Corporate Social Responsibility and International Investment Law: Tension and Reconciliation

Ying Zhu*

* J.S.D. Candidate, Yale Law School. The author would like to thank Vibe Garf Ulfbeck, Katerina Mitkidis, Alexandra Horváthová, James Tierney, Sam Leander, and participants in the International Conference on "To Pursue or Not to Pursue CSR Goals - Legal Risks and Liabilities" hosted by University of Copenhagen Faculty of Law, for their helpful comments and suggestions. I am grateful to the Oscar M. Ruebhausen Fund for the financial support of this research. All errors are of course my own.

ABSTRACT

A host state's pursuance of Corporate Social Responsibility (CSR) goals may lead to a violation of international investment law (IIL). This tension results from the imbalance between international economic regulation and social regulation of foreign investments. The paper explores the tension between IIL and CSR, analyses the recent practice of reconciling the tension through incorporating CSR provisions into investment treaties, and proposes to solve the tension through a more balanced interpretation of substantive obligations in international investment arbitration.

The host state's regulation of foreign investments to promote their social and environmental responsibilities may violate IIL in three aspects: First, the host state may violate the non-discrimination principle by differentiating between foreign investments having different social and environmental impacts. Second, the host state may violate the Fair and Equitable Treatment (FET) standard if the regulation on CSR issues has frustrated foreign corporations' legitimate expectations at the time of investment. Third, the regulation in pursuit of CSR taken by the host state may constitute indirect expropriation if the measure has substantially deprived the value of foreign investments. As a response to these tensions, recent years have seen a new approach taken by Canada, Brazil and the EU of incorporating CSR provisions to investment treaties. Nonetheless, the effectiveness of these CSR provisions is questionable, as a result of the traditional role of foreign investors as third-party beneficiaries in investment treaties, the 'soft law' nature of CSR norms, and the unclear definition of CSR in these provisions.

In conclusion, the paper proposes to harmonise the host state's pursuance of CSR goals and IIL obligations by making a balanced interpretation of international investment obligations: First, in the discrimination assessment, the tribunal should take account of non-economic factors of foreign investments in the determination of whether two investors suffering different treatments are 'in like circumstances', and should allow differentiation between investors to be justified by a legitimate CSR policy. Second, in the FET examination, the tribunal should strike a balance between the stability requirement under the FET standard and the evolving nature of the host state's regulation on CSR issues. Third, in the expropriation analysis, the tribunal should take account of the host state's sovereign right to regulate CSR in the assessment of whether a CSR measure constitutes indirect expropriation.

1. INTRODUCTION

The growth of multinational enterprises (MNEs) in the past century has prompted international regulation of MNEs in two dimensions. In the *economic* dimension, MNEs are leading drivers of foreign direct investments (FDI) which can stimulate economic developments in both

home and host states.[1] Considering FDI as an economic motivational force, and maintaining awareness of the political risk faced by foreign investors in overseas investments, the international community has constructed the international investment law (IIL) regime to protect foreign investments.[2] Today, this regime consists of 3304 international investment agreements (IIAs), including 2946 bilateral investment treaties (BITs) and 358 treaties with investment provisions.[3] These investment treaties contain substantive provisions that oblige host states to provide foreign investors non-discriminatory treatment, fair and equitable treatment, and adequate compensation in case of expropriation. They also include an investor-state dispute settlement mechanism (ISDS) that allows foreign investors to bring claims against host states before international arbitral tribunals.

The *social* dimension of MNE regulation is a different story. The increasing global recognition of the role of MNEs in the protection of the social welfare of the host state, including labour rights, human rights, environmental protection and anti-corruption, has lent impetus to a corporate social responsibility (CSR) movement.[4] Unlike IIL, which restrains the host state's intervention in the activities of foreign investors, the CSR movement promotes the regulation of the private sector to protect social and environmental interests. Such regulation on CSR issues, in a broad sense, consists of two kinds of rules: On the one hand, a series of *soft* initiatives have been drafted in the international and national levels to encourage businesses to take voluntary actions above legal requirements for societal goods.[5] On the other hand, states have enacted *hard* rules enforcing social and environmental responsibilities of corporations

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[1] R. Doak Bishop, James Crawford, and William Michael Reisman, *Foreign Investment Disputes: Cases, Materials, and Commentary* (Kluwer Law International 2005) 7.

[2] José E. Alvarez, *The public international law regime governing international investment* (Brill 2011) 13-30.

[3] UNCTAD, *World Investment Report 2016, Investor Nationality: Policy Challenges* (2016) 101 <http://unctad.org/en/PublicationsLibrary/wir2016_en.pdf> accessed 27 March 2017.

[4] Alice De Jonge, *Transnational Corporations and International Law: Accountability in the Global Business Environment* (Edward Elgar Publishing 2011) 1-2.

[5] In the international realm, a series of international standards for corporate responsibility have been developed, including Global Reporting Initiative, UN Global Compact, ILO Tripartite Declaration, OECD Guidelines for Multinational Enterprises, ISO Standards and the UN Guiding Principles on Business and Human Rights. In the national realm, recent years have seen the evolution of CSR from a voluntary business-led concept to a public policy that calls for governmental regulation. See, e.g. Federal Ministry of Labour and Social Affairs, *CSR Made in Germany* (2012) 8 <http://download.diplo.de/New_Delhi/csr-made-in-germany.pdf> accessed 27 March 2017; Atle Midttun, et al. 'Public Policies for Corporate Social Responsibility in Four Nordic Countries: Harmony of Goals and Conflict of Means' (2015) 54.4 Business & Society 464, 473-480.

through domestic legislation and administration.[6] These *hard* rules on CSR issues have been in tension with states' international investment obligations as a result of their adverse impacts on foreign investments, while the *soft* CSR initiatives, in the recent years, have been incorporated into investment treaties to reconcile this tension.

This paper explores the tension between CSR and IIL, and examines the approaches to reconcile this tension. Part 2 of the paper addresses the evolution of the tension between the CSR movement and IIL. Part 3 illustrates three specific tensions between the host state's regulation on CSR issues and their international investment obligations, including non-discrimination, fair and equitable treatment and no expropriation without adequate compensation. Part 4 analyses the recent practice taken by Canada, Brazil and the EU to incorporate soft CSR standards to investment treaties, and examines whether this new approach is effective to reconcile the aforementioned tension between IIL and CSR regulation by the host states. Part 5 concludes that a better balance between investor protection and investor responsibilities should be struck in international investment arbitration.

2. INVESTOR PROTECTION VS. INVESTOR RESPONSIBILITIES: THE EVOLUTION OF THE TENSION BETWEEN IIL AND CSR

Prior to WWII, both the international investment regime and the notion of social responsibilities of corporations were at early stages and had little interaction with each other. The substantive obligations employed by bilateral and multilateral investment treaties in the contemporary world originate from the legal terms in bilateral treaties of 'Friendship, Commerce and Navigation' (FCN) concluded in the Colonial Era.[7] The FCN treaties oblige one Party to provide 'special protection' or 'full and perfect protection' to the property of nationals of the other Party in its territories and oblige the Parties to provide national treatment and most-favoured nation (MFN) treatment and to pay compensation in case of expropriation.[8]

These substantive obligations in the FCN treaties were drafted to serve the policy of protection of overseas investments, with no attention paid to the social benefits of the host countries. Although the awareness of corporate's responsibilities to society can date back to the longstanding

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[6] The narrow view of CSR as purely voluntary norms has been criticized by some commentators for its misunderstanding of the relationship between CSR and law. See, e.g. Jennifer A. Zerk, 'Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law' (Vol. 48, CUP 2006) 29-42.

[7] Rudolf Dolzer and Christoph Schreuer, *Principles of international investment law* (2nd edn, OUP 2012) 6.

[8] Kenneth J. Vandevelde, 'A Brief History of International Investment Agreements' (2005) 12 UC Davis J. Int'l L. & Pol'y 157, 159.

debate about the relationship between business and society since the Industrial Revolution in 1800s, the notion of CSR was in the 'philanthropic' era, in which companies viewed their social contributions more as donations to charities than anything else.[9] Moreover, the corporate responsibility at that time was viewed as a domestic issue within certain civilised countries and had not yet risen to a global problem.[10]

The boom of foreign investments after the Second World War called for global regulation in two dimensions: in the economic dimension, there was a demand, especially by developed countries, for a stronger mechanism at the international level to protect these investments. From the 1950s to the 1970s, European countries, pioneered by Germany, began to conclude bilateral investment treaties to protect overseas investments.[11] This practice was joined by the US in the 1970s and by China in the 1980s.[12] Moreover, the creation of the International Centre for Settlement of Investment Disputes (ICSID), an investor-state dispute settlement mechanism, in 1965 marked a major innovation in investment protection.

In the social dimension, the development of foreign investments had brought global awareness of the significant social impacts of multinationals in host states, especially in developing countries. In response, a series of international instruments were drawn up to provide global codes of conduct for MNEs, such as the United Nations Draft Code for Transnational Corporations,[13] the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (ILO Tripartite Declaration), [14] and the OECD Guidelines for Multinational

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[9] Archie B. Carroll, 'A History of Corporate Social Responsibility: Concepts and Practices' in Andrew Crane (ed) *The Oxford Handbook of Corporate Social Responsibility* (OUP 2008) 21. Rhys Jenkins, 'Globalization, corporate social responsibility and poverty' (2005) 81.3 International affairs 525, 526.

[10] For the early development of CSR notion in the UK and the US, see Jenkins (n 9) and Carroll (n 9) 21-24.

[11] Dolzer and Schreuer (n 7) 6-7. Vandevelde (n 8) 169-70.

[12] Ibid.

[13] From 1974 to 1990, the United Nations drafted a series of codes to regulate the behaviour of transnational corporations. The last draft in 1990 stressed the need for foreign investors to obey the law of the host state, to follow the host state's economic policies and to refrain from interfering in the host state's domestic political affairs. However, the draft codes were never adopted. Draft United Nations Code of Conduct for Transnational Corporations, UN Doc. E/1990/94 (1990). See also De Jonge (n 4) 29.

[14] In 1977, the International Labour Organization (ILO) adopted the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy. The ILO Tripartite Declaration, as a voluntary and non-binding instrument, provides standards for employment, training, conditions of work and life, and industrial relations. International Labour Organization, *Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy* (1977) 17 ILM 422 (1978). The ILO Tripartite Declaration was revised in 2000, 2002, 2006 and 2017.

Enterprises (OECD Guidelines).[15] Compared with investment treaties, these international instruments are of a voluntary nature and lack effective enforcement mechanisms.

A fierce confrontation between investment protection and the regulation of investors' social responsibilities took place during the negotiation for the Multilateral Agreement on Investment (MAI) in the 1990s. The draft MAI, negotiated under the auspices of the OECD, was crafted as an investment protection and promotion agreement based on earlier models of investment protection standards.[16] The NGO community had criticised the one-sided nature of the draft MAI due to its inclusion of only provisions on investor protection, without any regulation of the investor's social responsibilities.[17] Upon the extensive campaign by NGOs, some general provisions on labour and environmental standards were incorporated into the preamble of the draft MAI, and some *quid pro quo* clauses, including an additional labour and environment clause and a 'no lowering of standards' clause, were proposed during the drafting processes.[18] Although the negotiations of the MAI broke down in 1998 and the draft was never adopted, the success of including environment and labour issues into the draft has contributed to future reconciliation between investor protection and investor regulation under the international investment regime.[19]

Since the 1990s, the tension between investment protection and the enhancement of investors' social responsibilities has increased as a result of the proliferation of investment arbitration cases in which foreign investors have claimed their investment treaty rights against the host state's regulation in the fields of human rights and environmental protection.[20] The international investment regime has been criticised for

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15 In 1976, the Organization for Economic Co-operation and Development (OECD) adopted its Guidelines for Multinational Enterprises. The Guidelines covered a variety of enterprise activities, including general policies of operation, disclosure of information, competition, financing, taxation, employment, industrial relations, science and technology. However, like the ILO Tripartite Declaration, the Guidelines were 'voluntary and not legally enforceable'. OECD, 'OECD Guidelines for Multilateral Enterprises' (1976) 12-17 <www.oecd.org/corporate/mne/50024800.pdf> accessed 27 March 2017. The most recent version of the Guidelines was adopted in 2011 <http://dx.doi.org/10.1787/9789264115415-en> accessed 27 March 2017.

16 Peter T. Muchlinski, 'The Rise and Fall of the Multilateral Agreement on Investment: Where Now?' [2000] The International Lawyer 1033, 1038.

17 Peter Muchlinski, 'Corporate Social Responsibility' in Peter Muchlinski, Federico Ortino, and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008) 642, 642.

18 Muchlinski (n 16) 1048.

19 Muchlinski (n 17).

20 From 1995 to 2004, the number of claims registered in ICSID was four times that of the previous 30 years. By the end of 2016, there have been 696 publicly known investor-state arbitration claims, which involve 107 countries as respondents. Gus Van Harten

its 'chilling effect' on the host state's right to regulate foreign investments for public interests.[21] Meanwhile, the rapid development of international CSR standards has contributed to the reform of investment treaties.[22] In recent years, several countries and regions, including Brazil, Canada and the EU, have incorporated CSR standards and guidelines into their newly concluded investment agreements. The following sections will first analyse the tension between host states' obligations under investment treaties and their rights to regulate foreign investors' social responsibilities, and will then examine whether the recent practice of incorporating CSR provisions into investment treaties is effective to reconcile this tension.

3. THE RIGHT TO REGULATE CSR AND INTERNATIONAL INVESTMENT OBLIGATIONS

States have sovereign rights to protect society and the environment in its territories from harm by foreign investors.[23] Nonetheless, their regulation on the social and environmental responsibilities of foreign investors may conflict with their substantive obligations under investment treaties, including the non-discrimination principle, the fair and equitable treatment standard and the compensation requirement for expropriation of foreign investments.

3.1. NON-DISCRIMINATION

Discrimination is a negative formulation of the principle of equality of treatment in international law, which entails like persons in similar circumstances being treated differently without justifiable grounds.[24] The

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and Martin Loughlin, 'Investment treaty arbitration as a species of global administrative law' (2006) 17.1 EJIL 121, 124. UNCTAD, 'World Investment Report 2016, Investor Nationality: Policy Challenges' (2016) 104.

[21] Jorge E. Viñuales, *Foreign investment and the environment in international law* (Vol. 94, CUP 2012) 2; Nicolas Hachez and Jan Wouters, 'International Investment Dispute Settlement in the Twenty-first Century: Does the Preservation of the Public Interest Require an Alternative to the arbitral model?' in Freya Baetens (ed), *Investment Law Within International Law: Integrationist Perspectives* (CUP 2013) 417. Burke-White, William W. and Andreas Von Staden, 'Private Litigation in a Public Law Sphere: The Standard of Review in Investor-State Arbitrations' (2010) 35 YALE J INTL L. 283; Van Harten and Loughlin (n 20).

[22] Since 1990s, new soft international instruments have been made to balance business protection against their responsibilities to the social welfare of the host states. See, e.g., the 2000 UN Global Compact, the 2006 UN Principles for Responsible Investment, and the 2011 Guiding Principles on Business and Human Rights.

[23] Suzanne A. Spears, 'The Quest for Policy Space in A New Generation of International Investment Agreements' (2010) 13.4 Journal of International Economic Law 1037, 1038.

[24] *Plama Consortium Ltd v Republic of Bulgaria* [2008] ICSID Case No. ARB/03/24, Award [184]; AFM Maniruzzaman, 'Expropriation of Alien Property and the Principle of Non-Discrimination in International Law of Foreign Investment: An Overview' (1998) 8 J. Transnat'l L. & Pol'y 69, 69.

non-discrimination principle in IIL prohibits a host state from unreasonable differentiation between foreign investors and other similar investors. In investment treaties, non-discrimination is mainly reflected in two provisions: the national treatment (NT) provision and the most-favoured nation treatment (MFN) provision,[25] which employ very similar language, except that MFN prevents discriminatory treatment between foreign investors of different nationalities,[26] while NT prohibits discrimination between foreign investors and domestic investors.[27]

Investment tribunals conducting discrimination assessment need to first determine whether the investors being treated differently are 'in like circumstances'. Many investment tribunals held that two investors are comparable under the non-discrimination clause if they are in a competitive relationship, i.e., in the 'same business or economic sector'.[28] However, states' regulation on CSR issues usually uses a different basis of comparison. For example, it is not uncommon that states' regulation in social and environmental realms may distinguish between different groups of enterprises based on their size and activities. In 2014, the European Parliament and the Council adopted the Directive on disclosure of non-financial and diversity information relating to CSR issues by large companies and groups.[29] The directive only applies to large enterprises

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[25] Christopher Dugan, et al., *Investor-state Arbitration* (OUP 2011) 397. Federico Ortino, 'Non-Discriminatory Treatment in Investment Disputes' in PM Dupuy, F Francioni and EU Petersmann (eds), *Human Rights in International Investment Law and Arbitration* (OUP 2009) 346.

[26] The MFN clause provides that a foreign investor and its investment should not be treated less favourably compared with the investor or investment in like circumstances from any third country. For example, Article 1103 of the NAFTA provides: 'Each Party shall accord to investors of another Party treatment no less favourable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.' North American Free Trade Agreement 1994 [hereinafter NAFTA], art 1103(1).

[27] The NT clause requires that the host state accord a foreign investor and its investments no less favourable treatment than that accorded to its own investor and investments in like circumstances. For instance, Article 1102 of the NAFTA provides: 'Each Party shall accord to investors of another Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.' NAFTA, art 1102(1).

[28] *S.D. Myers, Inc. v Government of Canada* [2000] UNCITRAL, Partial Award [248], [250]; *Pope & Talbot, Inc. v Government of Canada* [2001] UNCITRAL, Award on the Merits of Phase 2 [78]; *Marvin Roy Feldman Karpa v United Mexican States* [2002] ICSID Case No. ARB(AF)/99/1, Award [171]; *Champion Trading Company, Ameritrade International, Inc. v Arab Republic of Egypt* [2006] ICSID Case No. ARB/02/9, Award [130].

[29] Directive 2014/95/EU of the European Parliament and the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups [2014] OJ L 330/1.

with more than 500 employees, leaving small and medium-sized enterprises (SMEs) untouched.[30] Another common basis of distinction is the activities conducted by enterprises. For instance, highly polluting industries, such as chemical, oil refining and steel industries may face a heavier burden of environmental protection than other less-polluting industries.

Since sizes and activities of enterprises are not a basis of comparison in the discrimination assessment under IIL, a foreign investor may claim that the host state's measure involving such distinction constitutes discrimination because of its different treatments of investors in the same business or economic sector. A large foreign enterprise, for example, may claim that the aforementioned EU Directive is discriminatory, since it has been treated differently from those SMEs in the same business sector. In *Parkerings v. Lithuania*, the host state's regulation for the protection of cultural heritage was claimed by the foreign investor as a violation of the non-discrimination clause, since the regulation had differentiated between investors based on their sizes. In this case, Lithuania rejected the foreign investor's construction project but permitted another similar project because of the former's proximity to a culturally and environmentally sensitive Old Town. The foreign investor argued that Lithuania had violated the non-discrimination clause by differentiating between two investors in like circumstances. Fortunately, this claim was correctly refused by the tribunal. The tribunal noted that although the two projects had shown obvious similarities, except for their different sizes,[31] the potential negative impact of the foreign investor's project in the old town was increased by its considerable size and by its proximity to the old town, and as a result, the foreign investor's project 'was not similar with' the other comparator.[32]

Other than the tribunals adopting the 'same business or economic sector' approach, a small number of tribunals held that investors in different business or economic sectors are also comparable.[33] This broad interpretation of likeness makes it possible for foreign investors to claim that the host state's social or environmental regulation, which makes a distinction between different business sectors, is discriminatory. In *Arcelor*, several steel producers claimed before the European Court of Justice (ECJ) that the European Emissions Trading Directive (established to fulfil the commitments under Kyoto Protocol) and the French implementing measures violated the equal treatment standard, because the emission trading system was applied to the steel sector, but not to the chemical and

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30 Ibid.

31 *Parkerings-Compagniet AS v. Republic of Lithuania* [2007] ICSID Case No. ARB/05/8, Award [381].

32 Ibid [392].

33 *Occidental Exploration and Production Company v. The Republic of Ecuador* [2004] LCIA Case No. UN3467, Final Award [173].

aluminium sectors, which also produce large emissions of greenhouse gases. The court examined whether the three sectors were in comparable situations. Noting that the purpose of the Directive was to reduce greenhouse gases emissions, the court held that 'the different sources of greenhouse gas emissions relating to economic activities are in principle in a comparable situation, since all emissions of greenhouse gases are liable to contribute to dangerous interference with the climate system and all sectors of the economy which emit such gases can contribute to the functioning of the allowance trading scheme'.[34] The court also based its conclusion on the text of the Directive, stating that 'policies and measures should be implemented across all sectors of the economy of the Union'.[35] With respect to the respondent's argument that these three sectors were not in a competitive relationship, the court objected that, as regards the comparability of the three sectors, 'the possible existence of competition between those sectors cannot constitute a decisive criterion'.[36] For this reason, the court found these sectors to be comparable under the equal treatment clause.[37]

A more balanced interpretation of 'in like circumstances' can be achieved by taking account of not only the business sector of the investments, but also other non-economic factors, such as the investment's social and environmental impacts in the likeness assessment. The Investment Agreement for the COMESA Common Investment Area has been a pioneer in this respect. Article 17(2) of this treaty provides that the references to 'like circumstances' in the National Treatment clause 'requires an overall examination on a case by case basis of all the circumstances of an investment including' 'its effects on third persons and the local community' and 'its effects on the local, regional or national environment, including the cumulative effects of all investments within a jurisdiction on the environment'.[38] This interpretation of 'like circumstances' will provide guidance for future tribunals assessing the national treatment clause to balance the foreign investor's right against the host state's right to protect public interests affected by the foreign investor's activities.

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[34] *Société Arcelor Atlantique et Lorraine and Others v Premier ministre and Others* [2008] Case C-127/07, Judgment [34].

[35] Ibid [35].

[36] Ibid [36].

[37] However, the ECJ finally held that the EU Emissions Trading Directive did not violate the equal treatment clause, because it was a novel and complex scheme whose implementation could have been disturbed by involving too many participants, and therefore, involving only steel sector as the first step was within the discretion of the Community legislature. Ibid [60]-[61].

[38] Investment Agreement for the COMESA Common Investment Area, art 17(2) <www.tralac.org/wp-content/blogs.dir/12/files/2011/uploads/Investment_agreement_for_the_CCIA.pdf > accessed 1 May 2017.

Another way to achieve such balance is by treating legitimate social or environmental protection objectives as justifiable grounds for discriminatory treatment of foreign investors. However, although almost all the tribunals have acknowledged that a host state's discriminatory treatment against foreign investors can be justified if such treatment is based on a rational public policy, there is no clear-cut answer among the tribunals with respect to what constitutes a 'rational' policy and how the challenged measure should be designed to achieve that policy.

In the cases so far decided by investment tribunals, rational public policies have been interpreted broadly, encompassing a wide range of governmental objectives, including economic development,[39] environmental protection[40] and cultural policies.[41] Therefore, it is doubtless that CSR goals should be seen as a 'rational' policy by investment tribunals. However, the existence of rational policy by itself does not justify a differentiation. Some tribunals have required a reasonable relationship between the rational public policy and the challenged governmental measure. For example, the *Pope & Talbot* Award required that the difference in treatment must be in a 'reasonable nexus' with a rational public policy.[42] The *Parkerings* tribunal adopted a similar approach, noting that 'a less favourable treatment is acceptable if a State's legitimate objective justifies such different treatment in relation to the specificity of the investment.'[43]

Other tribunals have examined whether the different treatment against the foreign investor was *necessary* to achieve the relative public goals.[44] A typical example was *S.D. Myers v. Canada*, which concerned a Canadian ban on the export of a hazardous chemical, polychlorinated biphenyl (PCB). The claimant, a US company exporting PCB from Canada to the US, alleged that it had been discriminated against compared with domestic investors, because the business of the US investor inevitably involved exporting PCB materials to the US, which was not the case for the domestic investors. This discrimination, argued by the claimant, was a violation of Article 1102 (national treatment) of the NAFTA. In this case, the tribunal upheld the respondent's legitimate objective of ensuring the economic strength of the domestic industry. But merely having a legitimate objective, in the view of the tribunal, could not of itself justify the differentiation.[45] Since there were two alternative measures that could have achieved the same objective without infringing the investor's right,

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[39] *Gami Investments, Inc. v. The Government of the United Mexican States* (2004), UNCITRAL, Final Award [114]. *S.D. Myers* (n 28) [255]; *Pope & Talbot* (n 28) [87].

[40] *Marion Unglaube v. Republic of Costa Rica* [2012] ICSID Case No. ARB/08/1, Award [264]; *Parkerings* (n 31) [392] and [396].

[41] *Parkerings* (n 31) [396].

[42] *Pope & Talbot* (n 28) [79].

[43] *Parkerings* (n 31) [371].

[44] *S.D. Myers* (n 28) [215]; *Arcelor* (n 34) [47].

[45] *S.D. Myers* (n 28) [255].

the tribunal concluded that the measure taken by the respondent was not justifiable.[46]

These different approaches adopted by tribunals in the 'justification' analysis make it uncertain whether the discriminatory treatments of foreign investors can be justified by a purpose of promoting CSR goals. It would be relatively easy to justify a discriminatory measure in pursuit of CSR if the tribunal adopts a 'rational nexus' approach. On the other hand, if the tribunal adopts a necessity test, the host state needs to prove that the discriminatory treatment was 'necessary' to achieve the CSR policies.

3.2. FAIR AND EQUITABLE TREATMENT

The Fair and Equitable Treatment (FET) standard has been a key component in a majority of bilateral and multilateral investment treaties, and has been the most frequently invoked standard in investment arbitration.[47] Although the FET clauses have diverse language, most of them require host states to accord foreign investors and their investments 'fair and equitable treatment', without a further illustration of what is 'fair' and 'equitable'.[48] For instance, Article 10 of the Energy Charter Treaty (ECT) provides that:

'Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. *Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment* …'[49]

One main function of the FET standard is to ensure the stability of the investment environment in the host state. Before making an investment, a prudent foreign investor will conduct a careful investigation of the host state's investment environment, including an examination of the host state's legal framework as well as any undertakings made by the host state, in order to have a general expectation of the potential success of an investment and, accordingly, to decide whether and how to make an investment. Stability of the host state's investment environment is a key issue here.[50] If, after the establishment of the foreign investment, the host

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[46] Ibid.

[47] Dolzer and Schreuer (n 7) 130.

[48] A small number of investment treaties refer the FET standard to the minimum standard of treatment (MST) in customary international law. See, e.g., the US Model BIT 2012, Article 5; the China-Korean FTA 2015, Article 12.5. However, a reference to MST does little help to anchor the meaning of FET, since the meaning of MST itself is unclear. W. Michael Reisman, 'Canute Confronts the Tide: States versus Tribunals and the Evolution of the Minimum Standard in Customary International Law' (2015) 30.3 ICSID Review 616.

[49] The Energy Charter Treaty 1994, Article 10 (emphasis added).

[50] Muthucumaraswamy Sornarajah, *The Settlement of Foreign Investment Disputes* (Kluwer Law International 2000) 25-60.

state changes its law (e.g. by enacting new legislation or revoking the investor's operating licenses) or breaches its assurances (e.g. by violating specific representations made by governmental officials to the foreign investor), it would frustrate the investor's initial expectations with respect to the planning of its investment. To ensure the predictability and stability of the host state's legal framework, the tribunals have interpreted the FET standard such that a host state's conduct that frustrates the foreign investor's legitimate expectations at the time of investments will lead to a violation of the FET standard in IIL.[51] As the tribunal in *Biwater Gauff v. Tanzania* stated:

'[T]he purpose of the fair and equitable treatment standard is to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment, as long as these expectations are reasonable and legitimate and have been relied upon by the investor to make the investment'.[52]

The FET standard is in tension with the host state's right to regulate social responsibilities of foreign investors, since this sovereign right is subject to an obligation of not infringing the foreign investor's legitimate and reasonable expectations at the time of investments. In investment arbitration, this tension has often been seen in cases involving the host state's regulation of the environmental responsibilities of foreign investors due to the rapidly evolving environmental law as a result of the growing scale of pollution and ecological degradation, increasing environmental consciousness and scientific development. [53]

First, the host state may frustrate the foreign investor's expectations by enacting new legislation on investors' environmental obligations. *Glamis Gold v. US* is an illustrative example. Glamis was a Canadian company that mined gold on federal land in southeastern California. Its open pit mining project was located in a culturally sensitive area where there existed designated Native American sites. To protect cultural sites, the U.S. federal government denied the project based on the 'undue impairment' standard that was newly enacted in a solicitor's M-Opinion. This was, however, claimed by the foreign investor as a frustration of its legitimate expectations, which were based on the preexisting mining law that adopts a less strict 'unnecessary or undue degradation' standard. The investor's argument was supported by the tribunal, which held that the shift in standards 'represented a significant change from settled practice

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[51] *CMS v Argentina* [2005] 14 ICSID Reports 158, Award [274]; *LG&E v Argentina* [2007] 21 ICSID Review-FILJ 203, Decision on Liability [125]; *Unglaube* (n 40) [248]. *Duke Energy v Ecuador* [2008] ICSID Case No. ARB/04/19, Award [337]-[340].

[52] *Biwater v Tanzania* [2008] ICSID Case No. ARB/05/22, Award [602].

[53] Daniel Bodansky, Jutta Brunnee and Ellen Hey, *The Oxford Handbook of International Environmental Law* (OUP 2007) 30. Daniel Bodansky, *The Art and Craft of International Environmental Law* (Harvard University Press 2010) 19.

and, arguably, surprised Claimant.'[54] Despite this, the tribunal finally held that the adoption of the novel standard by the US government did not violate the FET clause, since the M-Opinion did not occasion 'a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons.'[55]

Second, the host state might frustrate the foreign investor's expectations by enacting 'novel' environmental regulation. The term 'novel' means that the environmental regulation is in contrast with the assurances made by the host state upon which the foreign investor has based its expectations. Such assurances may come from the existing law of the host state. For example, in *Bilcon v. Canada*, the tribunal held that Canada's usage of a novel concept of 'community core values' in the environmental impact assessment had frustrated the foreign investor's legitimate expectations and constituted a violation of the FET clause.[56] In this case, the U.S. investors constructed and operated a mining quarry and marine terminal project located in Nova Scotia, Canada. This project, however, was denied by a Canadian review panel in the environmental assessment, because of the project's potential harm to the 'community core values', which, the panel held, could not be remedied by any mitigation measure. The investors claimed that the term 'community core values' was a novel concept that had not been mentioned in any existing environmental legislation. The tribunal, upholding that investor's position, held that the novel usage of the concept of 'community core values' frustrated the investors' reliance on the Canadian government's previous encouragement of the investment.[57] The tribunal concluded that this 'distinct, unprecedented and unexpected' approach taken by the Canadian review panel in the environmental assessment had violated the FET standard.[58]

The environmental regulation by the host state may also frustrate the foreign investor's expectations if it contradicts the assurances that have previously been made by the host state's officials to the foreign investors. In *Metalclad v. Mexico*, the US investor Metalclad invested in a hazardous waste landfill in Mexico. After having received both federal and state permits to construct and operate the landfill, and having been assured by federal officials that it had all authority necessary to undertake the project, Metalclad started its construction, which, however, was later halted by the municipal government for environmental reasons. In this case, the tribunal protected the foreign investor's expectations based on the representations made by the host state's federal officials, holding that a denial of a construction permit by the Mexican municipal government had

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[54] *Glamis Gold, Ltd. v US* [2009] UNCITRAL, Award [759].
[55] Ibid [762].
[56] *Bilcon v Canada* [2015] UNCITRAL PCA Case No. 2009-04, Award [589]-[591].
[57] Ibid [589].
[58] Ibid [601].

violated the FET standard since the federal officials had promised the foreign investor that the investor had received all the permits needed to start construction.[59]

The aforementioned cases have shown the circumstances in which the host state's efforts to promote environmental responsibilities of foreign investors, either through legislation or administration, may constitute a violation of the FET standard in IIL. In all these cases, a key goal is striking a balance between the stability requirement under the FET standard and the dynamic environmental regulation by the host state. On the one hand, the host state should ensure a certain degree of stability of its legal framework to protect foreign investments in its territories; on the other hand, the stability requirement must not be interpreted as an absolute standard, and the host state should enjoy sovereign right to adjust domestic environmental regulation to evolving social needs.[60] An appropriate balancing point seems to be that, under the FET standard, the host state can change its environmental regulation as long as this change is made in due process and does not result in a discriminatory effect on foreign investments.

3.3. INDIRECT EXPROPRIATION

Expropriation, as the most severe form of infringement on property rights, has been a central concern in IIL.[61] Modern investment treaties do not prohibit the host state from expropriating foreign investments in its territory, but require that the expropriation must be conducted in a legal method, that is (1) for a public purpose, (2) not arbitrary or discriminatory, (3) in due process, and (4) accompanied by prompt, adequate and effective compensation. Expropriation can be categorised into direct and indirect expropriation. Direct expropriation occurs when the governmental measure leads to transfer of ownership of property from investors to states or third parties.[62] Today, direct expropriation has been very rare, since a drastic and open taking of foreign property will jeopardise host

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[59] *Metalclad v Mexico* [2000] 5 ICSID Reports 212, Award [88]-[89].

[60] The tribunal in *Saluka v. Czech Republlic* held in this respect: 'No investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor's expectations was justified and reasonable, the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well. (…) The determination of a breach of [the FET clause] by the Czech Republic therefore requires a weighing of the Claimant's legitimate and reasonable expectations on the one hand and the Respondent's legitimate regulatory interests on the other.' *Saluka v Czech Republic* [2006] 15 ICSID Reports 274, Partial Award [305]-[306].

[61] Dolzer and Schreuer (n 7) 98.

[62] Catherine Yannaca-Small, '"Indirect Expropriation" and the "Right to Regulate" in International Investment Law' 3 (OECD Working Paper, No. 2004/4, 2004) <www.oecd.org/investment/internationalinvestmentagreements/33776546.pdf> accessed 27 March 2017.

states' reputation in attracting foreign investments.[63] Alternatively, states tend to conduct indirect expropriation, which can be defined as any governmental measure that substantially impairs the value of the investment without affecting the ownership.[64] For instance, in *Goetz v. Burundi*, the tribunal held that Burundi's revocation of a free-zone status granted to the foreign investor had forced the investor 'to halt all activities' and had constituted a 'measure having similar effect' to expropriation.[65] In *CME v. Czech Republic*, the tribunal held that the host state's interference with the contract rights of the foreign investor's subsidiary, which had destroyed the commercial value of the investments, had amounted to an indirect expropriation.[66]

Although the concept of indirect expropriation has been incorporated into many multilateral and bilateral investment agreements,[67] it is difficult to differentiate between indirect expropriations, in which the host states have to pay compensation to aggrieved investors, and the legitimate right of host states to regulate their internal affairs.[68] In this context, an important question is: if the host state's enforcement of the social responsibilities of the foreign investor has substantially deprived the foreign investor from utilising its investments, does the host state's regulation constitute an indirect expropriation so that an adequate compensation should be paid, or is it within the host state's right to regulate so that no compensation is needed? Investment jurisprudence on this question has been inconsistent.

Some tribunals have adopted the 'sole effects doctrine', which means, to determine whether a governmental measure constitutes an indirect expropriation, one should examine only the effects of the measure on the property allegedly expropriated, with no consideration of the

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63 Dolzer and Schreuer (n 7) 101.

64 W. Michael Reisman and Robert D. Sloane, 'Indirect Exproprion and Its Valuation in the BIT Generation' (2004) 74.1 British Yearbook of International Law, 115; Yannaca-Small (n 62) 3-4; Anne K. Hoffman, 'Indirect Expropriation' in August Reinisch (ed) *Standards of Investment Protection* (OUP 2008) 151.

65 *Goetz v Burundi* [1999] 6 ICSID Reports 5, Award [124].

66 *CME v. Czech Republic* [2001] 9 ICSID Reports 121, Partial Award [591].

67 For instance, Article 1110 of the NAFTA stipulates that '[n]o party may directly or *indirectly nationalize or expropriate* an investment … or *take a measure tantamount to nationalization or expropriation*' (emphasis added); Article 13 of the ECT reads '[i]nvestments of investors … shall not be nationalised, expropriated or *subjected to a measure or measures having effect equivalent to nationalisation or expropriation*' (emphasis added); Article 6 of the 2012 United States Model BIT also provides that '[n]either Party may expropriate or nationalize a covered investment either directly or *indirectly through measures equivalent to expropriation or nationalization*.' (emphasis added)

68 Markus Perkams, 'The Concept of Indirect Expropriation in Comparative Public Law-Searching for Light in the Dark', in Stephan W. Schill (ed) *International Investment Law and Comparative Public Law* (OUP 2010) 107-8; *Generation Ukraine, Inc. v Ukraine* Award [2003] ICSID Case No.ARB/00/9 Award [20.29]; *Saluka* (n 60) [263].

objective underlying the measure.[69] Under this approach, even if a measure is adopted for enforcing social responsibilities of corporations, it will result in compensation by the host state in circumstances that the measure has substantially deprived the investors from utilising their investments. As stated by the Iran-United States Claims Tribunal in the *Phelps Dodge* case, 'the Tribunal understands the financial, economic and social concerns that inspired the law pursuant to which [Iran] acted, but those reasons and concerns cannot relieve the Respondent of the obligation to compensate Phelps Dodge for its loss.'[70] In *SPP v. Egypt*, the Egyptian government withdrew an approval of a foreign tourist project to protect nearby cultural heritage. The tribunal found that the withdrawal of approval had amounted to indirect expropriation, and Egypt should pay fair compensation to the foreign investor even though 'antiquities are involved'.[71] In *Metalclad v. Mexico*, the tribunal held that an Ecological Decree issued by Mexico to prohibit the operation of a foreign hazardous waste facility had constituted indirect expropriation, and that the tribunal 'need not decide or consider the motivation or intent of the adoption of the Ecological Decree.'[72]

Contrary to the sole effects doctrine, the 'police powers doctrine' provides that regulatory conducts within the police powers of the state do not constitute indirect expropriation as long as they are in good faith and non-discriminatory. In *S.D. Myers v. Canada*, the tribunal rejected the investor's claim that the Canadian ban on the export of PCB, a hazardous material, constituted indirect expropriation. The tribunal held that '[r]egulatory conduct by public authorities is unlikely to be the subject of legitimate complaint under Article 1110 of NAFTA, although the tribunal does not rule out that possibility.'[73] The tribunal also stated that both the purpose and the effect of the export ban had to be considered to determine indirect expropriation.[74]

The *Methanex v. US* case concerned a ban on the use or sale of the gasoline additive MTBE in California, US. The foreign investor argued that the ban had expropriated parts of its investments. The tribunal rejected this claim, holding that a governmental regulation does not constitute indirect expropriation if it is: 1) for public purpose, 2) non-discriminatory, 3) enacted in due process and, 4) without specific contrary commitments given by the government to the investors.[75]

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[69] Valentina Vadi, *Public health in international investment law and arbitration* (Routledge, 2012) 137.

[70] *Phelps Dodge*, 10 Iran-US CTR 130 [22].

[71] *SPP v Egypt* [1992] 3 ICSID Reports 189 Award [159].

[72] *Metalclad* (n 59) [109]-[111].

[73] *S.D. Myers* (n 28) [281].

[74] Ibid.

[75] *Methanex v US* [2005] 44 ILM 1345, Award [7].

The same approach was adopted in the subsequent *Chemtura v. Canada* case.[76] In this case, the Canadian government cancelled the registrations of the US investor's products that involved the use of lindane, a hazardous insecticide. The US investor claimed that the Canadian government's act was tantamount to expropriation under Article 1110 of NAFTA. However, the tribunal held that the Canadian government 'took measures within its mandate, in a non-discriminatory manner, motivated by the increasing awareness of the dangers presented by lindane for human health and the environment. A measure adopted under such circumstances is a valid exercise of the State's police powers and, as a result, does not constitute an expropriation.'[77]

The third category of tribunals, citing the jurisprudence of the European Court of Human Rights, have tended to adopt a proportionality test to strike a balance between investment interests and the host state's right to regulate public interests. In *LG&G v. Argentina*, the tribunal held that '[w]ith respect to the power of the State to adopt its policies, it can generally be said that the State has the right to adopt measures having a social or general welfare purpose. In such a case, the measure must be accepted without any imposition of liability, except in cases where the State's action is obviously disproportionate to the need being addressed.'[78]

This proportionality test has been adopted by the *Azurix v. Argentina* tribunal concerning Argentina's water regulation. In this case, the US investor Azurix was granted an exclusive right to operate the water and sewage systems in the Argentinian Province of Buenos Aires based on a 30-year concession. However, several months after the commencement of the operation, there was an incident of algae outbreak that resulted in the contamination of local water. Blaming Azurix for this incident, the Argentinian government encouraged consumers to refuse to pay their water bills and eventually terminated the concession. Azurix argued that Argentina's conduct was tantamount to expropriation under the Argentina-US BIT, while Argentina insisted that its regulatory actions were for public purpose and did not amount to expropriation. The tribunal examining the claim correctly recognised the necessity to distinguish non-compensable regulatory actions from compensable indirect expropriation. The tribunal noted: 'In the exercise of their public policy function, governments take all sorts of measures that may affect the economic value of investments without such measures giving rise to a need to compensate.'[79] This approach is in contrast to the 'sole effects doctrine' which refuses to take account of the intent of the host state in the assessment of indirect expropriation. On the other hand, the *Azurix* tribunal also disagreed with the police powers doctrine that generally

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[76] *Chemtura v Canada* [2010] UNCITRAL, Award [138].
[77] Ibid [266].
[78] *LG&E* (n 51) [195].
[79] *Azurix v. Argentina* [2006] 14 ICSID Reports 374, Award [310].

excludes all *bona fide* regulation from an obligation to compensate. Adopting a third method, the tribunal sought guidance in the jurisprudence of the European Court of Human Rights, especially by reference to the *James and others v. UK* case, holding that 'a measure depriving a person of his property [must] pursue, on the facts as well as in principle, a legitimate aim "in the public interest"', and must also bear 'a reasonable relationship of proportionality between the means employed and the aim sought to be realized'.[80]

Among the three doctrines, the sole effects doctrine is often criticised for its restriction on state's right to regulate.[81] This doctrine ignores social and environmental goals underlying the measure, obscures the boundary between indirect expropriation and legitimate regulations, and has 'chilling effects' on the host state's efforts to regulate public interests. Compared with the sole effects doctrine, the police powers doctrine saves the regulatory space of host states, ensuring that a legitimate measure for public objectives does not lead to compensable indirect expropriation. The proportionality doctrine also takes due regard for the state's right to regulate, and strikes a balance between the investors' interests and the host state's interests by requiring the act of the host state to be proportional to achieve public policies.

4. THE OBLIGATIONS TO REGULATE CSR? INCORPORATING CSR STANDARDS INTO INVESTMENT TREATIES

4.1. BALANCING INVESTOR RIGHTS AND SOCIAL INTERESTS IN INVESTMENT TREATIES

Although most investment treaties do not explicitly recognise the right or duty of host states to regulate for policy objectives other than investment protection and promotion,[82] recently a growing number of investment treaties have included social and environmental protection provisions to balance the foreign investor's rights against the public interests of the host state. Some investment treaties pursue this balance by indicating non-economic objectives such as public health, environmental protection and labour rights in the preamble of the treaty.[83] These social

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[80] Ibid [311].

[81] *See, e.g.,* Rahim Moloo and Justin Jacinto, 'Environmental and Health Regulation: Assessing Liability under Investment Treaties' (2011) 29 Berkeley J. Int'l L. 1, 63; J. Martin Wagner, 'International investment, expropriation and environmental protection' (1999) 29.3 Golden Gate UL Rev. 465, 517-525; Suzy H. Nikièma, 'Best Practices: Indirect Expropriation' (International Institute for Sustainable Development, 2012) <www.iisd.org/pdf/2012/best_practice_indirect_expropriation.pdf> accessed 27 March 2017.

[82] Spears (n 23) 1045.

[83] One example is the 2012 US Model BIT, the preamble of which states the Parties' desire to achieve the economic and investment objectives 'in a manner consistent with the protection of health, safety, and the environment, and the promotion of

and environmental objectives in preambles serve as guidance for the interpretation of treaty provisions by investment tribunals,[84] though they could not provide a practical method for balancing the competing interests of foreign investors and the public.

Some treaties have gone a step further by adopting the 'no lowering of standards' provision, which, responding to the 'polluter haven' hypothesis, prevents states from lowering its environmental or labour standards as an inducement to foreign investments.[85] For example, Article 1114(2) of the NAFTA stipulates that it is 'inappropriate to encourage investment by relaxing domestic health, safety or environmental measures'.[86] However, this 'no lowering of standards' provision is in non-binding 'best efforts' language and is not linked up to the dispute settlement mechanism.[87]

As a third approach, some investment treaties incorporate exception clauses that exclude the host state's acts in pursuit of certain public objectives from violating substantive investment obligations. One type of such exception clause is modelled on Article XX of the General Agreement on Tariffs and Trade (GATT) and Article XIV of the General Agreement on Trade in Services (GATS). However, different from the WTO law, there has been no coherent style of general exceptions clause in investment treaties.[88] The threshold for justifying non-conforming state measures under legitimate public objectives varies among different treaties: some treaties require the host state's non-conforming measures to be 'necessary'[89] or 'proportional'[90] to achieve public objectives, while others have a less strict requirement that the measure should be 'appropriate'[91] for the relevant objectives.

Another kind of exceptions clause applies in particular to the IIL's prohibition on performance requirements. For example, the NAFTA prohibits the host state from imposing performance requirements on

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internationally recognized labor rights'. The 2012 US Model BIT, preamble <www.state.gov/documents/organization/188371.pdf> accessed 1 May 2017.

84 Vienna Convention on the Law of Treaties [1969] 1155 U.N.T.S. 331, 8 I.L.M. 679, art 31(1).

85 Muchlinski (n 17) 671. Mary E. Footer, 'Bits and Pieces: Social and Environmental Protection in the Regulation of Foreign Investment' (2009) 18 Mich. St. U. Coll. LJ Int'l L. 33, 43.

86 NAFTA, article 1114(2).

87 Muchlinski (n 17) 671-2. Footer (n 85) 43.

88 For a detailed analysis of different types of general exceptions clauses in investment treaties, see Spears (n 23) 1060-2.

89 The 2004 Canadian Foreign Investment Protection Agreement (FIPA), art 10 <www.italaw.com/documents/Canadian2004-FIPA-model-en.pdf> accessed 1 May 2017.

90 The 2007 Colombian Model BIT, art VIII <www.italaw.com/documents /inv_model_bit_colombia.pdf> accessed 1 May 2017.

91 Investment Agreement for the COMESA Common Investment Area (n 38) art 22(2).

foreign investors, except that the measures are 'necessary to protect human, animal or plant life or health' or 'necessary for the conservation of living or non-living exhaustible natural resources', provided that they are not applied arbitrarily or unjustifiably, and that they 'do not constitute a disguised restriction on international trade or investment'.[92]

The above-mentioned approaches for reconciling investor and social interests have one thing in common: they balance competing interests by protecting the right of states to regulate (through the exceptions clause) social or environmental issues or by imposing obligations on states to regulate (through 'no lowering of standards' provision) such issues, but they do not impose direct obligations on foreign investors themselves to respect social responsibilities.[93] Unlike these approaches, recent years have seen a new approach of incorporating CSR standards into investment treaties.

4.2. Incorporating CSR Standards into Investment Treaties

An early attempt to adopt CSR norms in investment treaties can be seen in the 2007 draft Norwegian Model BIT, which includes an article stating that '[p]arties agree to encourage investors to conduct their investment activities in compliance with the OECD Guidelines on Multinational Enterprises and to participate in the United Nations Global Compact'.[94] This provision does not impose direct CSR obligations on foreign investors, but uses weak language to indicate the Parties' agreement to 'encourage' investors to abide by CSR standards. Recently, a notable phenomenon of including CSR provisions into investment agreements has been seen in Canadian, Brazilian and EU treaty-making practice.

4.2.1. Canada

Canada has incorporated CSR norms into its investment treaties in the last few years. The 2013 Benin-Canada BIT, for example, provides that the 'Guiding Principles' of the obligations of the Contracting Parties include 'national treatment, most-favoured-nation treatment, minimum standard of treatment, compensation for losses, compensation for

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92 NAFTA, Article 1106(6).

93 UNEP, 'Corporate Social Responsibility and Regional Trade and Investment Agreements' (2011) 24 < http://unep.ch/etb/publications/CSR%20publication/UNEP_Corporate%20Social%20Responsibility.pdf> accessed 1 May 2017.

94 The 2007 Norwegian Draft Model BIT, art 32 < http://investmentpolicyhub.unctad.org/Download/TreatyFile/2873> accessed 1 May 2017. However, due to the critical public comments on the draft from both business groups and NGOs, the Norwegian government withdrew the drat BIT in 2009. See Damon Vis-Dunbar, 'Norway shelves its draft model bilateral investment treaty' (*Investment Treaty News*, 8 June 2009) <www.iisd.org/itn/2009/06/08/norway-shelves-its-proposed-model-bilateral-investment-treaty/> accessed 1 May 2017.

expropriation, transparency, subrogation *and corporate social responsibility*'.[95] (emphasis added) Article 16 of this BIT, entitled 'Corporate Social Responsibility', obliges the Parties to encourage enterprises in its territory to commit to internationally recognised CSR standards. It provides:

'Each Contracting Party should encourage enterprises operating within its territory or subject to its jurisdiction to voluntarily incorporate internationally recognized standards of corporate social responsibility in their practices and internal policies, such as statements of principle that have been endorsed or are supported by the Contracting Parties. These principles address issues such as labour, the environment, human rights, community relations and anti-corruption.'[96]

This CSR provision marks a start of incorporating soft ICSR terms into hard international investment treaties, despite the fact that the provision has a soft character by using the terms 'encourage' and 'voluntarily', and that the CSR provision cannot form a basis for a claim raised by the foreign investor against the host state in investment arbitration.[97] Moreover, the provision does not refer to particular intentional instruments on 'internationally recognized standards of corporate social responsibility'.

Most subsequent Canadian investment treaties that adopt CSR provisions have employed an almost identical wording as that adopted in Article 16 of the 2013 Benin-Canada BIT.[98] However, the CSR provision of the 2013 Canada-Honduras FTA seems to provide a lower CSR requirement than that in other Canadian investment treaties. Different from other treaties that require states to encourage enterprises to commit to CSR in their 'practices and internal policies', the 2013 Canada-Honduras FTA only requires states to encourage CSR in the enterprises' 'internal policies'.[99] On the other hand, the 2014 Canada-Mali BIT and the 2015 Burkina Faso-Canada BIT provide a relatively stricter CSR obligation than that of other treaties. Instead of requiring Parties to encourage enterprises to 'voluntarily incorporate' internationally recognised CSR standards, both BITs delete the word 'voluntarily' and oblige Parties to encourage enterprises to 'incorporate' those standards.[100]

A unique wording has also been adopted by Article 16 of the 2014 Canada-Senegal BIT, which not only obliges states to encourage CSR commitments by the enterprises, but also directly encourage such

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[95] The 2013 Benin-Canada BIT, art 4.

[96] Ibid, art 16.

[97] Ibid, art 23.

[98] The 2014 Cameroon-Canada BIT, art 15; The 2014 Canada-Nigeria BIT, art 16; The 2014 Canada-Serbia BIT, art 16; The 2014 Canada-Republic of Korea FTA, art 8.16; The 2014 Canada-Côte d'Ivoire BIT, art 15.

[99] The 2013 Canada-Honduras FTA, Chapter 10, art 10.16.

[100] The 2014 Canada-Mali BIT, art 15(3); The 2015 Burkina Faso-Canada BIT, art 16.

enterprises 'to make investments whose impacts contribute to the resolution of social problems and preserve the environment.'[101]

Although almost all CSR provisions in Canadian investment treaties prohibit the foreign investor from bringing investment arbitration claims based on a violation of the CSR provision by the host state,[102] one exception is the 2015 Burkina Faso-Canada BIT, which does not prohibit an arbitration claim formed on the basis of the CSR provision.[103] As a result, the foreign investor who has incurred damages by reason of a violation of the CSR provision by the host state can claim for compensation in the investor-state arbitration process under Article 21 of the Burkina Faso-Canada BIT. 4.2.2 Brazil

In 2015, Brazil concluded a series of Agreements on Cooperation and Facilitation of Investments (ACFIs) in the context of strong political opposition to traditional BITs.[104] Different from BITs aimed at investment protection, the ACFIs focus on the objectives of investment facilitation and risk mitigation. In terms of substantive obligations, the Brazilian ACFIs provide only limited standards of treatment for foreign investments (including NT and MFN clauses, but excluding FET and indirect expropriation clauses). Moreover, the ACFIs replace investor-state arbitration with two institutions—a Joint Committee and Focal Points – to implement the agreement and to settle potential disputes mainly through consultation, negotiation and mediation. This novel mechanism aims to deter foreign investors from judicially challenging host states' measures.[105]

The Brazilian ACFIs are also novel for its inclusion of CSR provisions. Different from Canadian BITs, most Brazilian ACFIs impose CSR obligations directly on investors rather than on State Parties. For instance, in the 2015 Brazil-Angola ACFI, the 2015 Brazil-Mozambique ACFI, the 2015 Brazil-Malawi ACFI and the 2015 Brazil-Mexico ACFI, the CSR provisions require 'investors and their investments' to strive to

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101 The 2014 Canada-Senegal BIT, art 16.

102 The 2014 Cameroon-Canada BIT, art 20; The 2014 Canada-Nigeria BIT, art 21; The 2014 Canada-Serbia BIT, art 21; The 2014 Canada-Republic of Korea FTA, art 8.18 and 8.19; The 2014 Canada-Mali BIT, art 20; The 2014 Canada-Côte d'Ivoire BIT, art 20. The 2013 Canada-Honduras FTA, art 10.19; The 2014 Canada-Senegal BIT, art 21.

103 The 2015 Burkina Faso-Canada BIT, art 21.

104 Fabio Morosini and Michelle Ratton Sanchez Badinmorosini, 'The Brazilian Agreement on Cooperation and Facilitation of Investments (ACFI): A New Formula for International Investment Agreements?' (*Investment Treaty News*, 4 August 2015) <www.iisd.org/itn/2015/08/04/the-brazilian-agreement-on-cooperation-and-facilitation-of-investments-acfi-a-new-formula-for-international-investment-agreements/> accessed 1 May 2017. Nitish Monebhurrun, 'Novelty in International Investment Law: The Brazilian Agreement on Cooperation and Facilitation of Investments as a Different International Investment Agreement Model' (2017) 8 Journal of International Dispute Settlement 79, 82.

105 Morosini and Badinmorosini (n 104).

achieve the highest possible level of contribution to the sustainable development of the host state and the local community.[106] However, a different approach can be seen in the 2015 Brazil-Chile ACFI, in which Article 15 imposes CSR obligations on both states and investors: on the one hand, State Parties recognise the importance of encouraging investors within its jurisdiction to apply social responsibility;[107] on the other hand, investors should do their best to comply with social responsibilities.[108] Another different approach has been adopted by the 2015 Brazil-Columbia ACFI, which merely obliges State Parties to ensure that undertakings within their territories incorporate the voluntary social responsibilities into their business conducts, without a direct obligation imposed on investors or investments.[109]

The CSR provisions in the Brazilian ACFIs are also innovative for the reason that they provide detailed implementation guidelines, covering a wide variety of CSR principles, including protecting environment, respecting human rights, cooperation with local community, creating employment opportunities, facilitating the training of workers, observing the legislation on environment, health, safety and labour issues, and refraining from discrimination against workers.[110] Investors are also recommended to bear the supply chain responsibility by encouraging their business partners to observe these principles. Despite this wide coverage, these ACFIs do not provide any CSR standard on corruption. Instead, they either require investors to respect local political processes and activities,[111] or require investors to refrain from undue interference in local political activities.[112] This might contribute to a cover-up of corruption issues.[113]

Although the Brazilian ACFIs have stipulated a wide arrange of CSR standards, they have also emphasised the voluntary and non-binding nature of these standards. All of these ACFIs stress that the CSR principles

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106 The 2015 Brazil-Angola ACFI, art 10; The 2015 Brazil-Mozambique ACFI, art 10; the 2015 Brazil-Malawi ACFI, art 9; the 2015 Brazil-Mexico ACFI, art 13.

107 The 2015 Brazil-Chile ACFI, art 15(1).

108 Ibid, art 15(2).

109 The 2015 Brazil-Columbia ACFI, art 13.

110 The 2015 Brazil-Angola ACFI, Annex II; The 2015 Brazil-Mozambique ACFI, Annex II; the 2015 Brazil-Malawi ACFI, art 9(2); the 2015 Brazil-Mexico ACFI, art 13(2); the 2015 Brazil-Columbia ACFI, art 13.

111 The 2015 Brazil-Angola ACFI, Annex II; The 2015 Brazil-Mozambique ACFI, Annex II; the 2015 Brazil-Malawi ACFI, art 9(2); the 2015 Brazil-Mexico ACFI, art 13(2).

112 The 2015 Brazil-Columbia ACFI, art 13.

113 Monebhurrun (n 104) 98. However, it is also noteworthy that some Brazilian ACFIs have particular anti-corruption clauses, indicating the Parties' obligations to prevent corruption and their rights to refuse protection of investments related to corruption. See the 2015 Brazil-Chile ACFI, art 14 and the 2015 Brazil-Colombia ACFI, art 14.

are 'voluntary' standards.[114] Moreover, they all use soft terms, such as 'highest possible level',[115] 'seek to ensure'[116] or 'do their best'[117], to define the State Parties' or the investors' obligations to pursue such voluntary standards.

The soft nature of CSR principles has also been reflected in the enforcement mechanism of these CSR provisions. With respect to some ACFIs, although the treaties allow state-state arbitration as a dispute settlement mechanism, they exclude claims based on the CSR provision from arbitration processes. For example, according to Article 23 of the Brazil-Columbia ACFI, a claim based on the CSR clause may not be submitted to arbitration.[118] In other ACFIs, states may not even be possible to be subject to a CSR claim in the state-state arbitration, since the CSR obligations are imposed on investors rather than on states.[119] Nonetheless, CSR provision may be implemented in a relatively soft way through the administration of Joint Committee and National Focal Points.

4.2.2. THE EU

In 2011, the European Parliament published a resolution on the future European investment policy, in which it calls for a corporate social responsibility clause 'to be included in every FTA the EU signs'.[120] Following this policy, in recent years, the EU has included CSR provisions in its newly concluded Association Agreements and Free-Trade Agreements (FTAs). Compared with bilateral and multilateral investment treaties, these Association Agreements cover a much wider variety of topics, including political, economic and social cooperation between the Parties, which naturally makes Association Agreements a better platform for reconciling investment protection and social interests than other investment agreements. In these Association Agreements, CSR provisions are usually placed in the chapter on promoting trade/investment

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[114] Almost all Brazilian ACFIs have expressly stated that the CSR principles are 'voluntary'. See the 2015 Brazil-Angola ACFI, art 10; The 2015 Brazil-Mozambique ACFI, art 10; the 2015 Brazil-Malawi ACFI, art 9; the 2015 Brazil-Mexico ACFI, art13; the 2015 Brazil-Columbia ACFI, art 13.The only exception might be the 2015 Brazil-Chile ACFI, but in this treaty, the voluntary character of the CSR norms could be inferred from the Article's reference to the OECD Guidelines. See the 2015 Brazil-Chile ACFI, art 15(2).

[115] The 2015 Brazil-Angola ACFI, art 10; The 2015 Brazil-Mozambique ACFI, art 10; the 2015 Brazil-Malawi ACFI, art 9; the 2015 Brazil-Mexico ACFI, art 13.

[116] The 2015 Brazil-Columbia ACFI, art 13.

[117] The 2015 Brazil-Chile ACFI, art 15(2).

[118] The 2015 Brazil-Columbia ACFI, art 23.

[119] The 2015 Brazil-Angola ACFI, art 10; The 2015 Brazil-Mozambique ACFI, art 10; the 2015 Brazil-Malawi ACFI, art 9; the 2015 Brazil-Mexico ACFI, art 13.

[120] European Parliament Resolution of 6 April 2011 on the Future European International Investment Policy (2010/2203(INI)) [2011] 2012/C 296 E/05.

favouring sustainable development and in the chapter on 'cooperation on employment, social policy and equal opportunities'.

The CSR provisions in the EU Association Agreements and FTAs impose the obligations to promote CSR at State Parties rather than directly at investors, and they all use non-binding language to describe the state's obligation to promote CSR. For example, the 2012 Colombia-EU-Peru FTA has a particular Title (Title IX) on Trade and Sustainable Development, under which Article 271 provides that the Parties should strive to facilitate and promote trade and FDI in environmental goods and services, and that '[t]he Parties agree to promote best business practices related to corporate social responsibility'.[121] Similarly, Article 293 of the 2012 EU-Ukraine Association Agreement provides that the Parties shall strive to facilitate and promote trade and FDI in environmentally friendly goods, services, technologies and energies, and shall strive to facilitate trade in products that contribute to sustainable development, including products 'respecting corporate social responsibility and accountability principles'.[122] In the 2016 EU-Kazakhstan Enhanced Partnership and Cooperation Agreement, Article 154 (entitled 'Trade and investment promoting sustainable development') provides that the Parties agree to promote 'trade and investment in environmental goods and services and in climate-friendly products and technologies' and to promote 'corporate social responsibility practices'.[123]

Unlike the above-mentioned agreements that generally mention 'corporate social responsibility', other EU Association Agreements refer to specific International Corporate Social Responsibility (ICSR) standards. The 2014 EU-Georgia Association Agreement, under the Title of 'Trade and investment promoting sustainable development', provides that the Parties agree to promote CSR, by reference to 'relevant internationally recognised principles and guidelines, especially the OECD Guidelines for Multinational Enterprises.'[124] The 2014 EU-Moldova Association Agreement and the 2012 EU-Ukraine Association Agreement refer to several ICSR guidelines, including the OECD Guidelines, the UN Global Compact, and the ILO Tripartite Declaration.[125]

These treaties have employed different enforcement mechanisms of CSR provisions. In some treaties, the CSR provision is implemented in a soft and non-binding way. Under the 2012 Colombia-EU-Peru FTA and the 2012 EU-Ukraine Association Agreement, for instance, the CSR

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121 The 2012 Colombia-EU-Peru FTA, art 271(2) and (3).

122 The 2012 EU-Ukraine Association Agreement, art 293(2) and (3).

123 The 2016 EU-Kazakhstan Enhanced Partnership and Cooperation Agreement, art 154.

124 The 2014 EU-Georgia Association Agreement, art 231(e). See also art 352.

125 The 2014 EU-Moldova Association Agreement, art 367 (e). The 2012 EU-Ukraine Association Agreement, art 422.

provisions cannot be claimed under state-state arbitration,[126] though the implementation of CSR can be monitored and facilitated in other soft ways, including consultations and an examination by a group of experts.[127] On the other hand, the 2014 EU-Georgia Association Agreement and the 2014 EU-Moldova Association Agreement do not exempt the CSR provisions from state-state arbitration.[128] As a third case, although a dispute regarding the CSR provision could be arbitrated under the 2016 EU-Kazakhstan Agreement, an arbitration result regarding the CSR provision is excluded from the protection provided by the treaty's compliance procedure, including the remedies for non-compliance. [129]

From a comparative perspective, the Canadian, Brazilian and EU practice of incorporating CSR provisions into investment agreements have similarities and differences. On the one hand, they all acknowledge the soft and non-binding nature of CSR obligations and adopt a 'best efforts' approach to encourage the promotion of CSR. Furthermore, the vast majority of investment treaties concluded by these three entities do not allow the CSR provisions to be claimed in the investor-state or state-state arbitration mechanisms. On the other hand, these treaties have adopted different approaches with regard to designation of liability. Most of the Canadian and EU treaties address the obligation to promote CSR to State Parties, while a majority of Brazilian ACFIs directly encourage investors and their investments to abide by CSR standards. The contents of the CSR obligations in these treaties are also different: The Canadian investment treaties generally refer to 'corporate social responsibility' in their CSR provisions; the Brazilian investment treaties specify several ICSR instruments; some of the EU investment treaties generally mention corporate social responsibility, while others indicate specific ICSR standards.

4.3. Challenges of Interpreting and Enforcing CSR Provisions in Investment Treaties

There have not been any investment cases concerning the interpretation of the CSR provisions in these investment treaties.

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126 The 2012 Colombia-EU-Peru FTA, art 285(5). The 2012 EU-Ukraine Association Agreement, art 322.

127 In both treaties, a Party may seek consultations to another Party with respect to sustainable development issues (including CSR), and may, after 90 days of the delivery of the consultation request, request that a Group of Experts be convened to examine the matter. The Group of Experts, comprised of one national from either Party and a chairman from a third country, will produce a non-binding report determining whether a Party has fulfilled its obligations on sustainable development. See the 2012 Colombia-EU-Peru FTA, art 283-5. The 2012 EU-Ukraine Association Agreement, art 301.

128 The 2014 EU-Georgia Association Agreement, Chapter 14. The 2014 EU-Moldova Association Agreement, s 3.

129 The 2016 EU-Kazakhstan Enhanced Partnership and Cooperation Agreement, art 155 and Chapter 14(3)(2).

Although it has been argued that CSR standards can be the *quid pro quo* for the dominating objective of investor protection in investment treaties,[130] there are several challenges concerning the interpretation and enforcement of these CSR provisions.

First, investment agreements are triangular treaties that impose obligations on State Parties to protect foreign investors as third-party beneficiaries.[131] Does the incorporation of CSR provisions into investment treaties change the very nature of investment treaties by imposing obligations not only on host states, but also on foreign investors?[132] How should the CSR provisions be interpreted alongside with other substantive obligations of host states, and how should the CSR provisions be enforced in the singe-direction investor-state arbitration mechanism in which only foreign investors can be claimants? As noted above, most Canadian, Brazilian and EU investment treaties have excluded CSR provisions from being a basis of claim in the arbitration process. Nonetheless, the arbitral tribunals may consider CSR provisions as a context when interpreting other substantive clauses in investment treaties, such as non-discrimination, FET and expropriation.

Second, contrary to investment obligations which have a 'hard law' character, most CSR standards in international instruments are seen as 'soft law' for their non-binding and voluntary language and the absence of an effective enforcement mechanism. What does it mean to incorporate these soft CSR norms into hard investment treaties? Should we expect these soft norms to act as a restriction to the hard investment obligations, or should we treat these norms as a 'good efforts' approach due to their voluntary nature in other international instruments? According to Canadian, Brazilian and EU practice, the CSR provisions in investment treaties have explicitly treated CSR as voluntary, and therefore, it seems at least by now an exaggeration to consider those CSR provisions as an effective method to balance public interests against investors' rights.

Third, the tribunals may face difficulties in the interpretation of these CSR provisions as a result of the unclear definition of CSR itself. A general reference to 'corporate social responsibility', as the approach adopted in Canadian investment treaties, may create difficulty for future tribunals to define CSR.[133] As a different approach, the Brazilian ACFIs and some EU investment treaties refer to specific ICSR instruments, such as the ILO

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130 Muchlinski (n 17) 643.

131 Anthea Roberts, 'Triangular Treaties: The Extent and Limits of Investment Treaty Rights' (2015) 56.2 Harv. Int'l L.J. 353, 353.

132 It seems that Canada and the EU have bypassed this question since they designate the obligation to promote CSR on States rather than on investors. Brazil, on the other hand, has imposed CSR obligations on investors, but the Brazilian ACFIs themselves are non-traditional investment treaties.

133 However, this approach has its own advantage: the CSR provision will be flexible to be interpreted by further investment tribunals taking account of the most recent development of CSR standards.

Tripartite Declaration or the OECD Guidelines, which can provide a clearer guidance for tribunals to determine the particular CSR standards adopted by the Parties.

5. CONCLUSION

The tension between IIL and CSR has been reflected in investment arbitral cases in which host states' regulation of social and environmental responsibilities of foreign investors, through legally binding legislation and administration, has been claimed by foreign investors as a breach of international investment obligations. As a response to this tension, recent years have seen a new approach, pioneered by Canada, Brazil and the EU, of incorporating soft CSR standards into investment treaties. Nonetheless, the effectiveness of this new approach is still uncertain, as a result of the traditional role of foreign investors as third-party beneficiaries in investment treaties, the 'soft law' nature of CSR norms, and the unclear definition of CSR in these provisions.

In such circumstances, international investment tribunals are taking the critical responsibility of balancing foreign investor's right to a fair investment environment and the host state's right to regulate social responsibilities of foreign investments. A more balanced interpretation of international investment obligations should be struck in investment arbitration, by taking account of CSR policies in the assessment of non-discrimination, FET, and indirect expropriation. First, the tribunal should consider non-economic factors in the determination of whether two investors are 'in like circumstances' in the discrimination assessment, and should regard CSR policy as a rational policy that can justify a discriminatory treatment if there is a rational relationship between the differentiation in question and the CSR policy it pursues. Second, investment tribunals should take the dynamic and evolving nature of regulation on CSR issues into consideration, and should refrain from interpreting the stability requirement of the FET standard in an absolute way. Third, the tribunal should take account of the host state's sovereign right to regulate CSR in the assessment of whether the host state's regulation on CSR issues constitutes indirect expropriation that calls for a compensation paid by the host state to the foreign investor.