Environmental claims by states in investment treaty arbitration

Gaurav Sharma

2 April 2020

First published on the Practical Law Arbitration Blog, 2 April 2020.

Overview

With environmental concerns and the attendant existential threat they pose at the forefront of the public consciousness, it is perhaps unsurprising that investment arbitration tribunals increasingly find themselves asked to determine claims and counterclaims by states against investors and other operators whose business activities have an environmental impact.

International investment agreements, such as bilateral and multilateral investment treaties (BITs and MITs), were traditionally intended to encourage foreign direct investment through the flow of capital, knowledge and resources to economies in the developing world. They achieved this initially by providing substantive protections against expropriation and, subsequently, other normative minimum standards for the treatment of foreign investments, as well as crucial procedural protections in the form of neutral international arbitration to resolve disputes between an investor of one state and the host state in which it has chosen to make its investment.

In the last few years, investment treaty tribunals have been asked to consider environmental counterclaims against investors under those treaties. But do tribunals hearing investment treaty disputes have jurisdiction to hear those counterclaims?

An open door

Counterclaims under treaty were first considered by the tribunal in ***Saluka v Czech Republic*** as the Czech Republic counterclaimed on the basis of alleged breaches by the investor of a share purchase agreement, and of corporate and commercial provisions of Czech law. The tribunal considered that article 8 of the Netherlands-Czech Republic bilateral investment treaty provided the tribunal with jurisdiction to decide "All disputes between one Contracting Party and an investor of the other Contracting Party concerning an investment", which encompassed counterclaims by the host state in principle.

However, the tribunal found that it did not have jurisdiction to hear disputes arising out of the share purchase agreement, which had its own choice of forum clause, or any of the other heads of counterclaim based on Czech law, which were referable to the Czech Republic's jurisdiction. The tribunal considered that the "general legal principle" which required counterclaims to have a close connection with the primary claim, was therefore not met, since the substantive breaches on which the counterclaim was premised were not of international law obligations, unlike the primary claim.

Investors subject to international law obligations

Is the problem, then, that while the treaty may admit of counterclaims in as a matter of jurisdiction, the investment protection scheme contained in investment treaties works one way and simply provides no substantive basis for a state to make an international law claim?

The overlay of environmental concerns arising in recent case law may provide some useful insight. The ICSID tribunal in ***Urbaser v Argentina*** was asked to consider counterclaims by Argentina, who alleged that the investor had failed to meet its investment obligations in respect of the water and sanitation concession it had been awarded, resulting in a violation of the human right to be provided with adequate drinking water and sewage services. Like the tribunal in ***Saluka***, the ***Urbaser*** tribunal found that the Spain-Argentina BIT, under which the primary claim had been brought, admitted of counterclaims, as its article X allowed any dispute "arising between a Party and an investor" to be referred to arbitration "at the request of either party", and was thus completely neutral as to the identity of the claimant or respondent in an

investment dispute.

The tribunal then examined whether there was a substantive right that had been breached, and specifically referred to the treaty's requirement for a tribunal to determine disputes on the basis of the treaty, Argentine law, and "general principles of international law applicable to the particular matter" (article X(5)). This enabled the tribunal to examine whether or not the environmental human right invoked by Argentina (namely the guarantee of access to water and sanitation) was only binding on the state as a matter of international law (as the investor argued), or could apply to private actors as well. The tribunal concluded that there was no such general rule and that the various sources of international law obligations to which it was referred (including, for example, the *Universal Declaration of Human Rights of 1948*) did not create obligations that lay exclusively on states. However, ultimately, the tribunal was unable to find any specific international human rights or environmental law obligation in those sources to provide access to water and sewage services that could be said to apply to the investor in the particular case.

The most recent tribunal to grapple with environmental counterclaims by states was that in ***Aven v Costa Rica***. In considering Costa Rica's counterclaim for environmental damage caused by the investor's alleged harm to wetlands and the related ecosystem in the course of the development of its tourist project, the tribunal affirmed Costa Rica's submission that "it can no longer be admitted that investors operating internationally are immune from becoming subjects of international law… particularly when it comes to rights and obligations that are the concern of all States, as it happens in the protection of the environment" (paragraph 699). The tribunal noted that this applied in the case of the provisions of the *DR-CAFTA* (under which the primary claim was brought), including its article 10.11 which related to enforcement measures taken by a state aimed at ensuring that "investment activity in its territory is undertaken in a manner sensitive to environmental concerns". The counterclaim failed, however, as the tribunal concluded that this provision of DR-CAFTA did not constitute "affirmative obligations" on investors, breach of which would be actionable as a matter of international law (paragraph 743).

Risky business

In short then, there is little reason to suppose that we will not see an increasing number of counterclaims brought by state parties assuming the treaty's language allows "either party" to submit a dispute to arbitration. Moreover, it is clear from the decisions of recent tribunals – particularly Urbaser – that there is a particular willingness on the part of tribunals today to conduct exhaustive analyses of potentially referable international environmental and human rights law obligations which could bind foreign investors. This may well reflect the broader paradigm shift in the public international discourse on climate change and the need for states to be seen to be taking all possible steps to assure environmental protection at the local level, including based on initiatives such as the Paris Agreement on Climate Change. Indeed, it may just be a matter of time before international environmental regulations are implemented that are enforceable against private actors and states alike, resulting in significant damages awards by investment treaty tribunals against both state and non-state parties upon whose shoulders the obligations fall.

Two consequences follow that may mean we are at the start of a trend towards more claims by states based on allegations of environmental damage. The first is that, before embarking upon investment treaty claims of their own, investors must be ready to face public scrutiny of allegations of environmental degradation by way of counterclaims by host states (regardless of the merits) before arbitral tribunals rather than, for example, domestic courts, with potentially significant damages claims attached to them. The second is that investors may face standalone treaty claims by states in the future, based on arguments that a foreign investor has impliedly consented to the jurisdiction of any given investment treaty tribunal. This will be a heavily analytical exercise, and is likely to be based on evidence that the investor specifically intended a particular treaty to apply in the case of its particular investment at the time it made it. The high evidential burden that will attach to proving an investor's consent to arbitrate international law claims brought by a state against it may or may not put states off, depending on the facts of the case. Either way, based on the recent arbitral case law, foreign investors whose activities in any way impact the local environment of the host state – from those in the natural resource and extractive industries to those operating in leisure and tourism, for example – face the reality of a markedly different risk landscape for their investments in the future.

GAURAV SHARMA

Gaurav Sharma

Gaurav is an international arbitration specialist with particular expertise acting in disputes in the energy industry. He is a highly accomplished advocate having appeared as lead counsel in international arbitrations throughout his career. He was named in the Legal 500 as a "Future Leader" and "Next Generation Lawyer" in 2018 and 2019. He is dual-qualified, having passed the Paris bar exams in 2008 to become an avocat. As such, he is equally adept at handling civil and common law disputes.

Before joining Quadrant, Gaurav was "Counsel" at the specialist international arbitration law firm Three Crowns LLP. Prior to that, he was a Senior Legal Counsel in Shell's Global Litigation group, which followed several years as an international arbitration Associate at the London and Paris offices of the international law firm, Debevoise & Plimpton.

Gaurav acts as sole counsel, together with other barristers or as part of a team with lawyers from instructing law firms (whether international- or UK-based). He is typically instructed to develop case strategies, and implement them through written and oral advocacy. His experience as a senior lawyer at specialist arbitration firms and in-house means he is also perfectly comfortable handling the day to day conduct of cases, including acting as a senior legal team leader and managing associates working on individual work streams in complex matters.

> view Gaurav's full profile

gaurav.sharma@quadrantchambers.com