

Implications of the Rise of ESG Concepts for IIA Reform: The Realization of Responsible Investment

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Abstract: The rise of Environmental, Social and Governance (ESG) investment has attracted worldwide attention in recent years, and the International Investment Agreement (IIA) regime and practice regularly interact with it. ESG factors have been reflected in international investment arbitration, and the IIA reform also promotes sustainable development, measures to counter climate change, responsible investment, energy transition and society governance embedded therein. Existing IIAs still have limited ability to respond to the rise of ESG concept and to realize the principle of responsible investment, i.e., there is a lack of provisions on investors' accountability and obligations. The rise and development of ESG concepts can provide insightful ideas for the IIA reform. While it is difficult to introduce detailed ESG standards directly as IIA provisions, the corporate social responsibility (CSR) provisions can be good guides for the IIA reform in terms of incorporating ESG factors. Besides improving on the corporate social responsibility (CSR) provisions, other substantive reform in IIAs can also enhance the accountability of investors. Further, the dispute resolution provision can also be reformed in pursuance of substantive reform, especially in the areas of counterclaims.

Keywords: Environmental, Social and Governance (ESG), International Investment Agreement (IIA) Reform, Responsible Investment

I. INTRODUCTION

The publication of *Who Cares Wins* by the United Nation Global Compact (UNGC) in 2004 laid the foundations for Environmental, Social and Governance (ESG) investment.¹ Environmental factors refer to an underlying investment's performance or impact in terms of emissions, energy use, waste disposal and other environmental issues; the social pillar stands for the social impact of a business, which includes labour relations and other more contemporary

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¹ Gillian Lofts, *Who Cares Wins in the Brave World of ESG*, *Financial Times*, 2018, <https://www.ft.com/content/64ce9225-0c55-3256-967c-5fae6622c637> (Last Visited on October 9, 2023).

concerns such as diversity and inclusion, community engagement and possibly even consumer protection; finally, governance refers to internal administration and relates to a company's internal controls, anti-corruption and bribery policies, and compliance issues.²

As our knowledge on important or urgent topics such as climate change mitigation and Sustainable Development Goals (SDGs) has grown, the ESG concept has gained increasing attention from the business and investment sectors due to its emphasis on a more caring attitude towards environmental, social, and governance issues. The concept of ESG has also become more popular because of the more quantifiable and concrete standards proposed by it. The concept of ESG has emerged from the fund management community, but it has a wider significance. ESG is a nexus. It maps out a common ground for consumers worried about the environment and the social impact of the global supply chains, for enlightened managers concerned about their companies' reputations, and for active investors seeking to maximize risk-adjusted returns on their investments, particularly in the emerging markets.³

In the context of International Investment Agreement (IIA)⁴ reform led by UNCTAD, IIAs are heading towards a more balanced, sustainable, environment friendly and human rights-oriented approach. To tackle climate change, states are gradually paying more and more attention on domestic and international sustainable development efforts, policies and measures, environment protection, human rights protection, and public order. Thus, their attitudes while concluding IIAs have also correspondingly shifted from solely favoring investors' treatment and protection to being more concerned about local sustainable development and public interests of the host states. The rise of ESG investment has resulted in new regulatory challenges for states; however, the ESG factors and the underlying principle of responsible investment, as a broad

² Nelson Goh, ESG and Investment Arbitration: A Future with Cleaner Foreign Investment? *The Journal of World Energy Law & Business*, Vol. 15, No. 6, 2022, p. 486.

³ Mark Mobius, Carlos von Hardenberg and Greg Konieczny, *Invest for Good: A Healthier World and a Wealthier You*, Bloomsbury Publishing, 2019, p. 187.

⁴ The definition of international investment agreements in this article refers to the UNCTAD Policy Hub website, "Terminology": International investment agreements (IIAs) are divided into two types: (1) bilateral investment treaties (BITs) and (2) treaties with investment provisions (TIPs), <https://investmentpolicy.unctad.org/international-investment-agreements> (Last Visited on October 9, 2023).

idea, do provide valuable guidance for the modernization of the IIA regime. To respond to the rise of ESG, the reform of the existing IIA regime will require a practice and realization of responsible investment.

This article first starts with an analysis of ESG-related disputes arising under IIAs, which shows the interaction between ESG factors and international investment law. Based on this case analysis, this article points out that the existing IIA regime has limitations in terms of realizing responsible investment as it is lacking legal basis for investors' obligations. Through a comparison between the ESG concept and Corporate Social Responsibility (CSR), especially an analysis of CSR provisions in IIAs, this article demonstrates the possibility and feasibility of directly including ESG standards into the IIA regime. Lastly, this article proposes IIA reform that can help in realization of responsible investment.

II. ESG-RELATED DISPUTES ARISING UNDER IIAS

Given the move towards, and push for, energy transition, tackling climate change and pursuing SDGs, ESG issues such as human rights, environment protection, conflicts with indigenous or local communities, bribery and corruption and tax issues are increasingly being included in international investment and trade treaties.⁵ Despite domestic ESG regulations being enacted in response to these issues, more and more investment treaty disputes are arising and will continue to arise due to these changes.⁶

A. Environmental Factors Related Cases

1. Cases Resulting from Energy Transition

In response to the need for domestic policy reforms, tackling climate change

⁵ Patricia Nacimiento, Antony Crockett and Alessandro Covi, The Rising Importance of ESG and Its Impact on International Arbitration, *Herbert Smith Freehills*, <https://www.herbertsmithfreehills.com/insights/2021-07/the-rising-importance-of-esg-and-its-impact-on-international-arbitration> (Last Visited on October 9, 2023); Holly Stebbing and India Furse, ESG Disputes in International Arbitration, *Norton Rose Fulbright*, <https://www.nortonrosefulbright.com/en/knowledge/publications/e01e3d5a/esg-disputes-in-international-arbitration> (Last Visited on October 9, 2023).

⁶ Jack Terceño, Will Thomas and Amanda Neil, The Rising Significance of ESG and the Role of International Arbitration, In *International Arbitration in 2022: Top Trends*, Freshfields Bruckhaus Deringer, https://www.freshfields.com/490835/globalassets/our-thinking/campaigns/arbitration-top-trends-2022/international_arbitration_top_trends_2022.pdf (Last Visited on October 9, 2023), p. 6.

and carbon reduction activity, the host states have started to adjust their respective energy policies in a cleaner direction, which tends to damage foreign investors' investment interests in such host states. This is the main reason underlying the increase in this type of investment disputes, especially under the Energy Charter Treaty (ECT). Not only did Spain, Italy, and the Czech Republic withdraw from the ECT, these countries also changed their investment incentives related to renewable energy. Alleging that their legitimate expectations had been frustrated, as well as a violation of the principle of fair and equitable treatment (FET), a number of foreign investors raised claims against them under the ECT. In *PV Investor v. Spain*, the Spanish government had adopted a series of reforms in its energy regime, including a 7% tax on power generators' revenues and a reduction in subsidies for renewable energy producers, that led to a group of investors filing a claim against it under the ECT.⁷ The Netherlands coal phase-out policies/regulations also resulted in International Centre for Settlement of Investment Disputes (ICSID) arbitration commenced by RWE and Uniper.⁸

2. Cases Related to Domestic Environment Protection

The case of *David Aven v. Costa Rica* (*Aven* case) was concerning an investment project related to tourism in Costa Rica's Central Pacific Coast. When wetlands and forests were discovered in that area, the Costa Rican authorities undertook inspections and eventually enjoined the claimant from operating the project. The local authorities also commenced criminal proceedings alleging that the claimants had violated local laws on forestry and wildlife conservation. The claimants filed a claim alleging that Costa Rica had breached its obligations of FET and that its actions constituted unlawful expropriation under the Dominican Republic-Central America FTA (DR-CAFTA). Relying on Article 10.11 of the DR-CAFTA, Costa Rica contended that the suspension of the project was justified on grounds of environment protection, and it also filed a counterclaim against the claimant for the project causing damage to the local ecosystem. The tribunal concluded that the measures undertaken by Costa Rica to

⁷ The *PV Investors v. Spain*, PCA Case No. 2012-14.

⁸ Stan Putter, The Netherlands Coal Phase-out and the Resulting (RWE and Uniper) ICSID Arbitrations, Kluwer Arbitration Blog, <https://arbitrationblog.kluwerarbitration.com/2021/08/24/the-netherlands-coal-phase-out-and-the-resulting-rwe-and-uniper-icsid-arbitrations/> (Last Visited on October 9, 2023).

protect the environment were consistent with international law and neither arbitrary nor in breach of the obligations under DR-CAFTA.⁹ As for Costa Rica's counterclaim, even though the tribunal did not allow the same, it did re-affirm the host states' right to regulate foreign investors over domestic environment protection issues, and the possibility of investors bearing environmental obligations.¹⁰

B. Social Factors Related Cases

With regard to social factors, investment disputes are usually in connection with human rights, labour protection, local communities, gender equality and other issues. *Urbaser v. Argentina* (*Urbaser case*) is a typical case concerning the human right to water. Urbaser raised the claim due to the termination of a concession for water and sewerage services granted to its subsidiary by the government of Argentina. In response to the claim, significantly, Argentina submitted a counterclaim alleging that Urbaser's failure to provide the relevant investment was a violation of its international obligation which had, in turn, resulted in damage of local residents' human right to water. Even though the counterclaim did not prevail because of a lack of international legal basis for Urbaser's human right obligation,¹¹ the tribunal did recognize the possibility of investors bearing obligations and the value of CSR in general.¹²

Another case, *Bear Creek v. Peru*, concerns the rights of indigenous peoples. Canadian investor Bear Creek was barred from starting a project involving exploitation of the silver mine in Peru due to the significant mistrust of the local population towards the project. This finally led to violent local protests and social unrest against mining activities. Bear Creek, thus, did not get a "social license", i.e., the acceptance by a local population and other stakeholders of an economic project, and it could not carry out its project in Peru. While the tribunal took the view that consultations with indigenous communities must be held so as to obtain consent from all relevant communities/stakeholders impacted by an investment project, it still found that Peru's measures violated the

9 David Aven et al. v. Republic of Costa Rica, ICSID Case No. UNCT/15/3, Award (September 18, 2018), paras. 394, 417-418, 439.

10 Ibid., paras. 412, 699, 734-739.

11 Urbaser S. A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic, ICSID Case No. ARB/07/26, Award (December 8, 2016), paras. 1206-1214.

12 Ibid., paras. 1194-1199.

Free Trade Agreement between Canada and the Republic of Peru (Canada-Peru FTA).¹³ However, one dissenting arbitrator gave the valuable opinion that foreign investors also play an important part in the process of obtaining local trust, that is, “social license”.¹⁴ This dissenting opinion, along with the trend illustrated by the *Urbaser* case, increased the attention on the international accountability of foreign investors with respect to social and human right obligations.

C. Governance Factors Related Cases

These cases include ESG-related issues that may affect the tribunal’s jurisdiction over a claim or its admissibility. As respondent, the host state may attempt to raise an objection on the grounds of jurisdiction against an investor’s claim by alleging that the investment was made illegally (“not in accordance with law”).¹⁵ If an investment is made illegally, it falls outside the definitional scope of an IIA, and is not entitled to treaty protection. The illegality also covers the notion of good faith or international public policy, as illustrated in *Hamester v. Ghana*, *World Duty Free Company v. Kenya*, and other cases.¹⁶

What is more, the cases concerning governance issues usually focus on bribery and corruption. *Metal Tech Ltd. v. Uzbekistan* is an example of a successful defense on the grounds of corruption. The dispute in this case was about a joint-venture agreement between the claimant and two state-owned companies of Uzbekistan. Metal Tech complained that the Uzbek government had adopted measures leading to the cancellation of their right to export material under the agreement. Uzbekistan raised an objection regarding jurisdiction on the ground that the agreement had been concluded by means of corruption. Thus, the tribunal found in favour of the Uzbek government and held that it lacked jurisdiction over the case, and that the claimant’s investments fell outside

¹³ *Bear Creek Mining Corporation v. Republic of Peru*, ICSID Case No. ARB/14/21, Award (November 30, 2017), para. 416.

¹⁴ *Bear Creek Mining Corporation v. Republic of Peru*, ICSID Case No. ARB/14/21, Partial Dissenting Opinion of Professor Philippe Sands QC (September 12, 2017), para. 37.

¹⁵ *Supra* n. 2, p. 495.

¹⁶ *Gustav F.W. Hamester GmbH & Co K.G. v Republic of Ghana*, ICSID Case No. ARB/07/24, Award (June 18, 2010), paras. 123-124; *World Duty Free Company v Republic of Kenya*, ICSID Case No. ARB/00/7, Award (October 4, 2006).

its protection due to non-compliance with the host state's laws.¹⁷

III. LIMITATIONS OF EXISTING IIAS: LACK OF INVESTORS' OBLIGATIONS

The abovementioned ESG-related investment disputes reflect that when foreign investors establish and operate their investment projects in the host states, they may negatively impact domestic public interests and public order, that is to say, the interests of investors may run afoul of the domestic legal system or domestic policy measures enacted by host states in response to climate change, SDGs and other vital public interests. The significance of ESG concepts in the context of foreign investments is to encourage enterprises to pay more attention to high-quality development. On the other hand, IIAs, with the consensus of states, can play a significant role in guiding multinational corporations to invest responsibly in a widely recognized manner. However, the existing IIAs fall far short of playing a leading role for investors, considering their limitations both in terms of provisions as well as dispute settlement mechanisms.

A. Limitations of the IIA Provisions

*1. Aspirational Statements*¹⁸

There have already been a number of IIAs that included ESG-related provisions, which have shown greater consciousness about the environment, social and governance factors.

The preambles of several IIAs express the consideration of sustainable development, environment protection, mitigation of climate change and other ESG-related issues. This can be found in the preamble of the Comprehensive Economic and Trade Agreement (CETA) that the parties agree on "REAFFIRMING their commitment to promote sustainable development and the development of international trade in such a way as to contribute to sustainable development in its economic, social and environmental dimensions", "RECOGNISING the importance of international security, democracy, human rights

17 *Metal Tech Ltd. v. The Republic of Uzbekistan*, ICSID Case No. ARB/10/3, Award (October 4, 2013), paras. 372-373.

18 Refer to the wording "Aspirational Statements" in *Supra* n. 2, p. 490.

and the rule of law for the development of international trade and economic cooperation”, and “IMPLEMENTING this Agreement in a manner consistent with the enforcement of their respective labour and environmental laws and that enhances their levels of labour and environmental protection, and building upon their international commitments on labour and environmental matters”.¹⁹ The concepts of sustainable development, environment protection, labour rights, and so on, are all covered under the ESG concepts. It may also be seen in the EU-Georgia Association Agreement that the parties have agreed to be “COMMITTED to respecting the principles of sustainable development, to protecting the environment and mitigating climate change, to continuous improvement of environmental governance and meeting environmental needs, including cross-border cooperation and implementation of multilateral international agreements”.²⁰ It clearly mentions that the Parties are determined to respect the principles which are also embodied in the ESG concepts.

However, the ability of preambles to be able to play the role of strong tools to regulate ESG related issues is limited. According to Article 31(2) of the Vienna Convention on the Law of Treaties (VCLT), the preamble forms part of the context of the treaty for the purposes of interpretation.²¹ However, the preamble has no specific statements on how to respect the values provided by itself, and it lacks enforceability that will help realize the principle of responsible investment.

Along with the preamble, a few IIAs also contain provisions that refer to the same ESG issues, as mentioned above, in their text. Whereas, this type of provisions are expressed as aspirations or declarations, rather than enforceable obligations,²² they clearly demonstrate the parties’ respect for ESG values, such as sustainable development, labour rights, environmental protection, and CSR, and will often also cite relevant international treaties, guidelines, or principles such as International Labour Organization (ILO) Conventions, the Universal Declaration of Human Rights, the United Nations Framework Convention on Climate Change (UNFCCC), and the Organization for Economic Cooperation

19 Comprehensive Economic and Trade Agreement (CETA), Preamble.

20 EU-Georgia Association Agreement (2014), Preamble.

21 Vienna Convention on the Law of Treaties (VCLT), Article 31.

22 *Supra* n. 2, p. 495.

and Development (OECD) Guidelines for Multinational Enterprises, etc.²³

However, neither preambles nor this type of provisions have stipulated specific requirements as to how the foreign investors should bear their ESG-related obligations or responsibilities while making investment in host states. The lack of enforceability is the key shortage of these aspirational statements in IIAs.

2. Lack of Regulatory Space for the Host States

Generally, IIAs focus on the protection of investors' rights and on their treatment instead of reserving regulatory space for the host states to take measures to protect their public interests, and perform their international obligations under international treaties about climate change, environment protection, human rights, and so on. The present IIA regime tends to compress the space and ability of host states to regulate their own necessary matters. At present, most IIAs contain provisions for exceptions. However, in practice, the host states can hardly ever successfully invoke the exception provisions to defend themselves. There are too many limitations on host states' power to regulate and take measures to secure their own domestic public order. Less scope for the host states to take reasonable and nondiscriminatory measures to regulate foreign investors and their investment means that it is easier for the foreign investors to establish and operate their investment project/scheme in an irresponsible manner.

3. Absence of Provisions on Investors' Obligations

Provisions on investors' obligations and responsibilities are rarely found in IIAs. This may be understandable because the original purpose of establishing the IIA regime was to encourage and protect investments made by investors from other states. There are only a few IIAs that require the "investment" to be "made in accordance with law" as discussed above.²⁴ The requirements of the

23 Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), Article 9.17; Morocco-Nigeria BIT (2016), Article 24; Interestingly, the Dutch Model BIT does not limit ESG-related concerns to the recitals, see Dutch Model BIT (2019), Article 6; Eric de Bradandere, The 2019 Dutch Model Bilateral Investment Treaty: Navigating the Turbulent Ocean of Investment Treaty Reform, *ICSID Review – Foreign Investment Law Journal*, Vol. 36, No. 2, 2021, p. 319.

24 Article 1(2) of the Egypt-Spain BIT (1992) defines an "investment" as assets and rights "acquired under the law of the host country". Article 3 provides protection for investments "made in accordance with [the host country's] laws and regulations by investors of the other Party".

element of “legality” in such provisions are too broad and vague, which makes it hard for the tribunals to interpret the provision in a consistent and predictable manner. While there is no provision in the IIA articulating the investor’s obligations and responsibilities in the course of their investment activities, it is not possible to check the investor, and the states cannot respond to the emerging trend of ESG investment by adopting measures in line with ESG concepts.

B. Limitation of the Dispute Settlement Mechanism

The original purpose of building the IIA regime was to encourage investment between states by providing foreign investors, who are more vulnerable than states, with protection and favourable treatment. Correspondingly, the dispute settlement mechanism under IIAs is mostly designed such that only investors have the right to file claims against the host states on the ground of violation of treaty protection and treatment standards. Under this unbalanced mechanism, the host states can only defend themselves passively in arbitration proceedings started by investors, and can hardly make reasonable public policies or avoid the huge amounts of compensation that are inevitably imposed.

In investor-state dispute settlement (ISDS) practice, a turning point might have already come. As mentioned above, in the *Urbaser* case and the *Aven* case, the host states, Argentina and Costa Rica respectively, raised counterclaims in the face of allegations of violations of the IIA provisions to request damages from investors for irresponsible investment causing negative impact on public interests (environment or human rights). Counterclaims can serve as a useful tool for rebalancing the asymmetric nature of IIAs.²⁵ Being able to raise counterclaims for environmental damage or for enforcement of human rights will also serve as a reminder for foreign investors to start, establish, and operate their investment projects in a responsible manner.

However, under the existing IIA regime, the host states have rarely ever succeeded in their counterclaims, except in the *Burlington* case and *Perenco*

²⁵ Ted Gleason, Examining Host-state Counterclaims for Environmental Damage in Investor-State Dispute Settlement from Human Rights and Transnational Public Policy Perspectives, *International Environmental Agreements: Politics, Law and Economics*, Vol. 21, 2021, p. 427.

case.²⁶ Based on the reasons mentioned above, most of the IIAs often limit the scope of investment disputes to those that “relate to a breach of the host state’s obligations” in order to ensure that the investors’ interests are protected. So, if the principal claims and counterclaims are raised under the mechanism of such kinds of IIAs, there is a high likelihood that the host states’ counterclaims will not be upheld by the tribunal, as the tribunal will only have jurisdiction over disputes relating to the host states’ breach of their obligations, and not the investors’ breach of any obligations. On jurisdictional issues, the tribunals will decline to hear the counterclaims, because they are not related to the violation of IIAs caused by states; and as for the merits, the tribunal will not rule for states to impose obligations on foreign investors because of the lack of such substantive provisions in IIAs. These obstacles exist throughout the whole investment arbitration proceeding from jurisdiction to merit stage.

IV. FROM CSR TO ESG: THE POSSIBILITY OF INCLUDING ESG STANDARDS INTO IIAS

Based on the nature and status of existinig IIA regime, is it possible to directly include ESG standards into IIAs?

A. The Existing ESG Principles and Policies

After the ESG concepts emerged in 2004, a group of the world’s largest institutional investors developed a set of principles for responsible, ethical and sustainable investing. This investor-led group supported by experts, inter-governmental organizations and civil society published the “*Principles for Responsible Investment*” (PRI) in April, 2006. The six principles offer a host of possible actions for incorporating ESG issues into investment practice. The six PRI principles that were agreed on are: (i) incorporate ESG considerations into investment analysis and decision-making processes (Principle 1); (ii) be active owners and incorporate ESG principles into their ownership policies and practices

²⁶ In these two cases, Ecuador won its counterclaims against the claimants. Burlington and Perenco had already accepted the jurisdiction of the Tribunal in advance, so the tribunal directly ruled on the merits of these two cases and made decisions for Ecuador. See *Burlington Resources, Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5 and *Perenco Ecuador Limited v. Republic of Ecuador*, ICSID Case No. ARB/08/6.

(Principle 2); (iii) seek appropriate disclosure on ESG issues by the entities in which they invest (Principle 3); (iv) promote acceptance and implementation of the Principles within the investment industry (Principle 4); (v) work together to enhance effectiveness in implementing the Principles (Principle 5); and (vi) report on activities and progress towards implementing the Principles (Principle 6).²⁷

The EU has adopted an integrated system of ESG policies. The starting point of EU ESG policies was the adoption of the Non-Financial Reporting Directive (NFRD) in 2014, which first incorporated ESG factors into the relevant regulations. In line with the European Green Deal, a key element for fostering sustainable growth and for financing green transition will be the channeling of funds that contribute to environmental, social and governance-related objectives.²⁸ NFRD requires certain large companies to disclose information on the way they operate and manage social and environmental challenges. It was mainly intended to help investors and other stakeholders evaluate the non-financial performance of large companies, and encourage these companies to develop a responsible approach to business.²⁹ To address the shortcomings of the NFRD, the European Parliament substantially increased the mandatory sustainability disclosure requirements by adopting a new Corporate Sustainability Reporting Directive (CSRD) in January, 2023. CSRD requires EU and non-EU companies with activities in the EU to file annual sustainability reports alongside their financial statements. These reports must be prepared in accordance with European Sustainability Reporting Standards (ESRS).³⁰ The ESRS set out detailed reporting requirements for EU companies within scope of the CSRD, including EU subsidiaries of non-EU companies. For companies already subject to the NFRD, the CSRD will apply starting from the fiscal year beginning

27 United Nations, About the PRI, <https://www.unpri.org/pri/about-the-pri> (Last Visited on October 9, 2023).

28 European Parliament, Implementation Appraisals: Brief of Non-financial Reporting Directive, pp. 1, 9, [https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/654213/EPRS_BRI\(2021\)654213_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/654213/EPRS_BRI(2021)654213_EN.pdf) (Last Visited on October 9, 2023).

29 David A. Ciffrino, The Rise of International ESG Disclosure Standards, Harvard Law School Forum on Corporate Governance, <https://corpgov.law.harvard.edu/2023/06/29/the-rise-of-international-esg-disclosure-standards/> (Last Visited on October 9, 2023).

30 Emma Bichet, Jack Eastwood and Michael Mencher, EU's New ESG Reporting Rules Will Apply to Many US Issuers, Harvard Law School Forum on Corporate Governance, <https://corpgov.law.harvard.edu/2022/11/23/eus-new-esg-reporting-rules-will-apply-to-many-us-issuers/> (Last Visited on October 9, 2023).

January 1, 2024, with the first reports to be published in 2025.³¹ The EU's direction has set a standard for worldwide reference.

B. CSR Provisions in IIAs

Generally, there is no clear or concrete definition of CSR in the area of international investment law, and the CSR standards found in international legal documents are usually in the form of soft law, such as the OECD Guidelines for Multinational Enterprises. Even if there are no documents that mention CSR, the tribunal could still apply the principles of CSR as international legal rules to a case. In the *Urbaser* case and *Aven* case, the relevant IIAs did not contain provisions incorporating the principles of CSR; however, the tribunals did still apply the principles of CSR and found that foreign investors should also bear the general obligation not to harm public interests.³²

In a few of the recently concluded IIAs, CSR principles have been included in the treaty text. In Article 22.2(b) of the CETA, it has been provided that the parties shall “encourage the development and use of voluntary best practices of CSR by enterprises, such as those in the OECD Guidelines for Multinational Enterprises, to strengthen coherence between economic, social and environmental objectives”.³³ This type of CSR provision emphasizes that the parties only “encourage” the multinational enterprises to “voluntarily” use best practices of CSR, and it refers to the OECD Guidelines as a source of CSR principles. Other CSR provisions directly impose investor obligations. For example, in the Morocco-Nigeria Bilateral Investment Treaty (BIT) (2016), Article 24 provides that investors and their investments should strive to make the maximum feasible contributions to the sustainable development of the host state and local community through high levels of socially responsible practices. It also mentions the application of other CSR rules.³⁴ This type of CSR

31 Thibault Meynier, Sarah H. Mishkin and Matthew Triggs, EU Finalizes ESG Reporting Rules with International Impacts, Harvard Law School Forum on Corporate Governance, <https://corpgov.law.harvard.edu/2023/01/30/eu-finalizes-esg-reporting-rules-with-international-impacts/> (Last Visited on October 9, 2023).

32 *Urbaser* case, *Supra* n. 11, para. 1195; *Aven* case, *Supra* n. 9, paras. 699-702.

33 CETA, Article 22.2(b).

34 Morocco-Nigeria BIT (2016), Article 24.

provision has progressively incorporated responsible business or investment obligations by clarifying the meaning of CSR in international documents.

C. From CSR to ESG: Feasibility Analysis of Including ESG Standards

The ESG concepts, which encompass the theories of sustainable development, responsible investment, and CSR, are of great relevance to the investment and trade sectors, particularly in the field of international investment law. CSR provisions in IIAs have values in common with the ESG concepts, especially from the perspective of corporate governance. If the CSR principle can be introduced into the IIA regime, what about the introduction of ESG standards into IIAs?

Though ESG has a much clearer and more organized framework in each of its aspects, it is not practical to be able to incorporate every detail of the ESG standards into the IIA regime. As the ESG standards are highly detailed, it is hard for states to reach an agreement on its every aspect, requirement and standard on a treaty level, and this is usually accomplished via domestic legislation or policies. The ESRS, as mentioned above, sets out detailed reporting requirements for EU companies within scope of the CSRD, including EU subsidiaries of non-EU companies. The ESRS covers general reporting principles, list of mandatory disclosure requirements for EU companies related to the identification and governance of sustainability matters, and 10 ESG topics where disclosure is required, subject to a materiality assessment.³⁵ As this is too specific and detailed for an IIA, it is actually not practical to directly include ESG standards into IIAs' provisions.

Another reason why directly including ESG standards into IIAs is not practical, is that there are already different sets of standards and requirements mandated by different agencies or bodies (such as the Global Reporting Initiative, the Sustainability Accounting Standards Board, etc.), and it is difficult to harmonize so many rules within a few IIA provisions. CSR provisions have

³⁵ See European Commission, Corporate Sustainability Reporting, https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en (Last Visited on October 9, 2023); See also *supra* n. 30, n. 31.

already played a model role in showing how CSR principles or ESG related factors can be introduced into the IIA regime. Hence, the ESG concepts and values, such as CSR, environment protection, human rights and anti-corruption, can be separately introduced in different provisions of IIAs.

V. IIA REFORM: TOWARDS MORE RESPONSIBLE INVESTMENT

The ESG concepts contain the core values of responsible investment. As important participants in international investment activities, investors, especially multinational corporations, are vital practitioners and conductors of responsible investment. Therefore, the proposed reform of the IIA regime mostly focuses on establishing a legal basis for investors' accountability. The reform of IIAs could be inspired by the ESG concepts towards a greener, more sustainable and more responsible orientation, and the framework of IIAs can be improved from the perspective of substantive provisions as well as dispute resolution.

A. Reform of Substantive Provisions

1. Right to Regulate Provision

By enforcing legislations or regulations to protect the environment or human rights or to strengthen labor rights and other public interests, a state may affect the profit expected by investors. The investors would usually file an investment arbitration claim alleging that there has been an indirect expropriation or wrongful taking of their investment, or a breach of IIA treatment standards. It is necessary to include a "right to regulate" clause in IIAs, preserving the policy space of the host states, which can exclude the non-arbitrary and non-discriminatory measures taken by the host states for protecting domestic public interests or for performing obligations under international environment and human rights conventions outside the scope of ISDS. As mentioned in the *Aven* case, the tribunal found that Costa Rica's adherence to international environment treaties had more importance than the investor's rights under DR-CAFTA.

The measures taken by Costa Rica to protect the environment were held to be consistent with international law and were found to be neither arbitrary nor in breach of the obligations under DR-CAFTA.³⁶ The “right to regulate” would create enough regulatory space for a state to take measures ensuring performance under international environment and human rights treaties and for promoting ESG policies in a non-arbitrary and non-discriminatory manner.

2. Investors’ Obligations

With regard to governance related factors, the IIAs usually require that the investment must be made in accordance with law and that the investors must comply with the host state’s domestic laws,³⁷ which is also a negative obligation that may restrict access of investors to treaty benefits.³⁸ Other than this, the IIAs also need to emphasize investors’ positive obligations in terms of the environment and human rights, corresponding to environmental and social factors. The Morocco-Nigeria BIT requires that investors and their investment must “comply with environmental assessment screening and assessment processes applicable to their proposed investments prior to their establishment” and must “conduct a social impact assessment of the potential investment”. It applies the precautionary principle, that comes from international environmental law, to the environmental impact assessment.³⁹ After the establishment of the investment, under the Morocco-Nigeria BIT, corporations involved in resource extraction and high-risk industries are also required to maintain environmental management standards in accordance with ISO 14001 or an equivalent standard. It also requires that the investors’ operations uphold human rights in the host state, act in accordance with core labour standards as required by the ILO Declaration on Fundamental Principles and Rights of Work, and not manage or operate the investment in a manner that circumvents international environmental, labour and human rights treaties to which the host state and/or home state

36 *Aven case*, *Supra* n. 9, paras. 412-413, 417-418, 585; *Supra* n. 2, p. 498.

37 2019 Dutch Model BIT, Article 7(1). In the 2019 Dutch Model BIT, the provision for “Corporate Social Responsibility” adopts the broad concept of CSR, including details on investors’ obligations.

38 Kabir A. N. Duggal and Laurens H. van de Ven, *The 2019 Netherlands Model BIT: Riding the New Investment Treaty Waves*, *Arbitration International*, Vol. 35, No. 3, 2019, p. 364.

39 Morocco-Nigeria BIT (2016), Article 14: Impact Assessment.

are parties.⁴⁰

3. Improvement on CSR Provisions

As discussed above, the Canada's 2021 Foreign Investment Promotion and Protection Agreement (FIPA) Model upgrades the original version of the CSR provision to the Responsible Business Conduct (RBC) provision, reaffirms the importance of internationally accepted standards, codes and principles concerning the environment and labour rights, and cites the OECD Guidelines for Multinational Enterprises and the Guiding Principles on Business and Human Rights. The RBC provision stipulates that contracting parties should encourage investors to voluntarily incorporate these standards into company operations and internal policies.⁴¹ The Canada's 2021 FIPA represents a typical CSR provision in the new era of reform of IIAs.

The CSR provisions could be further strengthened by clarifying the hierarchy of CSR related international norms referred in the provisions.⁴² In practice, CSR principles or standards are usually invoked by the investment arbitral tribunals because of their high relevance to the public interests (for example, "human right to water" in *Urbaser* case and "environment" in *Aven* case). However, due to the "soft law" nature and lack of explicit articulations for enforcing CSR principles, it is hard for the host states to invoke and the tribunals to apply such CSR principles to impose substantive obligations on foreign investors. Therefore, it is necessary to clarify the CSR norms articulated in IIA provisions by the public interests they involved or the legal hierarchy to apply them. For example, whether or not the referred CSR norms can be classified as *jus cogens* would determine what kind of obligations the investors can be made to bear (e.g. obligations *erga omnes*, positive obligation or others), and what the consequences will be if investors fail to perform their obligations.

40 Morocco-Nigeria BIT (2016), Article 18: Post-establishment Obligations.

41 Canada's 2021 Foreign Investment Promotion and Protection Agreement (FIPA) Model, Article 16.2, <https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/index.aspx?lang=eng>, https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/2021_model_fipa-2021_modele_apie.aspx?lang=eng#article-16 (Last Visited on October 9, 2023).

42 Huang Shixi, On the Strengthening of Corporate Social Responsibility Clause in International Investment Treaty, *Law Science*, No. 3, 2023, p. 189.

B. Reform of Dispute Resolution Clause: Permitting States' Counterclaims

Counterclaim is an important tool to rebalance the asymmetrical structure of the IIA regime, and also resolve the ISDS legitimacy crisis. It gives the host states a chance to call out investors' irresponsible investment as well as ask for compensation for environmental, human rights or public order damage caused by investors. When IIAs make ESG oriented improvements, the counterclaim mechanism can be a guarantee of support for ESG-related policies' enforcement.

After the inclusion of provisions for investors' obligations into IIAs, there will be more substantive legal basis for the host states to contend that foreign investors bear the obligations of respecting and protecting host states' public interests. The obstacles that hinder the tribunals when deciding counterclaims will be limited to the grounds of jurisdiction and admissibility. Permitting states' counterclaims under the existing ISDS mechanism can provide the host states with opportunities to directly "fight" against foreign investors' misconduct. The dispute resolution clause permitting the host states to raise counterclaim will serve as a jurisdictional base that authorize a tribunal to hear a counterclaim. The United Nations Commission on International Trade Law (UNCITRAL) Working Group III has provided a model counterclaim provision for host states as their reference when improving their own IIAs' dispute resolution clauses.⁴³ By explicitly permitting the host states to raise counterclaims, and articulating the connection requirements between the principal claim and the counterclaim, this type of counterclaim provision will solve the hardship that the tribunals lack of jurisdiction to rule on states' counterclaims.

43 UNCITRAL Working Group III, A/CN.9/WG.III/WP.231, Possible Reform of Investor-state dispute Settlement (ISDS): Draft Provisions on Procedural and Cross-cutting Issues, Draft Provision 11 – Counterclaim: 1. When a claim is submitted for resolution pursuant to Draft Provisions 3 or 4, the respondent may make a counterclaim: (a) Arising directly out of the subject matter of the claim; (b) In connection with the factual and legal basis of the claim; or (c) That the claimant has breached its obligations under the Agreement, domestic law, an investment contract or any other instrument binding on the claimant. 2. For the avoidance of doubt, the consent of the respondent to the submission of a claim by the claimant is subject to the condition that the claimant consents to any submission of a counterclaim referred to in paragraph 1.

VI. CONCLUSION

The rise of ESG concepts has meant its increasing interaction with the reform of the IIA regime in various respects such as sustainable development, environment protection, human rights, corporation governance, and so on. The international investment arbitrations have shown the trend in this interaction in respect of each of the factors, i.e., in Environmental, Social and Governance related aspects. After reviewing the ESG-related arbitration cases, the limitations of the existing IIA regime, especially with respect to investors' obligations and accountability, can be clearly seen. To respond to the rise in ESG investment, tackle the climate change crisis, and achieve sustainable development goals, states need to participate in the process for reform of the IIA regime. The reform should focus on making investors, especially multinational corporations, establish and operate their investment in a responsible way, and on making sure that the investors perform their obligations to protect host states' public interests. It is necessary to introduce the ESG concepts and the principle of responsible investment into the IIA provisions. Though it may not be practical to directly include ESG disclosure standards and other detailed requirements into IIAs, the reform can be brought about in several ways to guide investors to make and manage their investment responsibly and with accountability. Although CSR provisions have created a good model for inclusion of the ESG concepts into the IIA regime, more improvements can be accomplished by including the substantive right of the host states to self-regulate, along with provisions on investors' obligations. Correspondingly, to enhance the host states' ability to enforce their rights against the investors, and to be able to directly ask investors to perform their due obligations of protecting public interests, the dispute resolution provisions also need to include rules on counterclaims and damage calculation. What is more, there is a new form of investment agreement that illustrates that while host states continue to see trade and investment treaties as essential to achieving their economic objectives, they are increasingly looking for them to achieve their ESG objectives as well. This trend can

also provide insights into how host states can improve their IIA collaborations to realize the principle of responsible investment and SDGs.