

INSIDE ARBITRATION: DAVID AVEN V COSTA RICA: KEY TAKEAWAYS FOR FOREIGN INVESTORS TO CONSIDER WHEN RESORTING TO INVESTOR-STATE ARBITRATION IN ENVIRONMENTAL DISPUTES

07 February 2019 | Global
Legal Briefings

Investment disputes related to environmental protection can sometimes imply a tension between a state's obligation to protect its natural resources from environmental harm and its desire to promote foreign investment. Historically, environmental regulation has been thought to be inconsistent with international investment law. Indeed, investors have challenged the application and enforcement of states' domestic environmental regulations, as 'expropriation' and sought compensation for the state's actions.¹

INTRODUCTION

Despite the historical perception of the role of environmental regulation, the past six years have seen a wave of over sixty cases involving environmental issues being filed.² These cases have coincided with ever-increasing global focus on the environment and the blossoming of international, regional and national regulatory regimes aimed at responding to the challenges of environmental protection and climate change. The outcome of these cases and the evolution of investment tribunals' reasoning on the balance between investment protection and environmental protection are of significance for international law practitioners, but also for investors considering whether to bring a claim under an investment treaty.

The recent decision in *David Aven v Costa Rica*³ contributes to this debate as it (i) recognized – as a matter of international law – a state's right to apply and enforce its environmental protection laws against foreign investors; and (ii) admitted jurisdiction to entertain Costa Rica's counterclaim for environmental harm. This latter point is of particular note given the number of cases involving counterclaims for environmental harm are rare and those in which a tribunal has accepted jurisdiction over them are even more limited. The Latin American team of Herbert Smith Freehills' New York office successfully represented Costa Rica in this significant case, which constitutes a major milestone for Costa Rica's traditional and strong policy for the protection of the environment.

THE TRIBUNAL'S AWARD

The Claimants – citizens of the United States of America – brought claims under Chapter Ten, titled "Investment", of the Dominican Republic-Central America Free Trade Agreement ("**DR-CAFTA**") against Costa Rica. The dispute arose from investments comprising several parcels of land and a concession site in Esterillos Oeste on Costa Rica's Pacific coast in 2002 to develop a real estate project, the "Las Olas Project".

The Claimants alleged they obtained all municipal permits and approvals, including environmental viability and construction permits, required to commence the development. They argued that based on unsupported complaints by neighbours to the site, local authorities conducted inspections and identified alleged wetlands and forests within the project site. According to the Claimants, the administrative and judicial actions that shut down the project to avoid further environmental harm – which caused the destruction of the investment – were in breach of Costa Rica's obligations under the DR-CAFTA. In particular, the Claimants alleged that Costa Rica had failed to afford them fair and equitable treatment, had treated them discriminatorily and had indirectly expropriated their right to the value of their investment without compensation.⁴

In response, Costa Rica argued that the protection of the environment is a key governmental policy acknowledged under the DR-CAFTA, that the rights of investment protection granted to investors under the treaty may be subordinated to the protection of the environment, and that it had acted in accordance with its environmental laws to prevent further environmental harm to its protected ecosystems. Costa Rica also filed a counterclaim against the Claimants for breach of mandatory rules of environmental protection based on Article 10.16 of the treaty,⁵ and reasons of procedural economy and efficiency.

The Tribunal concluded that Costa Rica's actions were neither arbitrary nor in breach of the DR-CAFTA. A wetland had been damaged by the Claimants' development activities and the state's measures to protect the wetland were taken in accordance with domestic laws and international law. The Tribunal also found that DR-CAFTA could provide jurisdiction to hear counterclaims by Contracting States against investors for breach of the treaty's environmental and other obligations but rejected Costa Rica's counterclaim for environmental damage for procedural reasons.

STATES MUST ADOPT AND ENFORCE THEIR ENVIRONMENTAL LAWS IN A FAIR, NON-DISCRIMINATORY FASHION, FOLLOWING PRINCIPLES OF DUE PROCESS

While older generations of bilateral investment treaties ("**BITs**") generally do not include provisions relating to environmental obligations – as their primary purpose is to protect foreign investments – modern trade agreements more frequently include provisions to address states' environmental concerns. In this regard, since the early 1990s countries such as Canada, Mexico, the US, Belgium, Luxembourg and the Netherlands have included environmental language in their more recent treaties.⁶ The way in which states have incorporated environment-specific language into their treaties varies: some include a preamble where the object and purpose of the treaty mentions the environment;⁷ others confer wider latitude to states and enable them to determine their own level of environmental protection with carve-out clauses in relation to investment protection for environmental protection;⁸ while others include provisions on corporate social responsibility by incorporating soft law and guidelines.⁹

Consistent with this trend, the DR-CAFTA adopted the approach taken in the US 2004 and 2012 Model BITs¹⁰ to include a series of provisions relevant to environmental protection, and went even further to include a complete chapter (Chapter Seventeen, titled "Environment") dedicated to its Contracting States' environmental obligations. A key provision from the treaty which seeks to balance the Contracting States' obligations in Chapters Seventeen and Ten is Article 10.11, which provides that:

"Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns."

In interpreting this provision, the Tribunal recognized that the express terms of the DR-CAFTA subordinate the rights of investors to the rights of states to ensure investments are carried out "in a manner sensitive to environmental concerns".¹¹ However, the Tribunal held that this did not give Costa Rica an "absolute right" to implement its environmental laws as it desired but that it must do so in a fair, non-discriminatory fashion, following principles of due process.

After setting this standard, the Tribunal went on to analyse whether Costa Rica's conduct vis-à-vis the Claimants had been compliant with the DR-CAFTA and customary international law. After conducting a heavily fact-based assessment, the Tribunal concluded that Costa Rica's conduct was not in breach of the DR-CAFTA.

STATES' COUNTERCLAIMS ARE ADMISSIBLE UNDER DR-CAFTA

For the first time, an investment tribunal has ruled that counterclaims by respondent states are admissible under Chapter 10 of DR-CAFTA.

First, the Tribunal looked at the treaty's language.¹² While Chapter 10 sets out Contracting States' obligations, it could be concluded that only states can be sued and investors cannot be respondents. However, Chapter 10 also contains implicit obligations for investors with respect to compliance with environmental laws of a host state. In this sense, for the Tribunal, the investors' obligations to comply with environmental laws would not only arise under domestic laws and regulations, but also under Chapter 10 of the DR-CAFTA. The Tribunal went on to say that if those provisions could be interpreted to impose affirmative obligations upon investors, then it was "not impossible either de facto or de jure, that a foreign investor could be found to breach an obligation under Section A [of Chapter 10], by the violation of environmental domestic laws and regulations."¹³

Second, the Tribunal acknowledged that most investment tribunals have not recognized jurisdiction over counterclaims in the absence of explicit agreement between the parties to submit a counterclaim to the Tribunal. However, the Tribunal noted that two recent ICSID tribunals had asserted jurisdiction over a counterclaim in the cases of *Urbaser v Argentina*¹⁴ and *Burlington v Ecuador*.¹⁵

The Tribunal distinguished *Burlington* from the case before it, since in that case the parties had reached an agreement expressing their consent to resolve counterclaims arising out of the investments through arbitration, thus there was no challenge to the tribunal's jurisdiction. In addition, the tribunal in *Burlington* relied on Article 46 of the ICSID Convention, which empowers ICSID tribunals to decide "counterclaims arising directly out of the subject-matter of the dispute provided that they are within the scope of the consent of the parties and are otherwise within the jurisdiction of the Center."

In *Urbaser*, the tribunal found that the counterclaim had sufficient nexus to the underlying investment contract and the Respondent's right to bring counterclaims against investors was "supported by the need to avoid the duplication of procedures and to prevent the risk of contradictory decisions".¹⁶ The Tribunal in *Aven* agreed with the tribunal in *Urbaser*, which affirmed its jurisdiction to hear Argentina's counterclaim based on Articles 25 and 46 of the ICSID Convention and Article X of the Argentina-Spain BIT, stating that it could no longer be considered that investors operating internationally were immune from becoming subjects of international law, specifically with regards to the protection of the environment.¹⁷ In this sense, the Tribunal recalled the International Court of Justice's observation in *Barcelona Traction* that, "[i]n view of the importance of the rights involved, all states can be held to have a legal interest in their protection; they are obligations erga omnes".¹⁸

The Tribunal considered that "environmental law is integrated in many ways to international law, including DR-CAFTA" and that although the enforcement of environmental laws is primarily to the states, foreign investors are also subject to international law obligations in light of the specific environmental protection provisions of the treaty.¹⁹

Similarly, the Tribunal considered that under Section A of Article 10 of the DR-CAFTA, investors have an obligation to abide by and comply with a state's measures to protect the environment and there are no "substantive reasons to exempt [a] foreign investor of the scope of claims for breaching obligations under Article 10 Section A DR-CAFTA, particularly in the field of environmental law."²⁰

Finally, the Tribunal considered issues of procedural economy and efficiency by referring to Prof Reisman's 2011 Dissenting Opinion in *Spyridon Roussalis v Romania*,²¹ noting that Article 46 of the ICSID Convention worked to the benefit of the respondent state and the investor.

CONCLUSION

The award in *David Aven v Costa Rica* is highly significant. It contributes to the development of the jurisprudence regarding the interaction between a state's right to apply and enforce its environmental protection laws and the protection of investments. *Aven* is also only the second publicly known case to recognize that states may bring counterclaims against investors.

Given Costa Rica's focus on environmental protection and tackling environmental issues,²² this award is of considerable importance to that country. It affirms Costa Rica's right to protect its environment, finding that the measures taken to protect wetlands and forests were not arbitrary or in breach of the trade agreement.

The award also alerts investors of the limits to the development of their investments within Costa Rica (and DR-CAFTA Contracting States more widely): investments must be carried out "in a manner sensitive to environmental concerns",²³ and in accordance with the environmental laws of the host state.

The wider impact of this award has not yet been felt. However, the Tribunal's reasoning confirms that the Aven case can be seen within the context of a wider trend in investment treaty jurisprudence of holding investors accountable as subjects of international law. For instance, for investors, compliance with domestic and international environmental obligations might now be critical before considering bringing a treaty claim.

The possibility of counterclaims is also a fascinating development and one that we will all, no doubt, be watching with interest. This is yet another issue for careful consideration by investors, who might now have to include the possibility of facing a counterclaim in any risk assessment they conduct prior to pursuing international law avenues. Then again, respondent states would certainly embrace this decision as a useful precedent for future defences from claims where compliance with environmental law might be part of the issues in dispute.

NOTES

1. Martin Wagner, J., "International Investment, Expropriation and Environmental Protection", 29 Golden Gate U. L. Rev., 1999, pp. 465-466; Sundararajan, A., "Environmental Counterclaims: Enforcing International Environmental Law Through Investor-State Arbitration", Salzburg Global.
2. Parlett, K. and Ewad, S., "Protection of the environment in investment arbitration – a double edged sword", 20 *Essex Street Bulletin*, September 2017; Viñuales, J. E., *Foreign Investment and The Environment In International Law*, Cambridge University Press, pp. 17-18 (explaining that only four investment disputes with environmental components occurred prior to the year 2000).
3. *David R. Aven and others v. Republic of Costa Rica*, ICSID Case No. UNCT/15/3, Award, 18 September 2018 (hereinafter *David Aven v. Costa Rica*).
4. *Id.*, paras. 359-363.
5. DR-CAFTA, Article 10.16: Submission of a Claim to Arbitration: "1. In the event that a disputing party considers that an investment dispute cannot be settled by consultation and negotiation: (a) **the claimant, on its own behalf**, may submit to arbitration under this Section a claim (i) that the respondent has breached (A) an obligation under Section A, (B) an investment authorization, or (C) an investment agreement; and (ii) that **the claimant** has incurred loss or damage by reason of, or arising out of, that breach; and (b) **the claimant, on behalf of an enterprise of the respondent** that is a juridical person that the claimant owns or controls directly or indirectly, may submit to arbitration under this Section a claim (i) that the respondent has breached (A) an obligation under Section A, (B) an investment authorization, or (C) an investment agreement; and (ii) that the enterprise has incurred loss or damage by reason of, or arising out of, that breach. [...]" (Emphasis added).

6. For example, US Model BITs (2004 and 2012), United States-Georgia BIT (1994), United States-Trinidad and Tobago BIT (1994), United States-Uzbekistan BIT (1994); Mexico-Costa Rica FTA (1994), Articles 11.04, 13-15. Belgium/Luxembourg BITs contain language on the environment in addition to provisions confirming the state's right to legislate to protect the environment and excluding environmental measures from the scope of the dispute settlement mechanism. See for example, Belgium/ Luxembourg-Libya BIT (2004), Article 5 "Environment" and Belgium/ Luxembourg-Colombia BIT (2009), Article VII, "Environment".

7. The first references to environmental concerns appear in BITs signed by the U.S in 1994 and FTAs. These were later followed by China, Finland, Germany, Japan, Korea, the Netherlands, Sweden, Switzerland. The North American Free Trade Agreement preamble states: "Undertake each of the preceding in a manner consistent with environmental protection and conservation; ... strengthen the development and enforcement of environmental regulation." The Energy Charter Treaty (ECT) preamble also contains language related to the environment: "Recognizing the necessity for the most efficient exploration, production, conversion, storage, transport, distribution and use of energy; Recalling the United Nations Framework Convention on Climate Change, the Convention on Long-Range Transboundary Air Pollution and its protocols, and other international environmental agreements with energy-related aspects; and [...]."

8. See for example, China-Canada BIT (2012), Canada-Slovak Republic BIT (2010), Mexico-Bolivia FTA (1994), Mexico-Costa Rica FTA (1994), United States-Georgia BIT (1994), United States-Trinidad and Tobago BIT (1994), United States-Uzbekistan BIT (1994); see also, Zhan, J., "Investment policies for sustainable development: addressing policy challenges in a new investment landscape," in Echandi, R., and Sauvé, P., eds., **Prospects in International Investment Law and Policy**, Cambridge University Press, 2013, p. 26 and UNCTAD, World Investment Report: *Investing in a Low-Carbon Economy*, 2010.

9. See, Canada-Benin BIT (2013) and Brazil-Mozambique BIT (2015). The Dutch 2018 Model BIT includes reference to the G20 Guiding Principles for Global Investment Policymaking.

10. The 2004 and 2012 US Model BIT, state in their preamble: "Desiring to achieve these objectives in a manner consistent with the protection of health, safety, and the environment [...]." and "Article 12: Investment and Environment" acknowledges that it is "inappropriate to encourage investment by weakening or reducing the protections afforded to domestic environmental [...]."

11. *David Aven v. Costa Rica*, paras. 733-734.

12. DR-CAFTA, Article 10.9.3.c, “[...] paragraphs 1(b), (c), and (f), and 2(a) and (b), shall not be construed to prevent a Party from adopting or maintaining measures, including environmental measures: (i) necessary to secure compliance with laws and regulations that are not inconsistent with this Agreement; (ii) necessary to protect human, animal, or plant life or health; or (iii) related to the conservation of living or non-living exhaustible natural resources. [...]”; Article 10.11, “Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.”

13. *David Aven v. Costa Rica*, Award, para. 735.

14. *Burlington Resources Inc v. The Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Counterclaims, 7 February 2017 (hereinafter *Burlington v. Ecuador*).

15. *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic*, ICSID Case No. ARB/07/26, Award, 8 December 2016 (hereinafter *Urbaser v. Argentina*).

16. *Id.*, paras. 1118, 1151.

17. *David Aven v. Costa Rica*, Award, para. 738 citing *Urbaser v. Argentina*, Award, para. 1195.

18. International Court of Justice, *Barcelona Traction, Light and Power Company, Limited*, Report, 1970, para. 33 cited in *David Aven v. Costa Rica*, Award, para. 738.

19. *David Aven v. Costa Rica*, Award, para. 737.

20. *Id.*, para. 739.

21. *Spyridon Roussalis v. Romania*, ICSID Case No. ARB/06/1, Award, 7 December 2011.

22. See *David Aven v. Costa Rica*, paras. 417-420.

23. *Id.*, paras. 733, 739.

[More Inside Arbitration](#)

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



**CHRISTIAN
LEATHLEY**
PARTNER, NEW YORK

+1 917 542 7812
Christian.Leathley@hsf.com



DANIELA PAEZ
ASSOCIATE, NEW
YORK

+1 917 542 7829
Daniela.Paez@hsf.com

SUBSCRIBE TO STAY UP-TO-DATE WITH INSIGHTS, LEGAL UPDATES, EVENTS, AND MORE

Close