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Imposing Conditions on Investor Protection: A Role of Investor's Due Diligence

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The notion of Corporate Social Responsibility (CSR) is gaining momentum in international investment law. States continue to include the CSR provisions in their newest international investment agreements (IIAs). In addition to typical CSR clauses directed at states to encourage investors to incorporate the internationally recognized standards on CSR (*e.g*. Argentina –Japan BIT (2018); the Australia-Hong Kong FTA (2019)), more IIAs incorporate provisions directly addressing investors.

In 2018, Brazil has signed three new cooperation and investment facilitation agreements with Guyana, Ethiopia and Suriname. All of them contain elaborated CSR provisions, focusing on investors' obligations. For example, the Brazil – Ethiopia BIT (2018) provides in Article 14 that investors "shall endeavor (…) a) Contribute to the economical, social and environmental progress, aiming at achieving sustainable development; b) Respect the internationally recognized human rights of those involved in the investors' activities".[1)] Moreover, the Brazilian agreements subject foreign investor to compliance with national laws.[2)] The latter provision also exists in the Belarus-India BIT (2018), where in the provision on 'investor obligations' it is stated that "investors and their investments shall comply with all laws of a Party concerning the establishment, acquisition, management, operation and disposition of investments".[3)]

With an increasing number of CSR provisions providing a diverse range of investors' obligations, the central question is whether these types of provisions are binding and if so, how they can be enforced? Depending on the type of CSR clause, some IIAs provide a potential solution for enforcing investor's obligations. For example, a few IIAs include clauses establishing the liability of investors in the home State of investors (*e.g*. the Dutch Model BIT, the Morocco-Nigeria BIT).[4)] Several other treaties contain clauses allowing a host state to file a counterclaim against an investor that potentially offer an opportunity for a host state to challenge the human rights and environmental violations involving a foreign investor.

This contribution, however, discusses another option for effectuating the CSR provisions namely through compliance of investors with CSR provisions, as a condition for investor's protection under an IIA. The investor's failure to comply with the CSR obligations can be considered at different stages of investment proceedings: at the (i) jurisdictional stage, or at the (ii) merits stage while deciding on the violation of substantive IIAs provisions, and/or at the moment of (iii) determining the amount of compensation.

Regarding the first option, the investor's conduct can be subject to the jurisdictional limitations, or limitations of an access to investment-state dispute settlement (ISDS) through incorporation of legality requirement of an investment. Usually, this implies that an investment has to be in accordance with domestic law. The Iran-Slovak Republic BIT (2016) includes such limitations, specifying in the ISDS provision that "an investor may not submit a claim under this Agreement where the investor or the investment has violated the Host State law".[5] The BIT clarifies that a tribunal shall dismiss the investor's claim upon his involvement in serious violations of the host state law, *e.g*. fraud, tax evasion, corruption etc.[6] The draft Colombia Model BIT (2017) also includes a CSR clause that stipulates that for the purpose of accessing the ISDS, an investor has to accept the binding obligations established under the human rights and environmental treaties, to which Colombia or its counterparty are or become a party, throughout the making of its investment and its operation in the host party's territory. In *Cortec Mining v. Kenya*, the tribunal declined jurisdiction over an investor's claim for an unlawful revocation of the mining license under the Kenya-United Kingdom BIT, even without an explicit provision requiring compliance with domestic law. The tribunal agreed with the respondent state that the investor had failed to comply with the environmental impact assessment requirements imposed for the mining projects under Kenyan law.[7] Explaining that such investment as licence constitutes "the creature of the laws of the Host State"[8] and therefore in order to rise for protection, it has to be made in accordance with the domestic law.

The second option is to condition the protection of investors under IIA's substantive investment standards by taking into account the due diligence obligations of an investor. An example is the protection of the legitimate expectations of an investor under the fair and equitable treatment (FET) standard. One of the factors taken into account by tribunals in assessing whether the investor qualifies for the protection of the legitimate expectations is whether the investor has exercised the proper due diligence before investing into a host state. The requirement of due diligence concerns not only the economic aspects of an investment, but also includes a broader appraisal of the legal and socio-political circumstances in a host state. In a renewable energy case, *Charanne v. Spain*, the tribunal stated that in order for an investor to "exercise the right of legitimate expectations", it should perform a "diligent analysis of the legal framework for the investment".[9] The examples of the recent FET cases indicate the growing importance of cautiousness and proper preparation by the investor.[10]

Furthermore, the notion of investor's due diligence does not have to be limited to the legitimate expectations. For example, 2018 Dutch Model BIT included the general provision emphasising the importance of the investor's duty to conduct a due diligence process in order to identify, prevent, mitigate and account for the environmental and social risks and impacts of its investment.[11]

The third possibility is to take the investor's conduct into account at the stage of calculating the compensation. The 2018 Dutch Model BIT has incorporated the provision stipulating that the tribunal may take into account in determining the amount of compensation the investor's incompliance with its commitments under the UN Guiding Principles on Business and Human Rights (UNGPB), and the OECD Guidelines for Multinational Enterprises (OECD Guidelines).[12] Such provision does not mandate tribunals to consider the compliance of an investor's conduct with the UNGPB and the OECD Guidelines, however it exemplifies of how CSR obligations could potentially be taken into account in the calculation of damages. Such provision does not represent a novelty. Tribunals, in numerous cases, have been taking into account the misconduct of an investor in calculating the damages, *e.g.* by reducing the amount of compensation.[13)]

Conclusion

Imposing conditions on investment's protection under IIAs either at the jurisdictional or merits stage, or/and in calculating compensation, has a number of advantages. Firstly, it does not require significant legislative changes in domestic law in order for example to facilitate the possibility for the third parties to bring claims against multinationals in courts of home state. Secondly, it creates a better balance between the rights and obligations of states and investors, and contributes to promotion of sustainable and responsible investment.

A problematic notion regarding this approach is however the ultimate reliance on interpretation by tribunals on whether an investor has complied with social obligations laid down in an IIA, due diligence requirements, or with domestic law. For example, in determining whether an investor has committed "serious violations of the host state law" under the Iran-Slovak Republic BIT (2016), would require the tribunal's assessment of the seriousness of such violation under national law. That might result into an intrusive review of the application of domestic laws and policies. In the same vein, the appraisal of investor's conduct in calculating the damages, without clear guidance on this matter in the treaty itself, will hardly change anything in enforcement of CSR clauses.

The exercise of proper due diligence by an investor in order to receive protection under IIA's substantive investment standards, despite some drawbacks, has the potential to be further developed in treaty drafting. Of course, a weakness of this approach is the lack of objective and specific criteria on due diligence in investment law, which makes this requirement a rather a flexible notion with illusive contours rather than an identifiable legal standard. For example, tribunals in assessing the FET often employ different definitions of due diligence obligation. In *Masdar v. Spain*, the tribunal specified that in order to demonstrate the appropriate due diligence the investor has to "familiarize itself with the existing laws".[14)] In *Isolux v Spain*, the tribunal states that an investor's legitimate expectations can only be considered to have been violated if the new regulatory changes were not foreseeable by "a prudent investor".[15)] The different thresholds for a due diligence may yield different outcomes in determining whether this requirement has been sufficiently and properly performed by an investor for the purpose of an investor's protection. This requires a more refined definition of due diligence that can be included in IIAs or the interpretative treaty documents.

The benefits of the inclusion of a requirement of due diligence processes in a treaty, in contrast to voluntary CSR codes, is that a due diligence is an operational risk assessment tool, which is widely used in other legal contexts such as commercial law or competition law. The mandatory human rights due diligence of companies has been also gaining prominence in the last decade.[16)] Initially, it has conceptualized through the work of the UN Special Representative on Business and Human Rights, John Ruggie, and currently finding its way in national and regional laws manding companies to perform due diligence processes in different sectors (e.g. the 'UK Modern Slavery Act 2015'; France's 'duty of vigilance law' of 2017; and Dutch 'Child Labour Due Diligence Bill', 2019 and EU regulations (on timber, conflict minerals and chemicals). By drawing from examples from other legal sectors, jurisdictions and fields of law, a careful drafting of the required investor's due diligence processes, including specific steps in conducting such risk assessment procedures may benefit states and investors in early mitigation and the prevention of investment disputes.

References

?1 Article 14, Brazil – Ethiopia BIT (2018).

?2 Article 14, Brazil – Ethiopia BIT (2018); Article 15, Brazil – Guyana BIT (2018); Article 15, Brazil – Suriname BIT (2018).

?3 Article 11, Belarus-India BIT (2018).

?4 Article 7(4), Dutch Model BIT (2018); Art. 20, Morocco-Nigeria BIT (2016); Article 17(2), SADC Model BIT (2012).

?5, ?6 Article 14, Iran-Slovak Republic BIT (2016).

?7 *Cortec Mining Kenya Limited, Cortec (Pty) Limited and Stirling Capital Limited v. Republic of Kenya*, ICSID Case No. ARB/15/29, Award 22 October 2018.

?8 *Cortec Mining Kenya Limited, Cortec (Pty) Limited and Stirling Capital Limited v. Republic of Kenya*, ICSID Case No. ARB/15/29, Award 22 October 2018, para. 319.

?9 *SCC Case No. 062/2012, Charanne Construction v. Spain*, Award 21 January 2016, para. 505.

?10 For comprehensive analysis of the role of due diligence in the context of the FET standard, see: Y. Levashova, The Right of States to Regulate in International Investment Law: The Search for Balance between Public Interest and Fair and Equitable Treatment, International Arbitration Law Library, Wolters Kluwer, 2019 (forthcoming).

?11 Article 7(3), Dutch Model BIT (2018).

?12 Article 23, Dutch Model BIT (2018).

?13 *E.g. Biwater Gauff v. Tanzania*, ICSID Case No. ARB/05/22, Award 24 July 2008.

?14 *Masdar Solar & Wind Cooperatief U.A. v. Kingdom of Spain*, ICSID Case No. ARB/14/1, Award 16 May 2018, para. 494.

?15 *Isolux Netherlands, BV v. Kingdom of Spain*, SCC Case V2013/153, Award 17 July 2016, para. 781.

?16 Global Business Initiative & Clifford Chance, Business and Human Rights: Navigating a Challenging Legal Landscape, 22 March 2019.

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