarkable step backwards in environmental protection.[117] The majority however, perhaps in response to the dissenting opinion, did make a lengthy *obiter dictum* to defend its position and justify it in relation to environmental protection, showing at least a greater sensitivity for the implications of investment protection on non-economic issues.[118]

The tribunal in *Urbaser v. Argentina* was the first to admit a counterclaim based on international human rights law. The case will be further discussed later on in this thesis, but the tribunal made a number of interesting statements on the relationship between foreign investment and the protection of human rights. It rejected the view that private parties have no obligation for compliance in relation to human rights and asserted that the principle according to which corporations by nature are not able to be subjects of international law has "lost its impact and relevance".[119] The tribunal then continued to discuss CSR and the commitments therein for corporations to comply with human rights in their foreign operations and stated that "[i]n light of this more recent development, it can no longer be admitted that companies operating internationally are immune from becoming subjects of international law".[120]

In *Aven v. Costa Rica*[121], a dispute brought under the Dominican Republic-Central America-United States Free Trade Agreement (DR-CAFTA), the tribunal discussed investors responsibility in regards to the environment and

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[116] *Bilcon v. Canada*, Dissenting Opinion of Professor Donald McRae, 10 March 2015.
[117] *Bilcon v. Canada*, Dissenting Opinion of Professor Donald McRae, 10 March 2015, para. 51.
[118] *Bilcon v. Canada*, paras. 595-601; Jorge E. Viñuales, 'Foreign investment and the environment in international law: current trends' in Kate Miles (ed), *Research Handbook on Environment and Investment Law* (Edward Elgar 2019) 32-33.
[119] *Urbaser v. Argentina*, paras. 1193-1194.
[120] *Urbaser v. Argentina*, para. 1195.
[121] *David R. Aven and Others* v. *Republic of Costa Rica* (ICSID Case No. UNCT/15/3), Award, 18 September 2018 (*Aven v. Costa Rica*).

stated that "environmental law is integrated in many ways to international law, including DR-CAFTA", and that "[i]t is true that the enforcement of environmental law is primarily to the States, but it cannot be admitted that a foreign investor could not be subject to international law obligations in this field, particularly in the light of Articles 10.9.3, 10.11 and 17 of DR-CAFTA."[122] It further echoed the views of the tribunal in *Urbaser v. Argentina* in that "it can no longer be admitted that investors operating internationally are immune from becoming subjects of international law".[123] The tribunal also interpreted the substantive standards of the IIA in light of environmental provisions and concluded that the host State's measures to protect the environment were not arbitrary and not in breach of the IIA.[124]

Several other cases have also shown increased engagement with environmental issues and human rights, a trend that will likely continue, especially in light of IIAs giving more importance to such issues.[125]

3.2.4 Reform work at the international level

Several intergovernmental organisations are continuously contributing to the reform of the IIL regime. Perhaps the most significant exertion is the UNCITRAL Working Group III, which was mandated in 2017 to identify concerns regarding ISDS and develop potential reform solutions. The working group was tasked with a three-stepped process to: (a) identify and consider concerns regarding investor-State dispute settlement; (b) consider whether reform was desirable in the light of any identified concerns; and (c) develop any relevant solutions to be recommended, if the Working Group

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[122] *Aven v. Costa Rica*, para. 737.
[123] *Aven v. Costa Rica*, para. 738.
[124] *Aven v. Costa Rica*, paras. 585-587, 688.
[125] Barnali Choudbury, 'International Investment Law and Noneconomic Issues' (2020) 53(1) *Vanderbilt Journal of Transnational Law* 1, 32-34; Jason Rudall, 'Green Shoots in a Barren World: Recent Developments in International Investment Law' (2020) 67 *Netherlands International Law Review* 453, 461-467; Jorge E. Viñuales, 'Foreign investment and the environment in international law: current trends' in Kate Miles (ed), *Research Handbook on Environment and Investment Law* (Edward Elgar 2019) 29-37.

were to conclude that reform was desirable.[126] The Working Group have since identified and discussed a variety of concerns regarding ISDS, concluded that reform is desirable, and considered reform options related to the identified concerns.[127] Some notable propositions include an appellate mechanism,[128] a code of conduct for adjudicators,[129] and a standing first instance and appeal investment court.[130]

Other organisations are also conducting and supporting reform work. The United Nations Conference on Trade and Development (UNCTAD) launched the UNCTAD's Investment Policy Framework for Sustainable Development in 2012 which was updated in 2015, consisting of a set of Core Principles for investment policymaking, guidelines for national investment policies, and guidance for policymakers on how to engage in the international investment policy regime, in the form of options for the design and use of international investment agreements.[131] In 2020, UNCTAD also launched the IIA Reform Accelerator which identifies sustainable development-oriented policy options for a number of IIA provisions in need of reform.[132] The focus on sustainable development in investment is also shared by the OECD[133] with the OECD FDI Qualities Initiative which

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[126] United Nations, *Report of the United Nations Commission on International Trade Law,* Fiftieth session, UN Doc A/72/17, paras. 263-264.
[127] UNCITRAL, *Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its forty-second session*, UN Doc A/CN.9/1092, 23 March 2022. For further information on the work of the Working Group, which for the limited scope of this thesis cannot be thoroughly presented here, see UNCITRAL, 'Working Group III: Investor-State Dispute Settlement Reform' <https://uncitral.un.org/en/working_groups/3/investor-state> accessed 12 May 2022.
[128] UNCITRAL, 'Stand-alone review or appellate mechanism' <https://uncitral.un.org/en/appellatemechanism> accessed 12 May 2022.
[129] UNCITRAL, 'Code of conduct' <https://uncitral.un.org/en/codeofconduct> accessed 12 May 2022.
[130] UNCITRAL, 'Standing first instance and appeal investment court, with full-time judges' <https://uncitral.un.org/en/standing> accessed 12 May 2022.
[131] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015).
[132] UNCTAD, *International Investment Agreements Accelerator* (2020); UNCTAD, *World Investment Report 2021: Investing in Sustainable Recovery* (2021), 132-133.
[133] Organisation for Economic Co-operation and Development (OECD).

provides advice on how governments can enhance FDI's contribution to achieving the UN Sustainable Development Goals.[134]

[134] OECD, 'Harnessing investment for sustainable development' <https://www.oecd.org/investment/business-investment-sdgs.htm> accessed 12 May 2022.

4 The legal framework of counterclaims in ISDS

As have been discussed previously in this thesis, the issue of the asymmetry of ISDS is one that has been raising increasing concern, especially as investment arbitration cases increasingly implicates human rights and environmental protection. Within this debate, the concept of counterclaims has been raised as they in general tend to be dismissed by tribunals, furthering the perception of ISDS as asymmetrical.[135] The legal issues surrounding counterclaims in investment arbitration are complex, with tribunals having to determine whether or not a number of requirements are satisfied in order to decide the counterclaim on merit.[136] These questions have been handled differently by tribunals and to a large extent depend on both the arbitration rules under which a claim is brought and on the specific investment treaty applicable in the dispute.[137] The legal framework for counterclaims will therefore be presented below, with cases to exemplify how tribunals have handled these issues.

At the offset, the reader should be informed that the terminology and characterisation of the different requirements for admitting counterclaims varies both amongst scholars and in practice by tribunals, especially regarding the distinction between jurisdictional and admissibility requirements.[138] This distinction does have practical relevance as decisions

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[135] Anne K. Hoffman, 'Chapter 36: Counterclaims' in Meg Kinnear and others (eds), *Building International Investment Law: The First 50 Years of ICSID* (Kluwer Law International 2015) 506-507; Maxi Scherer, Stuart Bruce and Juliane Reschke, 'Environmental Counterclaims in Investment Treaty Arbitration' (2021) 36(2) *ICSID Review* 413, 413-414; Christian Tietje and Kevin Crow, 'The Reform of Investment Protection Rules in CETA, TTIP and Other Recent EU-FTAs: Convincing?' (13 December 2016), 9 <https://ssrn.com/abstract=2885279> accessed 12 May 2021.
[136] Maxi Scherer, Stuart Bruce and Juliane Reschke, 'Environmental Counterclaims in Investment Treaty Arbitration' (2021) 36(2) *ICSID Review* 413, 415-416;
[137] Vasuda Sinha and Gabriel Fusea, 'Counterclaims in Investment Arbitration: Key Threshold Issues for Claimants, Respondents and Tribunals' (2021) 15(1) *Romanian Arbitration Journal* 54, 54-57.
[138] Maxi Scherer, Stuart Bruce and Juliane Reschke, 'Environmental Counterclaims in Investment Treaty Arbitration' (2021) 36(2) *ICSID Review* 413, 415-416, 424.

concerning jurisdiction are reviewable, whilst decisions concerning admissibility are not.[139] The disposition in this thesis have been chosen solely for pedagogical and structural reasons and does not aim to settle the issue concerning the distinction between jurisdiction and admissibility, or other questions of the categorisation of requirements surrounding counterclaims.

4.1 Nature of counterclaims

In order to not confuse terminology and the different instruments that can be used by a respondent, a clarification on the nature of counterclaims is necessary. A counterclaim is an independent claim made by the respondent in the same proceeding as the original claim made by the claimant.[140] It therefore differs from a defence in the sense that it is not presented only to invalidate the factual or legal foundations of the primary claim, but to widen the scope of the original dispute and pursue objectives other than just the dismissal of the primary claim, such as damage compensation beyond the primary claim amount or even particular performance.[141]

This also sets it apart from set-offs, which only aim at lessening or extinguishing the original claim by offsetting the debts between the parties, and therefore decrease the amount the respondent has to pay. A set-off is tied to the primary claim in the sense that it will not be heard unless the case is decided in favour of the original claim.[142]

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[139] Flavia Marisi, *Environmental Interests in Investment Arbitration* (Kluwer Law International 2020) 247; Dafina Atanasova, Adrián Martínez Benoit and Josef Ostranský, 'The Legal Framework for Counterclaims in Investment Treaty Arbitration' (2014) 31(3) *Journal of International Arbitration* 357, 379.
[140] Borzu Sabahi, Noah Rubins and Don Wallace, *Investor-State Arbitration* (2nd edn, Oxford University Press 2019), 180.
[141] Jeremy Sharp and Marc Jacob, 'Counterclaims and State Claims' in Christina Beharry (ed), *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration* (Brill Nijhoff 2018) 350-351; Flavia Marisi, *Environmental Interests in Investment Arbitration* (Kluwer Law International 2020) 237-239.
[142] Flavia Marisi, *Environmental Interests in Investment Arbitration* (Kluwer Law International 2020) 239; Jeremy Sharp and Marc Jacob, 'Counterclaims and State Claims'

4.2 Applicable procedural rules

The most used procedural rules in investor-State investment arbitration are the ICSID and the UNCITRAL arbitration rules.[143] Therefore, and because of the scope of this thesis, the following discussion will be limited to these two sets of rules.

The ICSID institution provides a system of dispute settlement, including an institutional facility and procedural rules for arbitral tribunals constituted in each case.[144] Therefore, several sets of rules under the ICSID system can be applicable in investment arbitration. The rules of primary relevance for this thesis are contained in the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) and the Rules of Procedure for Arbitration Proceedings (ICSID Arbitration Rules).[145] Disputes administered by ICSID can also use other procedural rules, such as the UNCITRAL Arbitration Rules[146] if the parties so agree. Potential procedural rules contained in a BIT under which a dispute is brought will also be of relevance.[147]

In October 2016, ICSID launched an amendment process with the goal of modernising the rules of ICSID dispute settlement.[148] On March 21, 2022,

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in Christina Beharry (ed), *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration* (Brill Nijhoff 2018) 349.

[143] Borzu Sabahi, Noah Rubins and Don Wallace, *Investor-State Arbitration* (2nd edn, Oxford University Press 2019), 75.

[144] Ursula Kriebaum, Christoph Schreuer and Rudolf Dolzer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 342-343.

[145] ICSID, *ICSID Convention, Regulations and Rules* (2006), available at: <https://icsid.worldbank.org/sites/default/files/ICSID%20Convention%20English.pdf> accessed 12 May 2022.

[146] UNCITRAL, *UNCITRAL Arbitration Rules* (2013), available at: <https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/uncitral-arbitration-rules-2013-e.pdf> accessed 12 May (UNCITRAL Arbitration Rules).

[147] Article 44, ICSID Convention; ICSID, 'Introducing ICSID', 17 December 2021 <https://icsid.worldbank.org/sites/default/files/publications/ICSID_Primer_Dec2021.pdf> Accessed 12 May 2022; Borzu Sabahi, Noah Rubins and Don Wallace, *Investor-State Arbitration* (2nd edn, Oxford University Press 2019), 113-115.

[148] ICSID, 'About the ICSID Rule Amendments' <https://icsid.worldbank.org/resources/rules-and-regulations/amendments/about> accessed 12 May 2022. For further information about the amendment process and what changes have

the member States of ICSID approved the amendments, which will enter into effect on 1 July 2022. David Malpass, President of the World Bank Group and Chair of the ICSID Administrative Council said of the process:

> "The amended rules streamline procedures to enable greater access and speed, increase transparency, and enhance disclosures, with the ultimate goal of facilitating foreign investment for economic growth." [149]

Key changes of the rules regard increasing efficiency of the proceedings and enhancing transparency.[150] For the first time, the rules incorporate an obligation of parties to disclose third-party funding, a controversial issue that in recent years have bred great concern.[151] Whether or not the amendments will have the positive impact envisaged remains to be seen.

The UNCITRAL Arbitration Rules were initially adopted in 1976 and have since been updated on several occasions. It was latest revised in 2010 and following the adoption of the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration (UNCITRAL Rules on Transparency) in 2013, these were incorporated in the UNCITRAL Arbitration Rules.[152] Due to these updates, different versions of the UNCITRAL Arbitration Rules

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been made, see: ICSID, 'ICSID Rules and Regulations Amendment' <https://icsid.worldbank.org/resources/rules-amendments> accessed 12 May 2022.

[149] ICSID, 'ICSID Administrative Council Approves Amendment of ICSID Rules' (21 March 2022) <https://icsid.worldbank.org/news-and-events/communiques/icsid-administrative-council-approves-amendment-icsid-rules> accessed 12 May 2022.

[150] Randa Adra, Andrea Noujeim and Leslie Castello, '2022 ICSID Amended Regulations and Rules - What Has Changed?' (*Crowell & Moring LLP,* 24 March 2022) <https://www.crowell.com/NewsEvents/AlertsNewsletters/all/2022-ICSID-Amended-Regulations-and-Rules-What-Has-Changed> accessed 12 May 2022.

[151] Brooke S. Güven, Karl M.F. Lockhart and Michael R. Garcia, 'Chapter 14: Regulating Third-Party Funding in Investor-State Arbitration Through Reform of ICSID and UNCITRAL Arbitration Rules: Holding Global Institutions to Their Development Mandates' in Alan M. Anderson and Ben Beaumont (eds), *The Investor-State Dispute Settlement System: Reform, Replace or Status Quo?* (Kluwer Law International 2020) 287-299.

[152] UNCITRAL, 'UNCITRAL Arbitration Rules' <https://uncitral.un.org/en/texts/arbitration/contractualtexts/arbitration> accessed 12 May 2022.

may be applicable, depending on the wording of the particular investment treaty under which the dispute is brought.[153]

Provisions related to counterclaims

Both the ICSID and the UNCITRAL rules envision the possibility of counterclaims. Article 46 of the ICSID Convention provides that:

"Except as the parties otherwise agree, the Tribunal shall, if requested by a party, determine any incidental or additional claims or counterclaims arising directly out of the subject-matter of the dispute provided that they are within the scope of the consent of the parties and are otherwise within the jurisdiction of the Centre."

The corresponding rule in the ICSID Arbitration Rules states:

"Except as the parties otherwise agree, a party may present an incidental or additional claim or counter-claim arising directly out of the subject-matter of the dispute, provided that such ancillary claim is within the scope of the consent of the parties and is otherwise within the jurisdiction of the Centre."[154]

In a similar manner, Article 21(3) of the UNCITRAL Arbitration Rules provide:

"In its statement of defence, or at a later stage in the arbitral proceedings if the arbitral tribunal decides that the delay was justified under the circumstances, the respondent may make a counterclaim or rely on a claim for the purpose of a set-off provided that the arbitral tribunal has jurisdiction over it."[155]

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[153] Borzu Sabahi, Noah Rubins and Don Wallace, *Investor-State Arbitration* (2nd edn, Oxford University Press 2019), 78.
[154] Rule 40(1), ICSID Arbitration Rules.
[155] The previous version of the UNCITRAL Arbitration Rules from 1976, which are still applicable in many investment disputes if the IIA was concluded before the new rules entered into force, refer to counterclaims 'arising out of the same contract' in art. 19(3). However, this does not have significance for the purpose of this thesis as the term 'contract' have not hindered claims arising out of investments treaties (which technically are not 'contracts') and should therefore likewise not impact counterclaims arising out of the same investment treaty, see: Pierre Lalive and Laura Halonen, 'On the Availability of Counterclaims in Investment Treaty Arbitration' (2011) 2 *Czech Yearbook of International Law* 141, 145.

However, the requirements in these provisions have been interpreted differently by arbitral tribunals, especially in conjunction with procedural clauses relating to jurisdiction and consent in different IIAs. These discrepancies will be further examined in the following sections.

4.3 Jurisdiction

The question of jurisdiction depends primarily on the parties' consent to arbitration.[156] As have been mentioned before, ever since *AAPL v. Sri Lanka*, a State's consent to arbitrate is contained in the applicable investment treaty which provides a unilateral offer to arbitrate by the State, subject to the procedural provisions in the treaty, which the investor accepts, and therefore consents to arbitration on these terms, by submitting a claim to the relevant institution.[157] However, when it comes to counterclaims, the parties' consent to arbitration must also encompass the particular counterclaim presented by the host State, and therefore such consent must be determined on a case-by-case basis depending on the particular wording of the investment treaty on which the dispute is based.[158] Tribunals that have dealt with counterclaims raised by host States have through different ways evaluated whether such consent can, or cannot, be established and taken different approaches in this evaluation.

The relationship between the applicable investment agreement and the arbitration rules of the forum chosen for the dispute have led to two different approaches when it comes to establishing consent, depending on

[156] Pierre Lalive and Laura Halonen, 'On the Availability of Counterclaims in Investment Treaty Arbitration' (2011) 2 *Czech Yearbook of International Law* 141, 146.
[157] See section 2.3; Dafina Atanasova, Adrián Martínez Benoit and Josef Ostranský, 'The Legal Framework for Counterclaims in Investment Treaty Arbitration' (2014) 31(3) *Journal of International Arbitration* 357, 362, 365-366.
[158] Maxi Scherer, Stuart Bruce and Juliane Reschke, 'Environmental Counterclaims in Investment Treaty Arbitration' (2021) 36(2) *ICSID Review* 413, 416.

which instrument is given priority over the other.[159] In a much-cited dissenting opinion of Professor Michael Reisman in *Roussalis v. Romania*[160], he put forward the view that when State parties to a BIT consent to ICSID jurisdiction, the consent component of Article 46 in the ICSID Convention is *ipso facto* imported into any ICSID arbitration which an investor elects to pursue.[161] This reasoning would mean that the consent of the parties in the underlying BIT is expanded by the arbitrational rules of ICSID, when ICSID arbitration is chosen as the forum for a dispute.[162] This view have been endorsed by some scholars[163] and the declaration of Professor Reisman was cited by the tribunal in *Goetz v. Burundi*[164], which held that it does not matter that the BIT does not contain any provision on the possibility of counterclaims and that it would be against both the letter and the spirit of the ICSID convention to decline jurisdiction for a counterclaim that is directly related to the subject of the dispute.[165] However, the tribunal in *Goetz v. Burundi* did examine the dispute resolution clause in the BIT before coming to this conclusion, which was arguably broader than the relevant clause in *Roussalis v. Romania* which the majority asserted narrowed jurisdiction to claims brought by an investor as it referred to "[d]isputes between an investor of a Contracting Party and the

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[159] Dafina Atanasova, Adrián Martínez Benoit and Josef Ostranský, 'The Legal Framework for Counterclaims in Investment Treaty Arbitration' (2014) 31(3) *Journal of International Arbitration* 357, 362, 366.
[160] *Spyridon Roussalis* v. *Romania* (ICSID Case No. ARB/06/1) Award, 7 December 2011 (*Roussalis v. Romania)*.
[161] *Roussalis v. Romania*, Declaration by Professor Michael Reisman, 28 November 2011.
[162] Vasuda Sinha and Gabriel Fusea, 'Counterclaims in Investment Arbitration: Key Threshold Issues for Claimants, Respondents and Tribunals' (2021) 15(1) *Romanian Arbitration Journal* 54, 60.
[163] Mark N. Bravin and Alex B. Kaplan, 'Arbitrating closely related counterclaims at ICSID in the wake of *Spyridon Roussalis v. Romania*' (2013) 3 *Yearbook on International Arbitration* 185, 196; Zachary Douglas, 'The Enforcement of Environmental Norms in Investment Treaty Arbitration' in Pierre-Marie Dupuy and Jorge Viñuales (eds), *Harnessing Foreign Investment to Promote Environmental Protection: Incentives and Safeguards* (Cambridge University Press 2013), 432-433.
[164] *Antoine Goetz & Others and S.A. Affinage des Metaux* v. *Republic of Burundi* (ICSID Case No. ARB/01/2) Award, 21 June 2012 (*Goetz v. Burundi*).
[165] *Goetz v. Burundi*, paras. 279-280; Vasuda Sinha and Gabriel Fusea, 'Counterclaims in Investment Arbitration: Key Threshold Issues for Claimants, Respondents and Tribunals' (2021) 15(1) *Romanian Arbitration Journal* 54, 60.

other Contracting Party concerning an obligation of the latter […]".[166] The majority held that this limited the scope of permissible disputes and that the tribunal's jurisdiction *ratione materiae* therefore did not cover counterclaims by the host State.[167] The argumentation of the majority in *Roussalis v. Romania* was also upheld in *Oxus Gold v. Uzbekistan*[168] concerning similar language in the United Kingdom-Uzbekistan BIT.[169]

The opinion held by Professor Reisman, and in part echoed by the tribunal in *Goetz v. Burundi*, were based to a large extent on policy considerations such as procedural efficiency, limiting costs that will undoubtedly increase if the host State is forced to pursue claims in national courts despite their connectedness to the investment dispute brough before a tribunal and the implications, including further BIT claims that can arise from such procedures.[170] However, permitting such policy considerations to prevail over treaty language that precludes counterclaims, and the opinion of Professor Reisman, have been criticised by scholars and no consensus on the possibility of *ipso facto* importation of consent from the ICSID convention can be said to exist.[171]

The prevailing view consequently seems to be that the relevant IIA must allow for counterclaims for the tribunal to have jurisdiction. Judging from a number of investment tribunals' decisions, this can be achieved by a dispute

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[166] *Roussalis v. Romania*, paras. 868-869; *Goetz v. Burundi*, paras. 276-278; Maxi Scherer, Stuart Bruce and Juliane Reschke, 'Environmental Counterclaims in Investment Treaty Arbitration' (2021) 36(2) *ICSID Review* 413, 421-422.
[167] *Roussalis v.* Romania, para. 869; Dafina Atanasova, Adrián Martínez Benoit and Josef Ostranský, 'The Legal Framework for Counterclaims in Investment Treaty Arbitration' (2014) 31(3) *Journal of International Arbitration* 357, 371-372.
[168] *Oxus Gold* v. *The Republic of Uzbekistan* (UNCITRAL), Final Award, 17 December 2015 (*Oxus Gold v. Uzbekistan*).
[169] *Oxus Gold v. Uzbekistan*, paras. 944-948.
[170] *Roussalis v. Romania*, Declaration by Professor Michael Reisman, 28 November 2011.
[171] Dafina Atanasova, Adrián Martínez Benoit and Josef Ostranský, 'The Legal Framework for Counterclaims in Investment Treaty Arbitration' (2014) 31(3) *Journal of International Arbitration* 357, 367-368; Anne K. Hoffman, 'Chapter 36: Counterclaims', in Meg Kinnear and others (eds), *Building International Investment Law: The First 50 Years of ICSID* (Kluwer Law International 2015) 520; Maxi Scherer, Stuart Bruce and Juliane Reschke, 'Environmental Counterclaims in Investment Treaty Arbitration' (2021) 36(2) *ICSID Review* 413, 421-422, 424.

resolution clause that is sufficiently broad and therefore establishes an implied consent of the parties and in extension, jurisdiction of a tribunal over a counterclaim. This is most commonly the case when a dispute resolution clause refers to 'all' or 'any' disputes that may arise form an investment, as was the case in *Saluka v. Czech Republic*[172] where the tribunal based its decision on Article 8 of the Czech Republic-Netherlands BIT and stated that:

> "The Tribunal agrees that, in principle, the jurisdiction conferred upon it by Article 8, particularly when read with Article 19.3, 19.4 and 21.3 of the UNCITRAL Rules, is in principle wide enough to encompass counterclaims. The language of Article 8, in referring to "All disputes," is wide enough to include disputes giving rise to counterclaims, so long, of course, as other relevant requirements are also met. The need for a dispute, if it is to fall within the Tribunal's jurisdiction, to be "between one Contracting Party and an investor of the other Contracting Party" carries with it no implication that Article 8 applies only to disputes in which it is an investor which initiates claims."[173]

This was cited in the subsequent case of *Paushok v. Mongolia*[174] in which the tribunal followed the reasoning of the *Saluka v. Czech Republic* tribunal with the addition that there is no need to differ between a reference only to "disputes", as was the case in the Mongolia-Russian Federation BIT, as opposed to "all disputes".[175] Similarly, the tribunal in *Al-Warraq v. Indonesia*[176] found that the dispute resolution clause in the underlying agreement allowed for counterclaims, and potentially even arbitration initiated by the host State, as it referred to resort to arbitration by "each party".[177] The tribunal in *Urbaser v. Argentina* had a similar line of argumentation and concluded that the dispute resolution clause in the Argentina-Spain BIT was completely neutral in regards to the identity of the

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[172] *Saluka Investments B.V*. v. *The Czech Republic* (UNCITRAL), Decision on Jurisdiction over the Czech Republic's Counterclaim, 7 May 2004 (*Saluka v. Czech Republic*).
[173] *Saluka v. Czech Republic*, para. 39.
[174] *Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company* v. *The Government of Mongolia* (UNCITRAL), Award on Jurisdiciton and Liability, 28 April 2011 (*Paushok v. Mongolia*).
[175] *Paushok v. Mongolia*, para. 689.
[176] *Hesham T. M. Al Warraq* v. *Republic of Indonesia* (UNCITRAL), Final Award, 15 December 2014 (*Al-Warraq v. Indonesia*).
[177] *Al-Warraq v. Indonesia*, paras.660-661.

claimant or respondent in an investment dispute "between the parties" as it made no distinction of which party could initiate arbitration.[178] The tribunal therefore held that both the investor and the host State had the right to submit a dispute to arbitration and that this dual possibility meant that counterclaims were envisaged as "when both parties are entitled to lodge a claim, it cannot happen that in acting first one party could prevent the other from raising its claim. This can be avoided only by admitting the possibility of a counterclaim."[179] Nonetheless, despite broad treaty language such as 'any', 'all', or simply 'disputes', tribunals have asserted that if the relevant provision nonetheless only references the bringing of claims by investors, this bars jurisdiction over counterclaims by the host State, as no consent for claims of the host State can be established.[180]

Drawing from this jurisprudence, the general consensus seems to be that the wording of the investment treaty on which a dispute is founded, sets the limits of the parties' consent. Thus, implied consent in regards to counterclaims cannot be construed, either by *ipso facto* importation of arbitration rules allowing for counterclaims, or otherwise broadly worded dispute resolution clauses, if the dispute resolution clause of the investment agreement narrows the right to bring a claim only to investors, or if it narrows the scope of the consent only to obligations of the host State.[181]

This has the effect that counterclaims by host States are often not accepted due to the limitations of the parties' consent contained in dispute resolution clauses in IIAs. However, the jurisdictional hurdles for States to bring

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[178] *Urbaser v. Argentina*, para. 1143.
[179] *Urbaser v Argentina*, para. 1144.
[180] *Rusoro Mining Ltd.* v. *Bolivarian Republic of Venezuela* (ICSID Case No. ARB(AF)/12/5), Award, 22 August 2016, paras. 619-628; *Karkey Karadeniz Elektrik Uretim A.S.* v. *Islamic Republic of Pakistan* (ICSID Case No. ARB/13/1), Award, 22 August 2017, paras. 1011-1016.
[181] Maxi Scherer, Stuart Bruce and Juliane Reschke, 'Environmental Counterclaims in Investment Treaty Arbitration' (2021) 36(2) *ICSID Review* 413, 422; Dafina Atanasova, Adrián Martínez Benoit and Josef Ostranský, 'The Legal Framework for Counterclaims in Investment Treaty Arbitration' (2014) 31(3) *Journal of International Arbitration* 357, 375-376.

counterclaims may be lessened in the future as there seems to be a greater interest of States to include express provisions allowing for counterclaims in more recently negotiated investment treaties.[182] Examples include the 2018 Argentina-United Arab Emirates BIT, stating that:

"Upon submission of its counter-memorial, or at a later stage of the proceedings, if the Arbitral Tribunal decides that, under the circumstances, the delay is justified, the respondent may submit a counter-claim directly related with the dispute, provided that the disputing party shall specify precisely the basis for the counter-claim."[183]

The 2016 Iran-Slovakia BIT is another example:

"The respondent may assert as a defense, counterclaim, right of set off or other similar claim that the claimant has not fulfilled its obligations under this Agreement to comply with the Host State law or that it has not taken all reasonable steps to mitigate possible damages."[184]

Nevertheless, despite these and other examples[185], explicit consent to counterclaims is still far from the norm in IIAs and most investment disputes between investors and host States are still under the older generation of IIAs.[186] The case law concerning implied consent to the bringing of counterclaims is therefore still of the utmost relevance.

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[182] Godwin Tan and Andrea Chong, 'The future of environmental counterclaims in ICSID arbitration: challenges, treaties and interpretations' (2020) 9(2) *Cambridge International Law Journal* 176, 187; Maxi Scherer, Stuart Bruce and Juliane Reschke, 'Environmental Counterclaims in Investment Treaty Arbitration' (2021) 36(2) *ICSID Review* 413, 417-418.
[183] Article 28(4), Agreement for the Reciprocal Promotion and Protection of Investments between the Argentine Republic and the United Arab Emirates, 16 April 2018.
[184] Article 14(3), Agreement between the Slovak Republic and the Islamic Republic of Iran for the Promotion and Reciprocal Protection of Investments, 19 January 2016.
[185] See, e.g., Article 13(3), Bilateral Agreement for the Promotion and Protection of Investments between the Government of the Republic of Colombia and the Government of the United Arab Emirates, 12 November 2017.
[186] Ted Gleason, 'Examining host-State counterclaims for environmental damage in investor-State dispute settlement from human rights and transnational public policy perspectives' (2021) 21 *International Environmental Agreements: Politics, Law and Economics* 427, 440.

4.4 Admissibility

The issue of admissibility consists primarily of the question of whether the counterclaim is sufficiently connected to the primary claim. The prerequisite can be found in the ICSID rules as both article 46 of the ICSID Convention and article 40 of the ICSID Arbitration Rules requires that a counterclaim arises "directly out of the subject-matter of the dispute", but it has also been held to be a general principle.[187] The UNCITRAL Arbitration Rules does not explicitly require a connectedness between a counterclaim and a primary claim but tribunals constituted under these rules have nevertheless insisted on such a connection.[188]

As previously mentioned, the requirement of connectedness has by some tribunals been treated as a question of jurisdiction rather than admissibility.[189] This characterisation can have practical relevance and is not merely academic[190], but this thesis does not aim to settle that debate and the question will therefore not be further addressed.

As with consent of the parties, what the connectedness requirement actually entails is debated, and tribunals have differed in their determinations of it. The tribunal in *Saluka v. Czech Republic* required that counterclaims of the host State share both a factual and legal basis with the primary claim, and this assessment was followed by the *Paushok v. Mongolia* tribunal. As the counterclaim in both cases were based on domestic law, they were dismissed.[191] This approach has been criticised by commentators as being

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[187] Vasuda Sinha and Gabriel Fusea, 'Counterclaims in Investment Arbitration: Key Threshold Issues for Claimants, Respondents and Tribunals' (2021) 15(1) *Romanian Arbitration Journal* 54, 63-64.
[188] See, e.g., *Saluka v. Czech Republic*, para. 76; *Paushok v. Mongolia*, para. 694.
[189] Maxi Scherer, Stuart Bruce and Juliane Reschke, 'Environmental Counterclaims in Investment Treaty Arbitration' (2021) 36(2) *ICSID Review* 413, 425.
[190] Dafina Atanasova, Adrián Martínez Benoit and Josef Ostranský, 'The Legal Framework for Counterclaims in Investment Treaty Arbitration' (2014) 31(3) *Journal of International Arbitration* 357, 379-380.
[191] *Saluka v. Czech Republic*, paras. 76-79; *Paushok v. Mongolia*, para. 694.

too strict and making counterclaims in investment arbitration virtually impossible.[192]

More recently, other tribunals have deemed a factual connection as sufficient.[193] In *Al-Warraq v. Indonesia,* the tribunal simply stated that Indonesia's counterclaim was "closely related both to the investment and to the Claimant's claims" and that the counterclaim was based on the same factual basis as the primary claims.[194] Similarly, the tribunal in *Burlington v. Ecuador* briefly discussed the requirements of Article 46 of the ICSID Convention and affirmed that the counterclaims "arise directly out of the subject-matter of the dispute, namely Burlington's investment in Blocks 7 and 21."[195] In *Urbaser v. Argentina*, the tribunal asserted that the factual link between the primary claim and the counterclaim was manifest, as it was based on the same investment. However, the tribunal also discussed the legal connection and deemed it established "to the extent the Counterclaim is not alleged as a matter based on domestic law only".[196] This suggests that the tribunal would not have been satisfied with only a factual connection, although it also discussed reasons of procedural efficiency and declared that it would be "wholly inconsistent" to have separate proceedings for the claims.[197]

It therefore seems that the issue of connectedness remains unclear, and tribunals' decisions on the questions may continue to be inconsistent.

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[192] Dafina Atanasova, Adrián Martínez Benoit and Josef Ostranský, 'The Legal Framework for Counterclaims in Investment Treaty Arbitration' (2014) 31(3) *Journal of International Arbitration* 357, 380-386; Pierre Lalive and Laura Halonen, 'On the Availability of Counterclaims in Investment Treaty Arbitration' (2011) 2 *Czech Yearbook of International Law* 141, 154.
[193] See e.g., *Inmaris Perestroika Sailing Maritime Services GmbH and Others* v. *Ukraine* (ICSID Case No. ARB/08/8), Award, 1 March 2012, para. 432; *Goetz v. Burundi*, para. 285.
[194] *Al-Warraq v. Indonesia*, para. 667.
[195] *Burlington v. Ecuador*, para. 62.
[196] *Urbaser v. Argentina*, para. 1151.
[197] *Urbaser v. Argentina*, para. 1151.

4.5 Obligations of investors

For a host State's counterclaim to succeed, an obligation of the investor must evidently be found, and subsequently breached. However, as has been discussed, establishing an obligation for an investor also implicates whether or not a counterclaim is arbitrable at all, as the parties' consent must encompass such an obligation, and has therefore at times been treated as a jurisdictional issue by tribunals.[198] Other tribunals have handled the questions at the merits phase of the dispute.[199] The division made in this thesis between jurisdiction and obligations of investors is purely for structural reasons and does not intend to solve the question or promote one viewpoint over the other. Regardless, a host State presenting a counterclaim must found it on an arguable cause of action for it to be accepted, that is to say show that a substantive obligation of the investor existed, and that this obligation was breached.[200]

Apart from the material scope of the parties' consent, which can hinder a counterclaim by a host State, the applicable law clause of an investment treaty may also have importance for the finding of investors' obligations. If an IIA does not contain any instructions on the applicable law, the IIA itself constitutes *lex specialis* as a general rule and because of the traditional approach to not include investors' obligations in such agreements, a counterclaim can be difficult to sustain.[201] However, as discussed in section 3.2.2 of this thesis, States are increasingly incorporating explicit obligations

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[198] See section 4.3; Dafina Atanasova, Adrián Martínez Benoit and Josef Ostranský, 'The Legal Framework for Counterclaims in Investment Treaty Arbitration' (2014) 31(3) *Journal of International Arbitration* 357, 370; Anna Bilanová, 'Environmental Counterclaims in Investment Arbitration' (2020) 5(1) *European Investment Law & Arbitration Review Online* 400 <https://brill-com.ludwig.lub.lu.se/view/journals/eilo/5/1/article-p400_17.xml> accessed 12 May 2022, 402.
[199] *Urbaser v. Argentina*, para. 1156, under the section 'B. The Merits of the Counterclaim'.
[200] Maxi Scherer, Stuart Bruce and Juliane Reschke, 'Environmental Counterclaims in Investment Treaty Arbitration' (2021) 36(2) *ICSID Review* 413, 427-428.
[201] Pierre Lalive and Laura Halonen, 'On the Availability of Counterclaims in Investment Treaty Arbitration' (2011) 2 *Czech Yearbook of International Law* 141, 150; Andrea K. Bjorklund, 'The Role of Counterclaims in Rebalancing Investment Law' (2013) 17(2) *Lewis & Clark Law Review* 461, 469.

of investors in IIAs. Tribunals have also in the past found a cause of action for a host State's counterclaim, despite a lack of explicit obligations for investors in the relevant IIA.[202]

Obligations sourced from domestic law of the host State

In the previously mentioned *Aven v. Costa Rica*, the tribunal found that articles 10.9.3.c and 10.11 of the DR-CAFTA construed an obligation for foreign investors, not just under domestic law but also under the DR-CAFTA, to comply with environmental domestic laws and regulations, including measures adopted by the host State to protect human, animal, or plant life or health.[203] The case concerned the construction of a tourism project by US investors which was halted when Costa Rican authorities initiated environmental investigations after complaints from neighbours.[204] The investors claimed that Costa Rica had breached the FET standard as well as indirectly expropriated the investment.[205] Costa Rica counterclaimed that the claimants unauthorised works harmed the environment of the project's site and therefore should be ordered to repair the damages.[206] The tribunal found that since the treaty protected the host State's right to regulate and enforce measures for protecting the environment, these measures are binding on everyone under the jurisdiction of the State, particularly foreign investors. Therefore, a breach of such measures by a foreign investor would amount to a breach of both domestic law and international law.[207] Regrettably, Costa Rica's counterclaim failed on procedural grounds as the tribunal found that the pleading requirements in

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[202] Godwin Tan and Andrea Chong, 'The future of environmental counterclaims in ICSID arbitration: challenges, treaties and interpretations' (2020) 9(2) *Cambridge International Law Journal* 176, 187.
[203] *Aven v. Costa Rica*, paras. 732-734; Article 10.11 of the DR-CAFTA reads: "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."
[204] *Aven v. Costa Rica*, paras. 93-181.
[205] *Aven v. Costa Rica*, paras. 359-363.
[206] *Aven v. Costa Rica*, para. 689.
[207] *Aven v. Costa Rica*, paras. 732-735.

the UNCITRAL Arbitration Rules were not sufficiently met in a timely manner, so the counterclaim was never decided on the merits.[208] However, the assertion of the possibility to incorporate investor's obligation under domestic law in the investment treaty through provisions protecting the host State's right to regulate should still be considered a major development as tribunals previously have dismissed counterclaims based on domestic law, despite treaty language referencing such a right.[209]

A more obvious example of how domestic law can be incorporated in an IIA to establish investors' obligations can be seen in *Al-Warraq v. Indonesia*. The dispute was based on the Organisation of Islamic Cooperation Investment Agreement (OIC Agreement) in which Article 9 reads:

> "The investor shall be bound by the laws and regulations in force in the host state and shall refrain from all acts that may disturb public order or morals or that may be prejudicial to the public interest. He is also to refrain from exercising restrictive practices and from trying to achieve gains through unlawful means."

The tribunal held that this article imposed a positive obligation on investors and that this obligation was raised from "the plane of domestic law (and jurisdiction of domestic tribunals) to a treaty obligation binding on the investor in an investor state arbitration."[210]

In the intertwined cases of *Burlington v. Ecuador* and *Perenco v. Ecuador*, Ecuador raised nearly identical counterclaims against the two enterprises, alleging damages to the environment and infrastructure. The cases

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[208] *Aven v. Costa Rica*, para. 745-746.
[209] Vasuda Sinha and Gabriel Fusea, 'Counterclaims in Investment Arbitration: Key Threshold Issues for Claimants, Respondents and Tribunals' (2021) 15(1) *Romanian Arbitration Journal* 54, 75-76; See, e.g., *Rusoro Mining Ltd.* v. *Bolivarian Republic of Venezuela* (ICSID Case No. ARB(AF)/12/5), Award, 22 August 2016, para. 628. Part II.10.a of the Annex to the Canada-Venezuela BIT which the dispute was based on reads: "Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting, maintaining or enforcing any measure otherwise consistent with this Agreement that it considers appropriate to ensure that invesunent activity in its territory is undertaken in a manner sensitive to environmental concerns."
[210] *Al-Warraq v. Indonesia*, paras. 662-663. The counterclaim was however dismissed due to insufficient definition of the claimant's personal liability by Indonesia, see para. 669.

concerned the same project, namely the operation of oil exploration blocks in Ecuador's Amazon rainforest. In *Burlington*, Ecuador based its counterclaim on Ecuadorian tort law and the tribunal found this applicable through the second leg of Article 42(1) of the ICSID Convention as it designates the host State's domestic law and international law as applicable in the absence of an agreement between the parties on applicable law.[211]

In *Perenco*, the tribunal also used Ecuadorian domestic law, the justification of this is however more unclear. Concerning the primary dispute, Perenco's claims were based on both Participation Contracts with Ecuador and the France-Ecuador BIT. In the Participation Contracts, the choice of law clause designated Ecuadorian law to be applicable and thus the tribunal was bound to apply it due to the first leg of Article 42(1) of the ICSID Convention.[212] Concerning the claims relating to the BIT, the tribunal applied Ecuadorian law on the same basis as the *Burlington* tribunal, namely the second leg of Article 42(1) of the ICSID Convention.[213] In relation to the counterclaim however, the tribunal does not explicitly reference the basis of which it finds Ecuadorian law to be applicable, but any objections to the applicability of it was not raised.[214] The parties' did not, on the other hand, agree on the interpretation and applicability of the 2008 Ecuadorian Constitution which placed great significance on environmental considerations, as this was not yet in force for the majority of Perenco's operations in Ecuador. The tribunal concluded that the constitution did not significantly alter the Ecuadorian law applicable to the dispute but noted that: "the Constitution's focus on environmental protection means that when choosing between certain disputed (but reasonable) interpretations of the Ecuadorian

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[211] *Burlington v. Ecuador*, para. 74; Article 40(1) of the ICSID Convention: "The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable."
[212] *Perenco v. Ecuador*, Decision on Remaining Issues of Jurisdiction and on Liability, 12 September 2014, paras. 318-320.
[213] *Perenco v. Ecuador*, Decision on Remaining Issues of Jurisdiction and on Liability, 12 September 2014, paras. 532-533.
[214] *Perenco v. Ecuador*, Interim Decision on the Environmental Counterclaim, 11 August 2015, paras. 65-114, 321.

regulatory regime, the interpretation which most favours the protection of the environment is to be preferred", and did therefore use it as an interpretive tool in regards to the operations done before its entry into force.[215]

In both cases, Ecuador succeeded with its counterclaims and was awarded damages for the environmental destruction caused by the investors.[216] These are the only cases in which a host State have succeeded with a counterclaim and shows both the increasing importance investment tribunals affords environmental protection, the influence domestic law can have on such issues in investment arbitration and how counterclaims in ISDS can contribute to holding transnational corporations liable for environmental harm.

Obligations sourced from international law

In the aforementioned case of *Urbaser v. Argentina*, an investment tribunal for the first time affirmed the possibility of a counterclaim by a host State based on an obligation of an investor under international human rights law. The case concerned emergency measures by Argentina in the aftermath of its economic crisis which affected the investors operation of water and sewage services.[217] In its counterclaim, Argentina claimed that the investors had an obligation under international law to comply with human rights, which they had breached by failing to guarantee the access to water of the State's population.[218] The tribunal therefore had to examine whether such an obligation of the investors existed. It asserted that the Argentina-Spain BIT did not exclude rights of the host State and that the BIT did in fact confer rights, albeit procedural ones, on the host State.[219] The tribunal looked to the

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[215] *Perenco v. Ecuador*, Interim Decision on the Environmental Counterclaim, 11 August 2015, para. 322.
[216] *Burlington v. Ecuador*, para. 1075; *Perenco v. Ecuador*, Award, para. 1023(b).
[217] *Urbaser v. Argentina*, para. 34.
[218] *Urbaser v. Argentina*, paras. 1156-1164.
[219] *Urbaser v. Argentina*, paras. 1183-1184.

applicable law provision of the BIT, which included not only its own rules but also, "where appropriate", other treaties in force between the State parties and general principles of international law.[220] It further argued that since the definition in the BIT of disputes able to be submitted to arbitration did not exclude the host State from invoking rights other than the procedural rights that could be found in the BIT, such invocation should be possible. It compared the dispute resolution clause regarding investor-State disputes to the one regarding State-State disputes which was limited to disputes concerning the interpretation or application of the BIT, which according to the tribunal must mean that the broader wording of the first provision was made on purpose.[221] The tribunal further declared that that the BIT cannot be understood as an isolated set of rules, strictly preserving investors' rights, without consideration given to rules of international law external to its own rules.[222] As mentioned earlier, the tribunal rejected the view that private parties have no obligations for compliance with human rights, and further established that "the human right for everyone's dignity and its right for adequate housing and living conditions are complemented by an obligation on all parts, public and private parties, not to engage in activity aimed at destroying such rights."[223] It thus held that investors have a negative "obligation to abstain" from violating human rights, which was incorporated in the applicable law of the BIT.[224] However, the tribunal concluded that the human right to water does not entail an obligation for performance on a private party to provide drinking water and sewage services, but that such a positive obligation can only be construed through domestic law, not general international law, which Argentina had argued.[225] Thus, Argentina's counterclaim was ultimately rejected, but the novelty of the tribunal in finding obligations of investors under international human rights, which

[220] *Urbaser v. Argentina*, para. 1188.
[221] *Urbaser v. Argentina*, para. 1187.
[222] *Urbaser v. Argentina*, paras. 1191-1192.
[223] *Urbaser v. Argentina*, paras. 1193-1199.
[224] *Urbaser v. Argentina*, paras. 1200-1203, 1210.
[225] *Urbaser v. Argentina*, paras. 1206-1210.

thus can be enforced through investment arbitration, should not be diminished.

Inclusion of direct obligation for investors in IIAs

The awards presented here show that investor obligations can be incorporated in ISDS even under old-generation BITs. As was briefly discussed in section 3.2.2, new-generation IIAs are increasingly incorporating direct investor obligations pertaining to human rights and environmental protection. A number of newer IIAs also contain provisions on CSR, but these are however often stipulating only "soft" standards in the sense that they "encourage" or "endeavour" investors to incorporate CSR, or that investors "should strive" to do so.[226]

Some States have on the other hand gone further and used more strict obligations. The 2015 Brazil-Malawi BIT stipulates that "[i]nvestors and their investment ***shall*** strive to achieve the highest possible level of contribution to the sustainable development of the Host Party and the local community, through the adoption of a high degree of socially responsible practices, based on the voluntary principles and standards set out in this Article."[227]

CSR provisions in BITs can encompass both human rights obligations and obligations relating to the environment. Some treaties additionally

[226] Article 16, Agreement between the Government of Canada and the Government of Burkina Faso for the Promotion and Protection of Investments, 20 April 2015; Article 17, Agreement between the Argentine Republic and Japan for the Promotion and Protection of Investment, 1 December 2018; Article 12, Treaty between the Republic of Belarus and the Republic of India on Investments, 24 September 2018; Article 10(3), Agreement between the Slovak Republic and the Islamic Republic of Iran for the Promotion and Reciprocal Protection of Investments, 19 January 2016.
[227] Article 9(1), Investment Cooperation and Facilitation Agreement Between the Federative Republic of Brazil and the Republic of Malawi, 25 June 2015 (emphasis added).

incorporate specific obligations to respect human rights and protect the environment in different ways.[228]

Such inclusions should facilitate the bringing of counterclaims by host States in the future, however, it remains to be seen how such investor obligations will be handled and interpretated by investment tribunals.

[228] Article 14(2), Supplementary Act A/SA.3/12/08 Adopting Community Rules on Investment and the Modalities for their Implementation with ECOWAS, 19 December 2008; Article 12(1) and 15(1), Southern African Development Community, SADC Model Bilateral Investment Treaty Template with Commentary, July 2012; Article 37(3), African Union Commission, Draft Pan African Investment Code, December 2016. See also section 3.2.3 of this thesis.

5 Counterclaims as a tool to rebalance ISDS

5.1 Introduction

As we have seen, the ISDS mechanism have been used by investors to challenge an array of different measures by host States to protect the environment, public health, and human rights such as restricting toxic chemicals,[229] prohibiting environmentally destructive mining activities,[230] denying permits for hazardous landfills,[231] and trying to ensure citizens' access to water.[232] At the same time, large transnational corporations (which foreign investors often are) can in principle not be held accountable under international law for violations of human rights and destruction of the environment caused by their activities as no effective mechanism for doing so currently exists.[233] The asymmetry of the IIL regime and the ISDS system in which investors only have rights, but no obligations towards the host State in which they operate, is fuelling this tension that exists between the protection of foreign investment and through it economic development, and the non-economic issues regarding human rights and the environment (that now have become salient issues in the international arena) and the dire need for not only economic development, but also sustainable development.

States are facing a difficult situation in which they must balance the obligations they have undertaken in investment agreements and their human rights and environmental obligations.[234] This balancing act becomes further

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[229] *Ethyl Corporation v. Canada.*
[230] *Bilcon v. Canada*; *Bear Creek v. Peru* (which also endangered human rights of indigenous peoples).
[231] *Tecmed v. Mexico.*
[232] *Urbaser v. Argentina*.
[233] Tomoko Ishikawa, 'Counterclaims and the Rule of Law in Investment Arbitration' (2019) 113 *AJIL Unbound* 33, 34.
[234] Barnali Choudbury, 'Investor Obligations for Human Rights' (2020) 35(1-2) *ICSID Review* 82, 87; Christina L. Beharry and Melinda E. Kuritzky, 'Going Green: Managing the Environment Through International Investment Arbitration' (2015) 30(3) *American University International Law Review* 383, 387.

intricate by the asymmetry of the ISDS mechanism and the power it vests in foreign investors in relation to the host State that does not have a possibility to raise claims against the investor in the same mechanism. The asymmetric system was developed in response to the previously stronger position held by host States and the need to protect foreign investors. But when the activity of investors threatens the public interests of the host State, as well as the rights of its citizens, these implications become part of the investment dispute, a situation that the traditional mechanism does not account for as it only protects the investors' rights.[235] This asymmetry could perhaps be at least partially remedied by the possibility for host States to raise counterclaims.[236] As one scholar has put it: "absent the ability to submit a counterclaim, a state cannot win; the most it can hope to do is not to lose".[237]

5.2 Benefits of counterclaims

One clear benefit of submitting a counterclaim in investment arbitration as opposed to seeking relief in domestic courts is the enforceability of the awards. When TNCs have been found guilty of human rights violations and/or causing environmental harm in domestic courts of the host State, these judgements have often been virtually unenforceable as it is often a subsidiary that operates in the foreign country, whose liability cannot be carried over to the parent company.[238] With domestic courts judgements often not being enforceable outside the jurisdiction of the State in which it was rendered, arbitral awards have a much broader reach as they fall under

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[235] Tomoko Ishikawa, 'Counterclaims and the Rule of Law in Investment Arbitration' (2019) 113 *AJIL Unbound* 33, 33.
[236] Flavia Marisi, *Environmental Interests in Investment Arbitration* (Kluwer Law International 2020) 250; Ted Gleason, 'Examining host-State counterclaims for environmental damage in investor-State dispute settlement from human rights and transnational public policy perspectives' (2021) 21 *International Environmental Agreements: Politics, Law and Economics* 427, 429.
[237] Andrea K. Bjorklund, 'The Role of Counterclaims in Rebalancing Investment Law' (2013) 17(2) *Lewis & Clark Law Review* 461, 464.
[238] Sarah Josephs, 'Protracted Lawfare: The Tale of Chevron Texaco in the Amazon' (2012) 3(1) *Journal of Human Rights and the Environment* 70, 89.

the New York Convention on Recognition and Enforcement of Arbitral Awards.[239] This also supports the rule of law by providing a venue in which investors can be held accountable for harm they have caused and with the strong enforceability mechanism of arbitral awards, rights of potential victims can be better secured than in national courts.[240]

The use of counterclaims can also help reinforce the soft-law instruments in the area of business and human rights, most notably the United Nations Guiding Principles on Business and Human Rights (UNGPs).[241] The UNGPs, as well as other instruments that impose obligations on transnational corporations to respect human rights and protect the environment have gained great recognition, but these however still remain voluntary in nature and not directly enforceable. A legally binding instrument on business and human rights is in the process of becoming a reality but the process is long and have progressed for almost eight years and will likely continue for years to come.[242] Even if such a treaty would be adopted, there is still fear that a number of major capital-exporting States would not ratify the treaty as they have been opposed to it and to a large extent have refused to participate in the negotiations.[243] Holding investors responsible for misconduct through counterclaims in ISDS when investor obligations can be incorporated in IIAs can "harden" the soft law obligations in the UNGPs, and it can in at least some instances be done

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[239] Andrea K. Bjorklund, 'The Role of Counterclaims in Rebalancing Investment Law' (2013) 17(2) *Lewis & Clark Law Review* 461, 475-476.
[240] Tomoko Ishikawa, 'Counterclaims and the Rule of Law in Investment Arbitration' (2019) 113 *AJIL Unbound* 33, 36.
[241] United Nations, *Guiding Principles on Business and Human Rigths: Implementing the United Nations "Protect, Respect and Remedy" Framework* (2011).
[242] Business and Human Rights Resource Center, 'Binding treaty: a brief overview' <https://www.business-humanrights.org/en/big-issues/binding-treaty/> accessed 12 May 2022.
[243] Joe Zhang, 'Breakthrough in business and human rights binding treaty negotiation but be prepared for a bumpy road ahead' (2021) *Investment Treaty News* <https://www.iisd.org/itn/en/2021/12/20/breakthrough-in-business-and-human-rights-binding-treaty-negotiation-but-be-prepared-for-a-bumpy-road-ahead/> accessed 12 May 2022.

immediately.[244] The awards of *Perenco* and *Burlington*, as well as *Urbaser*, show the potential of using ISDS to promote accountability for environmental destruction as well as human rights abuses.

Moreover, governments of developing countries that rely heavily on foreign investment might not have the capacity to identify and mitigate potential human rights and environmental implications from all investment projects until the harm is already done. Having the possibility to provide remedy through counterclaims in ISDS could then provide a balancing function.[245] Furthermore, the economic power of today's multinational companies oftentimes outweighs that of some States in which they operate, making it difficult for these States to regulate and control their activities which can lead to the corporations escaping proper regulation.[246] The use of counterclaims can then have the important effect of being a deterrent for bad behaviour by corporations and to promote good corporate governance.[247]

Another benefit that should not be overlooked is that of procedural economy and efficiency. The amounts awarded in investment arbitration are incredibly high and on top of that, the litigation costs in themselves are also considerable.[248] The often highly complex facts surrounding investment disputes can make them long and costly and it would arguably minimize expenses and expenditure of time to handle all claims connected to a dispute

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[244] Barnali Choudbury, 'Investor Obligations for Human Rights' (2020) 35(1-2) *ICSID Review* 82, 101.
[245] Xuan Shao, 'Environmental and Human Rights Counterclaims in International Investment Arbitration: at the Crossroads of Domestic and International Law' (2021) 24 *Journal of International Economic Law* 157, 173; Ted Gleason, 'Examining host-State counterclaims for environmental damage in investor-State dispute settlement from human rights and transnational public policy perspectives' (2021) 21 *International Environmental Agreements: Politics, Law and Economics* 427, 439.
[246] Sarah Josephs, 'Protracted Lawfare: The Tale of Chevron Texaco in the Amazon' (2012) 3(1) *Journal of Human Rights and the Environment* 70, 88.
[247] Andrea K. Bjorklund, 'The Role of Counterclaims in Rebalancing Investment Law' (2013) 17(2) *Lewis & Clark Law Review* 461, 477; Ted Gleason, 'Examining host-State counterclaims for environmental damage in investor-State dispute settlement from human rights and transnational public policy perspectives' (2021) 21 *International Environmental Agreements: Politics, Law and Economics* 427, 439.
[248] Lea Di Salvatore, 'Investor-State Disputes in the Fossil Fuel Industry', (2021) *IISD Report*, available at: <https://www.iisd.org/publications/report/investor-state-disputes-fossil-fuel-industry> accessed 12 May 2022.

in the same process, with the same arbitrators and counsels knowledgeable of all the facts.[249] It also has the potential to curtail frivolous claims and third-party funding, which are considerable problems in ISDS, and at the same time discourage host States from trying to delay hearings of the claim on the merits by submitting jurisdictional objections on doubtful bases if they themselves have a feasible claim.[250] Thus, it could streamline the process and be an incentive for both parties to only submit reasonable claims and objections and increase the willingness to move forward.

5.3 Potential drawbacks

Despite the positive impacts on procedural economy and efficiency that the submission of counterclaims can have, it should still be acknowledged that the ISDS mechanism has been criticised for no longer being the speedy and low-cost alternative to domestic courts as it traditionally has been perceived as.[251] The inclusion of counterclaims, especially as it currently often involves lengthy determinations on jurisdictional issues and admissibility, will of course increase both the time and cost of the arbitral process and therefore contribute to this issue.[252]

One of the most prominent concerns raised regarding host State counterclaims is the issue of the competence and expertise of arbitrators in matters relating to environmental protection and human rights and

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[249] Andrea K. Bjorklund, 'The Role of Counterclaims in Rebalancing Investment Law' (2013) 17(2) *Lewis & Clark Law Review* 461, 475; Flavia Marisi, *Environmental Interests in Investment Arbitration* (Kluwer Law International 2020) 249-250.
[250] UNCITRAL, *Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-seventh session (New York, 1-5 April 2019)*, UN Doc A/CN.9/970, 9 April 2019, paras. 18-19; Andrea K. Bjorklund, 'The Role of Counterclaims in Rebalancing Investment Law' (2013) 17(2) *Lewis & Clark Law Review* 461, 476; Melissa Ordonez, 'State's counterclaims: how hard is it to counterattack in international investment arbitration?' (2019) 22(1) *International Arbitration Law Review* 27, 41.
[251] Michael Waibel, Asha Kaushal, and others, 'The Backlash against Investment Arbitration: Perceptions and Reality', in Michael Waibel , Asha Kaushal , and others (eds), *The Backlash against Investment Arbitration,* (Kluwer Law International 2010), xl.
[252] Andrea K. Bjorklund, 'The Role of Counterclaims in Rebalancing Investment Law' (2013) 17(2) *Lewis & Clark Law Review* 461, 477.

especially when this involves the domestic law of the host State.[253] This can be exemplified by the cases of *Perenco* and *Burlington*. As previously specified, the counterclaims of Ecuador were essentially identical. However, the tribunals in the respective cases came to different conclusions regarding the interpretation of Ecuadorian domestic law and had different approaches to expert evidence concerning the environmental damage.[254] The *Perenco* tribunal asserted that fault-based liability was to be applied according to the laws of Ecuador that were in force at the time of the events, whereas the *Burlington* tribunal declared that Ecuadorian courts had in fact already established a strict liability regime for hazardous activities.[255] Moreover, in cases where sensitive human rights issues are involved, or environmental harm must be assessed, arbitrators may lack the expertise to properly evaluate the often highly complex facts and findings surrounding it.[256] Experts appointed by the parties might come to vastly different conclusions concerning the extent of damage, as was the case in *Burlington* and *Perenco*, and the *Perenco* tribunal therefore decided to appoint its own independent expert to evaluate the contaminations, whereas the *Burlington* tribunal to the contrary relied on the party-appointed experts' sampling.[257] The appointment of independent experts can definitely help to address concerns of this kind, as could third-party participation in the form of *amicus curiae* written submission regarding complex issues in which the tribunal might not have the expert knowledge required in the fields of

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[253] Melissa Ordonez, 'State's counterclaims: how hard is it to counterattack in international investment arbitration?' (2019) 22(1) *International Arbitration Law Review* 27, 41.
[254] Xuan Shao, 'Environmental and Human Rights Counterclaims in International Investment Arbitration: at the Crossroads of Domestic and International Law' (2021) 24 *Journal of International Economic Law* 157, 176-177.
[255] *Perenco v. Ecuador*, Interim Decision on the Environmental Counterclaim, 11 August 2015, footnote 881; *Burlington v. Ecuador*, para. 248.
[256] Jason Rudall, 'Green Shoots in a Barren World: Recent Developments in International Investment Law' (2020) 67 *Netherlands International Law Review* 453, 468; Christina L. Beharry and Melinda E. Kuritzky, 'Going Green: Managing the Environment Through International Investment Arbitration' (2015) 30(3) *American University International Law Review* 383, 416.
[257] *Perenco v. Ecuador*, Interim Decision on the Environmental Counterclaim, 11 August 2015, paras. 568-569; *Burlington v. Ecuador*, para. 77.

human rights and environmental protection.[258] In cases where the tribunal have to apply domestic law, another alternative that have been proposed is a procedure in which preliminary rulings of domestic courts should be required, in order to avoid inconsistent decisions on the interpretation of such laws.[259]

However, even if these issues could be remedied, the question still remains whether arbitral tribunals are an appropriate place to deal with questions that are very closely connected to public policy and where public interests are highly involved as it raises questions of the allocation of authority between domestic courts and international tribunals, especially where arbitrators are to apply democratically enacted legislation.[260] It has also been raised that States submitting counterclaims in investment arbitration instead of seeking remedies through domestic judicial proceedings could undermine the rule of law in the sense that it deprives the domestic judiciary of the opportunity to develop their capacity and could even risk disturbing the coherence of the domestic legal system.[261]

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[258] Christina L. Beharry and Melinda E. Kuritzky, 'Going Green: Managing the Environment Through International Investment Arbitration' (2015) 30(3) *American University International Law Review* 383, 414-417; James Harrison, 'Environmental Counterclaims in Investor-State Arbitration' (2016) 17 *Journal of World Investment & Trade* 479, 487.
[259] Xuan Shao, 'Environmental and Human Rights Counterclaims in International Investment Arbitration: at the Crossroads of Domestic and International Law' (2021) 24 *Journal of International Economic Law* 157, 177.
[260] Andrea K. Bjorklund, 'The Role of Counterclaims in Rebalancing Investment Law' (2013) 17(2) *Lewis & Clark Law Review* 461, 465, 478; Christina L. Beharry and Melinda E. Kuritzky, 'Going Green: Managing the Environment Through International Investment Arbitration' (2015) 30(3) *American University International Law Review* 383, 417-418.
[261] Tomoko Ishikawa, 'Counterclaims and the Rule of Law in Investment Arbitration' (2019) 113 *AJIL Unbound* 33, 34; Andrea K. Bjorklund, 'The Role of Counterclaims in Rebalancing Investment Law' (2013) 17(2) *Lewis & Clark Law Review* 461, 478-479; Xuan Shao, 'Environmental and Human Rights Counterclaims in International Investment Arbitration: at the Crossroads of Domestic and International Law' (2021) 24 *Journal of International Economic Law* 157, 176-177.

5.4 Developments and the way forward

As can be seen from recent case law, the use of counterclaims is becoming increasingly important and not only are States to a larger degree submitting counterclaims, but tribunals are also seemingly more open to the idea and are interpreting investment treaties in a more "counterclaim-friendly" way as well as giving more significance to issues of human rights and environmental protection implicated in investment disputes. However, current reform efforts are not completely straightforward, and the question of whether counterclaims will be more readily available in the future remains unclear.

The previously mentioned UNCITRAL Working Group III have to a certain extent discussed the question of counterclaims in their work on ISDS reform.[262] It has noted the difficulties for States to bring counterclaims due to the limited obligations of investors in investment treaties, the jurisdictional hurdles concerning consent and the connection requirement.[263] It further suggested possible reform options that could enable the bringing of counterclaims and considered that the devising of a framework in which States could raise counterclaims in ISDS would "reduce uncertainty, promote fairness and rule of law, and ultimately ensure a balance between respondent States and claimant investors" as well as "have a positive impact on the duration and cost of the proceedings as well as on a number of other procedural issues".[264] The suggestions included formulating provisions on investor obligations relating to the protection of human rights and the environment, compliance with domestic law, measures against corruption

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[262] UNCITRAL, *Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-seventh session (New York, 1-5 April 2019)*, UN Doc A/CN.9/970, 9 April 2019, paras. 34-35.
[263] UNCITRAL, Working Group III (Investor-State Dispute Settlement Reform), *Possible reform of investor-State dispute settlement (ISDS): Multiple proceedings and counterclaims*, Note by the Secretariat, UN Doc A/CN.9/WG.III/WP.193, 22 January 2020, paras. 35, 36, 39, 43.
[264] UNCITRAL, Working Group III (Investor-State Dispute Settlement Reform), *Possible reform of investor-State dispute settlement (ISDS): Multiple proceedings and counterclaims*, Note by the Secretariat, UN Doc A/CN.9/WG.III/WP.193, 22 January 2020, para. 38.

and the promotion of sustainable development and to consider how to impose such obligations in investment treaties.[265] However, it was also put forward that the Working Group potentially should not address the topic as its work was to focus on the procedural aspects of ISDS dispute settlement rather than on the substantive provisions in investment treaties and it was later clarified that drafting such obligations was outside the mandate of the Working Group.[266] Regarding the procedural aspects on the other hand, the jurisdiction and admissibility of counterclaims, it has expressed that it may wish to consider formulating clauses broad enough to encompass counterclaims as well as developing guidance and concrete criteria to be applied by tribunals.[267] At the thirty-ninth session of the Working Group, the secretariat was tasked with preparing model clauses and options to clarify the conditions under which a counterclaim can be brought.[268] Yet, the subject has largely been set aside and no concrete reform regarding counterclaims seems to be in motion.[269]

As have been discussed throughout this thesis, States have in recent years started to reform and renegotiate BITs in response to the backlash against the IIL regime and ISDS.[270] These reform efforts could facilitate the submission of counterclaims by either explicitly giving host States a right to

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[265] UNCITRAL, Working Group III (Investor-State Dispute Settlement Reform), *Possible reform of investor-State dispute settlement (ISDS): Multiple proceedings and counterclaims*, Note by the Secretariat, UN Doc A/CN.9/WG.III/WP.193, 22 January 2020, para. 41.
[266] UNCITRAL, Working Group III (Investor-State Dispute Settlement Reform), *Possible reform of investor-State dispute settlement (ISDS): Multiple proceedings and counterclaims*, Note by the Secretariat, UN Doc A/CN.9/WG.III/WP.193, 22 January 2020, para. 42; UNCITRAL, *Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-ninth session (Vienna, 5-9 October 2020)*, UN Doc A/CN.9/1044, 10 November 2020, para. 60.
[267] UNCITRAL, Working Group III (Investor-State Dispute Settlement Reform), *Possible reform of investor-State dispute settlement (ISDS): Multiple proceedings and counterclaims*, Note by the Secretariat, UN Doc A/CN.9/WG.III/WP.193, 22 January 2020, para. 44-45.
[268] UNCITRAL, *Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-ninth session (Vienna, 5-9 October 2020)*, UN Doc A/CN.9/1044, 10 November 2020, para. 61-62.
[269] See <https://uncitral.un.org/en/working_groups/3/investor-state> for the publiched documents of the Working Group; and <https://uncitral.un.org/en/multipleproceedings> for its work specifically related to counterclaims, both accessed 26 April 2022.
[270] See sections 3.2.2 and 4.3.

file counterclaim or by wording dispute resolution clauses broadly enough to allow for counterclaims. IIAs are also increasingly incorporating obligations for investors in regards to human rights and environmental protection or incorporating domestic law into the treaty by asserting that investors are under an obligation to adhere to such laws, which is needed for a host State to be able to found its counterclaim on a viable cause of action. Judging from recent case law, in particular the cases of *Burlington* and *Perenco v. Ecuador*, *Aven v. Costa Rica,* and *Urbaser v. Argentina*, such developments have great potential to provide for counterclaims as a tool to rebalance the current system. However, another trend can also be discerned where States are becoming increasingly protective of their domestic court jurisdiction and are limiting the jurisdiction of tribunals in newly concluded investment treaties.[271] Additionally, reforms of IIAs are still fragmentary and gradual, which could lead to this area of law only becoming more uncertain and complex.[272]

Another development that can be seen is the increasing connection between human rights and the environment, and the international recognition of this connection.[273] This was made clear beyond doubt when in October 2021, the right to a healthy environment was recognised as a fundamental human right by the United Nations Human Rights Council.[274] This recognition could pave the way for host States to argue a breach of this right in a counterclaim when an investor's activity has harmed the environment in such a way that the host State's population's enjoyment of this right is adversely impacted. Following the reasoning of the tribunal in *Urbaser v. Argentina*, such activities could then amount to a breach of the "obligations to abstain" from

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[271] Xuan Shao, 'Environmental and Human Rights Counterclaims in International Investment Arbitration: at the Crossroads of Domestic and International Law' (2021) 24 *Journal of International Economic Law* 157, 167.
[272] Ted Gleason, 'Examining host-State counterclaims for environmental damage in investor-State dispute settlement from human rights and transnational public policy perspectives' (2021) 21 *International Environmental Agreements: Politics, Law and Economics* 427, 439-440.
[273] David R. Boyd, 'Chapter 2: The Right to a Healthy and Sustainable Environment' in Yann Aguila and Jorge E. Viñuales (eds), *A Global Pact for the Environment – Legal Foundations* (Cambridge: C-EENRG, 2019), 31.
[274] UNGA Res 48/13 (18 October 2021) UN Doc A/HRC/RES/48/13.

violating human rights, which would be incorporated in an investment treaty if the applicable law clause included international law as an applicable source of law. [275]

To conclude, the role of counterclaims in ISDS and the potential contribution the use of it can have in the strive for reform of the system is far from certain. Developments to clarify the legal status is slow and fragmented but at the same time the use, and potential success, of counterclaims seems to be on the rise.

[275] *Urbaser v. Argentina*, paras. 1210; Ted Gleason, 'Examining host-State counterclaims for environmental damage in investor-State dispute settlement from human rights and transnational public policy perspectives' (2021) 21 *International Environmental Agreements: Politics, Law and Economics* 427, 436.

6 Analysis and conclusions

The nexus between international investment law and the protection of the environment and human rights is becoming increasingly important and apparent. The traditional aims of investment protection and promotion that guided the development of international investment law and the establishment of the ISDS system can no longer be seen in isolation from the salient issues of environmental protection and human rights that they implicate. The significant criticism that IIL has received over the last decade shows a need for reform in this area and especially a rebalancing of the asymmetric system that affords investors extensive rights and the power to challenge public policy measures that host States enact in order to achieve the goals of sustainable development, whilst not imposing any obligations on these investors to respect these goals and not interfere with fundamental human rights or not to engage in environmentally destructive activities. The use of counterclaims has in recent years increased and it has shown a potential to promote the rebalancing of IIL and the ISDS system as well as serve to increase the accountability of foreign investors for misconduct in their operations.

However, there still remain significant challenges when it comes to the use of counterclaims to rebalance the international investment arbitration system. The procedural hurdles of jurisdiction and admissibility that have been presented in this thesis will, with all probability, persist in a system without an overarching framework and where ad hoc tribunals render decisions without precedent. However, States are showing a willingness to reform the current system, remedy its asymmetries and align it with today's important goals of sustainable development, environmental protection, and human rights.

For counterclaims to become readily available and to serve as an effective tool for rebalancing ISDS, focus must be on reform of IIAs to facilitate the

use of counterclaims. Regarding procedural aspects, IIAs must either explicitly allow for counterclaims or contain dispute resolution clauses that are sufficiently broad to include the submission of counterclaims. Such modifications would also significantly reduce the time and cost that such submissions currently can entail and therefore improve the procedural efficiency of arbitral tribunals. Moreover, IIAs must incorporate investor obligations in order for counterclaims to have the desired effect in the rebalancing of the IIL regime and ISDS. This could be done either by integrating direct obligations on investors in IIAs regarding environmental protection and human rights, or by establishing an obligation of investors to adhere to the host State's domestic law. If the latter approach is chosen, the IIA must also appoint the host State's domestic law as the applicable law in order for tribunals to be able to apply obligations contained in that law to the conduct of investors.

With such reform of IIAs, counterclaims do have the potential to serve as a vehicle to support the rebalancing of the international investment arbitration system and to remedy the existing asymmetry in ISDS as well as increase the legitimacy of the system. This would contribute to the current strive of reforming international investment law and be an important and positive step in better aligning the regime with objectives of environmental and human rights protection that today have become some of the most essential issues on a global level. Counterclaims therefore have the potential to be an effective tool for investment arbitration reform.

Moreover, the availability of counterclaims and the establishment of investor obligations could facilitate investment arbitration tribunals to serve as a venue for holding TNCs accountable for environmental harm and human rights violations and therefore provide for the "hardening" of soft-law instruments aiming to compel corporations, including investors, to respect human rights, ensure the protection of the environment in which they operate and contribute to sustainable development. ISDS could then be used to address and enforce norms of human rights and environmental

protection against foreign investors that currently regularly escape responsibility for their misconduct. The concerns raised about whether ISDS is an appropriate forum to deal with these issues that are so connected to public policy and where democratically enacted legislation potentially will be applied in ad hoc tribunals are certainly valid but conversely, it might still be the best option as other alternatives such as domestic courts have to a large extent been proved inadequate.

However, the legal status as it stands today with a myriad of IIAs that to a large degree are narrowly drafted and therefore create considerable hurdles for the submission of counterclaims, makes the influence and potentials of counterclaims negligible. Tribunals are to a larger degree open to the submission of counterclaims as well as imposing obligations on investors through different modes of interpretations of the treaties currently in force, but until the reform needed to provide host State's with the recourse to counterclaims on a larger scale takes place, the significance of counterclaims as a tool to rebalance the international investment arbitration system will remain precarious.

7 Concluding remarks

The role of counterclaims in ISDS is currently a very complex, unclear and disputed area of international investment law. Much suggests that it will remain so for at least the near future as reform efforts are disparate and the inherent fragmentation of the IIL regime makes it difficult to achieve far-reaching and coherent reform. At the same time, considerations of environmental and human rights issues implicated in investment disputes are gaining greater recognition both in arbitral tribunals as well as by States and among scholars and academics. The need for sustainable development in all areas is crucial and international investment have a large role to play in this readjustment of the global economy. International investment law therefore cannot continue to be viewed as a completely separate area of international law that does not need to take into account non-economic issues that it implicates.

If States are so willing, reform of IIAs to allow for counterclaims by host States when investors breach obligations relating to environmental protection and the respect for human rights could make counterclaims an important tool for remedy of the highly asymmetric system that IIL and ISDS have become. This would further be a deterrent for misconduct by investors as well as provide a venue for holding investors accountable for wrongdoings in their activities, which today remains a huge issue in the globalised world we live in. Until such reform is implemented, the considerations of tribunals and their interpretations of IIAs will have great relevance to align the IIL regime with the salient non-economic issues at the global level. Whether arbitrators will continue in the footsteps of the *Perenco*, *Burlington* and *Urbaser* tribunals and whether current and future modifications of IIAs will have the desired effect only time will tell, and the developments must be closely followed and reviewed.

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