Threat of Inconsistent Awards to International Investment

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Abstract

In today's highly globalized world, international investment has become an indispensable factor for the economic growth of all countries. One of the reasons for the growth of international investment is an increase of bilateral investment treaties and free trade agreements of which investor-state arbitration is a distinctive feature. Yet, investment arbitration decisions are, unfortunately, not consistent. Where treaty provisions are similar or the same and facts relating to disputes are similar, arbitral tribunals often come up with different decisions. This situation has triggered the concern of the international community. This article will examine whether the current system and practice are conducive to the across border flow of capital and technology with a view to recommend some alternatives. Emphasis will be on cases relating to the interpretation of State responsibility and the most favored nation treatment clause.

Key Words: divergence, investment arbitration, international investment, arbitral tribunal, state responsibility, state of necessity, most-favored-nation clause, treaty interpretation, necessity defense, proportionality

Ⅰ. Introduction

With the development of globalization, as evidenced by the increased interdependence among all members of the international community, international economic cooperation and intercourse have become closer and more frequent. This has resulted in increasing cross-border capital flows, transfers of technology and trade in goods and services. Through this process, direct foreign investment has become ever more important in the economic development of all countries and has become one of the primary impetuses of economic growth.[1]

In so far as host States are concerned, international investment can accelerate national economic growth and the overall progression of the society by introducing scarce capital and technology, promoting industrial structural adjustment and technological innovation, increasing employment and enhancing the standard of living. From the point of view of foreign investors, international investment provides opportunities in a foreign State which can provide good conditions and where profits, often sizable profits, can be made.

As a result of globalization, all countries—large and small, developed and developing—are favorably inclined towards foreign investment, and even compete to attract it. To do so, each is prepared to offer good or even better conditions for foreign investors. This phenomenon—liberalization of foreign investment—is in sharp contrast to the situation of the 1970s and even 80s when host States tried to control foreign investments by imposing restrictive conditions.[2] The liberalization of investment has led host States to promise national treatment, most-favored-nation (MFN) treatment, fair and equitable treatment, full protection and security, minimum standards of treatment, etc. and, in doing so, have much improved market access by foreign investors. An important compromise made by many countries in their efforts to attract foreign investment is permission of investor-state arbitration which has become a trend since the 1990s. The fast spreading of arbitration has resulted in

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1. In the view of Johanna Kalb, "Attracting foreign direct investment (FDI) is key to economic growth for both developing and developed states. In the last few decades, FDI has expanded tremendously." *See* Johanna Kalb, "*Creating an ICSID Appellate Body*", 10 *UCLA J. Int'l L. & Foreign Aff.* 179, 180 (2005)..

2. *Id*. *See also* Susan D. Franck, "*The Legitimacy Crisis in Investment Treaty Arbitration: Privatizating Public International Law Through Inconsistent Decisions*", 73 *Fordham L. Rev*. 1521, 1524 (2005).

contradictory decisions which are now a serious concern of the international community. The perception is that current investment arbitration is biased in favor of foreign investors. This article will examine whether the current mechanism of investor-state arbitration and its implementation are conducive to across border investment, and what changes are needed to ensure a healthy growth of foreign investment.

Ⅱ. Contradictory Decisions of Tribunals: An Example Relating to Interpretation of the MFN Clause

Bilateral investment treaties (BITs) are intended to encourage the flow of foreign investment by granting foreign investors rights to MFN treatment, national treatment, fair and equitable treatment, full protection and security, minimum international standards of treatment, no expropriation without due compensation, and unilateral resort by foreign investors to international arbitration for settlement of investment disputes without requirements to submit such disputes to national jurisdictions. Through such provisions, host States give broad and effective substantive protection and procedural guarantees to foreign investors. As countries nowadays compete for foreign capital and technology, very few BITs or multilateral investment agreements contain provisions on the social responsibility of investors.[3]

However, under BITs, the enforcement of the rights foreign investors may have a significant impact on the host State. In this regard, whether a BITs provision is properly interpreted by arbitral tribunals will not only affect the interest of foreign investors but also that of the host State. International practice in this area is not unfortunately desirable. A development that is often being criticized is the inconsistency of arbitral awards. For instance, one commentator stated that “different tribunals come to different results under nearly identical textual treaty rights” and that “legal inconsistencies in the area of investment arbitration affect foreign investment decisions, economic

3. However, as notable exceptions to this, *see*, The Unified Agreement for the Investment of Arab Capital in the Arab States, art. 14 (1980); and Agreement for Promotion, Protection and Guarantee of Investments among the Member States of the Organization of the Islamic Conference, ch. 2, art. 9 (1981).

development, and foreign relations."[4]

This section is to focus the divergence of ICSID tribunals in determining the applicability of the MFN clause to dispute settlement issues. The Tribunal in *Maffezini v Spain* ruled that the goal of the BIT in question was investor protection and that dispute settlement arrangements were inextricably related to the protection of foreign investors; therefore, the MFN clause could be extended to procedural matters, including dispute resolution provisions.[5] Such an expansive interpretation was followed in *Siemens A.G. v Argentine*,[6] *Gas Natural v Argentina*,[7] *Tecmed v Mexico*,[8] and *Vivendi v Argentina*.[9]

In the recent *Hochtief v Argentina* case,[10] the Tribunal also allowed the investor, through operation of the MFN clause in the Argentina–Germany BIT (as the base treaty), to bypass the 18-month local court requirement before bringing its claims to international arbitration. In its analysis, the Tribunal noted the implicit limitations of a MFN clause as stated by the International Law Commission in its Commentary on its Draft Articles on Most-Favored-Nation clauses. It then went on to state:

> *[T]he MFN clause cannot create a right to go to arbitration where*

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4. Susan D. Franck, "*The Nature and Enforcement of Investor Rights under Investment Treaties: Do Investment Treaties Have a Bright Future*," 12 *U. C. Davis L. Rev. 47, 55-57 (2005).*

5. *Emilio Agustín Maffezini v Kingdom of Spain,* Case No. ARB/97/7, Decision on Jurisdiction, ¶ 54 (ICSID Jan. 25, 2000), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC566_En&caseId=C163.

6. *Siemens A.G. v Argentine Republic*, Case No. ARB/02/8, Award, (ICSID Feb. 6, 2007), http://italaw.com/documents/Siemens-Argentina-Award.pdf.

7. *Gas Natural SDG, S.A. v Argentine Republic*, Case No. ARB/03/10, Decision of the Tribunal on Preliminary Questions on Jurisdiction, (ICSID June 17, 2005), http://www.asil.org/pdfs/GasNat.v.Argentina.pdf.

8. *Técnicas Medioambientales Tecmed, S.A. v United Mexican States*, Case No. ARB(AF)/00/2, Award, (ICSID May 29, 2003), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC602_En&caseId=C186.

9. *Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A v Argentine Republic*, Case No. ARB/03/19, Order in Respond to a Petition by Five Non-governmental Organizations for Permission to Make an Amicus Curiae Submission, (ICSID Feb. 12, 2007), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC519_En&caseId=C19.

10. *Hochtief AG v The Argentine Republic*, Case No. ARB/07/31, Decision on Jurisdiction, (ICSID Oct. 24, 2011), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC2351_En&caseId=C260.

> *none otherwise exists under the BIT. The argument can be put more generally: the MFN clause stipulates how investors must be treated when they are exercising the rights given to them under the BIT but does not purport to give them any further rights in addition to those given to them under the BIT.*[11]

To answer the question whether bypassing the requirement of an 18-month litigation in the local courts would constitute "a distinct or new right" or "rather a matter of the manner in which those who already have a right to arbitrate are treated",[12] the *Hochtief* Tribunal concluded:

> *[I]t cannot be assumed that Argentina and Germany intended that the MFN clause should create wholly new rights where none otherwise existed under the Argentina-Germany BIT. The MFN clause stipulates a standard of treatment and defines it according to the treatment of third parties. The reference is to a standard of treatment accorded to third parties, not to the extent of the legal rights of third parties. Non-statutory concessions to third party investors could, in principle, form the basis of a complaint that the MFN obligation has not been secured.*[13]

The question is what difference, if any, does it make to define the 18-month local litigation period as a right or as a treatment. The other question is what criteria should be adopted in determining whether a provision is a right rather than a treatment. The third question is the legal basis for adopting such criteria. The *Hochtief* admitted that "there is no established criterion to distinguish for this purpose between a 'right' and 'treatment in relation to the exercise of a right'".[14] Yet it considered that "there are several indications that the 18-month pre-arbitration litigation requirement should be regarded as a matter of the treatment of investors in exercising their rights in relation to dispute settlement and not as the subject of a distinct right".[15] In the view

11. *Id* .¶ 79.
12. *Id*. ¶ 80.
13. *Id*. ¶ 81.
14. *Id* .¶ 82.
15. *Id*. ¶ 83.

of Tribunal, under the Argentina-Germany BIT, the Claimant would have the right to unilaterally submit its claims to international arbitration, once the 18-month litigation period had passed. At the same time, investors under the Argentina-Chile BIT may bring a dispute to international arbitration unilaterally without any waiting period. The tribunal considered investors under both BITs had the same right to submit their dispute to international arbitration in the end. Based on the above reasons, the Tribunal supported the Claimant's position. The issue is that the 18 months requirement is stipulated in the treaty. Where such a requirement has been modified or ignored by arbitral tribunals, other treaty provisions may be subject to the liberal interpretation of tribunals. In the end, the genuine intent of the contracting parties may not be realized in practice. It is often the case that a treaty provides strict procedures for revising its contents. Where it is difficult for the contracting parties to amend their agreement so reached, they may be modified by arbitral tribunals without the consent of contracting states in practice. Ultimately, where arbitral tribunals make contradictory decisions, at least some of them must be wrong and should therefore be corrected.

Impregilo[16] is another case that involved the interpretation of the MFN clause. The question facing the Tribunal was whether international arbitration was more favorable when compared with local court procedures. It addressed the issue by examining "whether a *choice* between domestic proceedings and international arbitration, as in the Argentina–US BIT, is more favorable to the investor than compulsory domestic proceedings before access is opened to arbitration".[17] The answer was then quite obvious, as no one would argue that a treaty which allows a choice is not more favorable than one which does not. The Tribunal also examined and attached importance to the provision "all other matters regulated by this Agreement". It concluded that all previous arbitral decisions, when dealing with treaty provisions like the one mentioned above, had extended the application of the MFN clause to dispute settlement.[18] It also stressed the importance of maintaining consistency in interpreting treaty provisions, stating that:

16. *Impregilo S.p.A. v Argentine Republic*, Case No. ARB/07/17, Award, (ICSID June 21, 2011), http://italaw.com/documents/Imgregilov.ArgentinaAward.pdf.

17. *Id*. ¶ 101 (emphasis original).

18. *Id.* ¶¶ 103, 108.

> *... the Arbitral Tribunal finds it unfortunate if the assessment of these issues would in each case be dependent on the personal opinions of individual arbitrators. The best way to avoid such a result is to make the determination on the basis of case law whenever a clear case law can be discerned.*[19]

Strictly speaking there is no case law or *stare decisi* in international investment law, although it might be argued that the principle of *stare decisis* exists *de facto*. The function of arbitration also differs from that of common law courts. It is an idealistic concept that where the case law is clear arbitral tribunals will follow it. The reality is that the jurisprudence of investment law is by no means consistent. Even arbitrators on the same tribunal often have different views. In *Impregilo,* for example, the minority arbitrator, in her dissenting opinion, severely criticized decisions rendered by previous investment tribunals on the application of the MFN clause. In her view:

> *Unless specifically stated to the contrary, the qualifying conditions put by the State in order to accept to be sued directly on the international level by foreign investors cannot be displaced by an MFN clause, and a conditional right to ICSID cannot magically be transformed into an unconditional right by the grace of the MFN clause.*[20]

Fraport v. the Philippines[21] and Malaysian Historical Salvors v. Malaysia[22] are two other examples. The minority arbitrator in each case held sharply different views from that of the majority. As a matter of fact, dissenting opinions have often been expressed in ICSID and other investment arbitrations.[23]

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19. *Id*. ¶ 108.
20. *Impregilo S.p.A. v. Argentine Republic*, Concurring and Dissenting Opinion, Brigitte Stern, ¶ 99.
21. *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines*, Case No. ARB/03/25, Award, (ICSID Aug. 16, 2007), http://italaw.com/documents/FraportAward.pdf.
22. *Malaysian Historical Salvors, SDN, BHD v. Malaysia*, Case No. ARB/05/10, Decision on the Application for Annulment, (ICSID Apr. 16, 2009), https://icsid.worldbank.org/ICSID/FrontServlet.
23. For further discussion on the matter, *see* David Schneiderman, "*Judicial Politics and In-*

Regarding treaty interpretation, another issue of interest in *Impregilo* was the contention of Argentina that the words "within its own territory" should limit the scope of the MFN clause. The Tribunal stated that "the question as to what legal protection Argentina shall give to foreign investors is in no way an issue over which Argentina has no power to decide, nor is it tied to any particular territory".[24] Thus, in the Tribunal's view, the application of the MFN clause was not limited by the provision of "within its own territory", which is common phrasing in BITs and FTAs. Such conclusion therefore has far-reaching effects on international investment and treaty practice.

The most difficult issue that had to be dealt with in *Impregilo* was the fact that, subsequent to the signing of the Argentina–US BIT, some of the BITs concluded by Argentina with other countries continued to contain a jurisdictional requirement similar to that of the Argentina–Italy BIT. The implication of this practice, as argued by Argentina, was that Argentina did not intend to have such provisions replaced or revised via the operation of the MFN clause. Unfortunately, the *Impregilo* Tribunal did not elaborate on this issue. Rather, it stated that "the argument becomes less persuasive in the present case, because the Italy–Argentina BIT (signed on 22 May 1990) preceded the Argentina–US BIT (signed on 14 November 1991)".[25] It is common knowledge that when negotiating with another country on unequal footing, a weaker country may be "bullied" into agreeing to special provisions or arrangements. In such circumstances, a broad interpretation of the MFN clause will not reflect the intent of the weaker country in relation to its granting of MFN treatment to other countries.

Nevertheless, in *Salini v Jordan*, the Tribunal refused to accept the investor's plea and refused jurisdiction via the MFN clause over the case. In its view, the base treaty did not expressly provide that the MFN clause would apply to dispute resolution and there was no indication that the parties intended the clause to apply to do so.[26] Similarly, the *Plama v Bulgaria* Tri-

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ternational Investment Arbitration: Seeking an Explanation for Conflicting outcomes," 30 *Nw. J. Int'l L. & Bus*.383 (Spring 2010).

24. *Impregilo*, Award, *supra* note.16, ¶ 100.

25. *Id*. ¶ 102.

26. *Salini Construttori S.p.A. and Italstrade S. p.A. v The Hashemite Kingdom of Jordan*, Case No. ARB/02/13, Decision on Jurisdiction, ¶¶ 114-19 (ICSID Nov. 29, 2004), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC635_En&caseId=C218.

bunal rejected the expansive interpretation of the MFN clause adopted by the *Maffezini* Tribunal. It asserted that "[d]oubts as to the parties' clear and unambiguous intention [could] arise if the agreement to arbitrate [was] to be reached by incorporation by reference".[27] The Tribunal held that the MFN clause should not apply to dispute settlement except when there was a clear intention of the parties.

The Tribunal in *Hicee v Slovak Republic*[28] took a similar view. It rejected the investor's claim, by operation of the MFN clause, to expand the notion of investment in the BIT. The *Hicee* Tribunal stated that "the clear purpose of [the MFN clause] is to broaden the scope of the substantive protection granted to the eligible investments of eligible investors; it cannot legitimately be used to broaden the definition of the investors or the investments themselves".[29] Therefore, at least by implication, in the view of the *Hicee* Tribunal, the application of the MFN clause should not be extended to procedural matters such as jurisdiction.

In *Telefónica,*[30] the Tribunal regarded the local remedy requirement "as a temporary bar to the initiation of arbitration" or a matter of inadmissibility which "would result in the Tribunal's temporary lack of jurisdiction".[31] The *Wintershall*[32] Tribunal regarded BIT provisions relating to dispute settlement as comprising a standing offer of the host State, in which "the eighteen-month requirement of a proceeding before local courts … [was] an essential preliminary step to the institution of ICSID Arbitration".[33] Therefore, in order to access ICSID arbitration, the investor must accept the entire terms of the standing offer and first satisfy the local remedy requirement. In the end, the Tribunal in *Wintershall* also found the recourse to local court proceedings to

27. *Plama Consortium Limited v Republic of Bulgaria*, Case No. ARB/03/24, Decision on Jurisdiction, ¶ 199 (Feb.8, 2005), http://www.asil.org/pdfs/ilibdecision050225.pdf.

28. *Hicee Bv v Slovak Republic*, Partial Award, (UNCITRAL May 23, 2011), http://www.italaw.com/documents/HICEEv.SlovakRepublicPartialAwardandDissentingOpinion.pdf.

29. *Id*. ¶ 149.

30. *Telefonica S.A. v Argentine Republic*, ICSID Case No. ARB/03/20, Decision of the Tribunal on Objections to Jurisdiction, 25 May 2006; available at: <http://www.italaw.com/documents/DecisiononJurisdictionTelefonica.pdf>.

31. *Id.* ¶ 93.

32. *Wintershall Aktiengesellschaft v Argentine Republic*, ICSID Case No. ARB/04/14, Award, 8 December 2008; available at: <http://www.italaw.com/documents/Wintershall.pdf>.

33. *Id*. ¶ 160.

be a matter which was jurisdictional in nature.[34]

Two recent cases—*Burlington v Ecuador*[35] and *Murphy v Ecuador*[36]—considered that the non-compliance with a treaty requirement relating to local remedies would justify dismissal of the claims by foreign investors. The *Murphy* Tribunal disagreed with the decisions of previous tribunals and stated:

[T]he requirement that the parties should seek to resolve their dispute through consultation and negotiation for a six-month period [as required by Article VI of the Ecuador-US BIT] does not constitute, as Claimant and some arbitral tribunals have stated, 'a procedural rule' or a 'directory and procedural' rule which can or cannot be satisfied by the concerned party. To the contrary, it constitutes a fundamental requirement that Claimant must comply with, compulsorily, before submitting a request for arbitration under the ICSID rules.[37]

The *Burlington* case was based on the same underlying BIT as that in the *Murphy* case. The *Murphy* Tribunal noted that, under the BIT, "a dispute under Article VI(3)(a) only arises once an allegation of Treaty breach is made, the six-month waiting period only begins to run at that point in time".[38] While the *Burlington* Tribunal agreed with the Claimant that Article VI(3) did not require formal notice and that some form of evidence, such as meeting minutes, would satisfy the requirement,[39] it found that the Claimant:

> *... made no allegations of Treaty breach in connection with the indigenous opposition in Blocks 23 and 24 prior to filing its Request for Arbitration. As a result, the waiting period of Article VI(3)(a) did not begin to run. And while Burlington did make allegations of Treaty breach once it filed its Request for Arbitration, at which point the dispute arose, it failed to comply with the six month waiting pe-*

34. *Id*. ¶ 172.

35. *Burlington Resources Inc. v Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Jurisdiction, 2 June 2010.

36. Murphy Exploration and Production Company International v Republic of Ecuador, ICSID Case No. ARB/08/4, Award on Jurisdiction, 15 December 2010.

37. *Id*. ¶ 149.

38. *Burlington v Ecuador, supra*, note 35, ¶ 336.

39. *Id*. ¶ 337.

riod, as it should have, before filing the Request.[40]

As a result, it decided the Claimant's claim to be inadmissible. The *Burlington* and *Murphy* tribunals' position that non-compliance with treaty requirements relating to local remedy procedures will justify dismissal of claims notwithstanding, it is still too early to conclude that they represent the new trend in deciding such issues. Nor can they yet be considered to signify a trend of consistency in investment arbitration decisions either.

The inconsistency in the decisions of investment tribunals has detrimental effects on the development of international investment law. In theory, decisions made by a tribunal only bind the parties to the case. In practice, however, a huge jurisprudence of investment law has been created in which the principle of *stare decisis* is recognized *de facto*.[41] Tribunals openly state that although they are not bound by the decisions adopted by other tribunals, they are nonetheless expected to pay due regard to earlier decisions and to adhere to the solutions established in a series of consistent cases, subject to the specific treaty provisions and the facts of a case.[42] The divergence and contradictory decisions of tribunals have made international investment law very uncertain. Parties in every case can find previous decisions that support their own case. Arbitrators in each case have to make the judgment of law by themselves. As mentioned by some tribunals, in expressing their own views on matters of law, some arbitrators may have done nothing other than express their personal views or their best understanding of the law.[43] The continua-

40. *Id*. ¶ 336.

41. Tai-Heng Cheng analyzed several areas of international investment arbitration and concluded that there was a system of precedent. *See* Tai-Heng Cheng, "*Precedent and Control in Investment Treaty Arbitration*," 30 *Fordham Int'l L.J.* 1014 (2007).

42. *See, Saba Fakes v Turkey*, Case No. ARB/07/20, Award, ¶ 96 (ICSID July 14, 2010), http://italaw.com/documents/Fakes_v_Turkey_Award.pdf. "The Tribunal is not bound by the decisions adopted by previous ICSID tribunals. At the same time, it believes that it should pay due regard to earlier decisions of such tribunals. … [I]t ought to follow solutions established in a series of consistent cases that are comparable to the case at hand, subject to the specificity of the treaty under consideration and the circumstances of the case. By doing so, it will fulfill its duty to seek to contribute to the harmonious development of investment law and thereby meet the legitimate expectations of the community of States and investors towards certainty of the rule of law."

43. For instance, the *Impregilo* Tribunal indirectly criticized the practice of some tribunals by saying that it found it "unfortunate if the assessment of these issues would in each case be dependent on the personal opinions of individual arbitrators"; *see*, *Impregilo*, *supra* note

tion of this situation will lead, in addition to uncertainty and unpredictability, to time-consuming and non-cost-effective processes of arbitration, which is contrary to the very basis of arbitration.

Ⅲ. Discretionary Treaty Interpretations

Contradictory arbitration decisions are mostly the result of the discretionary application of treaty interpretation principles or of the misinterpretation of treaties. Where the rules relating to treaty interpretation are misapplied, the intended goals and objects of the treaties in question will not be achieved. The way in which BITs are interpreted by investment tribunals is at times a cause of concern to the international community.[44] The Vienna Convention on the Law of Treaties (VCLT) sets out the rules for interpreting international treaties and is widely recognized by the international community. Article 31(1) of the VCLT prescribes the general rule of interpretation: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." Article 31(3) states: "There shall be taken into account, together with the context: … (c) any relevant rules of international law applicable in the relations between the parties."[45]

16, ¶ 108.

44. For instance, a commentator stated that "the incoherence in the developing ICSID jurisprudence reflects true continued disagreement among states on the underlying principles of investment law. The diversity necessary to achieve credibility in the international community brings a diversity of political perspectives to the arbitral process." *See* Kalb, *supra* note 1, at 203. Please also see the discussion of Section III of this article.

45. Article 31 of the VCLT reads as follows:
"1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
(a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
(b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. There shall be taken into account, together with the context:
(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

Therefore, the principle and method of interpretation of a BIT requires that attention be paid to the textual meaning, the contextual meaning, the object and purpose of the BIT, and the real intentions of the two contracting parties. This method of interpretation involves a comprehensive analysis rather than the consideration of these factors in a sequential and hierarchical order. Consequently, if an international arbitration tribunal does not give a reasonable interpretation of a BIT provision or gives an excessively extensive interpretation because of unclear and ambiguous treaty provisions, it will violate the true meaning of the BIT and the real intentions of the contracting parties.

Tribunals should therefore be cautious in exercising their interpretative power. In the process of interpreting the provisions of a BIT, they should seek to identify the common and real intentions of the contracting parties when they entered into the treaty. The common intentions of the parties should not be ascertained in a unilateral and subjective manner but in a bilateral and objective fashion. Article 30, on "Governing Law", in the 2004 US Model BIT prescribes that the Parties' joint decisions on the interpretation of a provision, decided and declared by a designated representative of the Parties, shall be binding on a tribunal, and any decision or award issued by a tribunal must be consistent with that joint decision.[46] This provision emphasizes the importance of the original intentions of the two parties during the negotiation of a BIT and the necessity for tribunals to reasonably limit their interpretative powers to avoid excessively broad and random interpretations and abuse of authority.

A. State of Necessity

In practice, however, the performance of investment tribunals is unsatisfactory. There have been cases where although the material facts relating to disputes are similar and the treaty provisions are similar or the same, arbitra-

(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
(c) any relevant rules of international law applicable in the relations between the parties.
4. A special meaning shall be given to a term if it is established that the parties so intended."

46. *Article 30(3) of the 2004 US Model BIT*, prescribes: "A joint decision of the Parties, each acting through its representative designated for purposes of this Article, declaring their interpretation of a provision of this Treaty shall be binding on a tribunal, and any decision or award issued by a tribunal must be consistent with that joint decision."

tion tribunals nonetheless came up with different decisions.[47] For example, in several ICSID awards which dealt with claims against Argentina because of measures it instituted during its economic crisis in 2001-2002,[48] an important issue was whether Argentina had rightly adopted the measures to address the national emergency and could invoke this as a defense to exempt its obligations under the BIT between Argentina and the United States. The undesirable result was that different tribunals made divergent interpretations of the relationship between the provisions of the BIT and customary international law regarding the "defense of necessity". Tribunals denied Argentina's defense in the cases of *CMS v Argentina* (2005), *Sempra v Argentina* (2007) and *Enron v Argentina* (2007), but other tribunals upheld its defense in the cases of *LG&E v Argentina* (2007) and *Continental Casualty v Argentina* (2008).

In the cases *CMS* and *LG&E,* one of the issues was whether or not Argentina could rely on the "state of necessity" defense so as to be exempted from liability for breaches of the Argentina-US BIT that resulted from its measures adopted during the financial crisis. The *CMS* Tribunal concluded that Argentina had failed to satisfy the requirements of the necessity defense in accordance with customary international law. It observed that the Argentine government "policies and their shortcomings significantly contributed to the crisis and the emergency and while exogenous factors did fuel additional difficulties, they do not exempt the Respondent from its responsibility" in the matter.[49] The *CMS* Annulment Committee, while affirming the monetary compensation ordered in the original award, severely criticized the Tribunal's

47. For a discussion on the issue, *see* Schneiderman, *supra*,note 23.

48. Briefly, the claimants in those cases made investments in the Argentine natural gas industry which had been granted a license for the distribution of gas in Argentina. The foreign investors were granted a favorable legal and regulatory framework, and Argentina enacted legislation which guaranteed that tariffs for gas distribution would be calculated in US dollars ("PPI" adjustments). As a result of the economic crisis in 1990–2000, the Government abrogated the guarantees, which led to a great reduction in the profits earned in the gas distribution business. In 2001, the Government issued the "Corralito" Decree restricting bank withdrawals and prohibiting any transfer of money abroad. In 2002, the Government enacted the "Emergency Law", which abolished PPI adjustments, and abrogated the right to calculate gas distribution tariffs in US dollars, which was originally set at one Argentine peso to one US dollar.

49. *See CMS v Argentina*, Case No. ARB/01/8, Award, ¶ 329 (ICSID May 12, 2005), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC504_En&caseId=C4.

reliance on the Draft Articles on Responsibility of States for Internationally Wrongful Acts adopted by the UN International Law Commission (ILC Articles) relating to the necessity defense.[50] It considered that the Award contained manifest errors of law and that the Tribunal should have considered Article XI of the Argentina-US BIT as a distinct defense:

> *If state of necessity means that there has not been even a prima facie breach of the BIT, it would be, to use the terminology of the ILC, a primary rule of international law. But this is also the case with Article XI. In other terms, and to take the words of the International Court of Justice in a comparable case, if the Tribunal was satisfied by the arguments based on Article XI, it should have held that there had been "no breach" of the BIT. Article XI and Article 25 thus construed would cover the same field and the Tribunal should have applied Article XI as the lex specialis governing the matter and not Article 25.*[51]

The *LG&E* Tribunal, however, did treat Article XI of the Argentina–BIT as a distinct defense and concluded that Argentina had satisfied its criteria. In its view, the Argentine measures were *necessary* to maintain public order or to protect its essential security interests; as a result, Argentina, was exempted from liability for taking the disputed measures during the crisis. The Tribunal considered that Argentina had the power to adopt such policies so long as the measures in question had a social or general welfare purpose and were not obviously disproportionate to that purpose.[52]

One of the reasons for the two tribunals' contradictory decisions may be their divergence in interpreting the relationship between Article XI of the Argentina-US BIT[53] and Article 25 of the ILC Articles).[54] Needless to say, as

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50. *See CMS v Argentina*, Case No. ARB/01/8, Annulment, ¶¶ 158, 163 (ICSID Sept. 25, 2007), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC687_En&caseId=C4

51. *Id.* ¶ 133.

52. *See*, LG*&E v Argentina,* ICSID Case No. ARB/02/1*,* Decision on Liability, para. 195.

53. Article XI of the US–Argentina BIT (1991) states: "This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests".

54. Article 25 of the International Law Commission's Draft Articles on Responsibility of

on other legal issues, there are different views relating to applicable conditions of "necessity". It should also be pointed out, however, that due to the nature of arbitration, investment arbitral tribunals have broad discretionary powers and where such powers are not exercised with due care, irrational interpretations are bound to result. For example, in deciding whether the Argentina-US BIT or customary international law as reflected in Article 25 of ILC Articles should apply, the *CMS* Tribunal gave preference to customary international law while the *LG&E* Tribunal considered the BIT provisions as having priority. The *CMS* Annulment Committee considered that the Tribunal should have applied Article XI of the BIT as the *lex specialis* governing the matter and not Article 25 of the ILC Articles. In its view, there is a distinct treaty defense in Article XI of BIT as "primary rule" and a defense based on customary international law relating to necessity, which was only a "secondary rule".[55] Most importantly, the Committee further noted: "If the Committee was acting as a court of appeal, it would have to reconsider the Award on this ground."[56]

Apparently the views of the *CMS* Annulment Committee are already being felt in international investment arbitration. For instance, in *Continental Casualty v Argentina*, the Tribunal extensively considered the differences between the situations regulated by Article 25 of the ILC Articles and that addressed by Article XI of the Argentina–US BIT and concluded that their conditions of application were not the same.[57] According to the Tribunal, Article 25 of the ILC Articles could only be applied as an exception,[58] as the Commentaries"

States for Internationally Wrongful Acts, provides:

"1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act:

a. Is the only way for the State to safeguard an essential interest against a grave and imminent peril; and

b. Does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole.

2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if:

a. The international obligation in question excludes the possibility of invoking necessity; or

b. The State has contributed to the situation of necessity."

55. *See*, *CMS v Argentina,* Annulment, *supra* note 50, ¶¶ 133-34.

56. *Id*. ¶ 135.

57. *Continental Casualty v Argentina*, Case ARB/03/9, Award, ¶ 157 (ICSID Sept.5, 2008), http://italaw.com/documents/ContinentalCasualtyAward.pdf.

58. *See*, ILC Commentary to Article 25, para. 14, notes that "to emphasize the exceptional

on Article 25 state:

> *As embodied in Art. 25, the plea of necessity is not intended to cover conduct which is in principle regulated by the primary obligations. This has a particular importance in relation to the rules relating to the use of force in international relations and to the question of "military necessity".*[59]

B. Bias in Interpreting Treaty Provisions

The question of whether or not the international community is forming a consensus on the relationship between customary international law and BITs , investment tribunals can be criticized not only for misinterpreting treaties but also for showing clear bias against host States, in particular those with legal and political systems that are different from their own. *Tza Yap Shum v Republic of Peru*[60] is a case in point. The Claimant investor in the case was born in Fujian Province of China and later became a Hong Kong resident. He invested in Peru through his company incorporated in the Virgin Islands. He submitted the dispute with regard to tax liens to the ICSID on the basis of the China-Peru BIT.

One point of controversy concerns the jurisdiction of the ICSID Tribunal. A case in point is Tza Yap Shum, the company's shareholder who comes from Fujian but possesses Hong Kong identification. Does he qualify as a "national of another Contracting State" under the Washington Convention? This issue cannot be addressed solely by the Washington Convention or Chinese law because international agreements concluded by China do not necessarily apply to Hong Kong. As a matter of fact, Hong Kong can independently enter into BITs with other States.[61] In this case, the Peruvian government ques-

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nature of necessity and concerns about its possible abuse article 25 is cast in negative language." Gabcìkovo-Nagymaros Project (Hungary v. Slovakia), 1997 I.C.J. 7, ¶ 51 (Sept. 25), *available at* http://www.icj-cij.org/docket/files/92/7375.pdf

59. *See*, ILC Commentary to Article 25, para. 21. *Id.*

60. *Tza Yap Shum v Republic of Peru*, Case No. ARB/07/6, Decision on Jurisdiction, (ICSID June 19, 2009), http://www.arbitration.fr/resources/ICSID-ARB-07-6-ENGLISH.pdf

61. For instance, as at 14 June 2011, Hong Kong had concluded BITs with 15 countries or regional bodies including Denmark, Germany, Australia, Japan, The Netherlands, etc., *available at* http://www.legislation.gov.hk/table2ti.htm.

tioned the status of Tza Yap Shum as a qualified investor under the BIT. If it is determined that Tza Yap Shum qualified based on his Chinese nationality, another problem might arise: a Hong Kong-registered company would not be regarded as a Chinese investor while a Hong Kong permanent resident could. This would inevitably further complicate the definition of "qualified investor" and bring more unnecessary trouble to the implementation of relevant provisions.

A related issue is the scope of the Tribunal's jurisdiction. In this regard, Article 8(3) of the China-Peru BIT provides:

> *[I]f a dispute involving the amount of compensation for expropriation cannot be settled within six months after resort to negotiations as specified in Paragraph 1 of this Article, it may be submitted at the request of either party to the international arbitration of the International Centre for Settlement of Investment Disputes (ICSID), established by the Convention on the Settlement of Investment Disputes between States and Nationals of Other Sates, signed in Washington D.C. on March 18, 1965. Any disputes concerning other matters between an investor of either Contracting Party and the other Contracting Party may be submitted to the Centre if the parties to the disputes so agree. The provisions of this Paragraph shall not apply if the investor concerned has resorted to the procedure specified in Paragraph 2 of this Article.*

The Peruvian government argued that, according to the above provision, only disputes "involving the amount of compensation for expropriation" could be submitted to international arbitration andnd that the Tribunal thus did not have jurisdiction over the dispute about tax liens.[62] The Tribunal indicated that Article 8(3) reflected a "certain degree of distrust or ideological unconformity on the part of communist regimes regarding investment of private capital, and maybe also certain concern about the decisions of international tribunals on matters such regimes are not familiar with and over which they had no control."[63] Such a statement demonstrates not only an overly expanded interpretation, if not misinterpretation, of the provision but also the

62. *Tza Yap Shum*, *supra* note 60, ¶ 134.

63. *Id*. ¶ 145.

Tribunal's bias against a country with a different political system. With such a bias, it could hardly be possible for the Tribunal to interpret the BIT's provisions objectively.

This is evidenced by the Tribunal's subsequent discussions. On the one hand, it recognized that Article 8(3) of the BIT had a limited scope and so could not be extensively interpreted. On the other hand, it held that this provision could be interpreted as including other important matters relating to expropriation, as otherwise it would be impossible to determine the amount of compensation for expropriation.[64]

Interpretations of this kind will not help establish the needed trust of host States in international arbitration. Unless such misinterpretation and bias can be rectified, the willingness of host States to employ arbitration mechanisms will be diminished, which will in turn affect the smooth flow of foreign capital and technology. In the end, not only may the property of foreign investors fail to receive adequate protection but also the livelihoods of the people of host States, the human rights of host States, will be adversely affected.

Ⅳ. Consequences of Contradictory Arbitration Decisions

The international community has reacted strongly in light of the the difficulties and problems of contradictory decisions of and misinterpretations by investment tribunals. For instance, Bolivia withdrew from ICSID in 2007,[65] Ecuador in 2009[66] and Venezuela on 16 January 2012.[67] The underlying reasons of the above actions by these countries have not yet been disclosed to

64. *Id*. ¶ 150.

65. For details, *see*, Skadden, Arps, Slate, Meagher & Flom LLP & Affilliates, *Bolivia Withdraws from the ICSID Convention and Venezuela May Follow Suit: Implications for Investors*, May 2007,,*available at* http://www.docstoc.com/docs/44569288/Bolivia-Withdraws-From-the-ICSID-Convention-and-Venezuela-May.

66. For details, *see*, Joshua M. Robbins, "*Ecuador withdraws from ICSID Convention*," Aug. 12, 2009, *available at* http://arbitration.practicallaw.com/2-422-1266.

67. Venezuela's Minister of Energy and Petroleum announced that country's intention to withdraw from the ICSID Convention in an interview on 15 January 2012. *See* a youtube video, *available at* http://www.youtube.com/watch?feature=player_embedded&v=rpgUXj5CmbA.

the public.. It is certain that if they are pleased with the implementation of the ICSID Convention in particular investment arbitration, there is no reason for them to withdraw from the Convention.[68] In a perhaps even more provocative vein, the current (Gillard) government of Australia announced in 2011 that it would "discontinue [the] practice" of seeking "the inclusion of investor–state dispute resolution procedures in trade agreements with developing countries". It said: "If Australian businesses are concerned about sovereign risk in Australian trading partner countries, they will need to make their own assessments about whether they want to commit to investing in those countries."[69] It is therefore unquestionable that measures should be taken by the international community to cure the deficiencies of investment arbitration and re-establish the confidence of all parties concerned in the investment dispute resolution system.

The reaction of the international community is also evidenced in treaty provisions. For instance, with investment tribunals continuously expanding the application of the MFN clause, there have been several cases where contracting parties have explicitly excluded the clause from application to dispute resolution. The China–New Zealand Free Trade Agreement[70] is an example. Following a general stipulation on granting MFN treatment to "investors, investments and activities associated with such investments by investors of the other Party … in like circumstances … with respect to admission, expansion, management, conduct, operation, maintenance, use, enjoyment and

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68. Schill argued that "the more drastic reactions of states, such as terminating investment treaties or withdrawing from the ICSID Convention, by contrast, are a phenomenon that seems to be limited to a minority of states and can often be explained more by the countries' internal political situation rather than a more widespread view of a lack of legitimacy of international investment law and arbitration." *See* Stephan W. Schill, *Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?*, 9 *Chi. J. Int'l* 471, 496 (Winter, 2009). The issue in fact is not whether investment arbitration is still legitimate. Rather, the question is how the current system can be improved.

69. Australian Government, Department of Foreign Affairs and Trade, *Gillard Government Trade Policy Statement: Trading our way to more jobs and prosperity*, Apr. 2011, *available at* http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.html.

70. The China-New Zealand Free Trade Agreement was entered into on 7 April 2008 in Beijing. The text of the FTA is *available at* http://www.chinafta.govt.nz/1-The-agreement/2-Text-of-the-agreement/12-Chapt-11-Investment/index.php. Like most contemporary FTAs, it covers investment as well as trade in goods and services.

disposal",[71] Article 139 continues to provide:

> *For greater certainty, the obligation in this Article does not encompass a requirement to extend to investors of the other Party dispute resolution procedures other than those set out in this Chapter.*[72]

The investment pact between Japan and Taiwan also provides that "[f]or greater certainty, the treatment referred to in paragraph 1 [MFN treatment] does not include treatment accorded to investors of any other countries or regions and to their investments in regard to dispute settlement mechanisms that are contained in international treaties or agreements".[73] The above position of China and Japan is further reflected in the investment treaty entered into by both countries together with Korea.

In the trilateral agreement between China, Korea and Japan, in respect of MFN treatment, it is provided that "Each Contracting Party shall … accord to investors of another Contracting Party and to their investments treatment no less favorable than that it accords … to investors of the third Contracting Party or of a non-Contracting Party and to their investments …"[74] It then stipulates that "It is understood that the treatment accorded to investors of the third Contracting Party or any non-Contracting Party and to their investments as referred to in paragraph 1 does not include treatment accorded to investors of the third Contracting Party or any non-Contracting Party and to their investments by provisions concerning the settlement of investment disputes between a Contracting Party and investors of the third Contracting Party or between a Contracting Party and investors of any non-Contracting Party that

71. China-New Zealand FTA, art. 139(1).

72. *Id*. art. 139(2).

73. Article 4 of the Arrangement between the Association of East Asian Relations and the Interchange Association for the Mutual Cooperation on the Liberalization, Promotion and Protection of Investment was entered into on 22 September 2011. The text of the arrangement is *available at* http://www.president.gov.tw/PORTALS/0/BULLETINS/PAPER/PDF/7026-1.PDF. As Taiwan and Japan only maintain non-diplomatic relations, this investment pact was signed by the associations on behalf of their respective governments.

74. The Agreement among the Government of the People's Republic of China, the Government of the Republic of Korea and the Government of Japan for the Promotion, Facilitation and Protection of Investment signed on 13 May 2012, art. 4(1).

are provided for in other international agreements."[75] Taking into consideration the treaty practice of China and Japan, to exclude application of the MFN clause from investor-state dispute settlement is not surprising. It should be pointed out that although Japan and Korea are traditional international investment home countries, while China has increased its foreign investment very rapidly in recent years. An extensive application of the MFN clause, at least in theory, favors foreign investors, and China, Korea and Japan should have supported such an interpretation. The very fact that these three countries have voted, through treaty practice, against the extension of MFN clause to dispute settlement shows that these countries perhaps including east Asian countries as a whole prefer arbitration tribunals to follow the traditional interpretation of MFN clause.

While the international community is forming a consensus on certain issues of international law, the tribunals should give more weight to such treaty practices in ascertaining the intent of the contracting parties. Unless the opinions of arbitrators become more uniform and less contradictory,, it remains that the correction and improvement of the situation is no doubt the most important task facing the international community.

Ⅴ. Alternatives Suggested

As the problem of contradictory arbitration decisions is far from being resolved,, alternatives should be considered by the international community. However, before examining the ways and means for improving the existing system, two questions should be asked: Are these diverse opinions the personal preferences of different arbitrators? Do arbitrators exercise unduly discretionary power on interpretation of treaty provisions and customary international law?

There are of course several potential answers. Firstly, some tribunals may have overly emphasized the BIT obligations of the host State for protection of foreign investors. In their view, the emphasis—even an over emphasis—on the protection of foreign investment can only lead to encouraging cross-border investment, which is in compliance with the aims and objectives of BITs and FTAS. Secondly, some tribunals have apparently failed to pay

75. *Id*. art. 4(3).

adequate attention to the "proportionality test" in assessing the liabilities of host States. Thirdly, many investor–State arbitration cases involve developing countries as the respondents. Although the arbitrators in charge are very experienced in arbitration, unless they are adequately familiar with the legal systems, cultures, traditions and habitual behavior of administration, they may not be able to understand the difficulties and particular circumstances of these host States.[76] Such lack of understanding of the local culture may lead to unpersuasive arbitral decisions. The lack of understanding—or an inadequate understanding—of such matters may result in contradictory decisions. Last but not the least is the fact that in most cases, arbitration is regarded by many as the last resort for resolving investor–State disputes. Therefore, unless a foreign investor firmly believes that the host State has violated the treaty provisions, he/she may not wish to initiate the arbitration. Any one of the above elements, and in particular an accumulation of them, may lead to unfavorable decisions toward the host States.

While any one of the reasons mentioned above, singly or collectively, may lead to undesirable performance of investment dispute resolutions, the almost unlimited powers enjoyed by arbitration tribunals may be regarded as the main cause of such performance. In a rule of law community, the more discretionary power a body enjoys, the more stringent the conditions imposed on the exercise of such power. In investment arbitration, there is no mechanism to supervise arbitral tribunals. At best, where procedural irregularities are committed, enforcement of arbitral awards may be stopped in accordance with the ICSID Convention and the 1958 New York Convention;[77] while mistakes made in interpretation of treaty provisions on substantive issues almost always go unchecked.

In reality, investment arbitration tribunals face the issue of interpreting substantive provisions all the time. In the abovementioned *CMS* and *LG&E* cases, one of the issues is related to the necessity defense. The interpretation

76. In this regard, a commentator stated: "The danger of such concentration is to legitimacy in that many states, especially those in the developing world, question a system in which they often lose to primarily western companies in front of predominantly western judges in a system that feels too similar to old world imperialism. There is also the concern that many of these arbitrators act simultaneously in similar cases as both arbitrators and counsel." *See* Leah D. Harhay, *Investment Arbitration in 2021: A Look to Diversity and Consistency*, 18 *SW. J. Int'l L.* 89, 93 (2011).

77. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done at New York, 10 June 1958, entered into force 7 June 1959.

of Article 25(1(a) of the ILC Articles involved the ascertainment of what is "an essential interest", "a grave and imminent peril" and "the only way". As noted by the International Law Commission, the invocation of necessity may cover a broad range of matters "to protect a wide variety of interests, including safeguarding the environment, preserving the very existence of the State and its people in time of public emergency, or ensuring the safety of a civilian population".[78] In *CMS*, the Tribunal ruled that "a grave and imminent peril" should be a circumstance that would lead to a worsening of the situation and the danger of total economic and social collapse.[79] It also decided that the measures to be taken by the government must be "the only way" to cope with the situation. Most of the arbitrators are without the benefit of experience in managing a state government, not to mention managing a crisis situation of a country. Their judgment on the measures adopted by State governments during an economic or other crisis may not necessarily be valid.

Therefore, it is suggested that, in order to appreciate the circumstances of host States, in particular, developing host States, the investment arbitration circle should be broadened to encompass experts with different cultural, political, history and legal backgrounds. The international community should also pay special attention to promoting mutual understanding among such experts. While most of the arbitrators' knowledge, experience and competence is not questionable, their shared cultural and legal backgrounds, etc. may limit them from adequately understanding the traditions, cultures and legal systems, in particular law enforcement, of developing host countries from other continents. For instance, when assessing whether a given act or omission of a local government is in violation of treaty provisions, the local customs and culture must be taken into account. At the same time, the intent of the contracting parties which is reflected in such provisions must be considered. All these require a solid understanding of the history, economic situation and culture of host countries. Also, it is easy for tribunals to state what should have been done by host countries in economic and other crisis after it is over. It

78. *See*, ILC, Commentary, at Article 25, para. 14.

79. *See*, *CMS v Argentina*, *supra* note 49, ¶ 322, stating "The Tribunal turns next to the question whether there was in this case a grave and imminent peril. Here again the Tribunal is persuaded that the situation was difficult enough to justify the government taking action to prevent a worsening of the situation and the danger of total economic collapse." Compare this to para. 355, which states: "[T]he Tribunal is convinced that the Argentine crisis was severe but did not result in total economic and social collapse."

may be even easier for those without government experience to suggest appropriate measures to be taken during times of crisis. At very least, in order to encourage an increased employment of arbitration, a collective body of international arbitrators with more diversified cultures and experiences should be built.

In so far as hearing investment disputes are concerned, tribunals should be reminded and encouraged to balance the interests of foreign investors with those of the host States. Where a host State is found to have violated international obligations, in assessing its liability for instance, the principle of the "proportionality test" should be employed. This principle, which has its origin in German law, is now regarded as one of the fundamental principles in the criminal and administrative area of domestic law. Since the European Court of Justice's ruling in the *Internationale Handelsgesellschaft* case in 1970,[80] the "proportionality test" has had a great effect on EU law. It has often been said that all rights are subject to the same limitation: proportionality.[81] One scholar has commented: "Proportionality thus provides a legal standard against which individual or state measures can be reviewed."[82] The core of this test means that the public authority may not impose an otherwise unreasonable obligation on a citizen unless it is necessary for the protection of the public interest, which reflects the balance between the interests and objectives, the means and the ends. "You must not use a steam hammer to crack a nut, if a nutcracker would do," opined Judge Diplock on proportionality in plain English.[83]

The concept of proportionality has its origin in German law. It was first applied in assessing policing measures, in order to determine whether such measures were excessive.[84] Later on, it was employed to challenge any dis-

80. Case 11/70, [1970] E.C.R 1161.

81. *See*, Opinion of Mr. Dutheillet de Lamothye: "… the internal legality of the disputed measures are linked to one and the same problem, namely whether or not these measures comply with a principle of 'proportionality', under which citizens may only have imposed on them, for the purposes of the public interest, obligations which are strictly necessary for those purposes attained." Case 11/70, Handelsgesellschaft, 1970 E.C.R 1146.

82. Malcolm Ross, *Behind Proportionality: The Cultural and Constitutional Context,* in English Public Law and the Common Law of Europe 83, 91 (Mads Andenas ed., Keyhaven Publications, Oxford 1998).

83. *See* Lord Diplock's concise exposition of the idea, in *Regina v Goldstein,* 1983 WLR 151.

84. Paul Craig, *Proportionality, Rationality and Review*, 2 *New Zealand Law Review* 265, 267 (2010).

cretionary power of an administrative body.[85] Jans observed: "The principle of proportionality, in its most elaborate form, consists of three different elements: suitability; necessity; and proportionality *stricto sensu,* which need to be assessed cumulatively."[86] In other words, in determining whether a given measure is proportionate, the first question to be asked is if it is suitable for the intended purpose. Then the question is whether it is necessary to employ the measure. In fact, these two questions are interrelated and could be raised in reversed order. Only after these prerequisites are satisfied, will the issue of whether the measure is proportionate be raised, or whether a less restrictive alternative is available and should be taken.

Nowadays, the "proportionality test" has been adopted extensively in the practice of WTO law. Proportionality has not explicitly been recognized as a general principle of WTO law, but it has been referred to by the Appellate Body in interpreting individual provisions of the WTO Agreements.[87] The point of reference has been the principle of proportionality as applied in the law on international countermeasures. In *US–Cotton Yarn*, the Appellate Body concluded:

> *It would be absurd if the breach of an international obligation were sanctioned by proportionate countermeasures, while, in the absence of such breach, a WTO Member would be subject to a disproportionate and, hence, 'punitive', attribution of serious damage not wholly caused by its exports. In our view, such an exorbitant derogation from the principle of proportionality .... could be justified only if the drafters of the ATC [Agreement on Textiles and Clothing] had expressly provided for it, which is not the case.*[88]

From the perspective of international investment arbitration, with economic globalization and investment liberalization, the application of the propor-

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85. *Id.* at 269.

86. Jan H. Jans, *Proportionality Revisited*, 27(3) *Legal Issues of Economic Integration* 239, 240 (2000).

87. *See*, for example, Appellate Body Report, *United States – Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea*, ¶¶ 256-58, WT/DS202/AB/R (Feb. 15, 2002).

88. *See* Appellate Body Report, *United States – Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan*, ¶ 120, WT/DS192/AB/R (Oct 8, 2001).

tionality test" will help promote international investment and protection of human rights. In this regard, the International Law Commission can improve the "necessity" provision of customary international law by establishing some applicable criteria and improving the rationality and feasibility of the provision so that the applicable conditions are clarified and the standard is not set too high.

In applying the proportionality test, the issue of which measures may be qualified as "necessary" should be clarified. In this regard, the Tribunal in *Continental Casualty* stated:

> *The necessity of a measure should be determined through 'a process of weighing and balancing of factors' which usually includes the assessment of the following three factors: the relative importance of interests or values furthered by the challenged measures, the contribution of the measure to the realization of the ends pursued by it and the restrictive impact of the measure on international commerce.*[89]

In other words, tribunals should give due consideration to the relative importance of interests and the value of particular measures for the host State; the restrictive impact of those measures on investors; and the proportional balance of contribution and impact. In *Continental Casualty*, the Tribunal considered that "[t]he devaluation has thus to be considered inevitable in view of the economic unsustainability of the parity [of the *peso*] with the U.S. dollar … [and the measure] was appropriate and reasonable to cope with the need urgently to stabilize the financial markets".[90]

In assessing the necessity of the measures in question, it should be ascertained that the objective and purpose of the measures must be to protect public security and interest, ensuring that the measures are not implemented in an arbitrary or discriminatory manner, rather than to escape the host State's international obligations. Where the genuine intent and purpose of the mea-

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89. *See, Continental Casualty v Argentina, supra* note 57, ¶ 194. *See also,* Panel Report, *Brazil – Measures Affecting Imports of Retreaded Tyres*, ¶ 7.104, WT/DS322/R (June 12, 2007).

90. *See Continental Casualty v Argentina, supra* note 57, ¶¶ 210-19.

sures are established, the question of whether the measures are within an appropriate and reasonable scope should be addressed before the defense of necessity and proportionality is upheld.

It is suggested that in applying the proportionality test the criteria employed by the WTO should be taken into account. In *Continental Casualty v Argentina*, for instance, the Tribunal was in line with WTO case law, especially as reflected by the Appellate Body's ruling in the *Korea–Beef* case, where it said:

> *The word "necessary" normally denotes something "that cannot be dispensed with or done without, requisite, essential, needful"*
> *...*
> *We believe that ... the reach of the word "necessary" is not limited to that which is "indispensable" or "of absolute necessity" or "inevitable". ... [T]he term "necessary" refers, in our view, to a range of degrees of necessity. At one end of this continuum lies "necessary' understood as 'indispensable'; at the other end, is "necessary" taken to mean as "making a contribution to". We consider that a "necessary measure" is, in this continuum, located significantly closer to the pole of 'indispensable' than to the opposite pole of simply 'making a contribution to.*
> *...*
> *In sum, determination of whether a measure, which is not "indispensable", may nevertheless be "necessary" within the contemplation of Article XX(d), involves in every case a process of weighing and balancing a series of factors which prominently include the contribution made by the compliance measure to the enforcement of the law or regulation at issue, the importance of the common interests or values protected by that law or regulation, and the accompanying impact of the law or regulation on imports or exports.*[91]

The *Brazil–Tyres* case also concerned interpretation of necessity. In that case, the Appellate Body upheld the Panel's finding that Brazil's import ban

91. *See*, Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, ¶¶ 160-61, WT/DS161/AB/R and ¶¶ 160, 161, and 164, WT/DS169/AB/R (Dec.11, 2000).

was provisionally justified as "necessary" within the meaning of GATT Article XX(b). The Panel "weighed and balanced" the contribution of the import ban to its stated objective against its trade restrictiveness, taking into account the importance of the underlying interests or values. The Panel correctly held that none of the less trade-restrictive alternatives suggested by the European Communities constituted "reasonably available" alternatives to the import ban.[92] The Panel confirmed that a measure taken according to GATT Article XX could be one part of complementary measures:

> *In "weighing and balancing" these elements, the Panel is mindful of the specific circumstances of this case. First, based on the elements presented by the parties, it appears to us that non-generation measures, i.e. measures that avoid the generation of waste tyres in the first place, are a pertinent way of addressing the risks arising from the accumulation of waste tyres. Secondly, it is clear from the submissions of both parties that in addressing such risks, including through the management of waste tyres, a combination of measures may be appropriate, so that the question of a specific measure's justification does not necessarily present itself in terms of simple alternatives or the replacement of one specific measure by another, as it is possible that different measures may address different aspects of the same risk and complement each other towards addressing this risk.*[93]

The *Continental Casualty* Tribunal took a similar stance, holding that it was "of the view that in the state of necessity faced by Argentina the elaborate mechanism described above was appropriate and reasonable to cope with the urgent need to stabilize the financial markets and the banks, reinstating progressively the rights of depositors"[94] and that "the Government's efforts struck an appropriate balance between that aim and the responsibility of any government towards the country's population".[95]

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92. *See*, Appellate Body Report, *Brazil – Measures Affecting Imports of Retreaded Tyres*, ¶ 182, WT/DS332/AB/R (Dec. 3, 2007).
93. *See, id.* .¶ 7.213.
94. *See, Continental Casualty v Argentina*, *supra* note 57, ¶ 219.
95. *Id*. ¶ 227.

It is suggested that the criteria employed by the WTO and by the ICSID Tribunal in *Continental Casualty* should be adopted by other tribunals. There are several reasons to do so. In the first place, all contemporary FTAs contain extensive provisions on investment.[96] Secondly, trade in services is one of the pillars of the WTO system, while services and investments are inseparable and indistinguishable in most circumstances; the fact that the WTO itself is concerned with certain aspects of investment. .[97] A consistent and unified application of the proportionality test will mutually reinforce and improve the trade and investment systems.

Ⅵ. Conclusion

In conclusion, international investment contributes to the economic development of host States. To promote and encourage foreign investment is undoubtedly in line with the interests of the entire international community. For that purpose, a balanced protection of both foreign investors and host States is important because, unless such a balance can be achieved, international investment cannot be sustained. In this regard, black letter protection stipulated in treaties is important. Yet, it is the implementation of treaty obligations which is critical. . As investment treaties are enforced with the help of international arbitration, the process of decision making in arbitration as well as the decisions themselves, play a fundamental role in ensuring the expansion, standstill or reduction of international investment. For instance, if international investment arbitration tends to pay more attention to the rights of foreign investors and gives inadequate consideration to the regulatory powers of host States, by awarding large indemnifications to investors on debatable legal grounds and without an adequate understanding of the operation of host State governments, it may have an adverse impact on the sustainable and healthy development of international investment since in the end, it is the nationals of those host States who will "pay the bill" for this unbalanced protection. In

96. For discussions on this matter, *see* Guiguo Wang, *China's FTAs: Legal Characteristics and Implications*, 105 Am. J. Int'l L. no. 3, 2011 at 493.

97. For discussion on the possible coordination between the WTO dispute resolution system and investment arbitration, *see* Guiguo Wang, *Radiating Impact of WTO on its Members' Legal System: The Chinese Perspective*, in 349 Hague Academy of International Law Recueil des cours, 280-535 (2010).

such circumstances, the host States may find it difficult to introduce measures to attract foreign investment. At the same time, where investment arbitration is overly protective of the interests of host States, foreign investors may be discouraged from making sizable investments in high-risk countries. In the end, any imbalance in the protection of investors and host States will have an adverse effect on international investment.

The encouragement and promotion of foreign investment cannot be effectively achieved without a sound dispute settlement system. There are currently several available mechanisms for resolving investor–State disputes. The problem is that such mechanisms are not functioning in a coordinated manner. As a result, contradictory arbitral decisions and questionable interpretations of treaty provisions frequently occur. There do not appear to be any easy solutions of the problems and the composition of arbitral tribunals may need to be considered. The current arbitration tribunals are mostly comprised of those from Western developed countries and in particular those with common law backgrounds. Such a narrowly formed arbitration body should incorporate members with more diversified cultural backgrounds and experience. Another point is that in applying investment treaties, the intent of the contracting parties should not be ignored or misinterpreted.[98] The proportionality test in assessing liabilities of host States should be employed as the starting point.

98. For discussions on other alternatives relating to treaty interpretation, *see* Ole Kristian Fauchald, *The Legal Reasoning of ICSID Tribunals: an Empirical Analysis*, European Journal of International Law, 301-64 (2008).

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