Enhancing Supply Chain Responsibilities through International Investment Agreements

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Abstract

Foreign direct investment is one of the modes of organisation of global supply chains. At the international level, foreign direct investment is mostly regulated through international investment agreements (IIAs). While most of these agreements are still silent on corporate responsibilities, there are some notable exceptions that mark the way forward toward a more balanced investment protection regime. This contribution argues that even though the main purpose of IIAs remains the promotion and protection of foreign investment, IIAs could equally be used to enhance corporate responsibilities. To that purpose, the contribution outlines possible legal sources and means of enforcement to establish corporate responsibilities through IIAs.

Keywords: Corporate Responsibilities, Global Supply Chains, CSR, Human Rights, International Investment Agreements, BITs, Investor Obligations, Soft Law, Counterclaims

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A. Introduction

Today's economy is characterized by global supply chains, in which intermediate goods and services are traded in internationally dispersed production processes.[1] Through these global supply chains, trade and investment are inextricably intertwined. Much of trade in natural resources is, for instance, driven by large cross-border investments in extracting industries by globally operating corporations. These corporations organise their supply chains through non-equity modes, arm's length transactions, foreign direct investment or a combination of these. Through foreign direct investment, transnational corporations relocate segments of their value chain to new host states, often spanning subsidiaries over different continents.[2]

Foreign direct investment is, to a large extent, regulated in international investment agreements (IIA) concluded between two or more states. The primary aim of these agreements is the promotion and protection of foreign investment. However, more recent IIAs also refer to a variety of non-economic interests, such as health, the environment, labour and social standards as well as corporate social responsibility (CSR).

CSR refers to business conduct consistent with applicable laws and internationally recognized standards in the areas of human rights, international labour and environmental standards, anti-corruption and sustainable development.[3] The concept suggests that corporations are expected to attain their profit-making goals while ensuring that their activities reflect positive business ethics.[4] On the international level, CSR has been enhanced through a mix of voluntary guidelines developed by international organisations, NGOs and companies themselves.[5] Legally binding instruments to hold corporations accountable exist, to date, only on the domestic level.[6]

This article argues that IIAs may serve as an instrument to enhance international corporate responsibilities. It may be particularly challenging for states to agree on a multilateral treaty on corporate responsibilities under international law. Further steps in that direction may be taken at a bilateral level – using bilateral investment treaties (BITs) as an instrument for that purpose.

One advantage of this approach is the high level of individualisation reached in international investment law. Besides a number of substantive rights, most IIAs en-

1 *UNCTAD*, World Investment Report 2013, Global Value Chains: Investment and Trade for Development, p. 10.
2 Ibid., p. 140.
3 *Yannaca-Small*, University of St. Thomas Law Journal 2021/2, p. 403.
4 *Hepburn/Kuuya*, in: Cordonier Segger et al (eds.), p. 592.
5 Ibid.
6 There is a proposal for a treaty on human rights and business. In October 2021, the UN Intergovernmental Working Group on a proposed treaty on business and human rights held the 7th session to discuss the Third Revised Draft of the proposed treaty. The draft is available at: https://www.ohchr.org/Documents/HRBodies/HRCouncil/WGTransCorp/Session6/LBI3rdDRAFT.pdf (23/2/2022).

dow foreign investors with direct standing in international arbitration to challenge host state measures that interfere with their investment. This procedural right is not only granted to the local subsidiary in the host state but also to other direct and indirect shareholders or controllers of the relevant subsidiary.[7] In other words, IIAs allow the shareholders/parent company established in the home state to claim in place of their subsidiary.

This particular procedural setting under IIAs could equally help to hold the controlling shareholders accountable for the misconduct of their subsidiaries abroad. But this option depends on multiple factors. The corporation must be a protected investor under the relevant IIA and decide to bring a claim against the host state of its investment. Most importantly, the IIA must contain a legal basis that allows the arbitral tribunal to hold the investor accountable.

The current landscape of BITs reveals that the investment protection regime is not (yet) apt for the systemic integration and enforcement of corporate responsibilities. The *status quo* is not satisfactory, considering that there are many ways in which foreign investors might abuse human rights or disregard due diligence standards.[8] Given that BITs are an essential legal tool of global supply chains, it seems only natural that states take on these concerns by including provisions on corporate responsibilities in their IIAs.[9]

This article aims at giving an impression of the *status quo* and sketching a possible path forward towards corporate responsibilities under IIAs. To that purpose, Section B will focus on possible legal basis, while Section C will give an overview of possible means of enforcement. Section D will conclude.

B. Corporate Responsibilities in IIAs

The primary aim of IIAs is to protect foreign investors against unlawful interferences by the host state of their investment. To that purpose, IIAs confer a number of substantive and procedural rights upon protected investors. Historically, these treaty-based rights were meant to fill the voids of customary international law in the protection of foreign investors abroad.[10] Therefore, traditional IIAs confer a variety of rights but no obligations on protected investors. This asymmetry is one of the main concerns that led numerous stakeholders (states, international organisations, NGOs, etc.) to question the legitimacy of the current system and to start discussing how to improve it.[11]

Today, those stakeholders are undertaking a number of efforts to reform the investment protection regime. One of the main initiatives in this regard is the negotiation of a multilateral reform of investor-state dispute settlement at the United Na-

7 *Yilmaz/Chambers*, International and Comparative Law Quarterly 2018/1, p. 398.
8 *Kriebaum*, in: Radi (ed.), p. 22.
9 *Hepburn/Kuuya*, in: Cordonier Segger et al (eds.), p. 598.
10 *Crow/Lorenzoni Escobar*, Boston University International Law Journal 2018/1, p. 95.
11 *Shao*, JIEL 2021, p. 157.

tions Commission on International Trade Law (UNCITRAL).[12] But this initiative focuses on procedural matters only. Substantive reform efforts are mostly undertaken at the bilateral level through the conclusion of a new generation of BITs. Accordingly, recent BITs include *inter alia* more balanced standards of investment protection and references to non-economic interests, such as the environment, social and labour standards and the protection of human rights.

Arguably, these reform efforts are incomplete without discussing genuine investor obligations to counter the system's inherent asymmetry.[13] This asymmetry may have been justified at the inception of treaty-based investment protection. But today, transnational corporations exercise diverse economic and political power, through which they may impede the realisation of important global goods, including the protection of human rights.[14] Some have even argued that large corporations exercise a sort of "corporate sovereignty" that must be controlled through concomitant obligations under international law.[15]

Even though the majority of IIAs do not establish any corporate responsibilities, recent IIAs and Model BITs have taken a step in that direction through different drafting techniques.

I. References to Domestic Law

One option to enhance corporate responsibilities under IIAs is the inclusion of a requirement to comply with the domestic law of the host state. One example can be found in Article 12.1 of the Indian Model BIT, which states that "[i]nvestors and their investment shall be subject to and comply with the Law of the Host States. This includes, but is not limited to, […] (v) Law relating to human rights".[16] This provision is an example for a specific reference to domestic obligations related to human rights. In any case, also a reference to the law of the host state *in general* would suffice as legal basis to address human rights abuses and other misconduct.

Even though investors are already bound by the law of the host state of their investment, an explicit requirement in IIAs integrates this obligation into the international legal relationship between the investor and the host state.[17] It operates, thus, similar to an umbrella clause,[18] with the difference that it elevates an *obligation* and

12 For an overview of the current state of the reform discussions, see *EI-IILCC Study Group on ISDS Reform*, ZEuS 2022/1, p. 15–75.
13 Similarly, *Choudhary*, EYIL 2020, p. 192.
14 *Ruggie*, American Journal of International Law 2007/4, p. 824; *Weissbrodt/Kruger*, American Journal of International Law 2003, p. 901 ff.; *Nowrot*, in: Krajewski (ed.), p. 7.
15 *Peters* et al, MPIL Research Paper Series No. 2020-06, p. 22.
16 Model Text for the Indian Bilateral Investment Treaty, available at: https://www.mygov.in/sites/default/files/master_image/Model Text for the Indian Bilateral Investment Treaty.pdf (24/2/2022).
17 *Krajewski*, Business and Human Rights Journal 2020/1, p. 119.
18 Umbrella clauses aim to bring non-treaty commitments under the protective umbrella of an investment treaty. See *Reinisch*, p. 95.

not a right of the investor to the international level.[19] That way, horizontal obligations found in different domestic legal sources, such as labour, tort, or criminal law, can serve as a legal basis for corporate responsibilities under IIAs.

Moreover, a trend can be discerned of states gradually adopting specific legislation aimed at establishing due diligence obligations for corporations across the supply chain.[20] Examples are the UK Modern Slavery Act, the French *Loi de Vigilance*, the Dutch *Wet Zorplicht Kinderarbeid* and the German *Lieferkettensorgfaltspflichtengesetz*. In addition, the EU Commission adopted a proposal for a directive on corporate sustainability due diligence in February 2022 to foster responsible corporate behaviour throughout global supply chains.[21] If enacted, the directive will require all EU Member States to integrate certain corporate responsibilities in their domestic legal system.

Through a requirement to comply with the law of the host state in IIAs, these due diligence laws could equally be used as a legal basis for corporate responsibilities in investor-state arbitral proceedings. That way, investors could, in theory, also be held accountable for lacking due diligence with regard to the conduct of their direct and indirect suppliers. However, whereas many developed countries are (on the path to) enacting corporate due diligence laws, other countries are still lacking effective domestic law in this regard.

One may wonder whether a requirement in IIAs to comply with the law of the *home* country could help to enhance treaty-based corporate responsibilities. An example of this approach can be found in the Nigeria-Morocco BIT. Article 14(1) thereof requires investors to comply with environmental assessment procedures applicable under the laws of the host *or home* state, whichever is more rigorous. A different, but related, approach is the inclusion of a clause stipulating that home states can hold investors civilly liable for acts relating to their investment in the host state.[22] Even though such a clause does not allow the law of the home state to be applied under the IIA, it might help to overcome the *forum non conveniens* doctrine, enhancing corporate responsibilities before the local courts of the home state.

In general, the establishment of indirect corporate responsibilities under IIAs through a reference to domestic law has advantages and disadvantages. On the one hand, this drafting technique would pay deference to domestic legislators and their determination of the extent to which corporations should be held accountable for irresponsible behaviour. But this would also mean, on the other hand, that the scope of corporate due diligence obligations would significantly vary in each case submitted to investor-state dispute settlement.[23]

19 *Krajewski*, Business and Human Rights Journal 2020/1, p. 199; *Shao*, JIEL 2021, p. 164; *Al Warraq v Indonesia*, UNCITRAL, Award (15 December 2014), paras. 662 f.; *Aven v Costa Rica*, ICSID Case No. UNCT/15/3, Award (18 September 2018), para. 734.

20 *De Brabandere*, Belgian Review of International Law 2017/2, p. 238.

21 See the press release by the Commission from 23 February 2022, available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1145 (27/2/2022). See also the contribution by *Hoffmeister* in this issue.

22 See Art. 13 of the 2019 Dutch Model BIT.

23 *Muchlinski*, in: Deva/Bilchitz (eds.), p. 350.

In addition, states have been rather defensive of their domestic jurisdiction over domestic legal issues in recent years.[24] This is evidenced by the trend of excluding domestic law from the applicable law clauses of recent IIAs.[25] For instance, EU investment agreements exclude the application of domestic law as such and require arbitral tribunals to treat domestic law "as a matter of fact" only.[26] In light of this tendency, states might not be inclined to integrate domestic provisions into the international legal relationship with foreign investors. Instead, they might refer to the courts of the home state as the appropriate forum to find investors to be civilly liable for the misconduct associated with the investment in the host state.

II. Corporate Responsibilities under International Law

Another option is a direct reference to corporate responsibilities in IIAs or to other sources of international law that contain such responsibilities. With regard to the drafting techniques available under this category, one may distinguish between preambular language (1), soft law approaches (2) and genuine investor obligations (3).

1. Preambular Language

According to the database of UNCTAD, 223 out of 2.574 IIAs contain preambular language referring to "social investment aspects", including human rights, labour rights or corporate social responsibility.[27] All EU investment agreements refer, for instance, to the Universal Declaration of Human Rights. The preamble of the 2016 Austria-Kyrgyzstan BIT[28] refers *inter alia* to the respect for human rights, sustainable development, international labour rights and anti-corruption efforts. It also expresses the contracting parties' belief that "responsible corporate behaviour can contribute to mutual confidence between enterprises and host countries".

These references confirm the paradigm change that can be witnessed in the new generation of IIAs. Non-economic concerns must now be balanced against the interests of foreign investors in case of a dispute with the host state. The preambular language must be used to interpret the treaty also in light of the non-economic interests expressed therein. But preambular language may merely serve as a means of

24 *Shao*, JIEL 2021, p. 165.
25 For an empirical study that confirms this tendency, see *Atanasova*, Journal of International Dispute Settlement 2019/3, pp. 396–422.
26 See e.g. Article 8.31 CETA, Article 3.13 EU-Singapore Investment Protection Agreement, Article 3.42 EU-Vietnam Investment Protection Agreement.
27 UNCTAD, Investment Policy Hub, available at: https://investmentpolicy.unctad.org/international-investment-agreements/iia-mapping (27/2/2022).
28 Agreement for the Promotion and Protection of Investment Between the Government of the Republic of Austria and the Government of the Kyrgyz Republic, entered into force 1/10/2017, available at: https://investmentpolicy.unctad.org/international-investment-agreements/treaties/bit/3688/austria---kyrgyzstan-bit-2016- (1/3/2022).

interpretation. The references to human rights, sustainable development or CSR may not be used as a legal basis to ground proper corporate responsibilities.[29]

2. Soft Law

Most of the IIAs that refer to corporate responsibilities in the main text take a soft law approach, including non-binding standards, best endeavour-obligations or other hortatory language.[30] One example is the 2016 Argentina-Qatar BIT, which states:

> Investors operating in the territory of the host Contracting Party should make efforts to voluntarily incorporate internationally recognized standards of corporate social responsibility into their business policies and practices.[31]

Others, such as the Canada-EU Comprehensive Economic and Trade Agreement (CETA), do not require investors to voluntarily adhere to international CSR standards. Instead, they require the state parties to encourage the development and use of voluntary best practices of corporate social responsibility by enterprises.[32] Another common drafting technique is the reference to well-known international CSR standards, such as the OECD Guidelines for Multinational Enterprises.[33]

Historically, the application of international CSR standards rests on a voluntary basis, which has been the cornerstone of the concept.[34] Without legally binding force, these best effort clauses in IIAs are no more effective than CSR references in the preamble.[35] However, a reference to these voluntary principles in an IIA could serve as an anchor to convert soft law into a legally binding obligation in the context of an investment dispute.[36] Through the right wording, compliance with certain international norms can be made binding under IIAs, thus "hardening" the respective soft law standard.

An IIA could, for instance, refer to the UN Guiding Principles on Business and Human Rights (UNGPS) in a binding manner.[37] These principles are based on three pillars. The second pillar relates to the corporate responsibility to respect human rights. Despite not being binding in nature, the UNGPS express the global standard of conduct for business enterprises with regard to human rights. These standards

29 *Panosch*, p. 155.
30 *Krajewski*, Business and Human Rights Journal 2020/1, p. 116.
31 The Reciprocal Promotion and Protection of Investment Between the Argentine Republic and the State of Qatar, signed 6 November 2016, Art. 12.
32 See CETA, signed 30/10/2016, Chapter 22, Art. 22.3(b).
33 OECD, Guidelines for Multinational Enterprises, 2011, available at: https://www.oecd.org/corporate/mne/ (1/3/2022).
34 *Nchalla*, Belmont Law Review 2021/1, p. 158. *Bantekas*, Boston University International Law Journal 2004, p. 317.
35 *Panosch*, p. 156.
36 According to *Viñuales*, an anchor can be understood as a provision (in domestic or international law) that incorporates or in some other way gives legal effect to standards or norms that would otherwise not be binding. See *Viñuales*, ICSID Review 2017/3, p. 351.
37 Similarly, future IIAs could reference the currently discussed treaty on business and human rights, if it comes into being.

appear to have reached a significant level of detail and acceptance to be directly applied to private actors.[38] By reference to these standards in an IIA, certain substantive unity at the international level could be reached. In an investment arbitration, the conduct of investors could be measured against the standards set out in the UNGPS, which would then become genuine investor obligations.

3. Investor Obligations

A final option to enhance corporate responsibilities in IIAs is the inclusion of fully-fletched investor obligations. The vast majority of IIAs do not make use of this drafting technique. One notable exception is the 2016 Nigeria-Morocco BIT. It requires investors *inter alia* to "act in accordance with core labor standards as required by the ILO Declaration on Fundamental Principles and Rights to Work",[39] or to "maintain an environmental management system".[40] Through the inclusion of investor obligations in the treaty text, arbitral tribunals are given a proper legal basis to hold investors accountable.

Even though the inclusion of investor obligations is an appropriate means to counter the system's inherent asymmetry, treaty drafters should be careful with the precise wording of such provisions. For instance, Article 18(1) of the Nigeria-Morocco BIT provides that "investors and investments *shall uphold* human rights in the host state". Such a formulation is problematic because it suggests that international human rights law would be applicable, as such, to foreign investors and their local subsidiaries.

However, international human rights law generally contemplates duties for states and not for private actors.[41] Private duties are only imposed in an *indirect* manner, e.g. by requiring states to restrict private actions that interfere with the enjoyment of human rights.[42] This aspect was highlighted by the tribunal in *Urbaser v Argentina*.[43] This case dealt with Argentina's termination of a concession granted to the claimant's enterprise to provide water and sanitation services in the Argentinian province *Gran Buenos Aires*. Argentina justified the termination of the concession with the investors' failure to achieve the contractually agreed extent of water coverage of the population in *Gran Buenos Aires*.[44] The tribunal rightly found that the

38 *Morgera*, in: Dupuy/Viñuales (eds.), p. 325.
39 This is an example of an anchor provision, rendering a soft law standard legally binding under the IIA.
40 Reciprocal Investment Promotion and Protection Agreement Between the Government of the Kingdom of Morocco and the Government of the Federal Republic of Nigeria, Art. 18(2) and (3).
41 An exception to this is international criminal law, through which a few duties are directly placed on private actors, including the duty not to commit genocide. See *Knox*, American Journal of International Law 2008/1, p. 2.
42 Ibid., p. 17 f.
43 ICSID, *Urbaser S.A. et al v. Argentina*, ICSID Case No. ARB/07/26, Award (8 December 2016).
44 Ibid., para. 199.

international human right to water entails an obligation of compliance on the part of the state but not an obligation to perform on the part of the investor providing the service.[45] As this case shows, international human rights law cannot be simply transposed to non-state actors.[46]

The BIT underlying the dispute in *Urbaser v Argentina* did not require investors to "uphold human rights". In fact, the Spain-Argentina BIT does not impose any obligations on investors. Still, the tribunal inferred the existence of investor obligations by means of a systemic interpretation of the BIT and other norms of public international law.[47] Even though the use of systemic interpretation may serve as a means to substantiate corporate responsibilities, it also causes legal uncertainty. Without an explicit legal basis for corporate responsibilities in the IIA, the approach of an arbitral tribunal becomes less predictable. Therefore, carefully drafted investor obligations seem to be the better option.

C. Enforcement of Corporate Responsibilities

Once a legal basis for corporate responsibilities is established, the question of enforcement must be voiced. Only a legally binding obligation can be enforced. A reference to binding domestic law, a "hardened" soft law provision or a genuine investor obligation could constitute a legal basis for that purpose. What negative legal consequences could be associated to the non-compliance with binding investor obligations?

Kozyakova defines "legal consequence" in this context as "a result, which is established, required or permitted by law that follows as an effect of individuals' actions or omissions".[48] The concept of negative legal consequences is broader in scope than the concept of liability. The law may react negatively in different ways, e.g. by rescinding, restricting or eliminating otherwise granted rights.[49] This broad understanding of "negative legal consequences" could be used to enforce corporate responsibilities established under IIAs. It may be difficult to integrate an obligation by investors to compensate any harm caused into the normative (and asymmetrical) structure of IIAs. Instead, investors that do not comply with their obligations may suffer a different legal disadvantage.[50]

As noted by *Viñuales*, due diligence duties can operate in an investment arbitration by virtue of numerous legal concepts intervening at different stages of the proceedings.[51] One could, for instance, render the treaty-based protection of an investment conditional upon the continuous observance of due diligence duties related to

45 Ibid., para. 1208.
46 *De Brabandere*, Belgian Revue of International Law 2/2017, p. 229; *Ratner*, p. 494.
47 ICSID, *Urbaser S.A. et al v. Argentina*, ICSID Case No. ARB/07/26, Award (8 December 2016), paras. 1182–1192.
48 *Kozyakova*, p. 47.
49 Ibid., p. 48.
50 *Nowrot*, Rechtswissenschaftliche Beiträge der Hamburger Sozialökonomie 2018/21, p. 21.
51 *Viñuales*, ICSID Review 2017/3, p. 347.

human rights.[52] The negative legal consequence associated with non-compliance would then be the inadmissibility of the claim. In a best case scenario, already the mere threat of inadmissibility convinces the investor to voluntarily comply with the required standards.

Alternatively, an arbitral tribunal could take the investor's non-compliance into account at the quantum stage. An example for this approach can be found in Article 23 of the 2019 Dutch Model BIT. It reads:

> Without prejudice to national administrative or criminal law procedure, a Tribunal, in deciding on the amount of compensation, is expected to take into account non-compliance by the investor with its commitments under the UN Guiding Principles on Business and Human Rights, and the OECD Guidelines for Multinational Enterprises.

Finally, corporate responsibilities could be enforced through counterclaims brought by the respondent host state.[53] Successful attempts of bringing counterclaims are still rare as tribunals are hesitant to find jurisdiction over such claims. Nonetheless, virtually all tribunals confronted with such attempts have in principle agreed that counterclaims can be brought.[54] In order to reduce legal uncertainty, those states that want to make use of this procedural mechanism could expressly authorise counterclaims in their IIAs.[55]

D. Conclusions

In light of their desire to increase sales in foreign markets and to lower production costs, large corporations often choose foreign direct investment as an essential means to organise their supply chains. That way, IIAs have become one of the legal tools that could be used to regulate the behaviour of transnational companies abroad. IIAs are certainly not the main instrument available for that purpose. Domestic due diligence laws and international (soft law) standards have more potential to specifically address corporate misconduct across the supply chain. But international investment law can also contribute to that development.

In order to enhance corporate responsibilities under IIAs, two main ingredients are required. *First*, arbitral tribunals need a legal basis to hold investors accountable. In a traditionally asymmetrical system, which focuses on states' duties and investors' rights, it is not easy to find such legal basis. At the same time, recent developments in (model) treaty-making have shown that it is possible to enhance corporate responsibilities through the inclusion of provisions referring to domestic or international law standards or directly integrating investor obligations. *Second*, appropriate enforcement mechanisms must be provided. If one deviates from a strict

52 *Kriebaum*, in: Radi (ed.), p. 36.
53 On counterclaims in investment arbitration, see *Nacimiento* et al., ZEuS Special Issue 2021, pp. 165–186.
54 *Schill*, ICSID Review 2018/1, p. 53.
55 *Shao*, JIEL 2021, p. 178.

concept of liability, the options to do so are manifold. In the spirit of legal certainty, these options should be explicitly laid down in IIAs.

Due to the current normative structure of IIAs, the propositions of this article rather amount to a "regulatory experiment".[56] But considering the recent initiatives by domestic legislators and international organisations such as the UN, EU and OECD, it might be worthwhile to integrate IIAs into the multilevel approach of regulating corporate misconduct across global supply chains.

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56 This term is borrowed from *Nowrot*. See *Nowrot*, Rechtswissenschaftliche Beiträge der Hamburger Sozialökonomie 2018/21, p. 11.

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