International Institute for Sustainable Development
Institut international du développement durable

http://www.iisd.org

International Investment Agreements, Business and Human Rights: Key Issues and Opportunities

Howard Mann
Senior International Law Advisor
International Institute for Sustainable Development

February 2008

Prepared for:
Prof. John Ruggie,
UN Special Representative to the Secretary General for Business and Human Rights

© 2008 International Institute for Sustainable Development

The **International Institute for Sustainable Development** (IISD) is a Canadian-based not-for-profit organization with a diverse team of more than 150 people located in more than 30 countries. As a policy research institute dedicated to effective communication of our findings, we engage decision-makers in government, business, NGOs and other sectors in the development and implementation of policies that are simultaneously beneficial to the global economy, the global environment and to social well-being.

IISD's work on investment seeks to promote investment as a means to achieve sustainable development. Our balanced and insightful approach is reflected in our widely circulated Investment Treaty News bulletin, and our solid expertise has persuaded tribunals in two cases (under ICSID and UNCITRAL) to grant us precedent-setting standing to intervene in investor-state disputes with broad public policy implications. We have been engaged to act as advisors to several developing countries in the course of their ongoing investment negotiations. Our recent work includes the drafting of a Model Agreement on Investment for Sustainable Development, which has won widespread critical acclaim.

IISD's investment work can be found at www.iisd.org/investment

Acknowledgements

The International Institute for Sustainable Development provided the financial support that made this project possible. I want to thank Bill Glanville, Vice President of IISD, for this support, and Mark Halle, Director of the IISD European Office and its Trade and Investment Program for his support in undertaking this work.

International Investment Agreements, Business and Human Rights: Key Issues and Opportunities

Table of Contents

1. Introduction 3
   1.1 What are International Investment Agreements? 3
   1.2 The recognition of the importance of IIAs to the business and human rights dynamic 5
   1.3 Scope and approach 7
   1.4 Limitations 9
2. Do existing IIAs promote and protect human rights directly? 9
   2.1 Summary of the existing state of affairs 9
   2.2 Can more extensive provisions be developed? 12
      2.2.1 Provisions relating to the state duty to protect and promote human rights 12
      2.2.2 Can foreign investors be directly regulated by IIAs? 13
3. Do existing IIAs enhance or constrain the duty of states to protect and promote human rights? 15
   3.1 The duty to protect and promote under human rights and the right to regulate under investment law 17
      3.1.1 The right to regulate in investment law 18
      3.1.2 The right to regulate versus investor rights 20
   3.2 Investor-state arbitrations and human rights: Is human rights law relevant? 25
   3.3 Human Rights issues of the investor-state process itself 29
4. IIAs and Host Government Agreements 32
5. Investment Liberalization Provisions and Human Rights: A Brief Note 35
6. Conclusions 39

International Investment Agreements, Business and Human Rights: Key Issues and Opportunities

Howard Mann
Senior International Law Advisor
International Institute for Sustainable Development

1. Introduction

The need to identify and understand the linkages between international investment agreements and the debate on business and human rights was recognized by the Special Representative of the Secretary General for Business and Human Rights (SRSG) at the consultations on the "Duty to Protect" held in Copenhagen in November 2007. This paper seeks to respond to this need by providing a broad-based review of these linkages, focusing on the existing international investment agreements (IIAs), and their relationship to business and human rights issues. This includes the general content of IIAs and the role of the investor-state dispute settlement system commonly associated with IIAs. [1]

1.1 What are International Investment Agreements?

International investment agreements (IIAs) are treaties between states. They exist in three primary forms today:

- Bilateral Investment Treaties (BITs) signed by two states;
- Regional investment treaties signed by groups of states within a single region; and
- Chapters of integrated trade and investment agreements that can be signed at the bilateral or regional level.

To date, over 2500 such agreements exist, and more are currently under negotiation. The majority remain between developed and developing countries, though there is an increasing trend towards more BITs and regional treaties among developing countries exclusively. Currently, approximately 25% of all BITs are between developing countries.[2]

IIAs today follow a fairly standard design. The focus is on providing foreign investors from the "home state" with special international law rights and remedies to protect the investment into the "host state". The investor rights generally include:

---

[1] A previous report in 2003, focused on the possible linkages between human rights and the negotiation of a possible investment agreement within the World Trade organization. Those broad negotiations have now been abandoned. See, "Economic, Social and Cultural Rights: Human Rights, trade and investment, Report of the High Commissioner for Human Rights" Commission on Human Rights, Sub-Commission on the Promotion and Protection of Human Rights, E/CN.4/Sub.2/2003/9, 2 July 2003.

[2] UNCTAD, IIA Monitor No. 3 (2007), Recent Developments in International Investment Agreements (2006-June 2007), UNCTAD/WEB/ITE/IIA/2007/6, 21 January 2008, at http://www.unctad.org/en/docs/webiteiia20076_en.pdf

- The requirement for national treatment of foreign investors compared to domestic investors in the host state, this generally means treatment no less favourable than a domestic investor would receive;
- The requirement for most favoured nation treatment of foreign investors, so that an investor from a home state covered by a treaty is given the best treatment available to any other foreign investor in the host state;
- Fair and equitable treatment, also known as the minimum international standards of treatment required of the host state, is a baseline level of treatment a host government must provide to foreign investors. This includes, in most cases, the protection of the "legitimate expectations" of the investor; and
- The prohibition against expropriation without compensation.

The relationship of these special rights for foreign investors to the issue of business and human rights is discussed in detail below.

In addition, a number of investment agreements (and "Services" chapters of trade agreements[3]) include provisions requiring states to liberalize their rules on foreign investment so that foreign investors have the same rights to invest as domestic investors. In many cases, this is associated with ongoing privatization programs in public services, such as water, energy, health or sanitation. When investment liberalization is included, which is now increasingly common, this may include both the services and non-services sectors. In addition, liberalization commitments are often accompanied by prohibitions on what are referred to as "performance requirements", economic requirements placed on foreign investors to conduct certain levels of business within the host economy, for technology transfer, training, research or other contributions to the local economy.[4]

Finally, almost all of the recent generations of IIAs have included special dispute settlement processes for foreign investors. This is the so-called "investor-state arbitration" process. It allows foreign investors the right to initiate international arbitrations directly against the host state for alleged breaches of the IIA rights they obtain. Many of these arbitrations take place in a completely confidential setting, a fact that raises its own human rights issues discussed below. To date, approximately 300 arbitrations under this process are known to have been initiated, with no way to know the exact number due to the confidentiality rules applied in many cases.[5] It may be noted here that only private foreign investors can initiate these arbitrations, as the foreign investors have no obligations under the IIAs to be enforced against them through the dispute settlement process.

---

[3] The General Agreement on Trade in Services (GATS) of the WTO and other similar agreements in regional and bilateral trade treaties include provisions on investment liberalization in services sectors that can be very far reaching.

[4] Issues related to liberalization are considered in s. 5 below, but are not a major feature in this paper.

[5] This is based on combined UNCTAD and IISD studies. See IIA MONITOR No. 4 (2005): Latest Developments in Investor-State Dispute Settlement, 16/01/06 (UNCTAD/WEB/ITE/IIT/2005/2), 2005; UNCTAD IIA Monitor No. 3 (2007): Recent developments in international investment agreements (2006 – June 2007), Recent developments in international investment agreements (2006 – June 2007), 21/01/08 (UNCTAD/WEB/ITE/IIA/2007/6), and Luke Eric Peterson, *Investment Treaty News 2006: Year in Review*, http://www.iisd.org/pdf/2007/itn_year_review_2006.pdf

The ability of private businesses to engage the international law dispute settlement processes of their own accord distinguishes international investment law from international trade law in a very significant manner. It allows a broad range of issues to materialize that may not have if only states had the ability to initiate the process. To date, the range of issues raised by foreign investors under this process has included taxation measures, environmental measures, changes in banking and radio and television laws, alterations of royalties in the resource sectors, and many others.

No comprehensive IIAs (i.e., investment protection and dispute settlement mechanisms, with or without investment liberalization) exist as yet at the multilateral or global level.[6] Previous efforts as far back as the 1948 Havana Declaration that led to the establishment of the General Agreement on Tariffs and Trade, the aborted effort in the 1970's to establish a Code of Conduct on Multinational Corporations, and the OECD failure to complete negotiations on a proposed Multilateral Agreement on Investment all testify to the difficulties negotiating such an instrument entails. The rejection by developing countries in particular of a broad investment component to the Doha Development Round also indicates the impossibility of a multilateral process being initiated during the trade round negotiations.

The lack of a multilateral regime reveals a further aspect of the existing IIA regime that is important to note: it has no central institutional structures. The bilateral and regional negotiations are diffuse and uncoordinated, even if they do reflect a relatively similar set of approaches today. In addition, the dispute settlement process remains completely ad hoc, with no coordinating body, no appellate or political oversight mechanisms as exist in the WTO, limited transparency at best, and no legal processes available to correct incorrect decisions.

Perhaps the most salient conclusion to be drawn here is that the existing IIAs have become extremely important legal documents, both for their impact in supporting the movement of capital and for the ability of foreign investors to directly enter the realm of international law and enforce their treaty rights. From less than 10 known investor-state arbitrations in the mid-1990s, we now have some 300 known cases. These cover all areas of investment and all types of government actions and measures. Thus, even while diffuse in origin and while lacking any international institutional structure, the existing international investment law regime is extremely important in today's globalization context, and it continues to expand.

1.2 The recognition of the importance of IIAs to the business and human rights dynamic

The SRSG has explicitly and implicitly noted that IIAs can play an important role in defining the current relationship of human rights governance to multinational corporations. The primary goal of this paper is to help provide some clarity on the legal issues relating to this role.

[6] The GATS does provide a framework for investment liberalization at the multilateral level, but is not comprehensive and does not have the investor-state process attached to it.

In his 2006 interim report to the Commission on Human Rights, the SRSG noted that "The rights of transnational firms – their ability to operate and expand globally—have increased greatly over the past generation as a result of trade agreements, bilateral investment treaties and domestic liberalization."[7] This understanding reflects one of the key roles of international investment law as part of the international economic law infrastructure for globalization.

Regarding the enforcement of IIAs, the SRSG notes that "a large fraction of disputes related to foreign investments nowadays is settled by private arbitration and not by national courts. So corporate law firms and accounting firms add yet additional layers to routine transnational rule-making."[8] The SRSG has thus properly noted the law making functions of both the treaties themselves and the dispute settlement process which is initiated by corporations to interpret and apply the treaties. In the field of international investment law, the role of the dispute settlement process is especially important as the arbitral decisions generally operate within a system that is subject to very narrow domestic court review and no full appeals process exists in this field. In addition, because so many of the treaties are cast in very general language, the traditional dispute settlement function of simply applying the law to a dispute is expanded in practice to include setting out more precise statements of the content of the law through the arbitration process.

Looking more broadly at the issues of governance of transnational business today, the SRSG also observed in 2006 that

> *"severe imbalances between the scope of markets and business organizations on the one hand, and the capacity of societies to protect and promote the core values of social community on the other, are not sustainable… Today, the widening gap between global markets and the capacity of societies to manage their consequences may pressure political leaders to turn inward yet again, pulled by economically disadvantaged but politically empowered segments of their publics, as a result of which assertive nationalisms or intolerant fundamentalisms may emerge as the promised means for providing social protection. Embedding global markets in shared values and institutional practices is a far better alternative; contributing to that outcome is the broadest macro objective of this mandate."*[9]

In his 2007 Report, the SRSG notes in his opening comments the broad context for understanding the business and human rights issues:

> *There is no magic in the marketplace. Markets function efficiently and sustainably only when certain institutional parameters are in place. The preconditions for success generally are assumed to include the protection of property rights, the enforceability of contracts, competition, and the smooth flow of information. But a key requisite is often overlooked: curtailing individual and social harms imposed by markets. History*

[7] "Interim report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises" Commission on Human Rights, E/CN.4/2006/97, 22 February 2006, para 12.
[8] Ibid, para 12.
[9] Ibid, para. 17

demonstrates that without adequate institutional underpinnings markets will fail to deliver their full benefits and may even become socially unsustainable.

In recent decades, especially the 1990s, global markets expanded significantly as a result of trade agreements, bilateral investment treaties, and domestic liberalization and privatization. The rights of transnational corporations became more securely anchored in national laws and increasingly defended through compulsory arbitration before international tribunals. Globalization has contributed to impressive poverty reduction in major emerging market countries and overall welfare in the industrialized world. But it also imposes costs on people and communities – including corporate-related human rights abuses, for reasons detailed in the SRSG's interim report.

These are challenges posed not only by transnational corporations and private enterprises. Evidence suggests that firms operating in only one country and state-owned companies often are worse offenders than their highly visible private sector transnational counterparts. Clearly, a more fundamental institutional misalignment is present: between the scope and impact of economic forces and actors, on the one hand, and the capacity of societies to manage their adverse consequences, on the other. This misalignment creates the permissive environment within which blameworthy acts by corporations may occur without adequate sanctioning or reparation. For the sake of the victims of abuse, and to sustain globalization as a positive force, this must be fixed. [10]

The question that arises for the international investment law regime in these various related contexts is whether it plays a positive or negative role today in embedding global capital markets with the shared values and institutional practices that are supportive of sound human rights policy. This question requires one to address the key issues that the international investment law regime raises in their broader context. Indeed, only by recognizing the international investment law regime as one of the major public international law branches acting as a foundation for globalization can one analyze its relevance to the business and human rights debate.

1.3 Scope and approach

This paper addresses two issues of primary relevance to the work of the SRSG. Broadly stated, these are:

- Whether IIAs at present include positive elements relating to the protection and promotion of human rights in the investment context, including the responsibility of business to respect human rights; and
- whether IIAs play a potentially supportive or constraining role in relation to the state duty to protect and promote human rights.

[10] "Business and Human Rights: Mapping International Standards of Responsibility and Accountability for Corporate Acts", Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises" Commission on Human Rights, A/HRC/4/035, 9 February 2007, paras 1-3.

A broad concept of human rights is used here. This includes political, civil, economic, social and cultural rights. Foreign investment is, for many states, a major component of their development strategies, and is obviously an economic activity. As such, it has a direct bearing on the economic and social welfare of not just the investor, but also on the communities in which the investment is made and on the people living there. The human rights dimensions of FDI in this context thus include the positive economic benefits in the community the investment goes to, as well as the prevention of negative economic consequences for poor and indigenous communities and the protection of rights in these communities. As this approach to human rights is dynamic, the notion of a state duty to protect and promote human rights is used here.

The responsibility for all economic actors to respect human rights, whether derived from legal or societal norms, has been recognized by the SRSG. The first issue raised above asks whether IIAs actually say anything explicit regarding the responsibilities of foreign investors in this regard, or of states in regard to the activities of foreign investors. Existing research and surveys show that, almost without exception, they do not.

While the great majority of IIAs are silent on this issue, there are some examples in which human rights are raised, either directly or through references to human rights related issues such as labour and environmental protection. These examples will provide an entrée into the question of whether it is possible to directly regulate the human rights related conduct of foreign investors under international investment agreements.

In the context of the state duty to protect and promote human rights, the most critical issue that arises are the duties to legislate in order to implement international human rights obligations into domestic law and to enforce such legislation. In investment law terms, this relates to what has been described in some texts as the right of host states to regulate. At the same time, however, IIAs limit the right of states to regulate, and these limits may extend to the state duty to protect and promote human rights. These limits arise from the application of the investor rights provisions common to almost all IIAs, and the ability of investors to unilaterally enforce these rights in investor-state arbitrations. This paper will give some examples of how these limits have been applied in practice, and raise the issue of the impact of these investor protections before measures are taken.

The role of international human rights law in assessing government conduct and investor conduct in the investor-state arbitrations will also be considered. There are just a few existing decisions that expressly deal with this issue, but decisions on issues that would be treated in a legally similar fashion do provide some extra guidance for present purposes.

This paper will also provide an initial consideration of the linkages between IIAs and Host Government Agreements (HGAs). In this regard, the present paper will draw upon a major research initiative of the SRSG working with the International Finance Corporation concerning the relationship of stabilization clauses in Host Government Agreements – the private agreements between foreign investors and the government in the host state where the investment is made – to human rights issues. The links between the international treaties and the private investment contracts are becoming more salient as the investor-state process begins now to address this in a concrete way. In broad terms, the initial arbitrations that address this linkage appear to give deference to stabilization provisions

over the traditional recognition of the state's right to regulate. In the human rights context, this suggests that stabilization clauses may override the international human rights law duty to regulate as part of the duty to protect.

At a broader level, this paper must also broach the issue of whether public international law is a unified body of law, in which one branch informs the workings of the other, or whether international investment law has become a separate branch unencumbered by considerations coming from other legal sources. This issue goes directly to the question of global governance over multinational corporations, and whether their extraordinary rights and remedies under IIAs pre-empt all human rights concerns. In fact, investment law does not have a history of isolation from other parts of international law, although the impact of other branches of international law to date has been minimal. Still, while this history reveals there is no inherent barrier to human rights law being a source of law that is relevant to the design, interpretation and application of IIAs, it also reveals that the systemic integration of human rights values is virtually completely absent in this area.

1.4 Limitations

The present paper seeks to identify and discuss the range of issues relevant to the linkages between IIAs, business and human rights. It is not intended to be comprehensive in its analysis and citations, but representative of the key issues and the approaches to them found in the IIA regime to date.

This paper also does not address issues related to the direct application of international human rights law to business. It relies upon the work and conclusions of the SRSG in this respect, and uses them as its starting point.

2. Do existing IIAs promote and protect human rights directly?

The first of the two main issues noted above, whether IIAs do or can provide explicit support for the protection and promotion of human rights by foreign investors and host states, is the subject of this section. It begins by considering the actual state of affairs to date in section 2.1, and then considering options for enhanced provisions on human rights in future agreements in section 2.2.

2.1 Summary of the existing state of affairs

Notionally, two types of provisions could expressly address human rights concerns. One would address the state duty to protect and promote human rights in terms of its regulatory, enforcement and policy processes. The second could address the investors directly, and set requirements for their observation of human rights standards. To date, a few examples of the former exist, but no examples of the latter.

The initial generations of IIAs were focused solely and exclusively on investor rights. It was not until the 1990s that any references to social issues, such as labour and the

environment, materialized in any such agreements. Hence, one may take it as a given that the pre-1990 IIAs, about one third of the current total, will have no such references. Post 1990, the majority of such references come from agreements that feature the United States, Canada and some European countries as one state party. South-south agreements do not appear to have such provisions, or at least not in significant quantity.

There are a very limited number of surveys concerning the inclusion of express provisions on human rights in IIAs, and these appear to document just one express inclusion of human rights obligations in an IIA.[11] This is the European Free Trade Area-Singapore Agreement of 2002, which includes a preambular paragraph, "REAFFIRMING their commitment to the principles set out in the United Nations Charter and the Universal Declaration of Human Rights".

While a preambular paragraph can have an impact on the interpretation of an agreement, it does not create rights or place obligations on any state party or an investor. Thus, it may be useful in setting a tone for interpreting the obligations in the agreement and can have an impact on its application, but it does not require in itself any acts (or omissions to act) by states or investors.

A further example of the inclusion of human rights comes from the recently concluded but not yet in force regional agreement among Eastern and Southern African states grouped into the COMESA region. Article 7.2.d of the COMESA Agreement places the human rights issue, along with other social issues, into a forward looking agenda for the institutional structure established to implement the Agreement (COMESA Common Investment Area Committee), enabling it to consider and make:

> *recommendations to the [COMESA] Council on any policy issues that need to be made to enhance the objectives of this Agreement. For example the development of common minimum standards relating to investment in areas such as:*
> *(i) environmental impact and social impact assessments*
> *(ii) labour standards*
> *(iii) respect for human rights*
> *(iv) conduct in conflict zones*
> *(v) corruption*
> *(vi) subsidies; and…*[12]

This is the first time that any investment agreement has expressly included human rights issues related to investment as a possible future working item under the Agreement. The inclusion of closely related mechanisms, such as social and environmental assessments, buttresses the human rights element *per se* as well. This global first falls short of including actual standards, but the express recognition of the linkage and enabling of future

[11] See Lahra Liberti, "Investissements et droits de l'homme", pp. 791-852 in Philippe Kahn and Thomas Walde, eds., *New Aspects of International Investment Law*, Hague Academy of International Law, 2007; OECD, "International Investment Agreements: A Survey of Environmental, Labour and Anti-Corruption Issues, 2007, (official publication number pending).

[12] Art. 7.2, Investment Agreement for the COMESA Common Investment Area, 2007 (not yet in force), available at http://www.comesa.int/investment/regimes/investment_area/Folder.2007-11-06.4315/Multi-language_content.2007-11-07.1023/en

standards-oriented work is still noteworthy. That this comes from a developing country region is also, it may be suggested, noteworthy.

This appears to be the current universe of express provisions on human rights. Given that there are over 2500 IIAs to consider, and even while recognizing that not all agreements have been reviewed in the existing surveys, this is a fairly meager result. At the same time, however, one may note that a much larger number of agreements do contain provisions on other related matters. Most prominent among these are preambular or general objectives provisions on respect for the environment, labour rights and the promotion of sustainable development. These provisions became a feature of US and Canadian IIAs in the post NAFTA period (post 1992), and have been adopted by several other countries in various forms as well. The majority of these provisions are preambular in nature, but in several instances of US agreements, more extensive labour obligations have been developed on states parties, in particular as regards the right of association and unionization, and basic health and safety standards. Recognition of the core labour standards, or slight variations on them, is also becoming more common as an element of investment agreements.[13]

While the labour provisions have imposed obligations on states to take certain measures, in no instance of reference to labour or environmental issues, or sustainable development more broadly, have any direct obligations been set out for foreign investors. The presumption is that states will implement their obligations and establish the domestic laws that foreign investors will then comply with. It is also worth noting that almost all of the references to labour, environmental and related issues are in North-South IIAs. Significantly fewer references to these issues appear in south-south agreements.[14]

There is no known instance of the labour provisions being involved in any investor-state cases to date, but the environmental provisions have been noted in some NAFTA cases. In the most prominent of these in terms of review of the environmental provisions of NAFTA and its environmental side agreement, *S.D. Meyers v. Canada,* the Tribunal noted the environmental and sustainable development issues and provisions, but still found against Canada and awarded damages to S.D. Meyers on the basis that the measure was deliberately intended to be discriminatory.[15] For reasons discussed in section 3, the environmental provisions have largely been a non-useful instrument in investor-state arbitrations under NAFTA's investment rules.

One may also note here that South Africa, in its more recent BITs, has made reference to its program for promoting black economic empowerment, seeking to isolate it from the reach of certain provisions.[16] Malaysia has similarly excluded measures designed to promote the

---

[13] See Liberti and OECD, *supra*, no. 11.
[14] OECD, *supra n*. 11, Annex 3
[15] *S.D. Meyers v Canada*, *Partial Final Award*, 13 November 2000. The measure in question was a temporary ban on exports of hazardous waste to the United States. The Tribunal found that the measure adopted by Canada was motivated by protectionism for Canadian hazardous waste firms and not for environmental reasons and was thus found to be discriminatory.
[16] See the references and discussion in Liberti, *supra* n. 11, p. 818-819.

economic empowerment of the Bumiputras ethnic group from the scope of its BITs.[17] Thus, there are at least these examples where the ability of the state to promote the economic rights of historically disadvantaged ethnic groups has been raised in the context of IIAs. As will be noted below, the South African black economic empowerment program has now become the subject of an investor-state challenge. There are no known challenges under IIAs of the Bumiputras economic empowerment program.

2.2 Can more extensive provisions be developed?

2.2.1 *Provisions relating to the state duty to protect and promote human rights*

Given the scarcity of human rights provisions in the current stock of IIAs, the logical question arises as to whether there is a structural impediment in IIAs that keeps references down to such low numbers. The short answer is no, there is not.

There is no legal or structural impediment to the imposition of obligations on states (we turn to investors below) under an IIA to meet certain basic human rights duties through the implementation of legislation or regulations designed to fully meet their duties under international human rights law. That some agreements impose such standards in the discreet human rights area of labour rights indicates that this is possible in other areas as well. While no such provisions exists in practice today, at least one model for such a provision has been drafted by the International Institute for Sustainable Development in the context of a redesign of IIAs focusing on their sustainable development linkages. This model includes two paragraphs under an article entitled Minimum standards for environmental, labour and human rights protection:

> *(B) Each party shall ensure that its laws and regulations provide for high levels of labour and human rights protection appropriate to its economic and social situation, and shall strive to continue to improve these laws and regulations…*
>
> *(E) All Parties shall ensure that their laws, policies and actions are consistent with the international human rights agreements to which they are a Party …*[18]

An advantage of this type of approach is that the implementation of it would be equally relevant to domestic and foreign investors. In addition, it could establish enforcement procedures that do not exist under human rights instruments, most notably state-state arbitration under the IIA. Finally, as foreign investors are subject to domestic law, this would ensure the applicability of the international human rights law within the host state jurisdiction to all foreign investors equally. (The exception to this could be when a stabilization clause exists in relation to an investor's host government agreement, an issue considered in section 4, below.)

---

[17] See the references and discussion in M. Sornarajah, *The International Law on Foreign Investment*, *Second edition*, 2004, pages 120-121; 366-367.

[18] Howard Mann, Konrad von Moltke, Aaron Cosbey, Luke Peterson, *IISD Model International Agreement on Investment for Sustainable Development*, *Negotiator's Handbook*, *Second edition*, International Institute for Sustainable Development, 2006, Article 21. (Hereinafter, IISD Model Agreement) http://www.iisd.org/publications/pub.aspx?id=686

There is no legal reason for states not to be able to enact such provisions, the legal effect of which would be to fully support the right of states to take such measures within the IIA as opposed to potentially conflicting with it and raising issues of possible compensation for foreign investors for doing so. Rather, the impediment seems to lie on a policy level. Many states have argued that encumbering IIAs with the range of social and environmental issues associated with the establishment and operation of an investment would make the agreements too broad and unwieldy. Representatives of different international organizations and states have, for example, argued that social issues – human rights, corruption, environmental and social impacts – should be left only to other international regimes dealing with these issues, even when no such regimes actually exist. Others have argued on occasions that adding "new issues" may create serious complications for the negotiation of IIAs.

Such rationales, however, belie the complicated nature of negotiations already taking place, with the OECD countries actually leading the way in expanding the length and scope of current IIAs. They also demonstrate the recognition of the extensive impacts that many investments have on the enjoyment of human rights in the local communities where the investments are made. These kinds of impacts underline the need for the rights of investors under the agreements to be balanced with human rights related expectations on host states and on investors under IIAs. This need for balance will become more apparent when the discussion on the current impacts of the investor state arbitration process is considered below.

2.2.2 *Can foreign investors be directly regulated by IIAs?*

A much more complex question than setting minimum standards for human rights performance by states is whether IIAs can set human rights performance standards for foreign investors. Here, the short answer is yes, they can, though more care must be taken regarding the means to enforce such provisions for them to be effective.

As no existing IIAs have sought to do so, examples must be sought elsewhere. The Kimberly Diamond process is one such example, where corporate conduct falls directly within the scope of the agreement and leads to an internationally based certification process. The enforcement of that process comes largely through the positive marketing and certification processes set out in the agreement.

The IISD Model Agreement on Investment for Sustainable Development includes a broad provision in this regard:

> *(B) Investors and investments should uphold rights in the workplace and in the state and community in which they are located. Investors shall not undertake or cause to be undertaken, acts that breach such human rights. Investors and investments shall not be complicit with, or assist in, the violation of the human rights of others in the host state, including by public authorities or during civil strife.*[19]

[19] IISD Model Agreement, Article 14(B).

In order to assist with the enforcement of this potential obligation on investors and their investments, the IISD Model Agreement takes four different approaches:

- the incorporation of the IIA itself into domestic law in order to ensure that the provision becomes part of domestic law and therefore subject to all the judicial enforcement processes of the host state. This is the approach found in relation to current labour rights provisions;
- the expansion of civil remedies against foreign investors by requiring states to remove legal barriers to civil suits against the foreign investor in its host state for acts where the investor has taken key decisions leading to violations of human rights (or other issues) in the host state;
- the elaboration of a mechanism to vitiate the rights of the investor under the IIA through an arbitral process initiated by the host state for a persistent failure by the investor or its investment to comply with its obligations; and
- the elaboration of clear provisions allowing counterclaims against an investor or investment in investor-state arbitrations for damages caused by the breach of the investor obligations.

Parenthetically, it may be noted that most IIAs do not mention the issue of counterclaims, though the ability of states to make such claims under the general arbitration rules used in these processes (ICSID and UNCITRAL Arbitration Rules, primarily) is under debate. The recent COMESA investment agreement, however, includes a specific provision allowing counterclaims against investors who initiate the investor-state process:

> *9. A Member State against whom a claim is brought by a COMESA investor under this Article may assert as a defence, counterclaim, right of set off or other similar claim, that the COMESA investor bringing the claim has not fulfilled its obligations under this Agreement, including the obligations to comply with all applicable domestic measures or that it has not taken all reasonable steps to mitigate possible damages*[20].

The objective of the multi-faceted approach set out in the IISD Model Agreement is to overcome the conceptual problems of making businesses direct subjects of international law obligations where no effective enforcement mechanisms would be applicable. Here, the goal is to seek compliance through interaction with the states concerned, while also better enabling victims to access civil justice remedies in the jurisdictions where decisions are made by the investors.

IIAs today have no enforcement mechanisms against corporations, as there are no obligations falling upon them. As a result, the suggestion is often made that they should be subject to suit by other stakeholders under a similar process to the investor-state arbitration. In the view of this author, such an approach is illusory, given the costs of international arbitration processes in many cases, and the difficulties in mounting such cases before tribunals designed for commercial law purposes rather than enforcement of legislation or obligations against corporations. The suggestions set out above seek to

[20] Common Market For Eastern And Southern Africa Investment Agreement For The COMESA Common Investment Area, Article 28.9

provide what may be more viable means for IIAs to contribute to both seeking compliance by corporations and seeking damages for victims. However, a purpose-driven mechanism for reviewing the responsibility of business to respect human rights may alleviate the above problems in the current IIA processes and create a more viable international law remedy directly against business entities.

3. Do existing IIAs enhance or constrain the duty of states to protect and promote human rights?

Given the paucity of human rights obligations of states or investors in the existing IIAs, it is important to consider whether the existing agreements can act as a brake on the ability of states to protect and promote human rights. The main process by which this would happen, if it does, would be the investor-state dispute settlement process which enables individual investors to enforce their treaty rights. The issue here, in broader international law terms, is whether international investment law as applied through the investor-state process preempts the rest of international law by exclusively creating rights for foreign investors, or whether IIAs must be interpreted as part of the greater body of public international law with the limitations and constraints that coherence among legal regimes requires.[21]

It is beyond doubt today that international human rights law imposes a positive duty on states to adopt and enforce measures necessary to ensure that the economic activities carried on by business within their territory[22] do not negatively impact the human rights of its people. This is the essence of the duty to protect individuals from the abuse of human rights by governments, other persons or corporations. There can also be no doubt that this positive duty extends to both domestic and foreign investors. The question for consideration in this section is whether this positive duty can come into conflict with the rights of foreign investors under IIAs, given that these rights may limit or condition the positive human rights duty of states.

As there is no central institutional framework that can set out any determinative answer to this question, the primary process to which one must turn for the best answers available is the investor-state arbitration process, and decisions issued through it. This can be addressed in two inter-connected ways. First, can disputes legitimately be raised by foreign investors to contest the application of new measures taken by governments to protect and enhance human rights in their jurisdictions, or to seek compensation for the taking of such measures? Second, if such disputes can legitimately be initiated, can one assess the likely outcomes of such disputes so that states may have confidence in their ability to legislate in a manner consistent with their human rights duties in the face of the investor rights?

---

[21] As noted by Liberti, *supra*, n. 11, at p. 820, "*Compte tenu di caractère très limité et le plus souvent tout à fait exeptionnel des références dans les TBI [BITs] aux droits de l'homme, seule une démarche interprétative alternative ou complémentaire pourra résoudre les interférences entre les normes sur la protection des investissements et les normes sur la protection de droits de l'homme et assurer une cohérence d'ensemble.*"

[22] The issue of extraterritorial controls by home states on their foreign investors is not germane to this discussion, as IIAs have no impact on the ability or inability of home states to regulate their foreign investors, only on the host state rights to do so.

As a basis for the analysis, this paper adopts the same legal approach to addressing the critical questions as found in the draft paper on *Stabilization Clauses and Human Rights* prepared for the SRSG and IFC:

> *38. This research aimed to gather empirical evidence that would either support or dispel the claim that stabilization clauses place obstacles in the way of host states' human rights obligations by limiting the action of the host state to apply dynamic social and environmental legislation to international investments.*
>
> *39. The state's ability to pass laws regulating the behavior of private parties (including investors) is fundamental to human rights protection, because such measures are primary tools by which states implement their international human rights obligations – specifically the duty to protect rights.*
>
> *40. Human rights law and jurisprudence supports the idea that failures by a state to regulate and enforce its regulations against companies can amount to a violation of the state's international treaty obligations. Indeed, within the UN system and regional systems, states have been found in violation of their human rights obligations for failing to properly regulate or prevent company actions or omissions that resulted in violations of human rights, including the right to life, privacy, and others. Human rights law and jurisprudence points to a duty of the state to take state action in the form of legislation, regulation, monitoring, and enforcement to ensure that company activities do not negatively impact the enjoyment of human rights.*
>
> *41. Social and environmental laws are used here as a surrogate for human rights obligations, because social and environmental laws (labour and employment, non-discrimination, health and safety, environment, protection of culturally significant property, and the like) are some of the more easily identifiable legislative areas that protect rights and could also directly impact investors….*[23]

The question being considered here simply replaces IIAs for stabilization clauses. Thus, some illustrative questions might include:

- Can a foreign investor covered by the rights in an IIA bring an investor-state arbitration against a host state that enables unions to be formed where none have been allowed before? What if the investment contract stipulated a no-union environment?
- Can an investor-state claim be initiated if a government enacts new environmental standards to protect the right to clean air in a community where a foreign investor is the main source of pollution?
- Could a claim for expropriation lie if a foreign investor requires and uses large quantities of water in an area where water is becoming increasingly scarce, and

[23] Andrea Shemberg, *Stabilization Clauses and Human Rights*, IFC/SRSG Research Paper, March 2008, forthcoming, paras. 38-41, footnotes omitted. (Hereinafter, Shemberg, Stabilization Clauses and Human Rights)

the government acts to limit its water supply in order to ensure local farm and household use of the resource, or other commercial businesses?

3.1 The duty to protect and promote under human rights and the right to regulate under investment law

The primary manifestation of the duty of states to protect and promote human rights is through legal means that ensure the protection of rights against abuse by others, and allow for enforcement against violators of applicable standards. In the human rights context, this is recognized as requiring the progressive enactment into domestic law of international standards. This is especially important in developing countries today, where weaker standards in key areas of the business and human rights relationship may be more prevalent. Thus, the ongoing implementation of the duty to protect and promote human rights is a dynamic one, unfolding over time.

The nearest equivalent in international investment law to the duty to protect in human rights law is found in the notion of the state's right to regulate. As there are no positive obligations on states or investors in existing IIAs to take human rights related actions, the right to regulate becomes the closest related concept in this field.

Absent a stabilization clause that negates the application of some existing laws, the key issue from the investment law perspective is the enactment of new laws to protect or promote human rights, whether in the form of labour and employment laws, public health and safety laws, environmental laws, anti-discrimination laws or the like. Generally speaking, and absent unjustified discrimination between domestic and foreign investors, existing laws at the time an investment is made will not create a problem. Rather, it is changes in the laws that can lead to assertions of breaches of the IIA protections for foreign investors.

The analysis that follows is based on the assumption that the enactment of human rights measures, be it under the label of human rights or through related environmental, labour, health and safety or other instruments, is *bona fide* when done. In other words, it assumes the measure is taken for its stated purposes, in this context to implement international human rights obligations, and that it does so in a non-discriminatory manner in the light of its aims and purposes. Although this may not always be true, applying this presumption for present purposes brings one to the "pure" legal issues in assessing the relationship between human rights law and the protections IIAs grant to foreign investors.

The analysis begins with the concept of the right to regulate, and then considers the interaction between this right to regulate and the rights of investors that may limit the right to regulate. The relevance of human rights law to the issues is then specifically considered, though it is not yet possible to draw firm conclusions on this point. The human rights issues raised by the high levels of confidentiality in the investor-state process itself are then considered, an issue that is currently being negotiated in another UN forum, UNCITRAL, at this very time. In the following section, the relationship of Host Government Agreements to IIAs is considered, based on new research that enables some

initial conclusions to be drawn on how these two types of international instruments, one a treaty and one a private investment contract, may work together in relation to human rights issues.

3.1.1 The right to regulate in investment law

The right of states to regulate is an inherent aspect of state sovereignty. Of this, there is no doubt. Yet, states routinely place limitations on the exercise of this sovereign right through international law, be it in treaties or through the development of customary international law. Indeed, the restriction of sovereign regulatory capacity is one of the most important results of international law, and allows states to address issues in a coherent and effective manner. Thus, the limitation of sovereign rights by international investment agreements is not, in itself, objectionable. Rather, it is the very purpose of international law. The real issue, then, is whether these limitations are consistent with broader social and societal expectations.[24] To restate the question posed in the introduction, do the limitations imposed by the international investment law regime play a positive or negative role today in embedding global capital markets with the shared values and institutional practices that are supportive of sound human rights policy?

The origin of the right to regulate in international investment law lies in the customary international law concept of "police powers". Police powers has been defined as

> *The power of a state to place restraints on personal freedom and property rights of persons for the protection of the public safety, health, and morals, or the promotion of the public convenience and general prosperity. … The police power is the exercise of the sovereign right of a government to promote order, safety, security, health, morals and general welfare within the constitutional limits and is an essential attribute of governmen*t.[25]

This definition would seem, with some degree of certainty, to include human rights law either directly or through its related mechanisms, and hence exclude such regulation from being compensable as a breach of international investment rights. The problem is that, notwithstanding the general consensus on the police powers concept, no formula has ever been fully accepted for distinguishing between a compensable taking and a non-compensable regulation. Phrased in more technical language, the issue may be understood as determining when the nature and public purpose of a measure should be the final test of a regulation, or whether its economic effects on a business should be the test. No clear rules are found for this choice. The uncertainty as to where to draw the line becomes even more acute when the rights of investors under IIAs are factored in. These issues are considered below.

---

[24] For a developing country perspective on these expectations see M. Sornorajah, *supra*, *n. 17*, pp. 311-313.
[25] Black's Law Dictionary, 6th edition, 1990. This definition draws on US law in this area, but is consistent with international law. For a fuller discussion under international law see Howard Mann and Konrad von Moltke, NAFTA's *Chapter 11 and the Environment: Addressing the Impacts of the Investor-state Process on the Environment*, International Institute for Sustainable Development, 1999, pp. 40-45, available at http://www.iisd.org/pdf/nafta.pdf ; George Aldrich, "What Constitutes a Compensable Taking of Property? The Decisions of the Iran-United States Claims Tribunal", 88 AJIL [1994] 585-610.

Given the uncertainties over the scope of the customary international law right to regulate, some IIAs have begun to include specific paragraphs reaffirming the right to regulate. Properly drafted, such paragraphs could reinforce the customary law police powers of states, and ensure a proper balance in the reading of IIAs. However, many of the so-called right to regulate provisions are not cast in a form that has this legal meaning. For example, the EFTA-Singapore Agreement noted previously for its reference to the Universal Declaration of Human Rights, includes a provision entitled "Domestic regulation":

> *Article 43 - Domestic Regulation*
> *Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure consistent with this Chapter that is in the public interest, such as measures to meet health, safety or environmental concerns.*

The breadth of the language "any measure that is in the public interest" clearly would encompass all manner of human rights legislation. However, the insertion of the phrase "consistent with this Chapter" renders the entire paragraph legally useless in terms of reinforcing the right to regulate. In practice, it states the opposite, that the right to regulate for a public purpose *must be* fully exercised in a manner consistent with the IIAs protections of the foreign investor. This qualifying language, which originated in 1992 in NAFTA's Chapter 11 on Investment, is now found in dozens of IIAs.[26]

The lesson here is simple: for right to regulate clauses to be effective for this purpose, they must be properly constructed to protect regulatory space, as opposed to leaving the legal issues to be determined on a reading solely or principally of the investor rights.[27]

One result of the current uncertainty and ambiguity is that the number of investor-state arbitrations continues to grow. With over 300 arbitrations known to have been initiated, the range of matters covers all types of regulatory measures, including environmental, human health, taxation, urban planning, and many more.[28] The answer to the first question posed above – can one expect human rights cases to be initiated under the

---

[26] The origin of this language is in Article 1114(20 of NAFTA, which was limited to environmental measures but includes the same "otherwise consistent with this Chapter" language. In multiple investor-state arbitrations, no government has relied on this as a means to avoid liability for enacting environmental measures.

[27] An alternative clause designed to have such effect is found in the IISD Model Agreement, at Article 25:
(A) Host states have, in accordance with the general principles of international law, the right to pursue their own development objectives and priorities.
(B) In accordance with customary international law and other general principles of international law, host states have the right to take regulatory or other measures to ensure that development in their territory is consistent with the goals and principles of sustainable development, and with other social and economic policy objectives.
(C) Except where the rights of a host state are expressly stated as an exception to the obligations of this Agreement, the pursuit of these rights shall be understood as embodied within a balance of the rights and obligations of investors and investments and host states, as set out in this agreement, and consistent with other norms of customary international law.
(D) Bona fide, non-discriminatory, measures taken by a Party to comply with its international obligations under other treaties shall not constitute a breach of this Agreement.

[28] UNCTAD, *Investor State Disputes Arising from Investment Treaties: A Review*, UNCTAD, 2006**;** Luke Eric Peterson, *Investment Treaty News 2006: Year in Review*, http://www.iisd.org/pdf/2007/itn_year_review_2006.pdf

investor-state process – is, therefore, an emphatic yes. The types of surrogate measures used to implement many human rights obligations have been subject to challenge since the mid 1990s.

3.1.2 The right to regulate versus investor rights

Given the uncertainties surrounding the right to regulate as a matter of customary international law, the interplay of this concept with the investor protections of IIAs is critical from a dynamic human rights law perspective.

It may be useful to briefly recall the key investor rights noted in the introduction:

- The requirement for national treatment of foreign investors compared to domestic investors in the host state, this generally means treatment no less favourable than a domestic investor would receive;
- The requirement for most favoured nation treatment of foreign investors, so that an investor from a home state covered by a treaty is given the best treatment available to any other foreign investor in the host state;
- Fair and equitable treatment, also known as the minimum international standards of treatment required of the host state, is a baseline level of treatment a host government must provide to foreign investors. This includes, in most cases, the protection of the "legitimate expectations" of the investor; and
- The prohibition against expropriation without compensation.

Each of these investor rights can have limiting effects on the state right to regulate. However, in practice the two most critical rights from a human rights or right to regulate perspective are the fair and equitable treatment clause and the provisions on expropriation. Issus related to non-discrimination are less likely to be as critical to *bona fide* human rights legislation because the jurisprudence on discrimination in investment law recognizes that legitimate distinctions can be made between individuals and economic actors when these are justified by sound public policy goals.[29]

The problem that emerges though is that the existing case law in the investor-state arbitrations does little to resolve the uncertainties for states on the balance between the right to regulate and the rights of investors. This is well highlighted through a simple comparative exercise of recent cases that take, on both the expropriation and fair and equitable treatment rights, opposite and essentially irreconcilable approaches.

Let us consider the issue of expropriation first. No IIA bans expropriations. Rather, they place conditions on the right to expropriate. NAFTA's Article 1110 is a good example:

> *Article 1110: Expropriation and Compensation*

[29] This is seen clearly in several recent investor-state decisions. See, e.g., the discussions in *Parkerings-Compagniet v. Lithuania*, Award, September 11, 2007, ICSID Case No. ARB/05/8, at section 8.3; *Methanex Corporation v. United States*, *Final Award*, August 3, 2005, Chapter IV B.

> *1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:*
> *(a) for a public purpose;*
> *(b) on a non-discriminatory basis;*
> *(c) in accordance with due process of law and Article 1105(1) [fair and equitable treatment] and*
> *(d) on payment of compensation in accordance with paragraphs 2 though 6.*

The key issue that arises here is whether a regulation designed to protect or promote human rights can be classified as an indirect expropriation of an investor's rights or assets.[30] The key legal question under IIAs is whether the economic impact of a regulation normally regarded as emanating for the proper use of the police powers of a government can constitute an indirect expropriation. If the measure is seen as an expropriation, compensation will then be due. While some authors argue for reduced compensation for environmental and human rights measures,[31] this has already been rejected by most tribunals, who argue that all expropriations are for a valid public purpose, yet still subject to proper levels of compensation defined in the IIAs themselves once the measure is found to be an expropriation. Singling out environmental or human rights issues as exceptions to compensation rules also suggests a hierarchy of public values for determining compensation that is not supported in law or policy today. Thus, the threshold question of whether a measure is an expropriation and therefore requires compensation to be paid, or is a non-expropriatory government regulation and therefore not subject to compensation is the most critical one.

Two cases highlight the divergent approaches to this same provision. In *Metalclad v. Mexico*, the tribunal identified its main tests for expropriation:

> *103. Thus, expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.*
> …
> *111. The Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree….*[32]

The legal reasoning here strongly supports an approach that leaves out the purpose of the measure from the analysis in determining whether an expropriation has taken place. Only the economic impacts of the measure are relevant. The measure in this case was a decision

---

[30] This issue arises largely from an American jurisprudential theory on "regulatory takings" which is very controversial in itself, and whose analysis is beyond the scope of this paper.
[31] A slightly contrary argument in support of reduced compensation for human rights measures is set out in Lahra Liberte, *The Relevance of non-investment treaty obligations in the assessment of compensation*", Transnational Dispute Management, Vol. 4, No. 6, November 2007, and sources cited therein.
[32] *Metalclad Corporation v. United Mexican States*, ICSID Case No. Arb/AF/97/1, August 30, 2000, paras. 103, 111.

by a municipal government not to grant a permit to operate a hazardous waste site in a facility that the municipality and local residents rejected as suitable for that purpose. In addition, the state government reclaimed the land as an ecological reserve and precluded all commercial uses of the property. This measure was deemed to be an expropriation by the Tribunal.

The present author has previously argued that the conclusion was right, but the legal reasoning very wrong, and damaging to the police powers rule. Had the Tribunal reviewed the nature and purpose of the measure, it would have found that in almost all states the setting aside of land for ecological reserves or parks is considered an expropriation and accompanied by compensation. The reason for this is simple: it takes private property and converts it to part of the public patrimony. This is very different than, for example, preventing pollution from harming other persons, which is not compensable under national laws. But instead of looking at its nature and purpose, the tribunal stated the purpose was not relevant to it, only the economic impact on the investor. As a practical matter, this type of approach effectively guts the police powers rule under customary international law.

The approach of not considering the purpose of a measure is restated in a more recent decision as well:

> *A different matter is the purpose of the expropriation, but that is one of the requirements for determining whether the expropriation is in accordance with the terms of the Treaty and not for determining whether an expropriation has occurred.*[33]

In the case of *Methanex v. United States*, however, the tribunal supported the broader notion of the customary international law police powers concept:

> *"[A]s a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects,* inter alios, *a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.*[34]

The significance of the caveat at the end of this passage is discussed in the section on Host Government Agreements below. For present purposes what is important is the incantation of the essence of the police powers rule as the basic principle in assessing whether a regulatory measure is an expropriation or not.

It is readily ascertainable that these two approaches are not reconcilable. It would not seem that both can be correct statements of the law. Yet both exist and govern the decisions in their respective cases. This is because legal correctness in itself is not a test of the legality or viability of a tribunal award. Therefore, incorrect statements of the law can

---

[33] *Siemens Corporation v. Argentina*, ICSID Case No. ARB/02/8, 17 January 2007, at para 270.
[34] See *Methanex Corporation v. United States*, *Final Award*, August 3, 2005, p. 278, Part 4, Chapter D, para. 7.

and do survive challenge under the limited forms of review available to challenge an arbitration decision.[35]

The same inconsistency in legal results can be found in regards to the fair and equitable treatment standard. Consider first the decision of the tribunal in another waste management case in Mexico under a Spanish-Mexican BIT, known as the TECMED case, on what is required of a host state under the fair and equitable treatment standard:

> *154. The Arbitral Tribunal considers 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.*[36]

What the limits of such a legal requirement are on governments is difficult to identify, indeed it may be impossible to do so. In contrast to the above is the decision of September 2007 in *Parkerings v. Lithuania*.

> *332. It is each State's undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a stabilisation clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. As a matter of fact, any businessman or investor knows that laws will evolve over time. What is prohibited however is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power.*
> *333. In principle, an investor has a right to a certain stability and predictability of the legal environment of the investment The investor will have a right of protection of its legitimate expectations provided it exercised due diligence and that its legitimate expectations were reasonable in light of the circumstances. Consequently, an investor*

---

[35] This has been recently re-affirmed in the review of the *CMS v. Argentina* award, where the so-called annulment committee rejected most of the reasoning of the original tribunal as incorrect but found it did not have the power to overturn the award despite these legal views. CMS Gas Transmission Company v. Argentine Republic, (ICSID Case No. ARB/01/8) (Annulment Proceeding), Decision of The Ad Hoc Committee On The Application For Annulment Of The Argentine Republic, 25 September 2007 AT para. 158, the Tribunal states: *Throughout its consideration of the Award, the Committee has identified a series of errors and defects. The Award contained manifest errors of law. It suffered from lacunae and elisions. All this has been identified and underlined by the Committee. However the Committee is conscious that it exercises its jurisdiction under a narrow and limited mandate conferred by Article 52 of the ICSID Convention. The scope of this mandate allows annulment as an option only when certain specific conditions exist. As stated already (paragraph 136 above), in these circumstances the Committee cannot simply substitute its own view of the law and its own appreciation of the facts for those of the Tribunal.*

[36] Tecnicas Medioambientales Tecmed S.A. (*TECMED) v. Mexico*, ICSID Case No. ARB/AF/00/2, May 29, 2003, para 154. This approach has been endorsed in other decisions. See eg. MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile, Case No. ARB/01/7, AWARD, May 25, 2004, section 4.

must anticipate that the circumstances could change, and thus structure its investment in order to adapt it to the potential changes of the legal environment.[37]

This broader understanding of the right of foreign investors provides a context and sense of realistic expectation that is quite different, and significantly more deferential to the right of states to regulate. Again, it appears very different, and not likely reconcilable with the approach in the previous passage from the TECMED case, yet no determination of the future application of one approach over another is possible given the ad hoc nature of the investor-state process.

In response to the initial decisions under NAFTA, the three NAFTA parties issued a joint statement designed to limit the scope of the fair and equitable treatment standard under NAFTA. In addition, Canada, the US and Mexico have begun to add additional texture to the provisions on expropriation in their more recent agreements. The Model BIT of the United States is illustrative. It includes the same language in the main provision on expropriation as found in NAFTA, but adds an interpretive Annex B:

4. The second situation addressed by Article 6 [Expropriation and Compensation](1) is indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.
(a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:
(i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
(ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
(iii) the character of the government action.
(b) Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.[38]

In the new Model Canadian BIT, the same language is used initially, but the concept of "rare case" is highlighted only by the example of a lack of *bona fides* in the enactment of the measure.[39]

The regional agreement concluded by the states in Eastern and Southern Africa in May 2007 includes very clear language on this point as well:

Article 20.8

---

[37] *Parkerings-Compagniet v. Lithuania*, Award, September 11, 2007, ICSID Case No. ARB/05/8, para. 332-333.
[38] United States Model Bilateral Investment Treaty, 2004, Annex B, at http://www.state.gov/documents/organization/38710.pdf
[39] Canada, Model Foreign Investment Protection Agreement, Annex B.13(1) at http://www.international.gc.ca/assets/trade-agreements-accords-commerciaux/pdfs/2004-FIPA-model-en.pdf

> *Consistent with the right of states to regulate and the customary international law principles on police powers, bona fide regulatory measures taken by a Member State that are designed and applied to protect or enhance legitimate public welfare objectives, such as public health, safety and the environment, shall not constitute an indirect expropriation under this Article.*[40]

Here, the only issue for traditional police powers measures is for them to be *bona fide*.

What one sees here is that the most developed states are responding to the challenges posed by the interpretation of IIAs in the investor-state process in order to protect their regulatory space from claims for compensation. However, recent studies show that these responses are coming primarily from the NAFTA parties and a limited number of non-NAFTA state agreements.[41] The result is that many developing countries, some of whom have several dozen existing BITS, are bound by provisions that have no additional texture or direction for the investor-state tribunals. In addition, developing countries are still negotiating new agreements without the safeguards for government measures being deployed in the more developed states. This leaves them much more open to the uncertainties of the process, and the vagaries of relying on a three person arbitral panel.

Given the above, one may now answer the second question posed for this section: if investor-state disputes can be legitimately initiated following the enactment of new human rights laws, can one assess the likely outcomes of such disputes so that states may have confidence in their ability to legislate in a manner consistent with their human rights duties in the face of the investor rights? The lack of consistency in the current ad-hoc investor-state dispute settlement process suggests that any predictions can be risky. Risk assessments can be made, but the larger the financial impact of a measure on a foreign investor (for example, the right to unionize may lead to very high wage differences in the operation, or the banning of certain products due to their human health impacts may cause a company to pay millions more for its production processes or even cease certain operations), the more difficult it will be to make that assessment. This is especially so for developing countries where multiple needs for precious financial resources may also become a factor in any risk assessment.

3.2 Investor-state arbitrations and human rights: Is human rights law relevant?

Given the uncertainties considered above, one may rightly ask whether international human rights law can be brought into the decision-making mix in investor-state arbitrations in order to tilt the balance in favour of a state's right to regulate. The short answer to this question today is yes, it can be raised. However, the impact of doing so

---

[40] Common Market For Eastern And Southern Africa Investment Agreement For The COMESA Common Investment Area, Article 20.8

[41] UNCTAD, *International Investment Agreements: Trends and Emerging Issues, 2006;* OECD, "International Investment Agreements: A Survey of Environmental, Labour and Anti-Corruption Issues, 2007, (official publication number pending), in particular Annex 3. These studies pre-date the above noted African regional agreement. Still, this agreement is not yet in force, and the general trend noted in these studies remains valid for all existing IIAs.

remains unclear, as the most direct cases on this are just now in the investor-state system and final decisions are still pending.

The first issue that arises here is that investor-state arbitrations under all existing IIAs will always begin from the allegation by the investor that its rights under the IIA have been breached. The case will be phrased and argued, at least initially, on the basis of international investment law. And the final decision will be on whether a state has violated the rights of the investor.

The critical issue for present purposes is whether, if the underlying issues also raise international human rights law questions, they can be raised in the course of the legal arguments? Existing jurisprudence suggests that they can be.[42]

Some examples may be drawn upon to illustrate this view. In *Maffezini v. Spain,* a question arose as to whether requiring compliance with an environmental impact assessment requirement for a manufacturing facility was contrary to the rights of the investor. The tribunal found it was not, and in the process noted that international environmental law supported the legitimacy of requiring a foreign investor to undertake an environmental impact assessment study prior to establishing its business. European Union law was particularly relied upon in this regard. In language reminiscent of the human rights concept of the duty to protect, the tribunal stated:

> *The Tribunal has carefully examined these contentions, since the Environmental Impact Assessment procedure is basic for the adequate protection of the environment and the application of appropriate preventive measures. This is true, not only under Spanish and EEC law, but also increasingly so under international law.*[43]

Similarly, in the recent case of *Parkerings v. Lithuania*, the UNESCO World Cultural Heritage that was applied to part of the old city centre in Vilnius was relied upon by the tribunal to demonstrate that no discrimination had occurred in that case. The designation was used to support the legitimacy of the distinction adopted by the Municipality of Vilnius between two proposed municipal car parking projects, one that impacted upon the designated area and one that avoided any such impacts.[44] The same UNESCO designation also had a significant impact on the determination of damages in the case of *SPP v. Egypt*, an arbitration under a contract rather than an IIA.[45]

In addition, at least two international arbitrations, one under an investment contract (*World Duty Free v. Kenya*) and one under a BIT (*Inceysa v. El Salvador*) have raised the question of whether the initial investments that were made through corrupt activities by the investors could lead to arbitral awards in favor of those investors. In both cases it was

---

[42] See generally, Peter Muchlinski, "'Caveat Investor'? The Relevance of the Conduct of The Investor Under the fair and Equitable Treatment Standard" 55 ICLQ 527 (2006); and Liberti, *supra* n. 11; as well as Liberti, *supra* n. 32.

[43] *Maffezini v. Spain*, ICSID Case No ARB/97/7, Final Award, November 13, 2000**,** at para 67. Footnote omitted.

[44] *Parkerings-Compagniet v. Lithuania*, Award, September 11, 2007, ICSID Case No. ARB/05/8, section 8.3.1.

[45] As reported in Liberti, *supra*, n. 35, p. 2-3.

ruled that the general concept of "ordre public international" prevented the Tribunals from taking jurisdiction and potentially awarding the illegal conduct of the investors under international law with arbitral awards.[46]

In each of these cases, international law drawn from non-investment law sources was successfully used by the state defending the claim to inform the debate on the proper application of the investment treaty to the situation at hand by illuminating the full context in which it was to be applied. The *Lithuania* case directly considered cultural rights under international law as a critical element. *Maffezini* applied a concept similar to recognizing the state duty to protect as regards environmental rights of citizens.

In addition, at least four cases have now seen other direct claims of the relevance of international human rights law. Three of these are in pending water privatization cases (two in Argentina and one in Tanzania) and one is in relation to conditions imposed on a prospective mining investment in California. In each of the water cases, the privatization failed, leading to the initiation by the investors of arbitrations under BITs. While the pleadings of the state and investors remain secret in all three of these cases, *amicus curiae* briefs were submitted that raised the human rights issues. The responses to this by the arbitrating parties remain unknown as well.

In each water case, the non-governmental groups sought the permission of the tribunal to submit an *amicus curiae* brief. As part of this process, the tribunals expressly acknowledged that human rights issues might arise in the course of the arbitration. In the first such case, the tribunal in *Aguas Argentinas v. Argentina* stated:

> *… The factor that gives this case particular public interest is that the investment dispute centers around water distribution and sewage systems of a large metropolitan area, the city of Buenos Aires and surrounding municipalities. Those systems provide basic public services to millions of people and as a result may raise a variety of complex public and international law questions, including human rights considerations. Any decision rendered in this case, whether in favor of the Claimants or the Respondent, has the potential to affect the operation of those systems and thereby the public they serve".*[47]

This same recognition was carried forward by the same three arbitrators sitting on the second separate water case against Argentina. In the third case, Biwater v. Tanzania, the Tribunal cited the above paragraph with approval.[48] It then noted that the *amicus curiae* can submit arguments addressing broad policy issues concerning sustainable development, environment, human rights and governmental policy.[49] In each of the three cases, extensive human rights arguments were made, arguing first and foremost for the relevance of human rights law to the case at hand.[50] In addition, the implications of the

---

[46] *World Duty Free v. Kenya*, ICSID Case No ARB/00/7, 4 October 2006; *Inceysa Vallisoletana v. Republic of El Salvador*, ICSDI Case No. ARB/03/26, 2 August 2006.

[47] Paragraph 19 of *Aguas Argentinas et al. v. Argentina*, Order in response to a Petition for Transparency and Participation as Amicus Curiae, ICSID Case No. ARB/03/19 (19 May 2005).

[48] Biwater Gauff v. Tanzania, ICSID Case No ARB/05/22, Procedural Order 5, 2 February 2007, para 52.

[49] Ibid, para 64.

[50] The arguments of each were different due to the particular context and facts of each. A full detailing of the arguments is unnecessary for present purposes. See In Case No. ARB/05/22 before the International Centre

right to water were raised to argue for high levels of responsibility for the foreign investors, and as a legitimate explanation for governmental acts in response to problems emerging with the privatized delivery systems. Thus, both government conduct and investor conduct were tied to the human rights issues.

In the arbitration between *Glamis Gold v. United States,* a Canadian mining company challenged certain environmental and cultural protection measures taken by the government of California in relation to its proposed mine. The cultural measures pertained in particular to sacred sites of local indigenous peoples, the Quechan Indian Nation. Although the international law dimensions were not a feature of either of the main arguments by Glamis or the United States, they did feature fully in an amicus curiae submission by the Quechan Indian Nation itself.

In that submission, the Quechan argued that such instruments as The United Nations Declaration of the Rights of Indigenous Peoples and ILO Convention 169 concerning Indigenous and Tribal Peoples in Independent Countries established the duty to protect indigenous peoples' cultural sites. This raised the duty to protect on the part of the United States, it was argued, which was then translated into domestic law through state and federal law.[51] The California measures concerning the mine site in question were, therefore, to be viewed as part of the state duty to protect the Quechan Indian sites under international law, and therefore had to be understood as legitimate measures not subject to compensation. The transcripts of the oral hearings available to the public in this case do not reveal any debate specifically on the Quechan submissions. The decision in the arbitration is still pending.

Finally, looming quickly on the horizon is the case against South Africa initiated by Italian investors in the granite industry in South Africa.[52] This arbitration will challenge parts of the Black Economic Empowerment measures in South Africa. It appears that the requirement for minimum shareholding by black South Africans in mining companies is part of the challenge, but the precise grounds for the challenge remain unclear as the documents initiating the arbitration are not available to the public. The most detailed reports on the initiation of the arbitration indicate that the claimants will claim for expropriation of all or part of their holdings, due to the requirement that 26% of the ownership be sold to local black investors. They will also claim for a breach of the fair and equitable treatment obligation for the same reason. Finally, it is suggested that they will claim for a breach of the national treatment requirement, due to being treated less

---

for Settlement of Investment Disputes BETWEEN Biwater Gauff (Tanzania) Limited and United Republic of Tanzania, AMICUS CURIAE SUBMISSION OF**:** The Lawyers' Environmental Action Team (LEAT); The Legal and Human Rights Centre (LHRC); The Tanzania Gender Networking Programme (TGNP); The Center for International Environmental Law (CIEL); The International Institute for Sustainable Development (IISD). 26 March, 2007; *Amicus Curiae Submission*, *Suez*, *Sociedad General de Aguas de Barcelona and Vivendi Universal v. Republic of Argentina*, *ICSID Case No ARB/03/19*, Amici: Centro de Estudios Legales Sociales (CELS), Asociación Civil por la Igualdad y la Justicia (ACIJ), Consumidores Libres Cooperativa Ltda de Provision de servicios de Accion Communitaria; Union de Usuarios y Consumidores; Center for internacional Environmental Law, April 4, 2007.

[51] *Non Party Supplemental Submission of the Quechan Indian Nation*, *Glamis Gold Ltd. v. United States of America*, 16 October 2006.

[52] *Piero Foresti*, *Laura de Carli and others v. Republic of South Africa*, ICSID Case No, ARB(AF)/07/1.

favourably than the Historically Disadvantaged South Africans entitled now to purchase shares in the company.[53]

The complexities of the Black Economic Empowerment measures make it very difficult to speculate further as to the precise nature of the claim. It is clear, however, that civil society groups in several countries are following this arbitration, with its clear economic and social rights background, with concern.

Until one or several of these ongoing cases with strong human rights connections has concluded, further suppositions as to how investor-state arbitral tribunals may address the state duty to protect and promote human rights would be just that, suppositions. Even afterwards, it is possible that different approaches will be taken. And, given the confidentiality that continues to surround all of these arbitrations, there appears to be no public information available to date as to how the states party to the arbitrations, or the investors, have responded to the human rights arguments. Thus, much remains to be learnt and determined. The only points one can argue with confidence is that the human rights issues can be raised before an investor-state tribunal. If, however, states do not participate in doing so, leaving it only to *amicus curiae* submissions, the weight of the submissions may not increase.

3.3 Human Rights issues of the investor-state process itself

Aside from the substantive content of the investor-state arbitration process, the process itself raises important human rights issues. Most notably, only with the NAFTA arbitrations and those that might be conducted under IIAs to which Canada and the United States are parties, investor-state arbitrations take place under a cloak of confidentiality. Under the ICSID Arbitration Rules, the existence of a case is made public. But this is the primary concession as the parties can otherwise keep the proceedings and all written submissions and arguments almost entirely confidential. The final award, however, may be made public by either party. Under the UNCITRAL Arbitration Rules (a UN Body) the existence of a case is not even made known in any formal manner. In addition, each arbitrating party may prevent the other from releasing even the final decision.

The lack of transparency in the investor-state process is unique to its field. In the WTO, all cases are known and governments are free to release at least their own legal materials to the public. In the investor-state process, even though no precise rule exists under ICSID and UNCITRAL, parties are able to gain confidentiality orders from the tribunals that work to keep all legal documents in a case confidential. In some recent instances, even when *amicus curiae* submissions have been allowed, the *amici* have not been given access to the written arguments in the case, making the preparation of such arguments a precarious experience.[54]

---

[53] Luke Eric Peterson, "European mining investors mount arbitration over South African Black Empowerment", Investment Treaty News, 14 February 2007, available at http://www.iisd.org/pdf/2007/itn_feb14_2007.pdf

[54] The present author was co-counsel in one such case, Biwater v. Tanzania, *supra*. n. 51.

This secrecy (to its opponents) or confidentiality (to its supporters) has its roots in the commercial arbitration process which was the forerunner to the investor-state process. As the same rules were generally simply applied across the types of arbitrations, the confidentiality rules of commercial law became the norm for investor-state arbitration. However, there is widespread recognition that investor-state cases raise issues that are very different from commercial arbitration, and that these issues require the weighing of public interests as well as private ones. No other democratically based judicial process involving public issues and the public welfare is, it is submitted, as devoid of the basic guarantees of public access and accountability as the investor-state arbitration process.

And the matter appears to be worsening under existing IIAs. For the first time since observers began to follow the known investor-state arbitrations, more investors chose to use the UNCITRAL Rules than ICSID in 2006, which is the latest year for which data exists. In addition, there is a still small but growing number of arbitrations in other arbitral fora that have strong rules on confidentiality, such as the Stockholm Chamber of Commerce, the London Court of International Arbitration, and the arbitration facility of the International Chamber of Commerce in Paris. As a result, there is a growing risk of even higher levels of secrecy/confidentiality surrounding these arbitrations, as only ICSID has a mandatory posting of all its cases.[55]

The confidentiality of the investor-state process raises issues of democratic rights to basic information about government conduct in relation to public interest issues. It raises important issues relating to government accountability. It raises human rights concerns relating to the right to information. All of this, in turn, has significant impacts on the basic political rights of citizens to participate in the democratic process, both at domestic and international levels. It prevents citizens from being able to follow or participate in public discourse as to the legitimacy of regulations adopted in many cases through democratic means, or to participate effectively in the determination of such legitimacy by tribunals.

As noted recently by the SRSG specifically in the context of this issue, "transparency lies at the very foundation of what the United Nations and other authoritative entities have been promulgating as the precepts of good governance."[56] In the broader business and human rights context, there is an overall push for transparency in business relations to governments and the communities in which they operate.[57] The continued promotion of

---

[55] In 2006, 19 arbitrations were initiated under UNCITRAL Rules, 15 under ICSID, and two elsewhere, of the known arbitration commenced in 2006. Luke Eric Peterson, *Investment Treaty News 2006: Year in Review*, http://www.iisd.org/pdf/2007/itn_year_review_2006.pdf

[56] Statement of the UN Secretary-General's Special Representative on Business and Human Rights, Professor John Ruggie To the UNCITRAL Working Group II (Arbitration and Conciliation), 48th session, New York, USA February 4-8, 2008 http://www.reports-and-materials.org/Ruggie-statement-UNCITRAL-Feb-2008.pdf

[57] See for example the Extractive Industry Transparency Initiative at: http://eitransparency.org/eiti/principles, which is a government, business and civil society initiative designed on embedding the principle of transparency into extractive industry projects. See also, the Kimberley Process http://www.kimberleyprocess.com, which is also a government, business and civil society initiative encouraging transparency of business at least with other participants in the Process, law enforcement officials and customs officials. There have also been a number of initiatives launched and laws passed on social reporting for companies, requiring increased transparency. See for example, the Global Reporting Initiative

secrecy/confidentiality in the investor state process under UNCITRAL or other arbitration rules raises the prospect that the dispute settlement process in this branch of public international law will continue to stay out of step with what the United Nations and other authorities are promulgating as proper approaches to good governance.

Finally, and importantly, one may note that the investor-state process now provides an alternative to what would otherwise be domestic court proceedings in the host state on issues such as breaches of contract by the host state or government compliance with local administrative laws and practices.[58] As a result, the investor-state process effectively, in many cases, will displace transparent domestic judicial processes, especially in developing countries, with non-transparent international judicial processes. In essence, the lack of transparency impacts all of the basic democratic rights noted above when transferring disputes concerning the public welfare from the domestic to the international level.

Addressing this systemic issue is not easy. It can be done through the revision of the arbitration rules or the revision of the IIAs to compel transparency. (Procedural rules included in an IIA will prevail over generic arbitration rules used in an arbitration such as the ICSID or UNCITRAL Arbitration Rules.) Canada and the US now pursue the latter course as a matter of routine in all new agreements, demonstrating unequivocally that there is no fundamental obstacle to a transparent process. In both cases, all new IIAs include provisions requiring:

- Public notice be given of all newly filed arbitration claims;
- All legal arguments of the parties are available to the public;
- The oral hearings can be opened to the public;
- All decisions of the Tribunal will be made public; and
- Procedures for the participation of civil society through *amicus curiae* submissions are set out.

While the transparency issue first surfaced and was responded to by the NAFTA states, it is no longer just a North American issue or response. In the African regional agreement noted previously, concluded in May 2007, one finds the following provisions on transparency in the investor-state process (as well as similar provisions in the state-state dispute settlement process):

> *ARTICLE 28*
> *Investor-State Disputes*
> …
> *5. All documents relating to a notice of intention to arbitrate, the settlement of any dispute pursuant to Article 28, the initiation of an arbitral tribunal, or the pleadings, evidence and decisions in them, shall be available to the public.*
> *6. Procedural and substantive oral hearings shall be open to the public.*

---

at: http://www.globalreporting.org and the UK Companies Act 2006 requiring public companies to report on social and environmental performance.

[58] The processes by which domestic court cases can be converted to international arbitration claims is considered in s. 4, below.

7. An arbitral tribunal may take such steps as are necessary, by exception, to protect confidential business information in written form or at oral hearings.
8. An arbitral tribunal shall be open to the receipt of amicus curiae submissions in accordance with the process set out in Annex A with necessary adaptation for application to investor-state disputes under this Article.[59]

At present, however, the UNCITRAL Arbitration Rules are in the process of revision.[60] Two civil society groups have obtained observer status in order to promote transparency in arbitrations involving states.[61] The current system, it may be argued, creates significant incoherence between the secrecy imposed by one set of UN Rules and the calls for transparency as one of the key ways to increase the appropriateness of corporate conduct, especially in developing countries. In addition, it is arguable that these UN arbitration rules breach basic rights of citizens to information that should be public, as well as accepted UN norms regarding judicial processes dealing with public welfare matters. Coherence of UN approaches to these issues is thus at stake in the current UNCITRAL Rules revision process.

4. IIAs and Host Government Agreements

The research work sponsored by the SRSG and International Finance Corporation on stabilization clauses and human rights provides a new window into bringing together, for the first time, the two types of instruments relating to foreign investment: IIAs and Host Government Agreements (HGAs). Given the conclusions set out above, that the existing investor-state jurisprudence leads to significant uncertainties for states seeking to protect and enhance human rights through new legislation after an investment is made, understanding the potential linkages between HGAs and IIAs becomes quite critical.

Particularly relevant for present purposes are the conclusions that:

> *146. The results of this study suggest that investors and governments continue to conclude investment contracts in which they agree to exempt the investor from – or compensate the investor for the costs of – the application of new laws. Further, it is clear that in a number of cases the stabilization clauses are in fact drafted in a way that may allow the investor to avoid compliance with, or seek compensation for compliance with, laws designed to promote environmental, social, or human rights goals. Assuming the validity of using social and environmental laws as a surrogate for human rights, it is possible to infer further that some stabilization clauses in modern contracts may negatively impact implementation the host state's implementation of its human rights obligations.*

---

[59] Common Market For Eastern And Southern Africa Investment Agreement For The COMESA Common Investment Area, Article 28.
[60] This process takes place under Working Group 2 of the UNCITRAL, which meets the first week of February 2008 in New York and the second week of September 2008 in Vienna.
[61] The International Institute for Sustainable Development and Center for International Environmental Law have prepared background materials and proposal towards this end. See Revising the UNCITRAL Arbitration Rules to Address Investor-State Arbitrations, IISD and CIEL, December 2007 revised version, at http://www.iisd.org/pdf/2008/investment_revising_uncitral_arbitration_dec.pdf

> *147. In the sample from this study, the stabilization clauses in non-OECD countries are more likely than those in OECD countries to limit the application of new social and environmental laws to the investments.*[62]

Given the conclusion that the stabilization clauses can support claims to compensation for the enactment of new human rights measures, and that such provisions are more commonly found in regions of the world where the need for dynamic new legislation is most clear, can this impact be extended into the IIAs as well? The *Stabilization Clauses and Human Rights* paper also notes the manner in which the interaction between the IIAs and HGAs may arise under the investor state process:

> *138. In the case of a foreign investor, where a bilateral or regional investment treaty applies to the investor, freezing, hybrid, or economic equilibrium stabilization clauses may also provide the investor with an argument that specific provisions of the treaty have been breached. International investment treaties might include at least one of three provisions: 1) an "umbrella clause," a guarantee given by the host state to the home state of the company that it will abide by all contractual obligations with investors; 2) a promise of the host state to offer "fair and equitable treatment" to foreign investors from the home state; and 3) a prohibition on expropriation.*
>
> *139. Pursuant to these provisions, a company may bring a claim for arbitration pursuant to the investment treaty claiming any or all of the following: 1) The host state violated its obligations pursuant to the investment contract (specifically the stabilization clause); 2) the host state did not treat the company fairly and equitably, because it breached a legitimate expectation of the company that it would be exempt from or compensated for new social and environmental laws; and 3) the host state's application of the new law is an expropriation of the contract right not to be subject to such laws without compensation.*[63]

The substantive issues raised by the different provisions noted here have already been discussed. The uncertainties created by the different approaches of arbitral tribunals and the absence of any means to reconcile them or to formally designate which approach is correct in advance of a given claim have been noted. However, the addition of a stabilization clause in an HGA does seem to have an impact that supports the expanded view of investor rights at the expense of the state right to regulate and thus at the potential expense of the state duty to regulate under international human rights law.

While there are no specific decisions to this effect on human rights, there are examples where tribunals have argued decisions would have been reversed had stabilization clauses been in effect. More importantly, one may note that the most favourable decisions on the state right to regulate under the expropriation clauses and the fair and equitable treatment clauses of IIAs contain statements along these lines. For example, in *Methanex v. United States*, the tribunal supported the broad notion of the customary international law police powers concept, but added a critical caveat relevant to this discussion:

---

[62] Shemberg, Stabilization Clauses and Human Rights, paras. 146-147.
[63] Shemberg, Stabilization Clauses and Human Rights, paras. 138-139.

> *"[A]s a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable* ***unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.***[64] *(Emphasis added.)*

The Methanex decision is often criticized for being too deferential to the state right to regulate. Given this concern, the inclusion of this caveat when it was not applicable to the case – no such guarantees had been given – is very significant. It clearly places the most favourable approach to the regulatory takings issue under expropriation clauses in IIAs into a very different light in the face of a stabilization provision that may affect the new measure in question and opens up the measure for a finding of expropriation.

Similar concerns arise in the context of the fair and equitable treatment clause. Here, one may refer to the recent decision in *Parkerings v. Lithuania,* noted earlier as a particularly friendly interpretation towards the state right to regulate in an ongoing manner. Here we turn to the issue of a stabilization clause, and how it could alter that interpretation:

> *It is each State's undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion.* ***Save for the existence of an agreement, in the form of a stabilization clause or otherwise****, there is nothing objectionable to the amendments brought to the regulatory framework existing at the time an investor made its investment.*[65]*(emphasis added)*

The Tribunal noted that the amendments to the laws in question did have an immediate financial impact on the investment made by Parkerings. However, the Tribunal made it clear that Lithuania had not given assurances to the investor "that no modification of law, with possible incidence on the investment, would occur."[66] Thus, the *a contrario* argument again looms large, that a finding of breach of the fair and equitable standard would have been found, had a stabilization clause or similar commitment been involved.

As a result of the reasoning in these and similar decisions, one can see that even the most favourable decisions towards the duty to protect and promote human rights could be reversed in the face of a stabilization clause. In essence, the impact of the stabilization clause can be transferred from the purely commercial or contractual litigation context to the investor-state context, reinforcing the jurisprudence that is more limiting of the state right to regulate in the process. As cases like this proliferate, it is entirely possible that more focus will be placed on stabilization clauses to reinforce or expand the investor protections in IIAs by virtue of how they may work together to limit the state right to regulate, and hence the ability to implement the duty to protect and promote human rights.

---

[64] See Methanex Corporation v. United States, Final Award, August 3, 2005, at p. 278, Part 4, Chapter D, para. 7

[65] *Parkerings-Compagniet v. Lithuania*, Award, September 11, 2007, ICSID Case No. ARB/05/8, para. 332.

[66] Ibid, para. 334.

In short, from a state right to regulate perspective, the weaknesses in IIAs are reinforced by the stabilization clauses. Thus, in many cases, improvements in the IIAs alone, or in approaches to their interpretation, will not suffice if the underlying investment arrangement contains stabilization clauses based on the more constraining models described in the Stabilization Clauses and Human Rights paper.

The reinforcement of the weaknesses in IIAs can be used in a strategic manner by foreign investors. Lawyers as part of their due diligence in reviewing a possible investment for a client are now seeking, in many instances, the coverage of an IIA as well as the HGA when one is available for the investor. In many instances, shell corporations are being established in a state with a BIT with the intended host state when the real state of origin of the investor does not have one with that host state. As one example, Bechtel established a partnership in the Netherlands for its water investment in Bolivia, and another one in Mauritius for a dam investment in India. The US does not have a BIT with either country, but the Netherlands does with Bolivia and Mauritius with India. This practice is becoming increasingly prevalent in order to secure two layers of rights.

Once secured, investors are able to initiate contract-based cases in the domestic court of the host state in most cases. Alternatively, international arbitrations under the HGA and a separate arbitration under the IIA can easily be commenced in many instances. And this is often done now in order to multiply opportunities for pressure and for success in litigation. This multiple opportunity is available because there is no international law requirement for a decision under an IIA to be consistent with a decision under contract litigation or arbitration, leaving open the possibility of the state winning the contract claim but losing the IIA claim, or vice versa. In either case, it is the investor that gets "two kicks at the can" in this way.

More work needs to be done on this relationship, but the initial research unequivocally supports the view that the investor-state process can be a viable option for the enforcement of stabilization clauses that can impact human rights. Indeed, even the most favourable approaches to date from a right to regulate perspective appear to yield to the restrictive stabilization clauses in investor-state arbitrations. This, combined with the strategic advantages of multiple remedies where HGAs and IIAs co-exist creates significant issues from a human rights perspective.

5. Investment Liberalization Provisions and Human Rights: A Brief Note

Foreign investments can take place into host countries with or without international law commitments being made on investment liberalization. Under customary international law, each state has the right to allow or not allow foreign investors, be they companies or individuals, to establish a business in its country. However, when investment liberalization commitments, often called pre-establishment rights for foreign investors, are made in an international agreement, they can have additional consequences from a human rights perspective. This section will provide a brief introduction to these additional issues.[67]

[67] A broader review is undertaken in the 2003 Report, *supra*, n. 1.

Investment liberalization is becoming an increasingly frequent component of investment agreements. Since the late 1980s this has been part of the agenda of US IIA negotiations. After NAFTA, Canada took the same approach, and in more recent years it has been spreading as the European Commission asserts its jurisdiction to negotiate liberalization issues on behalf of the member states, usually while leaving the investor protection issues to the individual members themselves. In addition, a number of major regional groups in Asia and Africa have negotiated regional agreements with investment liberalization components.[68]

As noted in the introduction, investment liberalization provisions usually consist of two components. The first, and the most central principle of investment liberalization provisions in IIAs, is the commitment to allow foreign investors to enter the host state on a non-discriminatory basis, i.e., on the same terms as domestic investors. This can be on a broad basis including all economic sectors, or a narrower basis in a limited number of sectors, depending on the agreement negotiated between the states. The WTO's General Agreement on Trade in Services (GATS) is a multilateral investment liberalization agreement for the services sector.

The second component is a provision that prevents the imposition of so-called performance requirements on foreign investors. These are requirements for the investor to have significant interaction with the local economy, such as engaging certain numbers of people, undertaking a given amount of local purchases, training, research and development or other requirements on a business in order to increase the economic benefits within the local community. Historically, high tariff levels generated many of these same benefits, including in OECD countries, often requiring foreign investors to purchase local goods as part of their product supply chains simply for lowest cost reasons due to high tariff levels on imported products. However, with the dropping of tariff levels under trade rules, other performance requirements have risen in importance for developing countries. The prohibition on using these mechanisms is designed to ensure the maximum efficiency of the investment, but does not address the development benefits of using these tools.

It may be noted here, once again, that even relatively high levels of foreign direct investment do not guarantee either significant development benefits or a sustainable development model for developing countries. Rather, investment policies must be made supportive of these goals in a deliberate way, not simply assuming that the quantity of investment will have the desired impact.[69] In the preceding sections, the issues concerning changes in the laws after an investment is made in order to support development and sustainable development goals, including expanded human rights implementation in the host state, are addressed. In this section, we consider issues that may arise prior to the investment being made.

---

[68] On this growing trend see, generally, UNCTAD, *International Investment Agreements: Trends and Emerging Issues*, UNCTAD, 2006, pp. 25-30. The main developing country regions with investment liberalization components in their regional IIA include ASEAN and COMESA now.

[69] For a broad discussion of this see, e.g., Theodore Moran, *Harnessing Foreign Direct Investment for Development: Policies for Developed and Developing Countries*, Center for Global Development, 2006.

The nexus between human rights and new investments will vary from sector to sector, investor to investor, and country to country. This will be a factual question in many cases. And, clearly, not all foreign investments raise such issues, as already noted. Where investment agreements with strong liberalization components can be a factor, however, is in limiting the government ability to seek economic development benefits from foreign investors when these are prohibited as performance requirements by an IIA, or by precluding higher standards of conduct of a foreign investors than of a domestic investor in certain circumstances. Such circumstances may include situations where domestic law does not exist to cover some key elements of a larger investment than the host state may be used to, and thus to address the full impacts of that foreign investment.

In the first of these situations, prohibitions on performance requirements, foreign investors may in fact have benefits over domestic investors who may be subject to tighter controls on sourcing production materials, or undertaking research. Domestic investors may also simply have less access to foreign sourced products or labour or technologies due to economies of scale or other economic factors. The prohibition on performance requirements will, in such cases, limit the ability of host states to promote economic rights of the local communities in the host states. The treatment may, in the end, actually be more favourable than that accorded domestic investors. Whether or not it is, the host state will lose certain capacities to promote the development of the economic rights its citizens.

In the second situation, where government regulations relating to the establishment of an investment are weak or non-existent at the time a putative investment is made known, pre-establishment rights may preclude the enactment of one-off rules for that investment through regulatory or policy processes. For example, if environmental impact assessment laws of general application do not allow specific environmental conditions to be set on an investment, there may be no mechanism available to do so because of the national treatment requirement for new foreign investments. In states with weak regulatory structures, this can be problematic.

Moreover, two additional factors may actually generate greater rights for foreign investors in situations where regulatory structures are weak prior to an investment being made. One is to create greater legal rights for the foreign investor as compared to the domestic investor or person. For example, in states with limited concepts of water rights, a foreign investor into a community that is granted a permit to operate and requires significant water for its production methods may be able to enforce its water access under an IIA, while other water uses may have no legal rights to turn to in order to preserve their access. Property rights under many domestic legal systems in developing countries are also weak or non-existent in many areas. Here again, a foreign investor may gain greater clarity and thus more legal rights than its neighbours through an applicable IIA.

In addition, the use of Host Government Agreements, negotiated prior to the investment being consummated, can also alter the legal rules applicable to foreign investors in such a way as to create more favourable rights than domestic investors. This can occur when laws applicable to the investment, including those relating to the implementation of human rights, are either rolled back for the investment, or frozen from later changes. Each of these issues is explored in detail in the paper on Stabilization Clauses and Human

Rights, and need not be repeated here. The main point is that while foreign investors are guaranteed a minimum level of national treatment for making an investment, provisions on performance requirements and provisions in HGAs can, in fact, create more favourable conditions for foreign investors. As already seen, this can include areas relevant to the government duty to protect and promote human rights.

These pre-establishment issues raise important questions for drafters of IIAs. The scope of pre-establishment rights needs some further examination from the human rights perspective. It also needs, it may be argued, further consideration from the policy and timing perspectives.

Sections 2 and 3 indicate the risks involved in changing legislation pertaining to human rights after an investment is made. By presenting obstacles to imposing higher standards from a human rights perspective on foreign investors than exist under domestic law, and even allowing foreign investors greater rights in areas that may relate to human rights, the pre-establishment obligations supporting investment liberalization may compound the difficulties of governments that do seek to actively apply their duty to protect and promote human rights.

A critical part of the response to this lies in timing, or sequencing, of investment liberalization commitments and the enactment of sound domestic regulations. Here, the legal and policy spheres coincide. When investment liberalization commitments are made on a national treatment basis, it becomes imperative that the regulatory and administrative infrastructures needed to address the impacts of such investment are in place prior to the commitment coming into force. This should include provisions outlining the process for making changes to the regulatory and administrative measures, to ensure that future changes to respond to social and environmental needs are clearly available and foreseeable by all investors. Where these regulatory and administrative measures are not in place before the liberalization commitment, a gap will exist that a foreign investor can benefit from to secure rights that may be greater than the domestic investors.

That said, one must recognize realities that many such commitments may already exist in the absence of proper regulatory structures. In such cases, the need for appropriate regulatory and administrative infrastructures to be in place before many investments are made, and especially major infrastructure investments, is one important aspect of preventing human rights abuses from arising. The window between the legal commitments in an IIA and the actual establishment of an investment should be used to the extent possible for this purpose.

In both of these scenarios, it is clear that having a proper regulatory infrastructure that is adequate to ensure the protection of human rights and other social values in place prior to the investments is an effective way to foresee and forestall human rights problems. This also reduces the risks described above under international investment law of enacting new measures for which an investor may seek compensation. Having a proper regulatory regime in place does not mean that no changes in the law will take place, of course. They will occur over the life of an investment. But by creating both a sound initial regulatory platform for the investment and a process within the structure for adopting new laws or regulations, the risk of such new laws attracting a requirement for compensation under

IIAs will be reduced. It may also be noted here that it is increasingly understood that having a sound regulatory structure in place before major infrastructure investments are made, including the social aspects of the investment, is a key component of supporting the success of many infrastructure investments.[70]

6. Conclusions

The work of the SRSG to date focuses on finding pragmatic solutions to complex problems of imbalances in global governance today. The principle question that this paper has sought to address points to one potential element in this imbalance: does the international investment law regime play a positive or negative role today in embedding global capital markets with the shared values and institutional practices that are supportive of sound human rights policy?

The answer that comes forward from this paper is that it does not at present play a positive role, and has the significant potential to play a negative role. Yet, this need not be permanently the case.

In section 2, the ability of states to include provisions in IIAs that expressly address the requirements of states to meet their basic human rights duty to protect and promote human rights is legally possible, but faces policy objections from many states that seek a streamlined investment regime. Most of these states are capital exporting states that seek to protect their foreign investors. In other instances it is developing countries that fear new restrictions on their development opportunities. In addition, mechanisms are available to include human rights obligations on investors under IIAs, and means to effectively enforce them are available through domestic legal processes as well as international processes. Thinking creatively here can lead to effective provisions that make the text of IIAs a positive human rights force. At the same time, as noted by the SRSG in his review of progress under his mandate in the American Journal of International Law, states have the capacity to impose direct human rights obligations on corporations, but have so far chosen not to do so.

It is therefore recommended that an expert meeting be convened with representatives of interested states, international organizations and civil society stakeholders to prepare model language that can be included in IIAs in order to promote the articulation and implementation of human rights values in international investment. This should include language that recognizes and supports the state duty to protect and the duty to promote human rights, as well as language that supports and clarifies the responsibility of business to respect human rights. The meeting should also consider the mechanisms needed to ensure compliance with such model provisions.

Section 3 raised the key question of whether there may be, in some circumstances, an incompatibility between international investment law and human rights law when the

[70] The lessons learned from the failures of many privatizations are considered by the World Bank in a special report that reaches the conclusions noted here. See Ioannis M. Kessides, *Reforming Infrastructure: Privatization, Regulation and Competition*, World Bank Policy Research Report, 2004.

investor-sate process is engaged. The need for properly crafted right to regulate clauses was raised, noting that there is a propensity today for drafters to include clauses that sound good but achieve little by way of legal security for a state's right to regulate. In the presence of continued uncertainty as to the application of the customary international law police powers rule, the need for clear right to regulate provisions is likely to grow. The uncertainties surrounding the existing right to regulate clauses and the police powers rule mean that states must continue to be prudent in enacting any new laws that might have a significant economic effect on foreign investors, lest they initiate investor-state arbitrations. Assessing the outcome of these arbitrations in advance is a very difficult and uncertain process.

It is therefore recommended that the mandate of the expert group convened under the first recommendation include clarifications and proposals relating to model right to regulate clauses. The proposed clauses should be effective from a right to regulate perspective while maintaining the integrity of investor protections.

The disparity between developed country responses to the uncertainties relating to the right to regulate, in particular in relation to the fair and equitable treatment and expropriation rules in existing IIAs, and the frequent lack of responses to this concern by developing countries, are putting the latter at greater risk of exposure to investor-state disputes than is necessary. This risk is augmented by the related fact that as development increases, the demands for regulatory measures, with and without human rights dimensions, will increase. This disparity in responses to key issues arising from current IIA texts must be addressed, lest developing countries become ever more exposed to claims for damages for enacting public welfare regulatory measures, including in the human rights field.

It is therefore recommended that special attention be paid to this issue by, *inter alia*, UN and other organizations having a special mandate to consider developing country interests in this field. The promotion of mechanisms to amend existing agreements to address the absence of right to regulate clauses should be a priority. In addition, the development of model clauses as referred to in the preceding recommendations should become part of the recommended design for new agreements.

It was also noted that very little information appears to be available to the public to assess the commitment of states to raise human rights issues in their defence to investor-state claims. This is a potential target audience for capacity building on the relationship between the IIA and human rights regimes. The evidence to date suggests that the international investment law regime does not hold itself out to be operating in isolation from the wider corpus of public international law. Hence opportunities for improving connections to other parts of international law do exist.

It is therefore recommended that governmental and non-governmental organizations responsible for preparing and delivering international training courses on investment law and policy include sessions on the relationships of IIAs to human rights, and the opportunities to include human rights law in arguments within the investor-state process.

A major problem in this regard, however, continues to be the opaqueness of the investor-state process. Addressing the lack of transparency of this dispute settlement regime, and its resulting lack of public accountability, remains an important priority. This includes the direct impact of the current process on basic democratic values for disputes having a public welfare component, and promoting consistency of approaches within the United Nations to dealing with corporate transparency issues. Fixing the arbitration rules is a priority in this regard.

It is therefore recommended that institutions such as UNCITRAL, ICSID, the International Chamber of Commerce, Stockholm Chamber of Commerce, and other arbitration rules applied in the investor-state arbitration process be made cognizant of the need for transparency in investor-state disputes, consistent with the broader UN policy on transparency in judicial processes, and the increased recognition of the need for transparency between corporations, government and local communities in the international investment process as part of the improvement of business and human rights processes. States should ensure that transparent dispute settlement processes are included in all new IIAs and consider amending existing agreements for this purpose as opportunities allow.

In section 4, the links between Host Government Agreements and IIAs were considered. It was concluded that existing case law leads to the view that the use of a stabilization clause in an HGA can support an expanded view of investor rights under IIA arbitrations at the expense of the state right to regulate, and thus at the potential expense of the state duty to protect and promote human rights. If the jurisprudence signals, as it now risks doing, that there may be two sets of approaches to the interpretation of IIAs, one for those case where there are stabilization clauses and one where there are no such clauses, lawyers active in this field will likely begin to promote the use of ever stricter stabilization provisions to buttress potential future claims. This could produce a result directly contrary to the goal of the Stabilization Clause and Human Rights paper, to reduce the impact of stabilization clauses on human rights protection. It would also be contrary to the intention of promoting an investment regime that is supportive of sound human rights policy. Care must be taken to avoid this result and more research on the links between IIAs and HGA will be an important part of this process.

It is therefore recommended that further study on the full range of issues arising in HGAs, including, but not limited to stabilization clauses, in relation to human rights is needed. Such study should include the impact of the linkages between HGAs and IIAs, including within the investor-state process. It is critical that the two types of major legal agreements and the private and public international law levels be made to work together towards a positive reflection of human rights needs in the globalization process.

Section 5 also briefly noted the issue of investment liberalization. This included the importance of establishing proper regulatory and administrative infrastructures prior to undertaking major investment liberalization commitments in IIAs, or, in the alternative, prior to major foreign investments being established. This proper sequencing can foresee and forestall human rights problems, and prevent unnecessary cases arising under IIAs.

It is therefore recommended that the international financial organizations and organizations such as the OECD and UNCTAD that promote investment liberalization reviews in developing countries adjust their policies and programs on investment liberalization to ensure that they reflect the need for sound regulatory and administrative mechanisms to be in place prior to encouraging liberalization commitments and programs in developing countries. The regulatory structures should expressly reflect the human rights issues related to the sectors in question, and be developed in a transparent, inclusive manner. This should now include, for example, such processes as the planned review of the OECD Policy Framework on Investment and its subsidiary process currently underway on principles for private sector investment in water infrastructure in developing countries.

In brief, there is no compelling reason why the IIA regime must be in opposition to the human rights duty of states to protect and promote human rights in a dynamic manner. But, at present, there is little to suggest it is moving towards a position of embedding the shared values and institutional practices that are supportive of sound human rights policy into global capital markets.