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**A QUESTION OF BALANCE:
INCORPORATION OF HUMAN RIGHTS
IN INVESTOR-STATE ARBITRATION**

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This paper discusses the interaction between investor-state arbitration and international human rights. It reviews the present interaction between human rights and arbitration, then examines the rights of the investor, before canvassing the treatment of human rights to date in investor-state arbitration. Investors must assume that states will always act to protect and uphold the human rights of their populations. This is achieved through expanding the current ambit of legitimate expectations, which have become an established aspect of investor-state arbitration. The paper then argues for the availability of both a defence on the merits and a counterclaim for raising the states counterarguments on the protection of human rights, with a heavy onus placed on the importance of proportionality to act as a balance between the rights of the state to uphold human rights and the rights of the investor. Finally, the paper discusses how an increased onus on human rights can assist in addressing the legitimacy crisis of investor-state arbitration.

International arbitration – human rights – legitimate expectations – proportionality

I Introduction

Following World War II, the United Nations was established and created the Universal Declaration of Human Rights (**UDHR**).¹ From this founding document, human rights have occupied space within international public law.² The notion that states must uphold and protect their population's human rights is firmly established. The late twentieth century saw the rising of international investment and the subsequent rise of investor-state disputes, where a multinational corporation has the power to sue a sovereign state in arbitration.³ This in turn has caused questions over how sovereignty and democracy can be protected from international corporate interests, and how international human rights can have a place in this primarily corporate regime.⁴

This paper will focus on the procedural mechanism by which human rights can be examined by an investment arbitration tribunal. It focuses on the fair and equitable treatment (**FET**) standard, and the use of investor's legitimate expectations to include human rights consideration. This paper argues that investors should have a legitimate expectation that all states will act to uphold and defend the international and constitutional human rights of the state's population. It argues that states should be able to raise a defence on the merits or counterclaim to an investor's claim that the state's actions were necessary to protect the population's human rights.

This paper will commence by setting out the current debate over the role of human rights in investor-state arbitration and review the current literature, especially the report prepared by United Nations (**UN**) Special Representative John Ruggie, which focuses on the incorporation of human rights in international corporate activity. This paper will then discuss the human rights which host states owe to investors, moving to defining what is mean by 'legitimate expectations' and the forms that legitimate expectations currently take in investor-state arbitration. It will set out past treatment of human rights in investor-state arbitration then discuss how best to incorporate human rights within the scope of legitimate expectations. This discussion will include how the incorporation of legitimate expectations could operate in practice and how states could raise the argument that action taken by the

1 Universal Declaration of Human Rights, 217A(III) (1984). (UDHR)
2 Frédéric Mégret "Nature of Obligations" in D Moeckli, S Shah, S Sivakumaran, & D Harris (eds) *International Human Rights Law* (Oxford University Press, Oxford, 2010) 124.
3 C McLachlan, L Shore and M Weiniger *International Investment Arbitration Substantive Principles* (Oxford University Press, Oxford, 2007) at 1.06.
4 F Balcerzak *Investor – State Arbitration and Human Rights* (Brill Nijhoff, Leiden, 2017) at 4.

state was in defence of human rights, through either a defence on the merits or as a counterclaim. The paper will consider the issues this proposal may pose to investors and possible methods to mitigate these factors, and finally discuss the legitimacy crisis of investor-state arbitration and how this proposal addresses this crisis.

This paper discusses the contents and operation of a range of international agreements that regulate international investment. The term ‘international investment agreements’ (**IAs**) will be used to refer to the three primary forms of agreement; bilateral investment treaties, regional investment treatments, and chapters of integrated trade and investment agreements.⁵ This is simply for clarity, the intention is for the abbreviation IIA to refer to as broad a range of international agreements and treaties between states that regulate or permit international investment.

II The Debate on Investors’ Human Rights Obligations

This section will discuss three areas of international human rights law. First, states’ current human rights duties, secondly the debate on “horizontal application” of states’ human rights obligations onto private parties, and thirdly the current landscape of human rights obligations in investor-state arbitration. These aspects provide guidance on states’ obligations to their populations and how these obligations may inform investors’ expectations. It also provides context on what international obligations are currently borne by investors.

A A State’s Duties

The Preamble of the UDHR states “[m]ember states have pledged themselves to achieve... the promotion of universal respect for and observance of human rights and fundamental freedoms”. This document, seen as one of the foundations of international human rights law, forms the base for all states to act in accordance with international human rights. This duty is one of the broadest and most pervasive functions of statehood, and applies universally.⁶ Since the signing of the UDHR, other major multilateral human rights conventions, such as the International Covenant on Civil and Political Rights (**ICCPR**) and the European Convention on Human Rights (**ECHR**) have come into force and further

5 Howard Man *International Investment Agreements, Business and Human Rights: Key Issues and Opportunities* (International Institute for Sustainable Development, February 2008) at 3.

6 Ursula Kriebaum “Foreign Investments & Human Rights – The Actor and Their Different Roles” (2013) 103 *Transnational Dispute Management* 1 at 2.

increased the substantive obligations on states.⁷ David Miller argues that states have a minimalist obligation to bring the population to a level where they are able to live a minimally decent life, without needing to struggle for the basics of survival.⁸ This minimalist approach has received heavy criticism, for example, John Pearson asks the question of why the standard need be so low.⁹ Instead, Pearson argues that states duties should be higher, that there is an obligation to create circumstances where populations are able to thrive and prosper.¹⁰ Human rights obligations are commonly imposed upon the state through domestic legislation, often, though not always, through a supreme constitution.¹¹ These legal obligations all serve a similar goal; to impose positive obligations upon a state to uphold, protect, and comply with the individual's human rights.

Rousseau's social contract argues for a for a relationship where the state receives the power to rule the people through their consent, and the obligations for the state to uphold the rights of the population forms a condition of existence for the state.¹² A state which does not protect and uphold the rights of its citizens violates one of its most basic tenants.¹³ Crawford sets out the state's "legal interest represented by its citizens, and anyone harming its citizens may have to account to that state".¹⁴ The state acts as a guarantor and protector of human rights, through both legislative regulation and the powers of the judiciary.¹⁵ According to Dicey, the rule of law requires that all are equal before the law, and all people are entitled to equal protection and benefit from the law.¹⁶ This includes protection of the

7 International Covenant on Civil and Political Rights 999 UNTS 171 (opened for signature 16 December 1966, entered into force 23 March 1976); European Convention for the Protection of Human Rights and Fundamental Freedoms 213 UNTS 221 (opened for signature 4 November 1950, entered into force 3 September 1953).

8 D Miller *National Responsibility and Global Justice* (Oxford University Press, Oxford, 2007).

9 John Pearson "Is Miller's Minimalist Approach to Human Rights Obligations Coherent?" (2011) 58(129) *Theoria: A Journal of Social and Political Theory* 35 at 36.

10 At 48.

11 New Zealand Bill of Rights Act 1990; Constitution of the United States of America, arts 1 – 15 (US); The Constitution of the Republic of South Africa, art 7 (SA); Constitution of the Argentine Nation.

12 J Rousseau *The Social Contract* (Dent, London, 1913).

13 A Vincent *The Politics of Human Rights* (Oxford University Press USA, New York, 2010) at 180.

14 J Crawford *Brownlie's Principles of Public International Law* (8th ed, Oxford University Press, Oxford, 2012) at 607.

15 At 655.

16 A Dicey *Introduction to the study of the law of the constitution* (3rd ed, Macmillan and Co, London, 1889).

peoples' human rights, and binds the state to obey the law by not violating the human rights of the population.

Fundamentally, there is a positive obligation upon states to both protect the human rights of their citizens from abuse and to ensure that no action undertaken by the state infringes the rights of the population. Any such conduct will give rise to liability in the states own judicial system, acting as a domestic check on any abuse of power by the state.¹⁷ The obligation of a state to protect human rights in all regards is central to this paper, as this fundamental obligation is what gives rise to the legitimate expectation for investors that a state will always act in accordance with the human rights of its population.

States owe human rights to a number of different parties through significant vertical international obligations.¹⁸ The human rights obligations of states are extensive, they include both legal and non-legal persons, domestic and international actors, and non-nationals acting as economic operators through investment.¹⁹ This can be seen as part of the broader balancing which a state must do between protecting human rights interests of its domestic actors and population, and the human rights interests of international investors, who may have aims in conflict with what may be best for the domestic parties. The situation is therefore highly complex when these obligations do come into conflict, and necessitate a choice from the state in favour of either the domestic parties or the investor.

B Horizontal Application

There is significant discussion over whether human rights can have a “horizontal” effect.²⁰ The horizontal application of human rights obligations refers to discussion over whether the human rights obligations currently binding on states can apply to third parties, specifically in the context of this paper, international corporations.²¹

17 McLachlan, above n 3, at 8.33.

18 Jasper Krommendijk and John Morijn “Proportional by What Measures(s)? Balancing Investor Interests and Human Rights by Way of Applying the Proportionality Principle in Investor-state Arbitration” in PM Dupuy, EU Petersmann and F Francioni (eds) *Human Rights in International Investment Law and Arbitration* (Oxford University Press, Oxford, 2009) 421 at 427.

19 At 428.

20 Crawford, above n 14, at 655.

21 At 655.

Currently, corporations are not consistently seen as having independent legal personality.²² This means that investors do not necessarily receive the same degree of legal recognition or protection, at either the national or the international level.²³ This in turn limits the obligations states owe corporations in international law relative to the obligations owed to people.²⁴ Corporations often engage in economic activity in states other than their “home” state, and do so often with little issue.²⁵ International investment is typically governed by IIAs. IIAs set out additional rights of investors and obligations upon the host state to respect those rights.²⁶ Investors can negotiate specific concession agreements with foreign governments that also convey additional rights to the investor and grant them a broad, long term, ability to engage in corporate activity.²⁷

This means that corporations, as independent actors in international law, do not have the same obligations as states with regards to upholding and actively furthering human rights. This paper will later discuss whether investors nevertheless have a negative obligation to ensure their activities do not further diminish a population’s human rights.

C Current Place of Human Rights in Investor-state Arbitration

International investors are able to act in a way which domestic actors may not be able to, depending on the clauses in the IIA or specific investment agreement. Furthermore, investors’ actions typically have the potential to affect a large number of people, often larger than that of the domestic actor.²⁸ This bolsters the argument that, given the investor receives additional rights and protections; they should also bear the burden of greater obligations.²⁹ Where a corporation has special rights and powers, and the ability to make decisions autonomously, independent of some aspects of the domestic law regime governing the state, it is arguable that the corporation has the characteristics of an international organisation and should therefore have international obligations.³⁰

22 At 122.

23 At 122.

24 At 122.

25 At 121.

26 McLachlan, above n 3, at 1.25.

27 Crawford, above n 14, at 122.

28 *John Ruggie Promotion and Protection of All Human Rights, Civil, Political, Economic, Social and Cultural Rights Including the Right to Development A/HRC/8/5* (2008) at [12].

29 At [122].

30 Crawford, above n 14, at 122.

It is uncommon to find specific guidance on human rights in IIAs, more commonly human rights are read into the IIA through a provision setting out the need for compliance with customary international law.³¹ For example, the North American Free Trade Agreement (NAFTA) is an IIA which sets out in article 102 that the Agreement should be interpreted “in accordance with applicable rules of international law”.³² The NAFTA Free Trade Commission issued an Interpretation in July 2001 stating that the FET standard requires treatment in accordance with the minimum standard required by customary international law.³³ The ICSID Convention Rules and Regulations allow an arbitration tribunal to consider “such rules of international law as may be applicable”, including customary international law rules.³⁴

Previous decisions have not held investors to the same standard as states regarding human rights breaches. In *Presbyterian Church of Sudan v Talisman Energy Inc*, the Court heard arguments that Talisman Energy had aided and abetted the Sudanese government in perpetrating human rights abuses against the population.³⁵ The Court found that, for Talisman to be liable, the plaintiff must prove that the defendant knowingly and intentionally assisted in a violation of international law and did so with the purpose to assist the human rights violation.³⁶ This is a high standard, and was not proven in the case, instead the court expressed a need to “proceed with extraordinary care and restraint” in deciding whether an investor violated customary international law.³⁷ There is no grounds to hold investors directly responsible, only grounds to sue them in tort for aiding and abetting breaches committed by the state.³⁸ However, *amici curiae* briefs filed in this case raised the point that customary international law allows for any court to find “universal” jurisdiction over alleged breaches of international law including cases of crimes against

31 Susan Karamanian “The Place of Human Rights in Investor-State Arbitration” (2013) 17 *Lewis & Clark L. Rev.* 423 at 442.

32 North American Free Trade Agreement (1993) 32 ILM 289 (open for signature 17 December 1992, entered into force 1 January 1994) (NAFTA), art 102(2).

33 *Notes of Interpretation on Certain Chapter 11 Provisions* (NAFTA Free Trade Commission, July 2001) at B(2).

34 Convention on the Settlement of Investment Disputes between States and Nationals of Other States 575 UNTS 159 (opened for signature 18 March 1965, entered into force 14 October 1966), art 42(1) (ICSID Convention).

35 *Presbyterian Church of Sudan v Talisman Energy Inc* 582 F 3d 244 (2d Cir 2009).

36 At 259.

37 At 255.

38 At 256.

humanity.³⁹ Furthermore, public international law is more permissive of extraterritorial jurisdiction in civil matters than criminal matters.⁴⁰ This presents avenues for investor accountability, where the party whose rights have been breached can take action against the investor in a wide array of jurisdictions.

Flomo v Firestone Natural Rubber Co raised similar matters of alleged human rights abuses, but in this case, the allegations were of the investor themselves directly perpetrating the human rights abuse, specifically hazardous child labour.⁴¹ The suit was based on claims that the investor violated customary international law.⁴² Posner J identified the difficulty in applying customary law in the domestic context because of the lack of codified guidance.⁴³ Firestone argued that a corporation is immune from customary international law for want of legal personhood.⁴⁴ Firestone claimed that because no corporation had ever been prosecuted for breaches of customary international law, there was no custom regulating what conduct gives rise to corporate liability, and therefore corporate liability did not exist.⁴⁵ The Court rejects this argument, and similarly rejects the argument that corporations should not be liable for customary international law because that would be “bad for business”.⁴⁶ The Court ultimately dismissed the claim for insufficient evidence, but held that corporations can be held liable in tort for breaches of customary international law, including human rights violations.⁴⁷

Most commonly, an arbitration tribunal in an investor-state arbitration does not have the power to find a breach of human rights obligations, the tribunal is limited to considering only matters raised under the IIA.⁴⁸ However, states are bound by international and domestic obligations, and sometimes these obligations may come into conflict, requiring the tribunal to decide which is more important. The Tribunal in *SPP v Egypt* considered an argument that a host state may be bound by obligations under an international agreement

39 *Presbyterian Church of Sudan v Talisman Energy Inc* 582 F 3d 244 (2d Cir 2009) Brief of *Amicus Curiae* (2 December 2008) at 7.

40 *Sosa v Alvarez-Machain* 542 US 692 (2004) at [762-763].

41 *Flomo v Firestone Natural Rubber Co* 643 F 3d 1013 (7th Cir 2011).

42 At 1016.

43 At 1016.

44 At 1017.

45 At 1017.

46 At 1021.

47 At 1024.

48 LE Peterson *Human Rights and Bilateral Investment Treaties* (International Centre for Human Rights and Democratic Development, Quebec, 2009) at 22.

separate to the IIA, in this case a UN Educational, Scientific, and Cultural Organisation Convention.⁴⁹ Although the tribunal ultimately held that the Convention did not excuse the state's actions, it showed that external international instruments could be considered when assessing a state's actions.⁵⁰ This demonstrates that, in assessing a state's conduct, arbitration tribunals can take existing obligations into account.

III The Ruggie Report

The argument in favour of horizontal application is that the guarantee of all human rights must extend to private parties as well as the state.⁵¹ This view is centred on the idea that human rights are of such fundamental importance that all parties whose actions carry a risk of violating human rights must act in such a manner that human rights are protected and therefore bear a duty to uphold them, similar to states.⁵² In 2005 John Ruggie was appointed as Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises. In 2008 he delivered a report to the Human Rights Council (**the Ruggie Report**).⁵³ This report discusses the role of private parties and the obligations upon them with regards to human rights which could be impacted by their corporate activities.⁵⁴

This section discusses the key findings of the Ruggie Report and how they relate to the broader scheme of human rights in investor-state arbitration. It concludes that ultimately, also Ruggie's findings are useful, they set the bar for investor conduct too high. Instead, a more appropriate avenue is for investors to have a negative duty to avoid acting in a way which furthers human rights abuses, and places the onus on the state to act against investors whom act in a way which threatens or violates human rights.

A Corporate Responsibility Regarding Human Rights

49 *Southern Pacific Properties (Middle East) Ltd v Egypt (Award)* ICSID ARB/84/3 20 May 1992 at [154].

50 At [190-191].

51 Crawford, above n 14, at 655.

52 John Bishop "The Limits of Corporate Human Rights Obligations and the Rights of For-Profit Corporations" (2012) 22 *Business Ethics Quarterly* 119 at 121.

53 John Ruggie, above n 28.

54 At [51].

The Ruggie Report initially noted the difficulty in identifying a set list of rights for which transnational corporate parties were responsible.⁵⁵ Ruggie argues that prior discussion in defining human rights obligations which extend to companies as centring on concepts of “primary versus secondary obligations and corporate sphere of influence”.⁵⁶ He rejects any attempt to define a limited set of rights linked to responsibilities, instead he argues that responsibilities of all companies should be defined specifically as applies to all human rights.⁵⁷

Ruggie noted the unequivocal distinction between the role of the state and the role of private parties.⁵⁸ Private parties are fundamentally economic organs whose primary motivation is commercial gain; they do not owe same duties or responsibilities as are owed by the state to the state’s population. This distinction is critical in assessing the responsibilities of companies as their human rights obligations cannot, and should not, be as heavy as the burden upon the state. Private parties do however owe an individual obligation to respect human rights.⁵⁹ Failure to comply with these obligations carries a risk of legal consequences in domestic courts, and the risk of ‘non-legal’ consequences such as damage to reputation.⁶⁰

A key aspect for corporations to respect international human rights will be due diligence.⁶¹ The corporation must make the effort to become aware of the likely human rights impact of its activity, and what action will be required to prevent or address the impact. Ruggie argues that there should be three sets of factors to consider; first the circumstances of the country their business takes place, secondly the likely human rights impact of the corporation’s activities, and finally whether their domestic business relationships may contribute to existing human rights abuses.⁶² This process would be necessary under the thesis proposed in this paper. Investors must inform themselves of the potential impact of their actions on human rights to inform their legitimate expectations of how the state may act to address a human rights abuse. The requirement for the investor to undertake the due diligence places a sensible burden on the investor to ensure adequate knowledge of the particular human rights factors in a state prior to investing.

55 At [51].

56 At [51].

57 At [51].

58 At [53].

59 At [54].

60 At [54].

61 At [56].

62 At [56].

Corporate entities must ensure due diligence is followed to avoid an inadvertent association with a human rights abuse. The standard for complicity is unclear, in large part owing to a lack of substantive case law on the topic.⁶³ However, it is clear that it is not a high bar for corporations to be complicity involved in abusive activity culminating in liability arising for the private party. Ruggie noted that “mere presence... paying taxes, or silence in the face of abuses is unlikely” to give rise to liability, however more significant acts of omission may trigger culpability under international criminal law standards.⁶⁴ Therefore corporations must be aware of their impacts on international human rights, both directly and indirectly, to ensure that they are not unintentionally complicit in abuses perpetrated by another actor.

B The State Duty to Protect

Ruggie identified that each state has a pressing need to create a “corporate culture respectful of human rights at home and abroad”.⁶⁵ This is the fundamental underpinning to creating a domestic environment which encourages and indeed requires the protection of human rights by national and multinational corporations. Ruggie defines it as an “urgent policy priority” given the rise in vulnerability to corporate related abuses and the increased reach corporations have into areas rife with diverse social risk.⁶⁶

Ruggie discusses how a state can encourage corporate attitudes and actions which will place respect for human rights at the centre of business interests.⁶⁷ There are two ways by which this can be done; corporate culture, and market pressure. Corporate culture in the report refers to the informal method of operating used by the corporation and its values, as well as its more formal procedures. Additionally, governments can increase market pressure on corporations to respect human rights.⁶⁸

The criticism of the Special Representative’s discussion is that it is of limited use in investor-state arbitration if the investor’s actions are not accessible to the public or if the investor has a monopoly. Rather than placing the onus on the investor, it is more practical

63 At [76].

64 At [77].

65 At [27].

66 At [27].

67 At [29].

68 At [30].

to give increased power to the state to prevent human rights abuses. States already have an onus to prevent human rights violations occurring while the obligations of investors are far more tenuous.⁶⁹

1 State Policy

Another issue raised by the Special Representative are issues in “horizontal incoherence”.⁷⁰ The first way this can occur is through policy designed to attract foreign investment, offering expanded investor protection without counterbalancing policies expanding the obligations on the investor to act consistently with human rights.⁷¹ Ruggie identified a particular issue with this in developing countries, where legislation and policy changes much more dramatically over time than in OECD countries.⁷² A promise of a regulatory freeze for investors as an incentive to investment can have a dramatic effect where the investor is essentially immune from regulatory advancement, rendering conduct that would be illegal if done by a domestic party legal for the investor.⁷³

The Special Representative identified transparency as a feature lacking from many international arbitrations, and which should become a “governing principle” of investor-state arbitration.⁷⁴ Fundamentally, Ruggie is concerned with the balance of investor protection and investor obligations imposed by the state. At present, there is concern that the balance of power lies too heavily in favour of the investor, at the cost of the wellbeing and, in the worst cases, human rights of the population.

C Conclusion

The Special Representative’s Report is a useful tool for assessing issues and potential solutions to addressing human rights abuses perpetrated by corporations. It underlines the issues faced by investment arbitration tribunals in their attempts to uphold human rights and include them as a consideration in decisions. It is also helpful in showing how human rights implications can and should be a consideration of any corporation when making decisions to engage in financial activity.

69 Onora O’Neill “The Dark Side of Human Rights” (2005) 81(2) *International Affairs* (Royal Institute of International Affairs) 427 at 436.

70 John Ruggie, above n 28, at [33].

71 At [34].

72 At [36].

73 At [35].

74 At [37].

However placing non-corporate obligations on corporate entities is a difficult proposition. Corporations are solely driven by profit. It seems more logical to expand the regulatory powers of states to influence and ultimately control investor action to remove any profit motive from human rights abuse. This paper does not agree with the premise of the Ruggie Report being that the best course of action is to encourage corporations to increase their social responsibility. Instead, it addresses how human rights protections can be assured by empowering the state to act against the investor without needing to fear having to compensate the investor when the investor is violating the population's human rights.

IV Human Rights in Investor-state Arbitration

A The Legal Basis of Human Rights in Investor-state Arbitration

Investors enjoy a range of rights granted through a combination of international law, IIAs, and the specific investment agreement. This section will examine the place of the human rights of a population in a host state in investor-state arbitration. This will in turn provide the framework within which the investor's legitimate expectations operate. As Ruggie noted, there is futility in attempting to define a closed list of applicable human rights.⁷⁵ Instead, this section will focus on the contexts in which human rights concerns could be raised.

Explicit references to human rights in IIAs are generally uncommon. Instead, IIAs frequently refer to the rules and principles of international law.⁷⁶ Furthermore, the ICSID convention includes international law as a relevant consideration in investor-state arbitration.⁷⁷ Therefore it is broadly concluded that general rules of international law, and customary international law, forms part of the applicable law governing all investor-state arbitrations. However, international human rights law arguably exists in a category separate from that of general customary international law and is in a special category bridging customary and public international law.⁷⁸ Gaillard and Banifatemi argue that human rights law is applicable in investor-state disputes because of the international public law

75 At [51].

76 Patrick Dumberry and Gabrielle Dumas-Aubin "When and How Allegations of Human Rights Violations Can Be Raised in Investor-State Arbitration" (2012) 13 J. World Investment & Trade 349 at 350.

77 ICSID Convention, above n 34, art 42(1).

78 Krommendijk and Morijn, above n 18, at 425.

implications of excluding such a critical and important body of law from consideration.⁷⁹ However, Krommendijk and Morijn make the case that either direct or indirect consideration of human rights in investor-state arbitration is largely immaterial, and all that matters is that human rights are, in some way, considered.⁸⁰

1 The Vienna Convention on the Law of Treaties

The Vienna Convention on the Law of Treaties (VCLT) sets out guidance and regulations on the application and interpretation of international treaties.⁸¹ Article 31 of the VCLT sets out general rules on interpretation of international treaties. Article 31(3)(c) states that “there shall be taken into account, together with the context... [a]ny relevant rules of international law applicable in the relations between the parties.”⁸² This is a mandatory part of the interpretation process but it is clear that arbitrators may view obligations under a BIT in the context of the wider international law obligations binding a state.⁸³ Previous tribunals have interpreted this article as meaning that rules of international law, including customary international law, can be read into treaties regardless of whether the rule is explicitly included within the text of the treaty.⁸⁴

In the human rights context, art 31(3)(c) can be interpreted to allow for the inclusion of human rights as part of wider international law applicable to relevant treaties and IIAs.⁸⁵ The use of the VCLT deals with the issue of whether human rights considerations need to be explicitly included within the scope of the IIA and instead allows them to be treated akin to an implied term, applicable across all IIAs. Commonly in investment tribunal cases where human rights are potentially at issue, the tribunal’s jurisdiction over the claim is disputed, with a party alleging that investor-state arbitral tribunals do not have jurisdiction to decide on matters relating to human rights. Increasingly, there is a trend towards art 31(3)(c) being used to find jurisdiction, by interpreting human rights law as part of

79 Emmanuel Gaillard and Yas Banifatemi “The meaning of “and” in Article 42(1), second sentencing of the Washington Convention: The role of international law in the ICSID choice of law process” (2004) 18(2) ICSID Review 375.

80 Krommendijk and Morijn, above n 18, at 426.

81 Vienna Convention on the Law of Treaties 1155 UNTS 331 (opened for signature 23 May 1969, entered into force 27 January 1980).

82 Article 31(3)(c).

83 Bruno Simma “Foreign Investment Arbitration: A Place for Human Rights?” (2011) 60(3) International and Comparative Law Quarterly 573 at 585.

84 For example; *Piero Foresti and Others v South Africa (Award)* ICSID ARB(AF)/07/1, 4 August 2010; *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v Argentina (Award)* ICSID ARB/07/26, 8 December 2016.

85 Simma, above n 83, at 587-588.

applicable international law applicable to all treaties.⁸⁶ However, this approach is controversial, as some commentators argue that it goes beyond the scope of arbitration by consent and bestows too broad a power on the tribunal.⁸⁷ This interpretation allows for the consideration of human rights in investment arbitration proceedings, mitigating concerns about jurisdiction.

B What Human Rights Should be Included?

If the question of whether to include human rights at all in investor-state arbitration is answered in the affirmative, the next issue is what is meant by ‘human rights’? It is difficult to argue that *jus cogens* human rights, such as prohibitions on slavery, torture, or human trafficking should not be included. Likewise, rights protected in the UDHR would also be included within the scope of consideration. The UDHR encompasses a broad range of rights, beginning with what may well be considered *jus cogens* rights against slavery,⁸⁸ discrimination,⁸⁹ and life for example.⁹⁰ More controversial rights contained within the UDHR include rights to free education and rest and leisure, which may be seen as more ‘borderline’ cases of human rights, potentially not sufficiently significant to be considered within the scope of investor-state arbitration.⁹¹

Precedent displays this discussion of more controversial aspects of human rights law. For example, *Maffezini v Spain*, *SD Myers v Canada*, and *Santa Elena v Costa Rica* all considered elements of a right to a clean environment.⁹² Cultural rights and the right for a state to promote affirmative action policies for the furtherance and betterment of citizens have also been the subjects of investor-state arbitrations where these human rights concerns

86 Vassilis Tzevelekos “The Use of Article 31(3)(c) of the VCLT in the Case Law of the ECtHR: An Effective Anti-Fragmentation Tool or a Selective Loophole for the Reinforcement of Human Rights Teleology” (2010) 31(3) Mich.J.Int’l L. 621 at 672.

87 Mélanie Samson “High Hopes, Scant Resources: A Word of Scepticism about the Anti Fragmentation Function of Article 31(3)(c) of the Vienna Convention on the Law of Treaties” (2011) 24 LJIL 701 at 710.

88 UDHR, art 4.

89 Articles 7.

90 Article 3.

91 Articles 24 and 26(1).

92 *Maffezini v Spain (Award)* (2000) 124 ILM 35; *SD Myers Inc v Canada (Second Partial Award on Damages)* (2000) 126 ILR 161; *Compania del Desarrollo de Santa Elena SA v Costa Rica (Award)* ICSID ARB/96/1, 17 February 2000.

have been significant issues.⁹³ The *Urbaser* decision involved consideration of whether the state acted appropriately to protect the human right to water and sanitation services, with the latter being viewed as including the right to dignity.⁹⁴

As remarked above in the Ruggie Report, commercial activity has the potential to impact on almost every available human right, and it would be both narrow-minded and woefully inadequate to attempt to create a definitive list of rights applicable to investors.⁹⁵ Instead, it is more appropriate to come to the broad conclusion that international human rights law forms part of the general body of international law which is applicable to all investor-state arbitrations. The specific subset of international law which applies to investor-state arbitration does not exist in a vacuum; it is not completely isolated from the influence of general international law.⁹⁶ International investment law remains a body of law founded upon international norms, and therefore remains subject to it. IIA are by their nature instruments of international law, and therefore there is significant support for the proposition that customary international law, including international human rights law, is automatically applicable to these instruments.⁹⁷

This argument is satisfactory for demonstrating why international human rights law should generally be applicable in investor-state arbitration. However, it does not go so far as to demonstrate *how* international human rights law can be considered in the context of an investor-state arbitration. It is not enough to accept that human rights law applies generally, it is necessary to include a methodology of how a typically investor-state arbitration tribunal could consider human rights in the context of a broader dispute, and in a typical situation, being raised in the form of a counterclaim by the state against an investor.

V Investors' Human Rights

This section will discuss the current ambit of human rights which apply to the investor, focusing on the right to property. It will then analysis the ways investors can protect

93 *Southern Pacific Properties*, above n 49; *Parkerings-Compagniet AS v Lithuania (Award)* ICSID ARB/05/8, 11 September 2007; *Piero Foresti*, above n 84.

94 *Urbaser*, above n 84, at [1158-1161].

95 John Ruggie, above n 28, at 51.

96 Pierre-Marie Dupuy "A doctrinal debate in the globalization era; on the 'fragmentation' of international law" (2007) 1 *European Journal of Legal Studies* 1, at 4.

97 Krommendijk and Morijn, above n 18, at 427.

themselves against abuse by the state. This section assists in demonstrating how recognition of human rights in investor-state relationships can be expanded without undue interference on the investor's human rights or the rights guaranteed under most IIAs. It will also closely analyse the investor's right not to have its property expropriated by the state. This is of central concern to this paper as the state's ultimate power in protecting the population from human rights abuses would be to expropriate the investment, rendering the investor unable to continue threatening or violating human right. It is important to set out the rights of the investor to underscore the importance of expropriation being seen as a last resort option.

Discussion about human rights in investor-state arbitration frequently centres on the human rights of the population of the host state. However, it is also important to consider the rights of the investor. International investment exists because it is mutually beneficial to both the state and the investor, it would be a detrimental outcome if, in the course of greater protection of individual human rights, the rights of the investor were undermined such that investment was disincentivised. The proposal of this paper must be counterbalanced with adequate recognition of investors' rights to ensure a balance is struck.

What rights extend to the investor, and the extent to which they apply, is unclear.⁹⁸ As Butler comments, the human rights afforded to legal persons differ from region to region, and indeed does whether investors are recognised as legal persons at all.⁹⁹ Nevertheless, transnational and multinational companies are increasingly being recognised as legal persons, justifying arguments that some international human rights should extend to them.¹⁰⁰ The UN Guiding Principles on Human Rights and Business and the OECD Guidelines for Multinational Enterprises both explicitly state that human rights extend to corporations and impose human rights obligations upon them.¹⁰¹ However, Butler observes that as human rights protection of legal persons grows so too should investors' responsibilities to observe and uphold the human rights of others.¹⁰²

98 Petra Butler "Red Riding Hood – Is Investor-state Arbitration the Big Bad Wolf?" (2017) 5 Penn. St. J.L. & Int'l Aff. 328 at 341.

99 At 341.

100 At 342.

101 *Guiding Principles on Business and Human Rights* HR/PUB/11/04 (2011) at 5; OECD *OECD Guidelines for Multinational Enterprises* (OECD Publishing, 2011) at 31.

102 Butler, above n 98, at 343.

Broadly speaking, there are two types of obligations which extend from states to investors under IIAs.¹⁰³ First, ‘non-contingent’ standards and duties, including the FET standard which will be discussed later.¹⁰⁴ Secondly, the state must follow contingent standards of “national treatment, most favoured national treatment, and non-discrimination” regulating state conduct towards the investor.¹⁰⁵ Contingent standards are determined by reference to an external factor, such as the treatment of other investors, while a non-contingent standard is absolute and applies regardless of treatment afforded to any other party.¹⁰⁶ An investor’s legitimate expectations are a non-contingent standard as a part of the FET standard as they are specific to the individual investor and are not determined by reference to any other investor’s legitimate expectations. Despite this, factors such as the state’s constitutional structure and specific socio-political conditions may inform the legitimate expectations of all investors.

A The Investor’s Right to Property

A fundamental right required for security of investment is the investor’s right to property.¹⁰⁷ Stability of statutory regime is critical for the continued protection and security of investment.¹⁰⁸ This right is not limited to international investors; many states hold the right to private property as a keystone of democratic liberty and protect it in their constitutions.¹⁰⁹ The right to own property and protection from arbitrary deprivation is a customary international human right and is protected under Article 17 of the UDHR.¹¹⁰

Property as a right is an amorphous concept. Some commentators have relied on the “bundle of sticks” theory of property rights to set out the boundaries of the right.¹¹¹ This theory espouses the idea that property is not necessarily limited to physical objects, but rather is a set of rights linked to economic value and that some of the rights can be lost

103 McLachlan, above n 3, at 7.19.

104 At 7.19.

105 At 7.19

106 At 7.19.

107 Krommendijk and Morijn, above n 18, at 428.

108 OECD ‘*Indirect Expropriation*’ and the ‘*Right to Regulate*’ in *International Investment Law* (OECD Working Papers on International Investment, 2004) at 17.

109 Butler, above n 98, at 344; T van Banning *The Human Right to Property* (Intersentia, Antwerp, 2002) at 136.

110 Butler, above n 98, at 345; UDHR, art 17.

111 Frank Michelman “Property, utility, and fairness: Comments on the ethical foundations of “Just Compensation” Law” (1967) 80(6) Harv.L.Rev. 1165; R Epstein *Takings: Private property and the power of eminent domain* (Harvard University Press, Cambridge MA, 1985).

without losing the right itself.¹¹² A central concern with proportionality is acknowledging that state regulation will always, to some degree, interfere with property rights. The key question is whether the interference with property becomes sufficiently intrusive that it violates the right.¹¹³

Furthermore, multiple IIAs and UN bodies have sought to define the limits of the right to property. The UN General Assembly stated that property includes rights to “personal property... and economically productive property, including property associated with agriculture, commerce and industry”, thereby covering a broad ambit of both personal and commercial property rights.¹¹⁴ Both the Inter American Court of Human Rights and the European Court of Human Rights have also defined property widely, including physical property, economic assets, intangible assets such as a customer base or licence, and judgements and arbitration awards.¹¹⁵

This demonstrates the importance of the right to property. It is the cornerstone on which international investment is founded, without a guaranteed right to property the investor is unable to have security in their investment and therefore would be unwilling to engage in corporate activity. This deprives the host state of the benefit of commercial activity and the economic growth caused by increased investment. It is thus crucial that the proposed expansion of states’ rights regarding human rights enforcement retains protection of the investor’s right to property.

B Expropriation

1 Direct and Indirect Expropriation

IIAs contain clauses designed to protect investors from arbitrarily being deprived of their private property. These clauses prevent the state depriving the investor of their benefit under the terms of the investment agreement.¹¹⁶

112 Michelman, above n 111, at 1184.

113 G Bücheler *Proportionality in Investor-State Arbitration* (Oxford University Press, Oxford, 2015) at 272.

114 *Respect for the right of everyone to own property alone as well as in association with others and its contribution to the economic and social development of Member States* A/Res45/98 (1990); Butler, above n 98, at 345.

115 Butler, above n 98, at 347.

116 Shawn Nichols “Expanding property rights under investor-state dispute settlement (ISDS): class struggle in the era of transnational capital” (2018) 25:2 *Review of International Political Economy* 243 at 245.

Expropriation can be direct or indirect. Direct expropriation refers to the state confiscating the property or depriving the investor of the benefits of their investment through targeted or intentional means.¹¹⁷ Indirect expropriation is where state actions create or contribute to an environment whereby the property of the investor can no longer be used, the property is taken from them, or the investment loses financial viability.¹¹⁸ Indirect expropriation is difficult to define, in part due to the myriad forms it can take and the blurry distinction between regulation and expropriation.¹¹⁹

2 *The Test for Expropriation*

Due to the many forms expropriation can take there is no single test for indirect expropriation. In some cases, the arbitrators examine the economic effect of the action on the investor and weigh up whether property was deprived to such an extent as to be expropriated.¹²⁰ Prior domestic legal decisions, especially in the United States, have rejected the argument that every government action which diminishes the value of private property is expropriation requiring compensation.¹²¹

A model test is set out under the United States Model BIT which takes three broad questions into account; first, the economic impact of the measure on the investor, secondly the legitimate expectations of the investor and the impact thereof, and thirdly the purpose of the state's actions.¹²² The inclusion of a "purpose" limb opens the doors to a discussion of the police powers exception. The police powers exception is recognised in customary international law as exceptions to rules against expropriation, allowing states to take action "in the interest of public health and morality".¹²³

A great deal of weight must be placed on the importance of ensuring a stable investment regime to ensure ongoing investment and the associated economic benefits. Protection from

117 McLachlan, above n 3, at 8.69.

118 At 8.75.

119 *Compañía del Desarrollo de Santa Elena, SA v Republic of Costa Rica (Award)* ICSID ARB/96/1, 17 February 2000 at [76].

120 *Waste Management Inc v Mexico (Award)* (2004) 43 ILM 967 at 995.

121 *Agins v City of Tiburon* 447 US 255 (1980); D Bromley *Environment and economy: Property rights and public policy* (Blackwell, Cambridge, 1991) at 36.

122 US Model BIT, available at <http://www.state.gov/documents/organization/117601.pdf>.

123 James Holbein and Nick Raniere "Balancing investors' rights with public policy in the NAFTA context" in J Holbein and N Raniere (eds) *NAFTA chapter 11 arbitration* (Oxford University Press, Oxford, 2007) booklet C.19.2 at 22.

expropriation gives investors a reasonable expectation that their rights will be respected. However there is significant discussion required over whether protection against expropriation may lean too far in favour of the rights of the investor and in the process neglect to recognise legitimate measures taken to protect a population's human rights.

C Fair and Equitable Treatment

A second means of protection for investors is through fair and equitable treatment (**FET**) clauses, present in almost every modern IIA.¹²⁴ Nichols defines an FET clause as requiring “governments to maintain a business environment that conforms to an ambiguously defined, and hotly debated, minimum standard”.¹²⁵ A claim that the state breached this standard is a feature of almost every investor-state dispute and is the most successful grounds of argument.¹²⁶

Although the exact parameters of the FET standard are unclear, there are three aspects which seem to be concrete:¹²⁷ First, that it is a non-contingent standard, connoting a minimum threshold for behaviour.¹²⁸ Second, that it is objective and is not limited only to conduct in bad faith.¹²⁹ Finally, it is an international standard, and although domestic jurisprudence can assist in determining the applicability of the standard in a particular case, it ultimately exists independently of any domestic determination of what is fair and equitable.¹³⁰ Elihu Root also attempted to give underpinning principles of the standard in the early 20th century, stating that the concern of the minimum standard of treatment is justice viewed through the lens of a state's system of law and administration.¹³¹ While these comments were in the context of the treatment of foreign citizens in other states, they are nevertheless applicable to what is required to treat a party fairly. The rationale for such a

124 McLachlan, above n 3, at 7.03.

125 Nichols, above n 116, at 244.

126 UNCTAD, *Fair and Equitable Treatment: A Sequel*, UNCTAD Series on International Investment Agreements 11 (New York, Geneva, 2012) 1.

127 Josef Ostránský “An Exercise in Equivocation: A Critique of Legitimate Expectations as a General Principle of Law under the Fair and Equitable Treatment Standard” in A Gattini, A Tanzi and F Fontanelli (eds) *General Principles of Law and International Investment Arbitration* (Brill Nijhoff, Leiden, 2018) 344 at 345.

128 McLachlan, above n 3, at 7.22.

129 Annika Wythes “Investor-State Arbitrations: Can the ‘Fair and Equitable Treatment’ Clause Consider International Human Rights Obligations?” (2010) 23 LJIL 241 at 245.

130 At 246.

131 E Root “The Basis of Protection to Citizens Residing Abroad” (1910) 4 AJIL 517 at 521-522; McLachlan, above n 3, at 7.12.

standard was absolute, it is a method of securing a minimum standard of justice to which all citizens are entitled, regardless of in what state they reside.¹³²

One aspect of the FET standard is that it entitled investors to a “general principle of due process”.¹³³ This concept depends upon a universality of the rule of law; an objective standard of due process applicable universally.¹³⁴ The issue of defining this standard of universal practice is describing a sufficiently narrow standard to which all states can adhere.¹³⁵ Customary international human rights law can assist in this process by demonstrating a minimum standard of conduct.¹³⁶

An aspect of the FET standard is the requirement to act in good faith.¹³⁷ This remains an amorphous concept, but does allow the incorporation of good faith standards from domestic jurisdictions, giving the benefit of substantial jurisprudence and precedent. Good faith is viewed as a “constitutional principle” of international law, a central tenant of the investor-state dispute resolution system and part of the core fabric of international obligation.¹³⁸ Some aspects of a good faith duty require both parties to approach the proceeding honestly and without seeking to undermine or unfairly disadvantage the other party.¹³⁹ Tanzi states that good faith should not be viewed as a list of behavioural standards; instead, the requirement to act in good faith forms a “framework of fairness, equity and reasonableness for the proper administration of justice”.¹⁴⁰ As noted by the tribunal in *Inveysa v El Salvador* “good faith is a supreme principle, which governs legal relations in all of their aspects and content”.¹⁴¹ It is therefore a fundamental principle which both permeates and stands over the FET standard.

132 Root, above n 131, at 21; McLachlan at 7.12.

133 McLachlan at 7.13.

134 At 7.13.

135 At 7.14.

136 At 7.15, J Paulsson *Denial of Justice in International Law* (Cambridge University Press, Cambridge, 2005) at 5-6.

137 *MTD Equity Sdn. Bhd. And MTD Chile S.A. v Chile (Award)* ICSID ARB/01/7, 25 May 2004 at [109].

138 *Nuclear Tests Case (Australia v France) (Judgement)* (1974) 57 ILM 348 at [46].

139 Attila Tanzi “The Relevance of the Foreign Investor’s Good Faith” in A Gattini, A Tanzi and F Fontanelli (eds) *General Principles of Law and International Investment Arbitration* (Brill Nijhoff, Leiden, 2018) 193 at 195.

140 At 194.

141 *Inceysa Vallisoletana S.I. v El Salvador (Award)* ICSID ARB/03/26, 2 August 2006 at [230].

The discussion in this paper will focus on whether human rights obligations can assist in forming the legitimate expectations of the investor. Under this proposal, a state would not breach the FET standard when acting to uphold these human rights obligations.

D Legitimate Expectations

The final category where investors' human rights are active is in the realm of legitimate expectations. Legitimate expectation have become a bedrock of investor-state arbitration claims, where they are invoked in almost every instance.¹⁴² There is no certain point of origin for legitimate expectations, nevertheless it appears clear the legitimate expectations have been accepted by investor-state arbitration jurisprudence as a valid principle of international law.¹⁴³

There are four broad approaches throughout international law commentary and jurisprudence to define the origins and limitations of legitimate expectations. First, one approach has been to define legitimate expectation as customary international law by process of convention.¹⁴⁴ This point is made on the basis that numerous IIAs now explicitly refer to legitimate expectations.¹⁴⁵ This demonstrates an acceptance of the validity of international expectations by the international community.

Secondly, there is an argument that legitimate expectations are a creation of arbitration. Early arbitration decisions seem to hold that expectations of the investor were protected *per se*.¹⁴⁶ These cases treated legitimate expectations as a component element of the requirement for a state to act in good faith, and read in this requirement to the applicable IIAs. These instances have been criticised as undercover law making by investor-state arbitration tribunals.¹⁴⁷ However, later tribunal decisions have provided arguments for legitimate expectations being included within the scope of investor-state arbitration, and

142 Ostřanský, above n 127, at 344.

143 At 344.

144 At 347.

145 At 437; for example, Comprehensive Economic and Trade Agreement, European Union-Canada (signed 30 October 2016, not yet in force), art X.9.

146 *Téchnicas Medioambientales Tecmed S.A v Mexico (Award)* ICSID ARB (AF)/00/2, 29 May 2003 at [154]; *MTD Equity Sdn. Bhd. And MTD Chile S.A. v Chile (Award)* ICSID ARB/01/7, 25 May 2004 at [180]; *CMS Gas Transmission Company v Argentina (Award)* ICSID ARB/01/8, 12 May 2003 at [279]; *Azurix Corp v Argentina (Award)* ICSID ARB/01/12, 14 July 2006 at [372].

147 Ostřanský, above n 127, at 350.

have done so by focusing on legitimate expectations as a general principle of international law within the FET standard.¹⁴⁸

The third theory of legitimate expectations argues that state's actions towards investors can create unilateral international obligations to respective investors.¹⁴⁹ This is initially problematic as it implies that a state can give rise to unilaterally binding obligations without intending to do so and without having a specific declaration for the state to be bound by these representations.¹⁵⁰ However, it would be equally problematic if investors who are incentivised to invest due to a state's international conduct and representations are subsequently held to not be able to rely on those actions.¹⁵¹ Moreover, international law directs unilateral declarations to be interpreted as narrowly as reasonably possible, thereby directing investment tribunals to take a limited approach when assessing whether liability may have arising if the investor relies heavily on a state's unilateral conduct.¹⁵²

The final, and most persuasive, argument of legitimate expectations is that they form as a general principle of international law. This treats legitimate expectations as a standalone principle of international law, a distinct and separate element of the FET standard.¹⁵³ It requires legitimate expectations to form a part of the fabric of general international law, and as such form a core principle of international investment law. This is a difficult process, as for a concept to become part of general international law, it must be seen to be present in most legal systems and be already generally recognised domestically.¹⁵⁴ However, this bar does not defeat legitimate expectations being included within the scope. The European Union is seen to be incorporating legitimate expectations within existing and new IIAs, and the principle is also present in some Latin American, African, and Caribbean countries.¹⁵⁵

148 *Thunderbird Gaming Corporation v Mexico (Separate Opinion of Thomas Wälde)* UNCITRAL, 1 December 2005; *Total S.A. v Argentina (Decision on Liability)* ICSID ARB/04/01, December 27 2010.

149 *Guiding principles applicable to unilateral declarations of states capable of creating legal obligations with commentaries thereto* [2006] vol 2, pt 2 YILC 369 at [1], [4].

150 Ostránský, above n 127, at 351.

151 Michael Reisman and Mahnoush Arsanjani "The Question of Unilateral Governmental Statements as Applicable Law in Investment Disputes" (2004) 19(2) ICSID Review – Foreign Investment Law Journal 328 at 342.

152 International Law Commission, above n 149, at [7].

153 Ostránský, above n 127, at 352.

154 At 353.

155 Hector Mairal, "Legitimate Expectations and Informal Administrative Representations" in S Schill (ed) *International Investment Law and Comparative Public Law* (Oxford University Press, Oxford, 2010) 416 at 417.

There is a legitimate expectation in all investments that the state shall not act arbitrarily, nor will it act to expropriate an investment without grounds for doing so.¹⁵⁶ Outside of consistent rules such as this, what may amount to a legitimate expectation will turn on the particular facts of each case. Commonly, there is a focus on the conduct of the host state.¹⁵⁷ This paper focuses on the introduction of a new, non-contingent legitimate expectation; that states will always act in accordance with their human rights obligations and will act against the investor if the investor's conduct threatens or violates their population's human rights.

Regardless of which argument is accepted for the creation of legitimate expectations, it is clear that they are now an entrenched part of this area of international law. The undefined nature of legitimate expectations and their flexibility relative to other areas of international law make legitimate expectations the best method through which to incorporate greater applicability of human rights in investor-state arbitration.

VI Previous Treatment of Human Rights in Investor-State Arbitration

In this section, previous arbitral decisions will be canvassed with the aim of determining what approach or approaches are currently taken by the investor-state arbitration regime. There are too many cases for each one to be analysed, instead a range of precedent has been selected, designed to provide a spectrum of approaches. It is also important to note that there is a significant number of cases where a tribunal declines to discuss, or outright ignores human rights arguments raised.¹⁵⁸

A The Proportionality Approach

1 Tecmed v Mexico

This claim concerned the investor, Tecmed, being granted rights operate a hazardous waste landfill site in Mexico with a representation that Tecmed's licence to continue to operate the waste site would continue.¹⁵⁹ The licence to operate the site was then not renewed by

156 *MTD Equity Sdn. Bhd. And MTD Chile S.A. v Chile (Decision on Annulment)* ICSID ARB/01/7, 21 March 2007 at [69].

157 McLachlan, above n 3, at 7.110-7.111.

158 For example; *Azurix*, above n 146, at [261]; *Siemens AG v Argentina (Award)* ICSID ARB/01/8, 17 January 2007 at [79], [121]; *Ioan Micula v Romania (Decision on Jurisdiction and Admissibility)* ICSID ARB/05/20 24 September 2009, at [88].

159 *Tecmed v Mexico*, above n 146, at [36-38].

Mexico.¹⁶⁰ Tecmed alleged that this indirectly expropriated its asset by rendering the ongoing business worthless.¹⁶¹

The tribunal adopted a proportionality approach to assess the breach of the interest of the state and the natural environment with the investor's human right to property.¹⁶² It concluded that a tribunal has the power to examine the actions of the state "to determine whether such measures are reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of [investors]."¹⁶³ It required a "reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realised by any expropriatory measure".¹⁶⁴

2 *CMS Gas v Argentina*

This case was one of the "Argentina cases"; arbitrations which arose following the Argentine economic crisis of the late 1990s.¹⁶⁵ As a result of the economic crisis, the Argentine government implemented a policy where one peso was the equivalent of 1 USD, and suspended CMS Gas' right to readjust tariffs.¹⁶⁶ This caused the value of the investment to become significantly decreased.

Argentina argued that the measures were done in order to protect the population and ensure that their constitutional human rights were upheld.¹⁶⁷ This relied on a constitutional argument that IIAs are superior to domestic law, but do not override the constitution of the state.¹⁶⁸ This argument was rejected by the tribunal.¹⁶⁹ Again, a proportionality argument appeared to be followed, where the tribunal determined whether the actions of the state were necessary given the significance of the threat posed by the crisis.¹⁷⁰ The

160 At [39].

161 At [41].

162 At [122].

163 At [122].

164 At [122].

165 Justin Li, "Human Rights in Investment Arbitration", Memorandum prepared for Dr Petra Butler (London, Oct 2015) at 3.

166 At 3.

167 *CMS Gas Transmission Company*, above n 146, at [113].

168 At [114].

169 At [119].

170 At [305].

proportionality approach to human rights interacting with investor's claims has been supported in a number of other decisions.¹⁷¹

The Tribunal disregarded this argument, instead holding that the state's actions were not necessary to protect human rights, and that Argentina breached the FET standard of the relevant IIA but did not amount to expropriation.¹⁷²

B Necessity

1 Sempra v Argentina

This case also relates to the Argentine financial crisis.¹⁷³ *Sempra* held equity interests in two Argentine gas companies, and Argentina had provided a legislative guarantee that tariffs for gas distribution would be calculated in US dollars in order to attract investment.¹⁷⁴

Argentina argued that a state of necessity existed which mandated the action taken, in order to protect human rights.¹⁷⁵ The tribunal held that, in order for a defence of necessity to be successfully raised, there must be a case where "the constitutional order and the survival of the state were imperilled by the crisis".¹⁷⁶ It determined that the state was not in sufficiently dire a situation, and therefore the action was not necessary.¹⁷⁷

The defence of necessity has likewise been raised in a number of other cases.¹⁷⁸ In all of these instances, the threshold for a successful claim has been set at a level which requires an existential threat to the state.

171 *LG&E Energy Corp., LG&E Capital Corp., and LG&E International Inc. v Argentina (Decision on Liability)* ICSID ARB/02/1, 25 July 2007; *Continental Casualty Company v Argentina (Award)* ICSID ARB/03/9, 5 September 2008.

172 At [294], [410]

173 *Li*, above n 165, at 9.

174 *Sempra Energy International v Argentina (Award)* ICSID ARB/02/16, 28 September 2007 at [85].

175 At [325-326].

176 At [332].

177 At [388].

178 *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. v Argentina (Decision on Liability)* ICSID ARB/03/19, 30 July 2010; *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v Argentina (Award)* ICSID ARB/97/3, 20 August 2007.

C Urbaser v Argentina

1 Facts

The *Urbaser* decision was another claim brought following the Argentine financial crisis. The claimants were Spanish investors who had obtained a monopoly concession to provide water and sanitation services to a province of greater Buenos-Aires.¹⁷⁹ *Urbaser* brought a claim alleging breach of the FET standard, breach of legitimate expectations, and expropriation.¹⁸⁰ Argentina made a counterclaim that the action had been necessary to protect the human rights of the population.¹⁸¹

2 Decision and Human Rights Aspects

The *Urbaser* tribunal considered the investor's claim that Argentina's action breached the FET standard by violating the legitimate expectation that the state would act in accordance with the terms of the Concession.¹⁸² While the tribunal agreed that the Concession was a binding agreement, it engaged in lengthy discussion of what should form and influence the investor's legitimate expectations.¹⁸³ It engaged in a form of a proportionality balancing exercise, considering that the investor's legitimate expectations must be informed by the host state's international, constitutional, and domestic law obligations.¹⁸⁴ They must be "measured against the expectations the investors had at the relevant time."¹⁸⁵ The tribunal held that the investor must expect for the host state to "act in furtherance of rules of law of a fundamental character", and further held that this includes the expectation that the state would act to uphold and protect human rights.¹⁸⁶

The *Urbaser* tribunal held first that Article 46 of the ICSID Convention allowed the host state to make counterclaims against an investor.¹⁸⁷ It held that human rights form a part of customary international law and therefore form part of the applicable law of the arbitral tribunal.¹⁸⁸ The tribunal discussed the increasing international recognition of the need for investors and other corporate actors to behave responsibly and not contradict human rights

179 *Urbaser*, above n 84, at [34].

180 At [35].

181 At [1156].

182 At [304].

183 At [620].

184 At [620].

185 At [620].

186 At [620].

187 At [1144].

188 At [1188-1192], [1200-1203].

in international law.¹⁸⁹ This right was protected within the Argentine constitution, thus placing a constitutional obligation upon the state to protect and uphold this right at all times.¹⁹⁰ The tribunal held that the investor’s legitimate expectations would be informed by their knowledge of the international and domestic obligations upon the state at the time of investing, and found that this includes an expectation that the state would act to uphold the constitutionally protected human rights of its population.¹⁹¹

It then moved on to discuss whether Urbaser itself was under any obligation to uphold the right to water of the population within the area of the Concession. The argument was made that, because Urbaser was granted a monopoly over the area and the Concession was to provide a human right, a horizontal application of the state’s human rights duties therefore pass onto Urbaser.¹⁹² The tribunal rejected Urbaser’s submission that human rights obligations are “never borne... by private investors”.¹⁹³ It indicated a number of provisions in the Spain – Argentina BIT which granted human rights to investors, and inferred that if investors are protected by international law provisions, then they can be bound by them.¹⁹⁴ It held that there is an obligation on all parties, public and private, “not to engage in activity aimed at destroying [human] rights.”¹⁹⁵

The *Urbaser* decision holds that a state has a positive obligation to act to uphold and further human rights, but that this obligation does not extend to private parties.¹⁹⁶ There is no “obligation for performance” on a private party.¹⁹⁷ It appears the tribunal does not find a requirement for investors to ensure their activities protect or uphold human rights, instead the duty is that investors should not interfere with or in any way denigrate human rights during their investment.¹⁹⁸

3 *Urbaser and Legitimate Expectations*

Urbaser framed its decision in the context of the legitimate expectations of the investor. It attempted to “integrate human rights obligations with investment protections and generate

189 At [1195].

190 At [622].

191 At [620].

192 At [1206].

193 At [1193].

194 At [1194].

195 At [1199].

196 At [1208].

197 At [1208].

198 At [1208].

a consistent set of state obligations”.¹⁹⁹ It held that all investors have a legitimate expectation that states will act in accordance with international and domestic law to uphold and protect human rights.²⁰⁰

The finding that the expectation for human rights to form part of the legitimate expectations of the investor adds an additional requirement on investors to consider the human rights implications of their actions and work to ensure that their activities do not violate or denigrate from the human rights of the population of the host state. This also gives host states the ability to intervene in situations where investors are violating the population’s human rights without fear of a successful claim being lodged against them by the investor.

VII Use of Legitimate Expectations to Uphold Human Rights

This paper proposes that expecting host states to abide by their domestic, constitutional, and international human rights obligations should form a consistent element of an investor’s legitimate expectations. In turn, an investor should be seen to be under a duty to reasonably inform themselves of the human rights obligations applicable to the state, and any special circumstances present in the state which may be impacted by the investor’s activity. The investor should also be under an expectation to engage in all reasonable due diligence to assess, examine, and mitigate possible human rights impacts of the investment activity. This solution allows states to monitor the activity of investors and intervene in situations where the investors’ activities have a detrimental impact on the human rights of the population.

A Expansion of Current Legitimate Expectations

Legitimate expectations are an evolving standard, they are not entrenched nor inflexible and have potential to adapt to include new methods of standard operation.²⁰¹ Any action of the state may influence the formation of an investor’s legitimate expectation.²⁰² For example, if state officials make public comments to the affect that government policy is to encourage investment in a particular industry and therefore to prioritise legal consistency,

199 David Attanasio and Tatiana Sainati “*Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v The Argentine Republic* ICSID Case No. ARB/07/26” (2017) 111(3) AJIL 744 at 747.

200 *Urbaser*, above n 84, at [620].

201 Ostránský, above n 127, at 365.

202 *Waste Management v Mexico*, above 120, at 986.

an investor may have a legitimate expectation that the state will not then engage in significant legislative reform of that area. Similarly, if a state's government embarks on a political campaign focused on combatting climate change, a legitimate expectation could form that the state will enact legislation which may be unfriendly to investors in the fossil fuel industry.

While some legitimate expectations depend on the individual circumstances of the investment, others are non-contingent.²⁰³ An investor will always have the legitimate expectation that a state will act in good faith, act in accordance with its international obligations, and will seek at all times to abide by the terms of the investment agreement if it is reasonably possible to do so.²⁰⁴ This paper proposes that an additional expectation be included within this list; the expectation that a state will always act to uphold and protect the human rights of its population and of the investor.

This expectation would be subject to a significant degree of limitation. States would be expected to uphold human rights in all instances, however wherever possible, the state's approach should also be consistent with protecting the rights of the investor. Direct or indirect expropriation of the investment would only be warranted if the situation were sufficiently dire for such a course of action to be the only realistic and reasonable avenue available to the state. In this way, the proportionality exercise seen in a number of prior arbitral proceedings remains a central part of the application of human rights in investor-state arbitration. Proportionality acts as a balance against a state seeking to use defence of human rights as an excuse to evade its obligations under an IIA.

B Operation in Practice

This section will set out how the proposed changes would operate in practice to enable greater respect and prominence of human rights across investor-state arbitration. First, an investment under an application IIA will be required. As part of that agreement, it would be necessary for the IIA to contain an express or implied term that the state will not infringe upon the investor's legitimate expectations, and similarly that the investor will act in accordance with all international and domestic obligations.

This paper proposes that the expectation that a state will take all reasonable and necessary measures to act in accordance with its domestic, constitutional, and international human

203 Ostránský, above n 127, at 345.

204 *Tecmed v Mexico*, above n 146, at 173.

rights obligations will form a part of the investor's legitimate expectations. There are a number of situations in which a state may need to act to protect the human rights of a population from an investor. One potential scenario is where the investor's actions either threaten or directly infringe upon the human rights of the population or a portion of the population.

For example, there is a right to clean water. Imagine if an oil company searches for oil near the source of a city's drinking water, and in doing so begins contaminating the drinking water supply with by-products of the extraction process such that the water became undrinkable. Further, suppose the method of oil extraction and the geographical area in which the extraction was taking place were both in accordance with the terms set out in a specific investment agreement under an IIA. In this situation, the human rights of the population, namely the right to clean water, is being violated by the investor's activity. It is therefore proposed that, when the investor was made aware of the situation, it would have two options. Either remedy the situation and provide measures to ensure the water is not contaminated and is safe to drink, or cease operations and provide necessary compensation for the harm already done. If the investor did not undertake any action to remedy to human rights violation and reduce the threat of future violation, the state would intervene and forcibly prevent further exploration taking place. If other options, such as proceedings in the domestic judicial system, were exhausted or not reasonably available, state intervention would likely result in the direct or indirect expropriation of the investment. This would *prima facie* give the investor a claim in an investor-state arbitration context for expropriation, breach of legitimate expectations, and breach of the FET standard. However, under this paper, the state would have a defence or counterclaim to the investor's alleged breach. The state would argue that part of the investor's legitimate expectations was the expectation that the state would act to prevent any threat or actual human rights violations from the investor. Therefore, when the investor refuses to remedy or stop the violation of the right to clean drinking water, the investor must have had an expectation that the state would intervene in the investor's activity to protect the population's human rights. Thus the investor doing so would be in accordance with the investor's legitimate expectations and not in violation of the agreement.

The second situation is what was seen in the Argentina series of cases. This instance is where a crisis arises separate from the investor's activities which poses a threat to the population's human rights. The crisis is such that it warrants a reaction from the state to uphold the population's human rights, and such action will impact negatively on the investor's activity. This situation is more complicated and requires a higher degree of

consideration of the proportionality factors outlined below. In this scenario, state action to uphold human rights would also form a legitimate expectation of the investor, however the situation is different in that the investor did not contribute to the threat and the crisis may not have been reasonably foreseeable at the time of the investment being made. As this situation is not due to the conduct of the investor, the investor's human rights must be afforded sufficient priority to avoid infringing upon them as much as possible. However, the legitimate expectation that the state will act to safeguard the population's human rights applies in circumstances which were not reasonably foreseeable at the time of making the investment. The legitimate expectation extends to situations where a crisis arises due to other causes. Although the state would be under an obligation to take an action which addresses the human rights threat while having as minimal an impact as possible upon the rights of the investor, if a reasonable measure involves the expropriation of the investment, and such a course of action is proportionate to the threat posed to the human rights of the population, again, the state would have a valid defence or counterclaim against proceedings brought by the investor.

The fundament purpose of these examples is to demonstrate two things. First, that a legitimate expectation that the state will uphold human rights should form a basic principle of all IIAs. Secondly, that the rights of investors must still be protected to avoid uncertainty and a chilling effect on international investment. States' actions must be proportionate to the threat faced and expropriation would only be warranted in situations where such a response was a reasonable and proportionate reaction to the scale of the human right threat posed.

VIII How to Raise the Legitimate Expectation

This section sets out the two ways in which a state could argue that it should not be liable in circumstances where it has expropriated the investment in order to defend human rights. It discusses both the use of a defence on the merits and a counterclaim, concluding that either option could be used, but a defence on the merits would be preferable.

A As a Defence on the Merits

The first method by which a state could raise the legitimate expectation that the investor must abide by human rights obligations is in a defence on the merits. This is done through the respondent making submissions in response to the claimant's principle arguments

stating why the claim is not correct either factually or legally.²⁰⁵ The objective of a defence on the merits is to show why the conduct alleged by the claimant either did not occur at all, or does not give rise to liability of the respondent; it seeks to directly confront and defeat the claimant's argument.²⁰⁶

A defence on the merits would allow a state to defeat an investor's principle claim that the state's actions violated the investor's legitimate expectations. The state would raise that the investor had a legitimate expectation that the state would act to protect human rights of the population, and therefore the state's actions were in accordance with the legitimate expectations of the investor.

For this to succeed, the state would bear the burden of proving a number of factors. First, it would have to prove that an understanding that the state would act to protect human rights, both generally and in the particular circumstances raised in the dispute, formed the legitimate expectation of the investor. Secondly, it would need to prove that there was a genuine threat to human rights; that the act or omission of the investor had created a situation where the state was bound to act. This obligation to act could take a variety of forms, ranging from a constitutional obligation to act, other domestic legislation mandating addressing the situation, or a customary international law norm to protect the human right or rights being threatened.²⁰⁷ The state would then need to demonstrate that the action taken actually addressed the breach or threat to the human right and was done so for that purpose.²⁰⁸ This step would prevent the human rights mechanism being used to unfairly expropriate states' assets or for the state to use human rights defences as an excuse for conduct. An additional safety mechanism is the final step; the state would be required to show that the action was a proportionate and necessary response to the human rights threat or violation.²⁰⁹ The proportionality requirement is necessary to ensure that states cannot act in a manner which does in fact protect human rights, but is disproportionate to the

205 C Antonopoulos *Counterclaims before the International Court of Justice* (T.M.C. Asser Press, The Hague, 2011) at 60.

206 At 60.

207 Clara Reiner and Christoph Schreuer "Human Rights and International Investment Arbitration" in PM Dupuy, EU Petersmann and F Francioni (eds) *Human Rights in International Investment Law and Arbitration* (Oxford University Press, Oxford, 2009) 82 at 89.

208 Tamar Meshel "Human Rights in Investor-State Arbitration: The Human Right to Water and Beyond" (2015) 6 *Journal of International Dispute Settlement* 277 at 281.

209 Sergio Puig "No Right without a Remedy: Foundations of Investor-State Arbitration" (2014) 35 *U. Pa. J. Int'l L.* 829 at 857.

infringement upon the rights of the investor.²¹⁰ The purpose of this requirement is also to require states to take the action which infringes on the rights of the investor to the smallest degree possible while still protecting the population’s human rights.

The use of a defence of the merits is the simplest method for greater protection of human rights in investor-state arbitration. It does not require a radical reform of arbitration process; states already have the ability to file a defence and arguing that the action undertaken is justified is already a relatively common practice, although it should be noted that the use of a defence in human rights claims is still rare.²¹¹ The significant change proposed by this paper is that states would no longer have the obligation to prove that the investor had the legitimate expectation that the state would act to protect human rights. Instead, this expectation would form part of the standard framework of investor-state arbitration. The crux of the issue in the dispute would therefore move to whether the state’s conduct was to defend human rights and whether the action was proportionate, both of which turn on the particular facts of the matter.

B The Use of Counterclaims

Almost all arbitration rules grant states the right to assert counterclaims over investors.²¹² A counterclaim is where the state responds to an investors claim within the same arbitral proceedings.²¹³ Counterclaims are a distinct cause of action, but are still part of the principle claim so far as the matters discussed must arise from the same legal and factual context.²¹⁴ The purpose of a counterclaim is to mitigate or completely negate an alleged breach by the party making the counterclaim.²¹⁵ In contrast to a defence on the merits, a counterclaim does not necessarily seek to defeat the claimant’s arguments on the facts or law. Instead, it seeks a finding from the tribunal that the respondent’s actions were not in

210 Vivian Kube and Ernst-Ulrich Petersmann “Human Rights Law in International Investment Arbitration” in A Gattini, A Tanzi and F Fontanelli (eds) *General Principles of Law and International Investment Arbitration* (Brill Nijhoff, Leiden, 2018) 221 at 241.

211 Meshel, above n 208, at 281.

212 Yaraslau Kryvoi “Counterclaims in Investor-state Arbitration” (2012) 21 *Minn J. Int’l L.* 216 at 216.

213 Dafina Atanasova, Adrián Martínez and Josef Orťanský “The Legal Framework for Counterclaims in Investment Treaty Arbitration” (2014) 31 *J. Int’l Arb* 357 at 359.

214 At 378.

215 Antonopoulos, above n 205, at 63.

breach of the agreement, on grounds which may or may not be initially raised in the principle claim.²¹⁶

When an investor brings a claim under an IIA, the statement of claim will set out the grounds on which the investor believes their rights have been infringed. As remarked above, almost every claim includes allegations that the state has violated the FET standard and infringed on the investor's legitimate expectations.²¹⁷ The state then has the opportunity to file a counterclaim against the investor, which it may allege that the investor breached the IIA or that the state's action was fully justified.²¹⁸ This was seen in the *Urbaser* decision, where Argentina counterclaimed claiming that the actions taken were fully justified by reason of upholding the human rights of the population.²¹⁹

The strengths of counterclaims rest in their flexibility and ability to counterbalance the favour afforded to investors under IIAs.²²⁰ A counterclaim must relate to the subject of the main dispute.²²¹ Counterclaims present states with a potential counterbalance to IIAs favour towards investors.²²² The ability to initiate proceedings are reserved for investors, by allowing states to raise counterclaims if an investor makes an initial claim, states are provided with the ability to tell their version of events and raise concerns about the conduct of investors.

Further, the ICSID convention appears to include the right to counterclaim in an effort to provide for increased efficiency.²²³ Article 46 of the ICSID Convention states that,²²⁴

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

216 *Case Concerning Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v Uganda) (Counter-Claims)*, Order of 21 November 2001, ICJ Rep. 2001, at 684.

217 Christopher Campbell "House of Cards: The Relevance of Legitimate Expectations under Fair and Equitable Treatment Provisions in Investment Treaty Law" (2013) 30 J.Int'l Arb. 361 at 362.

218 Dafina Atanasova, Adrián Benoit and Josef Ostřanský "The Legal Framework for Counterclaims in Investment Treaty Arbitration" (2014) 31(3) J.Int'l Arb. 357 at 359.

219 *Urbaser*, above n 84, at [1146].

220 Kryvoi, above n 212, at 220.

221 At 220; ICSID Convention, above n 34, art 46.

222 Kryvoi, above n 212, at 218.

223 At 223.

224 ICSID Convention, above n 34, art 46.

Article 46 shows clear intention for counterclaims to be included within the ambit of investor-state arbitration and extend the right to raise them to both the investor and the state.²²⁵ This method would increase efficiency by ensuring claims made by either party are addressed in the same arbitration. It also ensures greater fairness. Article 46 allows the state, in some circumstances, to counterclaim alleging that the investors conduct has breached an agreement, or that the states own conduct, which would otherwise be in breach of the agreement, is in fact justified. This gives the state the ability to make its own case, although it would remain dependent on the investor first initiating a claim in arbitration.²²⁶

A major issue with this provision is the ability of investors to contract out of counterclaims and deny consent for the state to raise such an argument.²²⁷ This grants investors significant authority in potentially being able to deny states a means to claim for human rights abuses. This proposal also extends counterclaims beyond the normal usage of the practice. Commonly counterclaims are used by states to claim costs arising from non-ICSID proceedings, interest payments, or taxes.²²⁸ The use for substantive claims of law including human rights, while not unheard of, would be a substantial expansion of the current scope of the usage of counterclaims.

Despite this, counterclaims are rarely pleaded and when they are, it is even rarer for them to be successful.²²⁹ The use of counterclaims is so severe that one commentator dubbed their usage “thirty years of failure”.²³⁰ The use of counterclaims is increasing, however there is insufficient evidence to suggest that counterclaims are becoming more successful.²³¹

225 Atanasova, Benoit and Ostránský, above n 218, at 363.

226 Kryvoi, above n 212, at 218.

227 At 218.

228 For example; *Maritime International Nominees Establishment v Guinea (Award)* ICSID ARB/84/4, 6 January 1988; *Benvenuti and Bonfant Srl v People’s Republic of the Congo (Award)* ICSID ARB/77/2, 15 August 1980.

229 Kelsey Farmer “The Best Defence is a Good Offence – State Counterclaims in Investment Treaty Arbitration” (LLB(Hons) Dissertation, Victoria University of Wellington, 2016) at 13.

230 Helen Bubrowski “Balancing IIA Arbitration through the Use of Counterclaims” in A Mestral and C Levesque (eds) *Improving International Investment Agreements* (Routledge, New York, 2013) 212 at 214.

231 José Rivas “ICSID Treaty Counterclaims: Case Law and Treaty Evolution (2014) 11 *Transnational Dispute Management* 1 at 2; Andrea Bjorkland “The Role of Counterclaims in Rebalancing Investment Law” (2013) 17 *Lewis & Clarke Law Review* 461 at 464

This paper argues that a state should have the ability to counterclaim against an investor's claim that the state breached the investor's legitimate expectations. The counterclaim would set out that the investor acted in a manner which threatened or infringed upon the human rights of the host state's population, warranting state action infringing on the rights of the investor. The state would argue that the alleged breach of the IIA or investment contract was necessary and proportional in order to defend the population's human rights against the investor.

C Conclusion

A counterclaim gives states the right to raise an argument that the conduct was justified in light of the investors legitimate expectation that the state would act to protect the population from human rights abuses. A defence on the merits empowers states to directly address the principle claim of the investor. Where possible, the simplest means of raising a dispute will be a defence on the merits, however where such a course of action is unlikely to be successful, or the dispute is of a character beyond that raised in the principle claim, a counterclaim should be available to the state. A defence on the merits is more likely to succeed given that it directly engages with the principle claim. Furthermore, an IIA or investment contract can remove the right for a state to use a counterclaim, but a defence on the merits is always available, therefore making it the more certain and reliable course of action.

IX Proportionality

This paper argues for the introduction of a novel legitimate expectation to allow states to act against investors who threaten or violate human rights. The problematic nature of the proposals emerges when considering borderline cases, where full expropriation is not necessarily warranted, but there is nonetheless the risk of a violation of international human rights.

A proportionality analysis involves balancing the threat posed by the investor's actions and the severity of the state's reaction.²³² Proportionality acts as a check against the state exercising undue power and over-reaching into the investor's rights.²³³ Instead, the state is bound to undertake the least infringing action possible to address the human rights

232 Bücheler, above n 113, at 38.

233 At 132.

violation.²³⁴ This paper does not propose to go so far as to limit state intervention to only circumstances where the constitutional order of the state is at stake. Instead, the responses of the state should be seen as a spectrum, with mediation or negotiation at one end and expropriation of the investment at the other. The requirement on the state to act will be relative to the severity of the threat posed, preserving the rights of the investor while also protecting the right of the state to act in the best interests of the population.

However, the tribunal should not go so far as to say what specific action the state should have taken. Instead, the approach of previous tribunals in this area can be taken into account. In these decisions, the tribunal considered whether the state's action was within the range of justified actions, taking into account all the circumstances of the time.²³⁵ This allows for the tribunal to preserve state autonomy, and consider the broader spectrum of potentially appropriate response, rather than traverse the potentially unstable ground of the specific response which the state should have undertaken. It is also questionable whether an investment arbitration tribunal in fact has the requisite knowledge and experience to make decisions regarding specific actions in which states should engage.²³⁶

Therefore the addition of a new legitimate expectation should be applied in investor-state arbitrations with an analysis of proportionality to determine whether the state's response to a human rights issue was appropriate in the circumstances. This measure seeks to balance the right of the state to govern itself as a sovereign territory and the right of the investor to be free from any unreasonable or overbearing state interference in the investment.

X Implications for Investors and Criticisms

A Impact on Investment

The fundamental reasoning for international investment law and IIAs more generally is to encourage international trade, commerce, and most pertinently, international investment.²³⁷ By its nature, international investment requires significant investment of capital into

234 At 74.

235 Tecmed, above n 146, at [115]; Azurix, above n 146, at [311], [312], [322]; LG&E, above n 171, at [194-195].

236 Bücheler, above n 113, at 208.

237 R Dolzer and C Schreier *Principles of International Investment Law* (2nd ed, Oxford University Press, Oxford, 2012) at 3.

projects which are commonly long term.²³⁸ These investments are susceptible to a large amount of risk, both commercially and from political changes within the host state.

Investment also carries significant benefit for the host state. By agreeing to the terms of the IIA, the state accepts being bound by the requirements therein and does so presuming that significant benefit from investment will follow.²³⁹ At present, IIAs exist to reduce the risk posed to investors by changing political circumstances.²⁴⁰ IIAs set out the minimum standard of treatment which the state must afford to the investor, and in doing so limit the capacity of the state to regulate.²⁴¹ These obligations guarantee minimum standards of treatment and provide some security to the investor that a changing political landscape would not result in the investment being arbitrarily expropriated, therefore creating a more investor friendly climate.²⁴²

This proposal adds to the risk of international commercial activity by introducing a potentially destabilising element to the investment regime. It presents an additional area of risk to the investor; if the circumstances surrounding their investment change such that it threatens or infringes upon human rights of the population, the investment may be lost.

This is a significant problem for the investor. The risk of political circumstances diminishing the value of the investment becomes far greater if an investment is long term, and now means that investors in areas with potential human rights implications face significantly greater risk than those in other areas. To compound the issue, these are areas of investment which are likely to be most valuable to the wellbeing of the host state's population, therefore a downturn of investment in this area poses significant detriment to states.²⁴³

B Justification for the Measures

An additional element of risk for investors may have a chilling effect. The section below will discuss potential actions which could be taken by investors to reduce this risk and

238 At 20.

239 At 20.

240 Z Douglas *The International Law of Investment Claims* (Cambridge University Press, Cambridge, 2012) at 1; Yaroslau Kryvoi "Counterclaims in Investor-State Arbitration" (2012) 21(2) *Minnesota Journal of International Law* 216 at 225.

241 Douglas, above n 240, at 2.

242 Dolzer and Schreuer, above n 237, at 21.

243 Butler, above n 98, at 332.

therefore mitigate concerns. This section will argue that the addition of the human rights legitimate expectation is warranted despite the potential ramifications, and why the positives of the measure outweigh the potentially detrimental effects.

Fundamentally, this paper's proposal is designed to increase recognition and protection of international human rights. This proposal gives states a last resort option of cancelling an investment contract or expropriating an investment only where such action is reasonable in the circumstances and less extreme measures would be insufficient to remedy the situation. These safeguards serve to provide the investor with some reassurance that the investment is not unacceptably high risk and that it will only be lost in extenuating circumstances such as a national financial crisis which renders the state with few other courses of action. Therefore the potential detriment is the risk of losing the investment; although the consequences if this risk is realised are severe, the probability of the investment actually being lost is low.

Furthermore, this proposal effectively creates a negative duty on investors. Rather than having to uphold and protect human rights, they only have to take reasonable care to ensure that their investment does not threaten or violate the international human rights owed to the population by the state. This duty is significantly less arduous than a positive obligation to ensure that investment activity furthers or protects human rights. The autonomy of the investor remains almost entirely intact, and they also remain free from state interference if human rights are not violated.

In addition, international human rights bind all actors to avoid violating the personal freedom, autonomy, and dignity and every human being.²⁴⁴ This is of great importance; the protection of these fundamental universal values is more important than the complete protection of corporate interests. Proportionality requirements offer some protection to investors, and the investor-state arbitration regime ensures that investors retain the ability to be compensated if the state unjustly violates their rights.²⁴⁵

C Options for Investors

The Ruggie Report recommends that corporate parties include human rights implications within the current ambit of due diligence for investment.²⁴⁶ In addition to the regular due

244 Bishop, above n 52, at 121-122.

245 Bücheler, above n 113, at 132.

246 John Ruggie, above n 28, at [56].

diligence over commercial viability and likely profit outcome, corporations would be encouraged to examine the potential human rights impact of their investment activity, and take all reasonable steps to mitigate the impact as far as possible. The ‘carrot’ option is presented through the positive media and bettering of relations with the government and population of the host state, while the ‘stick’ remains present that if an investor does not undertake sufficient due diligence, the host state may terminate the investment due to adverse human rights implications.

Ruggie sets out three grounds for the investor to consider; first the circumstances of the state in which their business takes place, second the likely human rights impacts of the corporation’s activities, and finally whether the investor’s domestic activity will exacerbate existing human rights abuses already taking place.²⁴⁷ If the investor faces the risk of having the investment expropriated should it breach human rights standards, it is far more likely that the investor will consider these three factors, as to not do so would carry a risk of economic loss.

Furthermore, the requirement that an investor must consider the state’s circumstances assists in mitigating the risk of a change beyond the control of the investor reducing the value of the investment.²⁴⁸ It encourages an investor to do additional due diligence in the socio-political environment of the state at the time of investment and gain an understanding of the likely risks facing the state for the period of the investment. Although the additional due diligence will mean the investor incurs a greater cost in preparing to make the investment, it is unlikely that such cost will be of a quantum to disincentive or deter investment. An additional positive ramification could be that if investors do not invest in a state because doing so may exacerbate existing human rights abuses, economic pressure would be put on the state to remedy to causes of these violations to encourage the investment to return.²⁴⁹ This is another means through which an increased focus on human rights in investor-state arbitration can have positive effects for international human rights.

A more difficult situation is in a situation such as the Argentina crisis. In this situation, it is reasonable that some investors, especially those engaging in long term investment, would be unable to foresee the coming crisis, the subsequent difficulty the Argentine government would face in remedying the situation, and the flowing human rights implications. This scenario is more problematic as it is due to circumstances outside the investor’s control.

247 At [57].

248 At [25].

249 At [88].

One answer is simply that such a situation is incredibly rare, however that is not particularly persuasive, given that a rare near-total economic collapse is still a near total economic collapse. The realistic response is that the potential for national level crisis to effect investment is a risk of doing business at the international level, especially in the developing world where the political and economic situation is less stable than in the OECD.

Ultimately, the proposals of this paper centre on the need to find a balance between protecting the rights of the investor and enabling states to protect their populations from human rights abuses. This balance depends on both parties ceding some control and having an appropriate system of checks and balances to ensure fairness and parity between both sides.

XI The Legitimacy Crisis of Investor-state Arbitration

This section steps back and looks at the wider impact of this proposal on investor-state arbitration. It particularly looks at the legitimacy crisis currently being faced by this method of dispute resolution. This crisis is based on political and public opinion undermining the ability of investor-state arbitration to operate effectively. It is important to include consideration of this aspect as an additional benefit to making human rights a more central focus of investor-state arbitration, and the subsequent positive political effects for both investors and states.

A What is the Legitimacy Crisis

There is increasing international discussion on the topic of what has been dubbed the legitimacy crisis of international investor-state arbitration. This refers to the political movement against international arbitration as a valid form of dispute resolution.²⁵⁰ There are two prevailing critiques of arbitration. First, critics argue that investor-state arbitral tribunals subordinate environmental concerns, human rights, and other social issues in favour of corporate interests, and secondly concerns about compromising national sovereignty where domestic laws are subject to IIAs or successfully challenged by investors.²⁵¹

250 Susan Franck “The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions (2005) 73 Fordham L. Rev. 152 at 1586.

251 Nichols, above n 116, at 244.

Critiques from the left of the political spectrum argue that investor-state arbitration is a neoliberal attempt to remove policies concerning international commerce from domestic control and therefore democratic decision making, essentially creating a legislative regime made for and by private corporate interests.²⁵² This in turn subjugates regulation and enforcement to methods desired by private interests, with little to no regard of the wider public interests or democratic process, despite the potential impact of the results of investor-state arbitration on domestic legislation.²⁵³ These interests in turn focus on normalising the law being enforced through methods that appear to be separate from economic considerations, when in fact being shaped by groups in power who are directly involved in the decision.²⁵⁴

This has major flow-on effects to addressing issues of human rights through investor-state arbitration. Public confidence in the dispute resolution mechanism is essential for the measure to be seen as valid.²⁵⁵ If the public do not recognise the validity of investor-state arbitration, it is unlikely that any decision regarding a population's human rights made by an arbitral tribunal will be seen as fair and unbiased, therefore invalidating the authority of the tribunal.

The *Phillip Morris v Uruguay* decision highlights an example where an arbitral decision has been publically viewed as “human rights friendly” and therefore received widespread political acclaim.²⁵⁶ However, this is likely only a limited and isolated examples. Cases where human rights considerations are raised but ultimately held to be unsuccessful outnumber those where the arguments are accepted.²⁵⁷ Furthermore, although some high profile cases such as *Philip Morris* and *Urbaser* can bolster public confidence in investor-

252 S Gill *Power and resistance in the new world order* (Palgrave Macmillan, New York, 2008).

253 Neil Brenner, Jamie Peck and Nik Theodore “New constitutionalism and variegated neo liberalization” in S Gill and A Cutler (eds) *New constitutionalism and world order* (Cambridge University Press, Cambridge, 2014) 126 at 129.

254 C May *A global political economy of intellectual property rights: The new enclosures?* (Routledge, New York, 2000) at 40.

255 Muthucumaraswamy Sornarajah “Developing countries in the investment treaty system: A law for need or a law for greed?” in S Schill, C Tams and R Hofmann (eds) *The International Law on Foreign Investment* (Cambridge University Press, Cambridge, 2009) 43 at 46.

256 *Philip Morris Brands SARL v Uruguay (Award)* ICSID ARB/10/7, 8 July 2016.

257 Michael Douglas “The Importance of Transparency for Legitimising Investor-State Dispute Settlement: An Australian Perspective” in J Williams, M Ramaswamy and J Ribeiro (eds) *Trade Development Through Harmonization of Commercial Law* (Comparative Law Journal of the Pacific, Wellington, 2015) at 114.

state arbitration, they are unlikely to be sufficiently persuasive as to resolve the legitimacy crisis. Wider action is needed.

B How this Paper Addresses the Legitimacy Crisis

1 Infringement on National Sovereignty

The proposed inclusion of a legitimate expectation that states will act to defend and uphold the human rights of their population addresses the legitimacy crisis issue of investor-state arbitration being viewed as an infringement on national sovereignty.²⁵⁸ As a consequence, states appear unable to govern in the best interests of the population, instead being bound to rules which are designed to protect international parties.

The ability to act against investors where the investment activity threatens or violates the population's human rights addresses this concern. It demonstrates that, although IIAs do indeed grant special protection to investors in order to promote and encourage international investment, there remains a base level of law over which the state maintains control. There is a "this far but no further" aspect to the measure, whereby the immunity from domestic legislation still exists, but does not extend to all conduct. Therefore the ability of the investor to act inconsistently with the population's human rights is removed. If this was properly promoted by the relevant political bodies, it would be an effective measure in building public faith and confidence in investor-state arbitration.

2 Separate System for Investors

The second concern raised under the legitimacy crisis is the criticism that investor-state arbitration creates a separate system for international corporations which exempts them from the same degree of regulation and oversight as a domestic party would receive.²⁵⁹ This criticism is closely linked to the perception that investor-state arbitration and IIAs generally undermine national sovereignty, but is different in that it focuses on the disparity between the treatment of national and international corporations, rather than the jurisdiction of the state over international investors.

Domestic law obligations do not necessarily extend to binding international investors.²⁶⁰ Provisions within specific IIAs may specify whether domestic law is applicable to an

258 OECD *Government perspectives on investor-state dispute settlement: a progress report* (OECD, Paris, 2012) at 6.

259 At 8.

260 Kryvoi, above n 212, at 237.

investment dispute, or it may be unclear in the IIA.²⁶¹ The arbitral tribunal has the power to determine what law is applicable to the particular dispute, including whether domestic law applies.²⁶²

This proposal also addresses this aspect of the legitimacy crisis. Any domestic corporation that threatens or violates the human rights of the population in the state in which they are acting is liable to prosecution through the domestic judiciary or other state regulatory body. The state would intervene and either order the conduct is changed or the commercial activity is shut down. By applying the same standard to international corporations, the state is, in this regard, treating investors in the same manner as a domestic actor. This demonstrates that there is again a bright line protecting human rights beyond which activity will not be tolerated, regardless of whether the actor is domestic or international. This addresses public perception by showing that international actors are also subject to the same fundamental regulations as domestic parties.

3 Criticisms

These measures do not of course fully remedy these aspects of the legitimacy crisis. Although international parties will be constrained from interfering with human rights, the ability of the state to intervene will be limited to only where other, less drastic measures of addressing the investor's conduct have been unsuccessful. The forum for addressing the investor's conduct will be an investor-state arbitration tribunal, not the domestic judiciary.²⁶³ This does not address the criticism that exemption from the domestic judiciary's jurisdiction appears to the public to exempt the investor from domestic law.

Furthermore, the state does not have the ability, and at times is reluctant, to bring an action against the investor.²⁶⁴ Reluctance to enforce rights against an investor may stem from an imbalance of power, lack of political will, or fear of discouraging other foreign investment.²⁶⁵ This distinguishes the investor from domestic actors who are subject to the state being able to initiate a claim. Instead, the state will be able to act in a manner it considers reasonable and necessary in the circumstances to protect human rights. If the investor considers the state's actions to breach the IIA or investment contract, the investor

261 At 236.

262 *ICSID Convention, Regulations and Rules Report of the Executive Directors of the International Bank for Reconstruction and Development on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, ICSID/15 (2006) at [40]

263 Balcerzak, above n 4, at 101.

264 Dumberry and Dumas-Aubin, above n 76, at 353.

265 At 353.

then has the unilateral right to initiate arbitration proceedings, and only then could the state defend its actions.²⁶⁶ This is a significant point of differentiation with the domestic situation, and continues to leave the investor-state arbitration system vulnerable to public and political criticism.

4 Conclusion

The legitimacy crisis is a serious threat to investor-state arbitration being viewed as a valid dispute resolution mechanism. Due to the involvement of states and subsequent need for involvement in IIAs to be government action, the world of investor-state arbitration is an inherently political one, which is open to being swayed by public opinion. It is therefore necessary to show that public interest and human rights considerations have a significant role in the system. This will not solve the legitimacy crisis, but it does offer steps in the direction of addressing it.

XII Conclusion

Presently, there is no consistent approach to human rights in investor-state arbitration. Some tribunals have dismissed human rights concerns outright, while others have considered principles of proportionality to varying degrees. This fractured and inconsistent approach is the problem that this paper seeks to address. Although there is myriad literature on whether human rights should be included within the ambit of investor-state arbitration, this paper addresses how to include these considerations in practice.

It seeks to do so in two ways. First, it is necessary to consider how to apply human rights to arbitration in a consistent fashion. An effective way to do so is through expanding the current regime of legitimate expectations. Legitimate expectations are a relatively novel phenomenon and retain a significant degree of flexibility. This paper proposes the inclusion of a non-contingent legitimate expectation that a state will act in whatever manner required to comply with its international human rights obligations. This enables the investor to know what the state will do if faced with a human rights crisis. To avoid a chilling effect on investment, the states reaction to a crisis must be proportionate to the severity of the threat posed.

The second substantive proposal is the mechanism by which states can argue that their actions were in accordance with the investor's legitimate expectations. Wherever possible,

266 At 360.

the state would raise the argument in the form of a defence on the merits. This is the simplest and most effective means of responding to the principle claim. Furthermore, a state always has a right of reply to an investment claim leaving no issues of consent or jurisdiction. In circumstances where a defence on the merits would be inappropriate, the state would have the option to raise a counterclaim. This enables more substantive argument and is an option if the principle claim does not allow for a sufficiently broad defence, but is not preferred due to the additional complexities, jurisdictional issues, and history of failure.

The presence of a state in investor-state arbitration distinguishes this area of arbitration from purely commercial ones. A state's concerns are focused on its population, and each state action must consider the well-being and security of millions of human beings. Furthermore, the state is accountable to the population, and the investor depends on the willingness of the state to enter into international investment. If the population has a negative perception of arbitration, the system becomes more difficult for all parties. It is in the best interests of all parties to expand the importance of human rights in investor-state arbitration to provide greater accountability, sustainability, and public faith in the system as a legitimate means of dispute resolution.

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