

# International Investment and National Security Review

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## ABSTRACT

*National security is a pillar of international law. As long as sovereign states exert power within the international legal regime, national security will be an exception to international law. These security concerns also come to light in the international investment legal regime. The international investment legal regime provides for essential security exceptions, aiming at protecting host states' interests. This practice has been honored by international investment treaties and international investment tribunals. Although such exemption provisions can balance the interests between international investors and host states, they might be abused by host states in virtue of rising protectionism.*

*Today, with respect to international investment, worldwide protectionism is rising under the guise of national security. Can domestic courts or international tribunals examine the process of national security review conducted under a relevant national committee? If yes, how should domestic courts or international tribunals evaluate the process of national security review? If no, what are the alternatives to prevent the abuse of application of national security grounds? In the international investment legal regime, the issue of how to balance essential security interests and foreign investors' interests has not been resolved until now. Aiming to fill this gap, this Article answers those questions with a comprehensive study of how to deal with national security issues in different phases of international investment.*

*This Article makes three contributions. First, it distinguishes national security issues in the pre-establishment phase and the post-establishment phase. Moreover, it distinguishes non-self-judging essential security clauses and self-judging essential security clauses in international investment agreements. Building upon these differences, this Article provides*

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*different methodologies to deal with national security review. Second, rejecting the popular “good faith” methodology to review national security decisions by international tribunals, this Article provides an alternative to deal with national security issues involving foreign investment—a model of compensation. Third, this Article offers some thoughts on how adjudicators and policy makers should think about national security in international investment law.*

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## I. INTRODUCTION

International investment agreements (IIAs) aim to protect and promote foreign investment by setting obligations for the host states. Investor–state arbitration has formed a part of the international investment legal regime for more than forty years. The first reported arbitral award was issued just twenty-nine years ago.<sup>1</sup> Today international investment has become the most important vehicle to bring goods and services to foreign markets,<sup>2</sup> and IIAs have grown considerably over the last decade.<sup>3</sup> According to the 2017 World Investment Report, thirty-seven new international investment agreements were concluded in 2016, resulting in 3,324 international investment agreements in total.<sup>4</sup> Sixty-two new investor–state dispute settlement cases were filed in 2016, resulting in 767 known IIA claims in total.<sup>5</sup> This fast development has generated serious systemic and legitimacy challenges.<sup>6</sup>

Foreign investment flowing into host states generally goes through two phases—the pre-establishment phase and the post-establishment phase.<sup>7</sup> Both phases potentially involve essential

1. Asian Agric. Prods. Ltd. v. Republic of Sri Lanka, ICSID Case No. ARB/87/3, Final Award, ¶ 116 (June 27, 1990), 6 ICSID Rev. 526 (1997).

2. KARL P. SAUVANT, THE INTERNATIONAL INVESTMENT LAW AND POLICY REGIME: CHALLENGES AND OPTIONS ii (Int'l Ctr. for Trade & Sustainable Dev. & World Econ. Forum eds., 2015).

3. See U.N. CONFERENCE ON TRADE & DEV., WORLD INVESTMENT REPORT 2017: INVESTMENT AND THE DIGITAL ECONOMY, at 111, U.N. Sales No. E.17.II.D.3 (2017).

4. *Id.*

5. *Id.* at 114.

6. Jürgen Kurtz, *The Use and Abuse of WTO Law in Investor-State Arbitration: Competition and its Discontents*, 20 EUR. J. INT'L L. 749, 750 (2009).

7. The line between the pre-establishment and the post-establishment phase is whether there is so-called investment in international investment law. If investment has not existed, then the period is within pre-establishment phase. If there is investment, then the period is within post-establishment phase. There are different approaches to define “investment” in international investment agreements. See *Salini Costruttori S.p.A. & Italstrade S.p.A. v. Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, ¶ 52 (July 23, 2009) [hereinafter *Salini*] (“The doctrine generally considers

security issues. IIAs can grant rights to protected foreign investors only after they have been allowed into the territorial jurisdiction of the state.<sup>8</sup> When a bilateral investment treaty (BIT) is limited to the post-establishment phase, the host country retains the right to set specific entry requirements for foreign investors.<sup>9</sup> National legislation may provide discriminatory rules in relation to the admission of foreign investments.<sup>10</sup> Once they are admitted, however, foreign investments may not be subjected to discrimination, regardless of their country of origin.<sup>11</sup>

IIAs may also grant rights to protected foreign investors after the admission or establishment of investment. With the emergence of investment chapters in free trade agreements (FTAs) in the 1990s, an increasing number of IIAs have granted rights to foreign investors after the admission phase to liberalize capital movement.<sup>12</sup> The North American Free Trade Agreement (NAFTA) Article 1103 started this

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that investment infers: contributions, a certain duration of performance of the contract and a participation in the risks of the transaction. In reading the Convention's preamble, one may add the contribution to the economic development of the host State of the investment as an additional condition.”; see also W. Michael Reisman & Anna Vinnik, *What Constitutes an Investment and Who Decides?*, in 4 CONTEMPORARY ISSUES IN INTERNATIONAL ARBITRATION AND MEDIATION: THE FORDHAM PAPERS 50, 70 (Arthur W. Rovine ed., Brill 2011). Michael Reisman and Anna Vinnik propose the “subjective approach” to define “investment” in BITs, that is, leaving the definition of “investment” to the parties. The “subjective approach” serves the object and purpose of ICSID since ICSID is a service provider whose function is to make available an arbitral option. See also Philip Morris v. Oriental Republic of Uru., ICSID Case No. ARB/10/7, Decision on Jurisdiction, ¶¶ 197, 199 (July 2, 2013) (A further aspect to be considered when interpreting the term “investment” under Article 25(1) of the ICSID Convention is its interplay with the definition of “investment” under the BIT. The consent of the Contracting Parties under the BIT to the scope of “investment” is of relevance when establishing the meaning of the term under Article 25(1) of the ICSID Convention, although such Parties do not have an unfettered discretion to go beyond what have been called the “outer limits” set by the ICSID Convention.)

8. See Agreement for the Promotion and Protection of Investments, U.K.-Mozam., art. 4, Mar. 18, 2004 [hereinafter United Kingdom–Mozambique BIT] (“Neither Contracting Party shall in its Territory subject Nationals or Companies of the other Contracting Party, as regards their management, maintenance, use, enjoyment or disposal of their Investments, to treatment less favourable than that which it accords to its own Nationals or Companies or to nationals or companies of any third State.”).

9. See M. SORNARAJAN, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* 97–115 (3d ed., Cambridge Univ. Press 2004).

10. See *id.* at 137.

11. See 2012 U.S. Model Bilateral Investment Treaty (BIT), arts. 3–4, Apr. 20, 2012, <https://ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf> [<https://perma.cc/2TCN-H6WA>] (archived Sept. 3, 2019).

12. SORNARAJAN, *supra* note 9.

trend,<sup>13</sup> followed by its respective model BITs.<sup>14</sup> The EU–Canada Comprehensive Economic and Trade Agreement (CETA) and the China–Australia FTA made the same arrangement.<sup>15</sup> Upon extending BIT benefits to the pre-establishment phase, host states waive any discriminatory measure on the admission of foreign investment, and they also waive their right to take new discriminatory measures in the future.<sup>16</sup> Extending the scope of BITs to the pre-establishment phase is an important limitation of state sovereignty.

The international investment legal regime provides for essential security exceptions, aiming at protecting host states' interests.<sup>17</sup> This practice has been honored by international investment treaties and international investment tribunals.<sup>18</sup> With respect to sovereignty concerns regarding national security, international investment treaties provide two categories of essential security clauses. The first one is the non-self-judging clause, such as United States–Argentina

13. See North American Free Trade Agreement, U.S.-Can.-Mex., art. 1103, Dec. 17, 1992 [hereinafter NAFTA] (“Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.”).

14. See 2012 U.S. Model Bilateral Investment Agreement, *supra* note 11, art. 4; Canadian Model Foreign Investment Protection Agreement, art. 4, Aug. 2004 [hereinafter FIPA].

15. See EU-Canada Comprehensive Economic and Trade Agreement, Can.-Eur., art. 8.7.1, Oct. 30, 2016 [hereinafter CETA]; see also Free Trade Agreement, Austl.-China, arts. 9.3.1, 9.4.1, June 17, 2015 [hereinafter Australia-China FTA] (“Each Party shall accord to investors of the other Party, and covered investments, in relation to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory, treatment no less favourable than that it accords, in like circumstances, to investors and investments in its territory of investors of any non-Party.”).

16. U.N. CONFERENCE ON TRADE & DEV., NATIONAL TREATMENT, at 10, U.N. Doc. UNCTAD/ITE/IIT/11, U.N. Sales No. E.99.II.D.16 (1999) [hereinafter UNCTAD I].

17. Here, the author uses “essential security” in international investment interchangeably with “national security.” See CETA, *supra* note 15. The title of Article 28.6 is “national security,” but the scope of essential security is smaller than that of national security. And essential security is part of national security.

18. See Argentina–United States: Treaty Concerning the Reciprocal Encouragement and Protection of Investment, Arg.-U.S., art. XI, Nov. 14, 1991, 31 I.L.M. 124 (1992) [hereinafter U.S.-Argentina BIT] (“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.”); see also United States–Uruguay: Treaty Concerning the Encouragement and Reciprocal Protection of Investment, U.S.-Uru., art. 18, Nov. 4, 2005 (“nothing in the Treaty may be construed to preclude a Party from applying measures that it considers necessary either to protect its own essential security interests or to fulfill its obligations with respect to the maintenance or restoration of international peace and security.”); CETA, *supra* note 15, at art. 28.6(b) (“Nothing in this Agreement shall be construed to prevent a Party from taking an action that it considers necessary to protect its essential security interests.”).

BIT Article XI.<sup>19</sup> This kind of clause does not clearly specify that state parties have full competence to assess the necessity of the measures related to essential security.<sup>20</sup> The other category is the self-judging clause, such as Article 18 of the U.S. Model BIT.<sup>21</sup> This kind of clause empowers the parties of the agreements to fully judge the necessity of the measures taken to protect their essential security interests. The difference between these two categories of clauses is that the latter contains the phrase “it considers necessary,” while the former only contains “necessary.” By means of the latter clause, states reserve the right to unilaterally declare such obligations to be nonbinding if the state in question determines that its essential interests are at stake. Although such exemption provisions can balance the interests between international investors and host states, they might be abused by host states due to rising protectionism. Can domestic courts or international tribunals examine the process of national security review? If yes, how should domestic courts or international tribunals evaluate the process of national security review? If no, what are the alternatives to prevent the abuse of application of national security exceptions?

The overarching objective of this Article is to set out a framework for the study of these aforementioned questions and offer some thoughts on how they might be used to guide adjudicators in dealing with national security issues in the international investment arena. With respect to non-self-judging essential security clauses, this Article asserts that the investment tribunals have the competence to review them, and the “reasonable available” approach is a better approach than the “only way” approach in reviewing non-self-judging essential security clauses. With respect to self-judging essential security clauses, this Article rejects the traditional “good faith” approach in reviewing self-judging essential security clauses. Instead, this Article offers an alternative option, that is, compensation should be paid for the loss from essential security measures, including the specific reasons for compensation.

This topic is timely and important. From the beginning of the international investment legal regime, to the economic crisis in Argentina, to worldwide protectionism today, legal scholars have not comprehensively explored how to deal with national security in

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19. U.S.-Argentina BIT, *supra* note 18, at art. XI.

20. Robyn Briese & Stephan Schill, “*If the State Considers*”: *Self-Judging Clauses in International Dispute Settlement*, 13 MAX PLANCK Y.B. UNITED NATIONS L. 61, 112 (2009).

21. U.S. Model Bilateral Investment Treaty (BIT), *supra* note 11, at art. 18 (“Nothing in this Treaty shall be construed (1) to require a Party to furnish or allow access to any information the disclosure of which it determines to be contrary to its essential security interests; or (2) to preclude a Party from applying measures that it considers necessary for 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.”).

international investment.<sup>22</sup> Today, worldwide protectionism is rising under the guise of national security, especially in the pre-establishment phase of international investment. Wary of “Made in China 2025,” the EU, United States, and Australia all are seeking to shield their industries under the guise of national security.<sup>23</sup> Aiming

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22. See Jürgen Kurtz, *Adjudging the Exceptional at International Investment Law: Security, Public Order and Financial Crisis*, 59 INT’L & COMP. L.Q. 325, 342 (2010); Katia Yannaca-Small, *Essential Security Interests Under International Investment Law*, in INTERNATIONAL INVESTMENT PERSPECTIVES: FREEDOM OF INVESTMENT IN A CHANGING WORLD 93, 93 (OECD ed., 2007); William J. Moon, *Essential Security Interests in International Investment Agreements*, 15 J. INT’L ECON. L. 481 (2012); Stephan W. Schill, *International Investment Law and the Host State’s Power to Handle Economic Crises—Comment on the ICSID Decision LG&E v. Argentina*, 24 J. INT’L ARB. 265 (2007); José Alvarez & Kathryn Khamsi, *The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime*, in THE YEARBOOK ON INTERNATIONAL INVESTMENT LAW AND POLICY 2008/2009 379 (Karl P. Sauvant ed., Oxford Univ. Press 2009).

23. In March 2018, CFIUS rejected a proposed takeover of Qualcomm, the San Diego-based chip maker, by Singapore rival Broadcom over concerns that it would pose a national security risk. Cecilia Kang & Alan Rappeport, *Trump Blocks Broadcom’s Bid for Qualcomm*, N.Y. TIMES, Mar. 12, 2018, <https://www.nytimes.com/2018/03/12/technology/trump-broadcom-qualcomm-merger.html> [https://perma.cc/Q2XX-4328] (archived Aug. 19, 2019). In January 2018, regulatory worries caused the collapse of a plan by Ant Financial, a sister company of the Alibaba Group, the Chinese e-retailing giant, to buy MoneyGram, the money-transfer provider. That deal would have been worth \$1.2 billion. Ana Swanson & Paul Mozur, *MoneyGram and Ant Financial Call Off Merger, Citing Regulatory Concerns*, N.Y. TIMES, Jan. 2, 2018, <https://www.nytimes.com/2018/01/02/business/moneygram-ant-financial-china-cfius.html> [https://perma.cc/VP9S-ERRL] (archived Aug. 19, 2019). In September 2017, the Trump administration blocked the \$1.3 billion purchase of Lattice Semiconductor, an American chip manufacturer, by a Chinese-funded private equity firm. Ana Swanson, *Trump Blocks China-Backed Bid to Buy U.S. Chip Maker*, N.Y. TIMES, Sept. 13, 2017, <https://www.nytimes.com/2017/09/13/business/trump-lattice-semiconductor-china.html> [https://perma.cc/GLR5-LXXX] (archived Aug. 19, 2019). The German Ministry of Economy and Energy withdrew its initial certificate of non-objection to the takeover of Aixtron (Germany) by a Chinese company on 24 October 2016. On 2 December 2016, following a recommendation of CFIUS, the U.S. President prohibited the acquisition of the United States subsidiary of Aixtron by the same Chinese company on the basis of national security concerns. Paul Mozur, *Obama Moves to Block Acquisition of a German Chip Maker*, N.Y. TIMES, Dec. 2, 2016, <https://www.nytimes.com/2016/12/02/business/dealbook/china-aixtron-obama-cfius.html> [https://perma.cc/BA28-BKNW] (archived Aug. 19, 2019). The CFIUS raised concerns about a planned sale by the Dutch electronics group Philips of the majority of its Lumiled (United States) LED lights unit to a consortium headed by Go Scale Capital of China on the basis of an alleged threat to the national security of the country. In January 2016, Phillips announced that it was abandoning the proposed sale. Maarten van Tartwijk, *Philips Nixes Lighting-Unit Sale to Chinese Investor as U.S. Rebuffs Deal*, WALL ST. J., Jan. 21, 2016, <https://www.wsj.com/articles/philips-lighting-business-sale-halted-by-regulatory-concerns-1453449046> [https://perma.cc/2JQQ-4GBC] (archived Aug. 19, 2019). Xiamen Sanan Integrated Circuit announced in March 2016 its intention of acquiring the Taiwan Province of China-based power electronics and chip foundry GCS Holdings Inc, including its California-based subsidiary Global Communication Semiconductors (GCS) LLC. The deal was abandoned on 1 August 2016 because of concerns expressed by the CFIUS. Liz Alderman, *Wary of China, Europe and Others Push Back on Foreign Takeovers*, N.Y. TIMES, Mar. 15, 2018, <https://www.nytimes.com/2018/03/15/business/china-europe-canada-australia-deals.html> [https://perma.cc/4CXJ-

to fill this gap in the existing literature, this Article will comprehensively explore this issue and provide a new, practical methodology to resolve national security issues in international investment. This Article takes the position that, upon international tribunals' urging call, the model of compensation can incentivize state parties to make careful choices, promote political efficiency, keep the option of adopting essential security measures open, and balance the interests of safeguarding the national security and protecting foreign investment. Only when a practical solution is provided for how to deal with national security in international investment can the international investment legal regime have sustainable development.

In Part II, this Article will address the trend towards a common, shared, and broad meaning of national security, as well as the rise of the self-judging nature of security measures and the underlying reasons for this rise. In Part III, this Article will explore whether domestic courts or international tribunals can examine the national security review process in the absence of an IIA, in both the pre-establishment phase and the post-establishment phase. In this Part, this Article also asserts that states are trying to build a Committee of Foreign Investment in the United States (CFIUS)-style national security review mechanism in the pre-establishment phase. Building on that, this Article will discuss how to examine the process of national security review in the pre-establishment phase and the post-establishment phase. Part IV will examine the national security review mechanism within the international investment treaty framework. In this Part, this Article will examine whether international investment tribunals can review non-self-judging essential security clauses or self-judging essential security clauses. This Article concludes that international investment tribunals review non-self-judging essential security clauses under the "reasonable available" approach, while international investment tribunals tend to review the self-judging essential security issue under a "good faith" standard. Part V will recommend an alternative option to deal with national security review in the international investment legal regime—just compensation should be paid to investors out of essential security measures. Part VI concludes this paper with the possibility that some disputes about essential security clauses may occur in the future.

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KPWY] (archived Aug. 19, 2019). See Jamie Smyth, *Australia to Tighten Foreign Investment Rules Amid China Concerns*, FIN. TIMES, Feb. 1, 2018, <https://www.ft.com/content/308ca8d6-06f6-11e8-9650-9c0ad2d7c5b5> [https://perma.cc/7T8T-2MAX] (archived Sept. 4, 2019); Joseph Nasr, *Germany Plans Tighter Scrutiny of Foreign Investments in Defense*, REUTERS, Aug. 8, 2018, <https://www.reuters.com/article/us-germany-m-a/germany-plans-to-lower-screening-threshold-for-foreign-investment-in-firms-idUSKBN1KT17C> [https://perma.cc/T69X-GPUF] (archived Aug. 19, 2019).



## II. TWO TRENDS IN NATIONAL SECURITY AND INTERNATIONAL INVESTMENT

### A. *Towards a Broad, Shared Meaning of National Security*

Originally, states linked national security with physical military threats or protecting the territory of one nation from external military threats and attacks.<sup>24</sup> However, the notion of national security has evolved, becoming a much more complex and comprehensive concept. States and international arbitral panels share a broader understanding of national security, which is not limited to physical military threats.

Today, the scope of “national security” is generally defined broadly. For example, on July 1, 2015, the National People’s Congress passed the People’s Republic of China National Security Law (NSL) and defined “national security” broadly.<sup>25</sup> In the NSL, “national security” means a status in which the regime, sovereignty, unity, territorial integrity, welfare of the people, sustainable economic and social development, and other major interests of the state are faced with relatively little danger, not threatened internally or externally, and have the capability to maintain a sustained security status.<sup>26</sup> Some states do not define the term “national security” in their statutes; rather, it is construed broadly to include all circumstances that have the potential to have national security implications. For instance, in the United States, the concept of national security is broadly construed to include potential effects on critical infrastructure.<sup>27</sup> The Canadian legislature does not define “national security” either, but rather the Guidelines on the National Security Review of Investment provide factors that should be taken into account to assess the potential threat to Canadian national security by any proposed investment.<sup>28</sup>

24. See David A. Baldwin, *The Concept of Security*, 23 REV. INT’L STUD. 5, 5 (1997).

25. National Security Law of People’s Republic of China, art. 2, July 1, 2015 [hereinafter NSL]. The NSL was adopted at the 15th Session of the Standing Committee of the 12th National People’s Congress of the People’s Republic of China on July 1, 2015. The NSL came into effect from the date of promulgation.

26. *Id.*

27. 50 U.S.C. App. § 2170(a)(5) (2007); see also Foreign Investment Risk Review Modernization Act of 2018, H.R. 5515, 115th Cong. § 1703 (2018) [hereinafter FIRRMA]. On August 13, the president again expanded the CFIUS mandate by signing FIRRMA into law as part of the National Defense Authorization Act of 2018. Under FIRRMA, “critical technologies” is updated to include “emerging technologies that could be essential for maintaining or increasing the technological advantage of the United States over countries of special concern with respect to national defense, intelligence, or other areas of national security, or gaining such an advantage over such countries in areas where such an advantage may not currently exist.” *Id.*

28. The Guidelines are issued under section 38 of the Investment Canada Act by the Minister of Innovation, Science and Economic Development, who is the Minister

International tribunals also share a broad understanding of national security. In *LG&E Energy Corp. v. Argentine Republic*, the tribunal clearly rejected that essential security only refers to military action and war.<sup>29</sup> In *Continental Casualty v. Argentine Republic*, the tribunal pointed out that the concept of international security covers not only “political and military security but also the economic security of States and of their population.”<sup>30</sup> The International Law Commission (ILC) argues that states have invoked necessity “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.”<sup>31</sup> Furthermore, “national security” and “essential security” are interchangeable with each other. Most IIAs express the object of protection at the core of the exception through the terms “national security,”<sup>32</sup> “national security reasons,”<sup>33</sup> or “essential security interests.”<sup>34</sup> The United Nations Conference on Trade and Development (UNCTAD) proposes that these literal differences do not actually intend to introduce a distinction between the terms and the scopes they represent;<sup>35</sup> but even the drafting history of IIAs evidences substantive differences between these formulations.<sup>36</sup>

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responsible for the administration of the Act. Investment Canada Act, 28 R.S.C. 1985, § 38 (1985).

29. *LG&E Energy Corp. et al. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, ¶ 238 (Oct. 3, 2006), 46 ILM 36 (2007).

30. *Continental Casualty Co. v. Argentine Republic*, ICSID Case No. ARB/03/9, Award, ¶ 175 (Sept. 5, 2008).

31. *ILC Commentary to Article 25*, 2 Y.B. INT'L L. COMM'N. 25, ¶ 14 (2001).

32. Agreement Between the Government of the Republic of Hungary and the Government of the Russian Federation for the Promotion and Reciprocal Protection of Investments, Hung.-Russ., art. 2, Mar. 6, 1995 [hereinafter Hungary–Russia BIT].

33. Agreement Between the Government of the Kingdom of Sweden and the Government of the United Mexican States Concerning the Promotion and Reciprocal Protection of Investments, Mex.-Swed., art. 18, Oct. 3, 2000 [hereinafter Sweden–Mexico BIT].

34. Agreement Between the State of Israel and Japan for the Liberalization, Promotion and Protection of Investment, Isr.-Japan, art. 15.2, Feb. 1, 2017 [hereinafter Israel–Japan BIT]; Comprehensive Economic Cooperation Agreement, India-Sing., art. 2.13, Apr. 8, 2002.

35. U.N. CONFERENCE ON TRADE & DEV., THE PROTECTION OF NATIONAL SECURITY IN IIAS, at 73, U.N. Doc. UNCTAD/DIAE/IA/2008/5, U.N. Sales No. E.09.II.D.12 (2009) [hereinafter UNCTAD II].

36. The negotiation materials of the US – Israel FCN (1951) teach that, “security” involves considerations of national defense while “safety” was construed as a narrower concept that somewhat overlapped with “considerations of public order.” Memorandum of Conversation, *Negotiation of Treaty of Friendship, Commerce and Navigation with Israel*, Nov. 20, 1950, NARA, U.S. Dep’t of State File No. 611.84A4/11-2050. The negotiations of US – Philippines FCN (1948) elucidate that “national emergencies” was understood as such that “might not have regard to international situations; that a threat of uprising or an earthquake might be a national emergency” and, that, this concept “had a physical connotation, such as volcanic eruption or war.” Telegram from the U.S. Embassy in Manila to the U.S. Dep’t of State, July 20, 1948, (NARA, U.S. Dep’t of State File No. 711.962/7-2048).

Following a common shared, broad meaning of national security, states adopt two strategies to protect their national security regarding international investment. First, states develop screening systems on national security grounds to review the appropriateness of foreign investment in the pre-establishment phase.<sup>37</sup> Second, states enact general essential security exception clauses in IIAs, such as Article XI of the United States–Argentina BIT, to reserve their competence to adopt security-related measures.<sup>38</sup>

### B. *Towards a Self-Judging Nature of National Security Measures*

While self-judging essential security clauses have traditionally only occupied a minor place in the jurisprudence of international investment tribunals, such clauses appeared frequently during the process of the international investment legal regime’s reorientation. From the first BIT signed between Germany and Pakistan in 1959, the international investment legal regime has gone through the “era of infancy, era of dichotomy, era of proliferation and era of re-orientation.”<sup>39</sup> An emerging move in the international investment arena is towards protecting states’ sovereignty.<sup>40</sup> U.S. Senators Elizabeth Warren and Bernie Sanders both opposed intrusion of regulatory sovereignty imposed by the investor–state dispute settlement (ISDS) regime.<sup>41</sup> Cecilia Malmstrom, the European Commissioner for Trade, stated that ensuring states’ regulatory sovereignty is one important part of the EU’s renewed vision of international investment policy in the twenty-first century.<sup>42</sup> The Indian government undertook a review of its 2003 Model BIT and made a new draft that would provide the terms and conditions for India’s

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37. See *infra* Part III.A.

38. See *infra* Part II.B.

39. U.N. CONFERENCE ON TRADE & DEV., WORLD INVESTMENT REPORT 2015: REFORMING INTERNATIONAL INVESTMENT GOVERNANCE, at fig. IV.1, U.N. Sales No. E.15.II.D.5 (2015) [hereinafter U.N. WORLD INVESTMENT REPORT].

40. Nikesh Patel, *An Emerging Trend in International Trade: A Shift to Safeguard against ISDS Abuses and Protect Host-State Sovereignty*, 26 MINN. J. INT’L L. 273, 283 (2017).

41. See Bernie Sanders, *Why I Oppose NAFTA*, VT. TIMES, Oct. 28, 1993, <https://www.scribd.com/document/239210728/Why-I-Oppose-NAFTA-Vermont-Times-Oct-28-1993> [https://perma.cc/SDC3-FC4V] (archived Sept. 3, 2019); Elizabeth Warren, *The Trans-Pacific Partnership Clause Everyone Should Oppose*, WASH. POST, Feb. 25, 2015, [https://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9\\_story.html](https://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9_story.html) [https://perma.cc/RSA9-PZDV] (archived Aug. 19, 2019).

42. Cecilia Malmstrom, *Investments in TTIP and Beyond – Towards an International Investment Court*, EUR. COMM’N, May 5, 2015, [https://ec.europa.eu/commission/commissioners/2014-2019/malmstrom/blog/investments-ttip-and-beyond-towards-international-investment-court\\_en](https://ec.europa.eu/commission/commissioners/2014-2019/malmstrom/blog/investments-ttip-and-beyond-towards-international-investment-court_en) [https://perma.cc/YT7B-VD2U] (archived Aug. 19, 2019).

future trade negotiations.<sup>43</sup> The new Indian Model BIT shifts towards a more host-state friendly framework to protect states' sovereignty, illustrated through such provisions as the Article 17 Security Exceptions clause.<sup>44</sup> India will reconsider and renegotiate its existing BITs and ongoing negotiations with the United States.<sup>45</sup> Similarly, as a result of numerous ISDS claims challenging public policy and regulatory measures in Canada, a growing backlash has developed against ISDS.<sup>46</sup> This trend towards protecting host states' sovereignty provides the opportunity for states to make essential security clauses more host-state friendly.

Following the Argentina series of cases involving the nature of Article XI in the United States–Argentina BIT, states tend to move from non-self-judging clauses to self-judging clauses due to wariness of their sovereignty over essential security issues.<sup>47</sup> Originally, states aimed to induce foreign investment and promote their economic growth when signing BITs;<sup>48</sup> however, it is no longer necessary that BITs promote economic development, especially for developing countries.<sup>49</sup> Therefore, states are trying to change, or even back out of, their existing IIAs, to make the terms more favorable to their own interests. In the era of reorientation, states have begun to evaluate the costs and benefits of IIAs and reflect on their future strategies.<sup>50</sup> A reflection in this phase of reorientation is the rise of self-judging clauses in IIAs.

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43. See analysis of the 2015 Draft Model Indian Bilateral Investment Treaty, ¶ 2.1.7, L. COMM'N OF INDIA (Aug. 27, 2015).

44. Model Text for the Indian Bilateral Investment Treaty, art. 17, 2016, [https://www.mygov.in/sites/default/files/master\\_image/Model%20Text%20for%20the%20Indian%20Bilateral%20Investment%20Treaty.pdf](https://www.mygov.in/sites/default/files/master_image/Model%20Text%20for%20the%20Indian%20Bilateral%20Investment%20Treaty.pdf) [https://perma.cc/XGY4-94YH] (archived Sept. 3, 2019).

45. See *India Approves Model Bilateral Investment Treaty*, BLOOMBERG, Feb. 11, 2016, <https://www.bna.com/india-approves-model-n57982067216/> [https://perma.cc/EYU2-8JZF] (archived Aug. 19, 2019).

46. See Scott Sinclair, *Investor vs. State: Canada is Being Pummeled by NAFTA Corporate Lawsuits. Why Do We Put Up with It?*, CANADIAN CTR. FOR POL'Y ALTS., July 1, 2015, <https://www.policyalternatives.ca/publications/monitor/investor-vs-state> [https://perma.cc/P2GG-T4A3] (archived Sept. 3, 2019).

47. Karl P. Sauvant et al., *The Rise of Self-Judging Essential Security Interest Clauses in International Investment Agreements*, 188 COLUMBIA CTR. ON SUSTAINABLE INV. 1 (Dec. 5, 2016), <http://ccsi.columbia.edu/files/2016/10/No-188-Sauvant-Ong-Lama-and-Petersen-FOR-WEBSITE-FINAL.pdf> [https://perma.cc/72CB-G36X] (archived Sept. 3, 2019).

48. The U.S.-Argentina BIT Preamble recognizes the importance of “stimulat[ing] the flow of private capital and the economic development of the Parties.” U.S.-Argentina BIT, *supra* note 18, at art. XI.

49. Susan Rose-Ackerman & Jennifer Tobin, *Do BITs Benefit Developing Countries*, in *THE FUTURE OF INVESTMENT ARBITRATION* 131–43 (Rogers & Alford eds., 2009); see also Jeswald W. Salacuse & Nicholas P. Sullivan, *Do BITs Really Work: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain*, 46 HARV. INT'L L.J. 67, 67 (2005).

50. U.N. WORLD INVESTMENT REPORT, *supra* note 39, at 50.

The self-judging security clause is on the rise out of necessity. The United States was the first to introduce the self-judging security clause in 1992 in the BIT with the Russian Federation.<sup>51</sup> Today, while the United States, Canada, and Japan are the top three users of complete self-judging clauses, a growing number of Asian and Latin American countries are trying to follow this trend.<sup>52</sup> The Columbia Center on Sustainable Investment has conducted a study on the move from the non-self-judging clause to the self-judging clause.<sup>53</sup> According to this study, 222 of 1,861 IIAs concluded by ninety countries before early 2016 contained self-judging security clauses.<sup>54</sup> The percentage of IIAs with self-judging security clauses has increased from a negligible number in 2000 to over 60 percent of IIAs concluded in 2015.<sup>55</sup> By early 2016, more than 134 countries, which together occupy 99 percent of global outward Foreign Direct Investment (FDI) flows, had enacted self-judging clauses in IIAs.<sup>56</sup>

Self-judging security clauses are likely to spread around the globe, since states try to protect essential security interests, especially with the rise of sovereignty concerns.<sup>57</sup> The rise of self-judging security clauses makes international investment protections difficult, subordinating treaty disciplines to governments' self-restraint.<sup>58</sup> Broad and strong self-judging security clauses ramp up the potential abuse by states to escape treaty obligations.<sup>59</sup>

### III. EXAMINING NATIONAL SECURITY REVIEW IN THE ABSENCE OF THE INTERNATIONAL INVESTMENT TREATY FRAMEWORK

Each country has its own national security review regime. Upon the analysis of several major states' national security review regimes, this Article points out that these states try to create a CFIUS-like style of national security review regime. Conducting national security review of foreign investment needs to satisfy due process in accordance with domestic law. Moreover, it will also need to satisfy nondiscrimination requirements within the international minimum standard.

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51. Treaty Between the United States of America and the Russian Federation Concerning the Encouragement and Reciprocal Protection of Investment, Russ.-U.S., art. 6, June 17, 1992, S. TREATY DOC. NO. 33 [hereinafter U.S.–Russia BIT]; see also Kenneth J. Vandavelde, *U.S. Bilateral Investment Treaties: The Second Wave*, 14 MICH. J. INT'L L. 621, 686 (1993).

52. Sauvart et al., *supra* note 47, at 1.

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.* at 2.

58. *Id.*

59. *Id.*

A. *The Convergence of National Security Review Mechanisms in the Pre-Establishment Phase*

This Part analyzes national security review regimes in the United States, China, United Kingdom, Canada, and Russia, including the composition of national security committees, and factors considered while evaluating possible national security concerns. Based on the analysis, this Part will point out the common characteristics of national security review mechanisms in different countries.

States are trying to adopt a CFIUS-like structure, a review regime of an interagency national security review committee, that comprises several ministries and agencies to work on national security review issues. Under the Exon-Florio amendment to the Defense Production Act,<sup>60</sup> CFIUS has the authority to conduct national security reviews and investigations of transactions that could result in foreign control of a US business.<sup>61</sup> The Foreign Investment Risk Review Modernization Act (FIRRMA) modernizes CFIUS's processes to better enable timely and effective reviews of covered transactions.<sup>62</sup> FIRRMA further broadens the purview of CFIUS by explicitly adding four new types of covered transactions.<sup>63</sup> It expands the jurisdiction of CFIUS to address growing national security concerns over foreign exploitation of certain investment structures that traditionally have fallen outside of CFIUS jurisdiction.<sup>64</sup>

In China, the national security review mechanism for foreign investments was first introduced in 2011 by the State Council in the Circular on Formalizing Security Review System for the Mergers and

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60. 50 U.S.C. App. § 2170(a)(5) (2007) (“The term “national security” shall be construed so as to include those issues relating to “homeland security,” including its application to critical infrastructure.”).

61. *See id.* § 2170(d)(1) (“The President may take such action for such time as the President considers appropriate to suspend or prohibit any covered transaction that threatens to impair the national security of the United States.”).

62. *See* Foreign Investment Risk Review Modernization Act of 2018, H.R. 5515, 115th Cong. § 1709 (2018).

63. *Summary of the Foreign Investment Risk Review Modernization Act of 2018*, <https://www.treasury.gov/resource-center/international/Documents/Summary-of-FIRRMA.pdf> (last visited Sept. 3, 2019) [<https://perma.cc/W734-R2PK>] (archived Sept. 3, 2019). The four new types of covered transactions include (1) a purchase, lease, or concession by or to a foreign person of real estate located in proximity to sensitive government facilities; (2) “other investments” in certain U.S. businesses that afford a foreign person access to material nonpublic technical information in the possession of the U.S. business, membership on the board of directors, or other decision-making rights, other than through voting of shares; (3) any change in a foreign investor’s rights resulting in foreign control of a U.S. business or an “other investment” in certain U.S. businesses; and (4) any other transaction, transfer, agreement, or arrangement designed to circumvent CFIUS jurisdiction.

64. Foreign Investment Risk Review Modernization Act of 2018, H.R. 5515, 115th Cong. § 1706 (2018).

Acquisitions of Domestic Enterprises by Foreign Investors (the Circular).<sup>65</sup> In January 2015, the Ministry of Commerce (MOFCOM) released the Law of the People's Republic of China (PRC) on Foreign Investment (Draft for Comments) (2015 Draft Law) and an accompanying explanation,<sup>66</sup> providing the main national security review regime in China. To ensure national security and to regulate and promote foreign investment, the state established a unified foreign investment national security review system, whereby all foreign investments that threaten or may threaten national security undergo review.<sup>67</sup> The State Council established an interministerial joint committee for foreign investment national security review.<sup>68</sup> On December 26, 2018, the Standing Committee of the National People's Congress (NPC) of the PRC published Foreign Investment Law of the People's Republic of China (Foreign Investment Law), purporting to create a level playing field for foreign investments in China.<sup>69</sup> However, the Foreign Investment Law merely states the principles that foreign investments are subject to national security review, and that decisions made by the relevant authorities will be final.<sup>70</sup> Although the Foreign Investment Law does not say how the national security review will be conducted, the final law will probably contain a reference to the Circular or to other regulations that have been implemented by that time.

In Russia, the Government Commission on Control over Foreign Investments (Government Commission) is the main organization to conduct national security review. Under the lead of the Chairman of the Russian Government, the Government Commission is composed of the heads of several ministries and institutions.<sup>71</sup> An acquirer must file if the proposed acquisition results in the acquirer's control over a strategic entity, which is an entity exercising activities of strategic

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65. State Council, *Circular on Formalizing Security Review System for the Mergers and Acquisitions of Domestic Enterprises by Foreign Investors*, PEOPLE'S REPUBLIC OF CHINA (Feb. 3, 2011).

66. *Comments of Draft Foreign Investment Law of the People's Republic of China* (Jan. 19, 2015), [https://www.uschina.org/sites/default/files/2015%20Draft%20Foreign%20Investment%20Law%20of%20the%20People%27s%20Republic%20of%20China\\_JonesDay\\_0.pdf](https://www.uschina.org/sites/default/files/2015%20Draft%20Foreign%20Investment%20Law%20of%20the%20People%27s%20Republic%20of%20China_JonesDay_0.pdf) [<https://perma.cc/8TT3-RG8W>] (archived Sept. 3, 2019) [hereinafter *2015 Draft Law*]. The national security review mechanism for foreign investments was first introduced in 2011 by the Ministry of Commerce in the Circular on Formalizing Security Review System for the Mergers and Acquisitions of Domestic Enterprises by Foreign Investors ("Circular 6"). The *2015 Draft Law* contained 26 substantive and procedural provisions regarding the national security review.

67. *Id.* at art. 48.

68. Hereinafter referred to as "Joint Committee."

69. Foreign Investment Law of China, 13th Cong. 2 (2019) (effective Jan. 1, 2020).

70. *Id.* at art. 35.

71. Although the final decision on the application is made by the Government Commission, all the preparatory work is done by the Federal Antimonopoly Service (FAS). FAS, among other things, performs a preliminary review of the application and prepares materials for a further assessment by the Government Commission.

importance to Russian national defense and security.<sup>72</sup> The acquirer should obtain consent from the Government Commission as a prerequisite for the acquisition of a strategic entity; otherwise, the acquisition of the strategic entity is void.<sup>73</sup> Certain transactions regarding strategic entities or their property are exempt from obtaining the Government Commission's approval.<sup>74</sup>

When conducting a national security review, states generally apply reviews to a larger set of sectors that go beyond those traditionally considered to be national security sensitive.<sup>75</sup> In China, there are eleven factors that shall be considered in carrying out a national security review of a foreign investment, such as the influence of technologies, key resources, and information and internet security.<sup>76</sup> Based on the results of a national security review, the State Council or the Joint Committee may issue an approval, a conditional approval, or a rejection.<sup>77</sup> In Canada, the government considers both the nature of the asset and the identity and background of the parties involved in the investment.<sup>78</sup> Relevant parties may include any third parties that could exercise influence with respect to the investment.<sup>79</sup> The guidelines put forward specific factors related to national security that the government may take into account during the review process.<sup>80</sup> In Russia, the Government Commission reviews transactions that result in acquisition of strategic entities.<sup>81</sup> Currently, there are forty-six activities of "strategic importance" that can cause the target to be considered a strategic entity.<sup>82</sup> The forty-six activities encompass areas related to natural resources, defense, media, and monopolies.<sup>83</sup>

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72. To apply for the consent, the acquirer must submit an application to the FAS with attachments, which include, among other things, corporate charter documents of the acquirer and the target, information on their groups' structures (including the whole chain of control over both the acquirer and the target), transaction documents, and a business plan for the development of the target post-closing.

73. See Government Resolution No. 510 on the Government Commission for Control over Foreign Investments in the Russian Federation, July 6, 2008.

74. Certain transactions include transactions in which the acquirer is ultimately controlled by the Russian Federation, constituent entities of the Russian Federation or a Russian citizen who is a Russian tax resident and does not have dual citizenship, as well as certain intra-group transactions.

75. UNCTAD II, *supra* note 35, at 7–25.

76. 2015 Draft Law, *supra* note 66, art. 57.

77. *Id.* at art. 58.

78. Investment Canada Act, *Guidelines on the National Security Review of Investments*, art. 6, Dec. 19, 2016 [<https://perma.cc/6P5J-NPAY>] (archived Aug. 19, 2019) [hereinafter *Guidelines*].

79. *Id.*

80. *Id.*

81. Procedures for Foreign Investments in Companies of Strategic Significance for the Defense and Security of the State, art. 2, FED. L. NO. 57-FZ (Apr. 29, 2008) [hereinafter Russian Foreign Investments Law].

82. *Id.* at art. 6.

83. See Amendments to Federal Law No. 160-FZ "On Foreign Investments in the Russian Federation," FED. L. NO. 165-FZ (July 18, 2017) (containing a package of



In the United States, CFIUS considers ten specific factors to assess the transaction's effects on national security.<sup>84</sup> Specifically, CFIUS tends to focus on those transactions involving technology, defense, and natural resources.<sup>85</sup> FIRRMA revises and nearly doubles the number of specific national security factors CFIUS may consider in its risk reviews.<sup>86</sup> In addition to suspending or prohibiting a transaction, FIRRMA empowers the president to take any additional action the president considers appropriate to address the risk to the national security.<sup>87</sup>

In sum, there are slightly different national security review procedures in various countries. However, these procedures all tend to be CFIUS-like structures of a national security review regime. They all bear some "formalistic resemblance" to each other due to legal transplantation among countries.<sup>88</sup>

### B. Examining National Security Review in the International Investment Pre-Establishment Phase

Without the restraints of the international investment treaty framework, a state can generally adopt any measure to regulate foreign investment out of a concern for national security.<sup>89</sup> However, any prospective investment-related measure safeguarding national security should be guided by certain basic principles, including nondiscrimination, transparency, and proportionality.

To protect national security, a state's discriminatory measures against foreign investment should be compatible with international law in the absence of an IIA.<sup>90</sup> A discrimination based on "sound economic and political grounds" may be lawful unless it is based on "nakedly racial grounds."<sup>91</sup>

International investment tribunals have held that no general obligation exists under customary international law to treat all aliens equally or as favorably as nationals. In *Genin v. Estonia*, the tribunal

amendments to Russian Foreign Investments Law. The amendments add the following to the list of strategic activities: operating an electronic platform for state purchases, closing the points of radioactive waste burial and using nuclear materials and radioactive substances while conducting atomic energy works for defense purposes.

84. 50 U.S.C. App. § 2170(f) (2007). The eleventh factor is anything that the President or Committee determines to be appropriate.

85. *Id.*

86. Foreign Investment Risk Review Modernization Act of 2018, H.R. 5515, 115th Cong. § 1702(c) (2018).

87. *Id.* § 1722.

88. See Xingxing Li, *National Security Review in Foreign Investments: A Comparative and Critical Assessment on China and US Laws and Practices*, 13 BERKELEY BUS. L.J. 255, 259 (2016). China's national security review system models on the United State. The United Kingdom is suggested to adopt U.S. CFIUS-like style.

89. SORNARAJAN, *supra* note 9.

90. *Id.* at 105–06.

91. *Id.* at 137.

noted that customary international law does not require that a state treat “all aliens (and alien property) equally, or that it treat aliens as favourably as nationals,” and that “even unjustifiable differentiation may not be actionable.”<sup>92</sup> In *Grand River Enterprises Six Nations Ltd. v. United States*, the tribunal asserted that states may discriminate against foreign investments in many ways, and states cannot be called to account for “violating the customary minimum standard of protection.”<sup>93</sup>

Moreover, within the WTO framework, a state’s discriminatory measures against foreign investment are compatible with GATT obligations. In the *Canada—Administration of the Foreign Investment Act*, the Canadian system made the acceptance of foreign investment proposals subject to the condition that investors export a certain amount or portion of their production.<sup>94</sup> The GATT Panel upheld that the Canadian system was compatible with the GATT.<sup>95</sup>

But the Organization for Economic Co-operation and Development (OECD) Recommendation of 2009 stresses that any prospective investment-related measure introduced to safeguard national security should be guided by certain basic principles.<sup>96</sup> The OECD Recommendation admits that the sovereign authority of each state means it has the right to set forth policies in its territory and to control foreign investment on national security grounds.<sup>97</sup> But the OECD Recommendation emphasizes that any prospective measure should be nondiscriminatory, have transparent policies and predictable outcomes, proportional measures, and hold implementing authorities accountable.<sup>98</sup> In addition to these principles, it recommends to procedural fairness, codification and publication, prior notification, consultation, disclosure of investment policy actions, regulatory proportionality, narrow focus, appropriate expertise, tailored responses, last resort, and the self-judging nature of essential security concerns.<sup>99</sup>

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92. Alex Genin, *Eastern Credit Ltd., & A.S. Baltoil v. Republic of Est.*, ICSID Case No. ARB 99/2, Award, ¶ 368 (June 25, 2001), 17 ICSID Rev. 395 (2002).

93. *Grand River Enterprises Six Nations Ltd., et al. v. U.S.*, ICSID Case No. ARB/10/5, Award, ¶¶ 208–09 (Jan. 12, 2011).

94. See Report of the Panel, *Canada—Administration of the Foreign Investment Act*, art. 3.1, L/5540-30S/140 (Feb. 7, 1984), GATT BISD (1984).

95. *Id.* at ¶ 6.2.

96. ORG. FOR ECON. COOPERATION & DEV. (OECD), GUIDELINES FOR RECIPIENT COUNTRY INVESTMENT POLICIES RELATING TO NATIONAL SECURITY 2 (adopted May 25, 2009) [hereinafter OECD RECOMMENDATION].

97. *Id.* at art. III.

98. *Id.* at art. I–II.

99. *Id.* at art. II–III.

*C. Examining National Security Review in International Investment  
in the Post-Establishment Phase*

The process of national security review in the post-establishment phase should satisfy requirements under two kinds of law, domestic law and customary international law. Domestic law—usually a state’s constitution—requires government organs to act with due process, while customary international law mandates states act under an “international minimum standard,” a standard shared by the international community.

With respect to domestic legal requirements, domestic courts often apply the political question doctrine to justify their inability to review a case involving national security and deference to executive branches.<sup>100</sup> Since September 11, 2001, federal courts have decided several cases involving issues of national security.<sup>101</sup> Recent litigation indicates that this doctrine is still a vibrant aspect of federal case law.<sup>102</sup>

In *Schneider v. Kissinger* in 2005, the survivors of a former Chilean general killed in a military coup backed by the United States sued the United States and former National Security Advisor Henry Kissinger under the Federal Tort Claims Act for “negligent failure to prevent summary execution, arbitrary detention, cruel, inhumane, or degrading treatment, torture, wrongful death, and assault and battery, and . . . for intentional infliction of emotional distress.”<sup>103</sup> The D.C. Circuit affirmed a district court ruling that the court lacked jurisdiction under the political question doctrine to adjudicate this case.<sup>104</sup> Upon dismissing the lawsuit, the circuit court stated that “there could still be no doubt that decision-making in the fields of foreign policy and national security is textually committed to the political branches of government.”<sup>105</sup>

But domestic courts were intent on compensating investors for the harm caused by national security measures. The *Ralls v. CFIUS* decision is a landmark case in the history of CFIUS reviews.<sup>106</sup> The legal challenge brought marked the first time that a foreign company,

100. *Haig v. Agee*, 453 U.S. 280, 292 (1981); *see also Dames & Moore v. Regan*, 453 U.S. 654, 688 (1981); *Rostker v. Goldberg*, 453 U.S. 57, 64–68 (1981); *Greer v. Spock*, 424 U.S. 828, 837–38 (1976); *Parker v. Levy*, 417 U.S. 733, 756, 758 (1974); *Harisiades v. Shaughnessy*, 342 U.S. 580, 589 (1952).

101. *Hamdi v. Rumsfeld*, 542 U.S. 507, 507 (2004); *Rumsfeld v. Padilla*, 542 U.S. 426, 426 (2004); *Coalition of Clergy v. Bush*, 310 F.3d 1153, 1153 (9th Cir. 2003); *Mahorner v. Bush*, 224 F. Supp. 2d 48, 48 (D.D.C. 2002).

102. Since a small fraction of cases reach the Supreme Court, the decisions rendered by the Courts of Appeals and District Courts become more significant.

103. *Schneider v. Kissinger*, 412 F.3d 190, 192–93 (D.C. Cir. 2005).

104. *Id.* at 194.

105. *Id.*

106. *Ralls Corp. v. Comm. on Foreign Inv. in the U.S. (Ralls I)*, 926 F. Supp. 2d 71, 76 (D.D.C. 2013).

as well as the courts, had formally argued that CFIUS decisions are open to judicial review. The court's holding, moreover, gave unprecedented recognition of a foreign company's property rights and protection under due process.<sup>107</sup> Despite the fact that FIRREA limits the judicial review to a review of the government's administrative record in reaching a decision, *Ralls* is still a compelling decision in examining the due process of national security review.<sup>108</sup>

In March 2012, a Delaware corporation, Ralls, acquired four Oregon wind farm project companies from an American owner.<sup>109</sup> Ralls was owned by two Chinese nationals who were also the CFO and a Vice President of the Sany Group (Sany), a Chinese manufacturing company.<sup>110</sup> Ralls intended to acquire the wind farm project companies to use Sany wind turbines and demonstrate their quality and reliability to the US wind industry.<sup>111</sup> After the acquisition was completed, CFIUS halted and U.S. President Barack Obama subsequently ordered Ralls to divest its acquisition of four wind farm project companies in Oregon because of their proximity to a U.S. Navy weapons testing and training facility.<sup>112</sup>

Ralls filed a lawsuit challenging the CFIUS and presidential orders in the U.S. District Court for the District of Columbia.<sup>113</sup> The District Court ruled against Ralls, citing, *inter alia*, its failure to file advance notice of the transaction with CFIUS and the nonreviewable nature of the president's actions.<sup>114</sup> A federal appeals court ruled in favor of Ralls.<sup>115</sup> The D.C. Circuit unprecedentedly allowed judicial review of a due process challenge to presidential orders in CFIUS reviews.<sup>116</sup> Moreover, it stated that foreign investors do have constitutionally protected state property rights after the close of a transaction, and those rights could not be deprived without due process protections, such as notice of deprivation, access to unclassified evidence, and opportunity for rebuttal.<sup>117</sup>

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107. *Ralls Corp. v. Comm. on Foreign Inv. in the U.S. (Ralls II)*, 758 F.3d 296, 318 (D.C. Cir. 2014).

108. Foreign Investment Risk Review Modernization Act of 2018, H.R. 5515, 115th Cong. § 1715 (2018).

109. Complaint at ¶¶ 2, 27–28, *Ralls II*, 758 F.3d 296 (No. 12-01513).

110. *Id.* at ¶ 29.

111. *Id.*

112. The sites of the Butter Creek projects overlap with a United States Navy restricted airspace and bombing zone that is used by military aircraft based out of Naval Air Station Whidbey Island, according to the court's memorandum opinion. Shortly after Ralls acquired the project companies, the United States Navy expressed concerns regarding the location of one of the wind farms, and Ralls agreed to move it to a new location, still within the restricted airspace. *See id.*

113. *Ralls I*, 926 F. Supp. 2d at 76.

114. *Id.* at 71, 86–92.

115. *Ralls II*, 758 F.3d at 296.

116. *Id.* at 311.

117. *Id.* at 318 (citing *Greene v. McElroy*, 360 U.S. 474, 496 (1959); *Gray Panthers v. Schweiker*, 652 F.2d 146, 165 (D.C. Cir. 1980)).

The D.C. Circuit did not decide on the constitutionality of deprivations of Ralls's property, since this case was settled in the end.<sup>118</sup> And this case provided the potential liability of the United States if the United States, out of national security measures, caused property damages for Ralls.<sup>119</sup> Moreover, Ralls alleged that it was treated singularly and unfairly with a CFIUS order when hundreds of other similarly situated turbines were within the area of the restricted airspace.<sup>120</sup> Thus, it claimed that CFIUS and the president violated its equal protection rights under the Fifth Amendment of the Constitution.<sup>121</sup> A merit ruling on this issue would have resulted in unprecedented review of CFIUS orders.

With respect to customary international law, the process of national security review should meet the "international minimum standard." While requiring an "international minimum standard" imposes additional requirements to domestic law; it is, indeed, a minimum standard.<sup>122</sup> The *Neer* Commission pointed out that a breach of the minimum standard of the treatment of aliens as requiring a treatment that amounts "to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency."<sup>123</sup> A few other historical cases applied this international minimum standard, or a similarly worded standard, in connection with the treatment of aliens.<sup>124</sup> Further, the minimum standard of treatment is evolving.<sup>125</sup> Today's minimum standard is broader than that defined in the *Neer* case and its progeny.<sup>126</sup>

Notably in *Ralls* there were other wind farms owned by foreign companies in the proximity of the airbase, but Ralls's wind farms were

118. On October 9, 2015, it was announced in a joint status report by the parties that Ralls and CFIUS had entered into a settlement agreement and determined it was not necessary for CFIUS to issue a new recommendation to the President on the matter. Joint Status Report and Joint Motion to Stay Litigation Deadlines, at 1, *Ralls Corp. v. Comm. on Foreign Inv.*, No. 1:12-cv-01513 (D.C. Cir. Oct. 9, 2015). Reportedly, under the terms of the settlement, Ralls was still required to sell the disputed assets to a third-party purchaser. See also Stephen Dockery, *Chinese Wind Company Settles with U.S. in CFIUS Battle*, WALL ST. J. BLOG (Oct. 9, 2015, 6:45 PM), [https://blogs.wsj.com/riskandcompliance/2015/10/09/chinese-wind-company-settles-with-u-s-in-cfius-battle/?mod=article\\_inline](https://blogs.wsj.com/riskandcompliance/2015/10/09/chinese-wind-company-settles-with-u-s-in-cfius-battle/?mod=article_inline) [https://perma.cc/2CKB-GSKF] (archived Aug. 19, 2019).

119. Amended Complaint at 147–48, *Ralls I*, 926 F. Supp. 2d 71 (No. 1:12-cv-01513).

120. *Id.* at 161–63.

121. *Id.*

122. *Id.*

123. LFH *Neer* & Pauline *Neer* (U.S. v. Mex.), 4 R.I.A.A. 60, 61–62 (1926).

124. Jan Paulsson & Georgios Petrochilos, "Neer-ly Misled?", 22 ICSID Rev.—Foreign Inv. L.J., 242, 242–57 (2007).

125. See International Law Association, *Final Report of the International Committee on Diplomatic Protection of Persons and Property*, Res. No. 5/2006 (June 4–8, 2006).

126. *Merrill & Ring Forestry L.P. v. Can.*, ICSID Case No. UNCT/07/1, Award, 213 (Mar. 31, 2010).

singled out.<sup>127</sup> CFIUS was actually more concerned about the close position of Ralls's project to military bases rather than the foreign ownership of the wind farm.<sup>128</sup> Ralls had alleged that it was treated unfairly with a CFIUS order when hundreds of other similarly situated turbines were within the area of the restricted airspace.<sup>129</sup> Here Ralls could have also argued that this discrimination violated customary international law—international minimum standard of treatment as an evolving concept—by asserting unfair treatment from CFIUS.<sup>130</sup>

#### IV. EXAMINING NATIONAL SECURITY REVIEW WITHIN THE INTERNATIONAL INVESTMENT TREATY FRAMEWORK

In this Part, self-judging and non-self-judging security clauses will be analyzed. Building upon this distinction, the tribunals adopt different attitudes toward the capacity of reviewing these security clauses. Moreover, the tribunals adopt various approaches to reviewing different security clauses. With respect to non-self-judging essential security clauses, investment tribunals have the competence to review them; and in reviewing these clauses, the “reasonable available” approach is better than the “only way” approach. With respect to self-judging essential security clauses, the tribunals tend to adopt the traditional “good faith” approach in reviewing self-judging essential security clauses.

##### A. Review of Non-Self-Judging Security Clauses

This Part will analyze whether Article XI of the Argentina–United States BIT is self-judging, that is, if the state adopting the measures is the sole arbiter of the scope and application of that rule, or whether the invocation of necessity is subject to judicial review. In the cases *CMS v. Argentina*, *LG&E v. Argentina*, *Enron v. Argentina*, *Sempra v. Argentina*, and *Continental Casualty v. Argentina*, all of which occurred in the wake of the Argentine economic crisis, each tribunal addressed the nature of Article XI of the Argentina–United States BIT and asserted its non-self-judging nature.

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127. See Amended Complaint, *supra* note 119.

128. *Ralls Corp. v. Comm. on Foreign Inv. in the U.S. (Ralls I)*, 926 F. Supp. 2d 71, 78 (D.D.C. 2013).

129. See Amended Complaint, *supra* note 119.

130. Whether U.S. domestic court can apply customary international law is arguable. See generally Curtis A. Bradley & Jack L. Goldsmith, *Customary International Law as Federal Common Law: A Critique of the Modern Position*, 110 HARV. L. REV. 815 (1997); Curtis A. Bradley & Jack L. Goldsmith, *The Current Illegitimacy of International Human Rights Litigation*, 66 FORDHAM L. REV. 319 (1997); Curtis A. Bradley & Jack L. Goldsmith, *Federal Courts and the Incorporation of International Law*, 111 HARV. L. REV. 2260 (1998); Harold Hongju Koh, *Is International Law Really State Law*, 111 HARV. L. REV. 1824 (1997).

## 1. The Reviewability of Non-Self-Judging Security Clauses

The cases discussed are based on the same facts, which can be briefly summarized. The Argentine Republic started economic reforms in 1989, which included the privatization of important industries and public utilities as well as the participation of foreign investment.<sup>131</sup> Toward the end of the 1990s, a serious economic crisis began to unfold in Argentina, producing profound political and social consequences.<sup>132</sup> Following the deepening crisis in 2001, the Emergency Law was enacted in 2002, which introduced a reform of the foreign exchange system—the peso was devalued and different exchange rates were introduced for different transactions.<sup>133</sup> The right of licenses of public utilities to adjust tariffs according to the U.S. Producer Price Index was terminated, as was the calculation of tariffs in dollars.<sup>134</sup> Investors turned to the International Centre for Settlement of Investment Disputes (ICSID), claiming that Argentina destroyed the regulatory environment on which foreign investors had relied *ex ante*.<sup>135</sup>

The CMS tribunal claimed that if states would like to “unilaterally determine the legitimacy of extraordinary measures importing non-compliance with obligations assumed in a treaty, they do so expressly.”<sup>136</sup> The wording of Article XI of the BIT, as given above, allows the parties to take “measures necessary”—not measures that a party considers as such.<sup>137</sup> Applying a textual approach, and comparing Article XI of the BIT with differently worded provisions in GATT Article XXI, the CMS tribunal pointed out that the tribunal was able to review Article XI of the Argentina–United States BIT.<sup>138</sup> The CMS tribunal also derived its findings from *Nicaragua I*, *Nicaragua II*, and the *Oil Platforms* case.<sup>139</sup> The tribunal further pointed out that the tribunal’s review would be a substantive one, including examining whether “the state of necessity or emergency meets the conditions laid down by customary international law and the treaty provisions and whether it thus is or is not able to preclude wrongfulness.”<sup>140</sup>

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131. See *Continental Casualty Co v. Argentine Republic*, ICSID Case No. ARB/03/9, Decision on the Application for Partial Annulment of Continental Casualty Company and the Application for Partial Annulment of the Argentine Republic, ¶ 107 (Sept. 16, 2011) [hereinafter *Continental Casualty, Annulment Proceeding*].

132. For a description of the financial crisis, see Martin Feldstein, *Argentina's Fall: Lessons from the Latest Financial Crisis*, FOREIGN AFFAIRS, Mar.–Apr. 2002.

133. *CMS Gas Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, ¶ 64 (May 12, 2005) [hereinafter *CMS Award*].

134. *Id.* at ¶ 65.

135. See *Continental Casualty, Annulment Proceeding*, *supra* note 131, at ¶ 19.

136. *Id.* at ¶ 370.

137. U.S.-Argentina BIT, *supra* note 18, at art. XI.

138. *CMS Award*, *supra* note 133, at ¶ 370.

139. *Id.* at ¶ 371.

140. *Id.* at ¶ 374.

The *LG&E* tribunal pointed out that Article XI of the BIT did not specify who, Argentina itself or the tribunal, should decide what constitutes essential security measures.<sup>141</sup> The United States did not consider the nature of essential security clauses as self-judging until the Russia–United States BIT of 1992 and the 1992 U.S. Model BIT; both the Russia–United States BIT and the U.S. Model BIT were concluded after the signing of the Argentina–United States BIT, and both of them noted explicitly the change in US policy toward seeing essential security provisions as self-judging.<sup>142</sup> Therefore, the *LG&E* tribunal pointed out that it could review Article XI and went on to decide the substantive issue of whether the measures adopted were necessary.<sup>143</sup> That is, Article XI does not empower one party to unilaterally assert the exception of security necessity.

The *Enron* case analyzed the language of GATT XX, as well as the International Court of Justice’s (ICJ) opinions in the *Nicaragua II* and the *Oil Platforms* cases, and concluded that the legal text reflected the intent that states did not confirm the self-judging interpretation.<sup>144</sup> The *Enron* tribunal further asserted that judicial review, not limited to measures taken in good faith, could be substantive to examine the facts and whether they qualify under the requirements of a state of necessity.<sup>145</sup> Following *Enron*, the *Sempra* tribunal reached the same conclusion of the non-self-judging nature of Article XI of the BIT.<sup>146</sup>

In *Continental Casualty*, the tribunal based its judgment on the language of the clause, the ICJ’s twice-repeated interpretation of substantially identical provisions, and the interpretation under Article 31 of the Vienna Convention on the Law of Treaties (VCLT). Again, the tribunal achieved the conclusion of the non-self-judging nature of the recourse to Article XI.<sup>147</sup>

In sum, all of the tribunals asserted the non-self-judging nature of Article XI of the Argentina–United States BIT.

## 2. The Approaches for Necessity Test

The doctrine of necessity is a recognized principle of customary international law; however, it has been strictly limited by the International Law Commission (ILC) Commentary and international

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141. *LG&E Energy Corp., et al., v. Argentine Republic*, ICSID Case No. ARB/02/1, Award, ¶ 212 (Oct. 3, 2006) [hereinafter *LG&E Award*].

142. *Id.* at ¶ 213.

143. *Id.*

144. *Enron Corp. & Ponderosa Assets, L.P. v. Argentine Republic*, ICSID, Case No. ARB/01/3, Award, ¶¶ 335–36 (May 22, 2007) [hereinafter *Enron Award*].

145. *Id.* at ¶ 339.

146. *Sempra Energy Int’l v. Republic of Argentina*, ICSID Case No. ARB/02/16, Award, ¶¶ 379–88 (Sept. 28, 2007) [hereinafter *Sempra Award*].

147. *Continental Casualty Co. v. Argentine Republic*, ICSID Case No. ARB/03/9, Award, ¶ 187 (Sept. 5, 2008) [hereinafter *Continental Casualty Award*].



tribunals to avoid the potential abuse by states.<sup>148</sup> The ILC Commentary states that “necessity will only rarely be available to excuse non-performance of an obligation” and “is subject to strict limitations to safeguard against possible abuse.”<sup>149</sup> The successful invocation of the doctrine of necessity is virtually impossible, especially in the international investment area.<sup>150</sup> To decide whether essential security measures adopted are indeed necessary, the necessity test required for the application of the BIT must be determined. The *CMS*, *Enron*, and *Sempra* tribunals adopted the “only way” approach, while the *Continental Casualty* tribunal evaluated the plea of necessity under the “reasonable available” approach.<sup>151</sup>

The “only way” test comes from Article 25 of the ILC Articles on State Responsibility:

Art. 25:

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.<sup>152</sup>

According to ILC commentaries, to invoke the customary necessity defense successfully, states need to meet all of its requirements

148. International Law Commission, *Draft Articles on Responsibility of States for Internationally Wrongful Acts with Commentaries*, art. 25 (2001) [hereinafter ILC Articles]; see also August Reinisch, *Necessity in International Investment Arbitration—An Unnecessary Split of Opinions in Recent ICSID Cases—Comments on CMS v. Argentina and LG&E v. Argentina*, 8 J. WORLD INV. & TRADE 191 (2007).

149. *ILC Commentary to Article 25*, *supra* note 31, at 195.

150. See Andrea K. Bjorklund, *Emergency Exceptions to International Obligations in the Realm of Foreign Investment: The State of Necessity and Force Majeure as Circumstances Precluding Wrongfulness*, in OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW (Peter Muchlinski et al. eds., 2008).

151. See *CMS Award*, *supra* note 133, at ¶ 316; *Enron Award*, *supra* note 144, at ¶ 305–08; *Sempra Award*, *supra* note 146, at ¶ 347–50; *Continental Casualty Award*, *supra* note 147, at ¶ 195.

152. ILC Articles, *supra* note 148, at art. 25.

cumulatively.<sup>153</sup> The “only way” element embedded in Article 25(1)(a) requires a state to show that it had no way to protect its essential interests other than breaching its international obligations.<sup>154</sup> In other words, a state would fail to meet this requirement if there are other means available to respond to emergency situations, even if they are more costly or less convenient.

The *CMS* tribunal assessed whether the state of necessity met the conditions set by customary international law and the treaty provisions, and whether it was able to preclude wrongfulness or not.<sup>155</sup> The *Enron* tribunal claimed that the treaty was inseparable from the customary law standard for the operation of the state of necessity.<sup>156</sup> The *Sempra* tribunal interpreted Article XI of the BIT under the requirements of the customary necessity defense.<sup>157</sup>

The *CMS*, *Enron*, and *Sempra* tribunals’ awards were all challenged by separate annulment committees.<sup>158</sup> Although the *CMS* annulment committee did not annul the award, it stressed that the *CMS* tribunal should have analyzed pleadings under the two norms separately as they are meant to function differently.<sup>159</sup> The *Sempra* annulment committee annulled the tribunal’s award.<sup>160</sup> The *Sempra* annulment committee held that the tribunal failed to separately analyze and apply Article XI in the BIT, constituting a total failure to apply the law and exercising a “manifest excess of powers.”<sup>161</sup> The *Enron* annulment committee found that the tribunal had failed to provide reasons for the adoption of the “only way” approach.<sup>162</sup>

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153. *ILC Commentary to Article 25*, *supra* note 31, at 80. The requirements are: (1) a threat to an “essential interest” of a particular state; (2) a “grave and imminent peril” to that interest; (3) the action taken is the “only way” to preserve that essential interest; (4) that the situation was not caused by the state in question seeking to invoke the plea; (5) that action does not impair the interests of other states; and (6) the action lasts only as long as the situation persists.

154. James Crawford, *Introduction, Texts, and Commentaries, in THE INTERNATIONAL LAW COMMISSION’S ARTICLES ON STATE RESPONSIBILITY: INTRODUCTION* 184 (Cambridge Univ. Press 2002).

155. *CMS Award*, *supra* note 133, at ¶ 374.

156. *Enron Award*, *supra* note 144, at ¶ 334.

157. *Sempra Award*, *supra* note 146, at ¶¶ 376, 378.

158. *CMS Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, Ad Hoc Committee on the Application for Annulment, ¶ 1 (Sept. 25, 2007) [hereinafter *CMS Transmission Annulment Proceeding*]; *Enron Corp. & Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Decision on the Application for Annulment of the Argentine Republic, ¶ 1 (July 30, 2010) [hereinafter *Enron Annulment Proceeding*]; *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Decision on the Argentine Republic’s Application for Annulment of the Award, ¶ 1 (June 29, 2010) [hereinafter *Sempra Annulment Proceeding*].

159. *CMS Transmission Annulment Proceeding*, *supra* note 158, at ¶ 135.

160. *Sempra Annulment Proceeding*, *supra* note 158, at ¶ 214.

161. *Id.* at ¶¶ 213–14.

162. *Enron Annulment Proceeding*, *supra* note 158, at ¶ 349.

However, the *Enron* annulment committee did not indicate whether it agreed with the tribunal's approach or not.<sup>163</sup>

In sum, the *CMS*, *Enron*, and *Sempra* tribunals interpreted Article XI of the BIT under the requirements of the customary necessity defense and found that the measures Argentina adopted as a response to the crisis failed to meet the "only way" test. However, these three separate annulment committees disagreed with the tribunals.<sup>164</sup>

Besides the "only way" approach, the "reasonable available" approach is widely used by the WTO in interpreting "necessity" clauses. It was first interpreted by the GATT Panel in Section 337 of the Tariff Act of 1930<sup>165</sup> when the United States claimed that the measure in question was necessary under GATT Article XX(d) to secure compliance with domestic patent laws.<sup>166</sup> The United States argued that Section 337 provided the only means of enforcement of US patent rights against imports of products manufactured abroad by means of a process patented in the United States.<sup>167</sup> In this regard, the Panel stated:

A contracting party cannot justify a measure inconsistent with another GATT provision as "necessary" if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it. By the same token, in cases where a measure consistent with other GATT provisions is not reasonably available, a contracting party is bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other GATT provisions.<sup>168</sup>

The "reasonable available" approach was first used in the *Continental Casualty* case in the international investment law area.<sup>169</sup> The *Continental Casualty* tribunal abandoned the necessity analysis within the framework of customary international law.<sup>170</sup> Instead, the tribunal adopted the "reasonable available" approach applied within GATT and WTO case law.<sup>171</sup> The *Continental Casualty* tribunal's task was to determine whether Argentina had no other "reasonable choice available" to protect its essential security interests to justify the plea of necessity by Argentina.<sup>172</sup> The *Continental Casualty* award survived

163. *Id.*

164. See *Sempra* Annulment Proceeding, *supra* note 158.

165. REPORT OF THE PANEL UNITED STATES-SECTION 337 OF THE TARIFF ACT OF 1930, Foreign Trade Information System, Organization of American States, L/6439-36S/345 (1989), <http://www.sice.oas.org/dispute/gatt/87TA3374.asp> [<https://perma.cc/NJT6-635U>] (archived Sept. 3, 2019) [hereinafter PANEL REPORT].

166. *Id.* at ¶ 3.59.

167. *Id.* at ¶ 3.62.

168. *Id.* at ¶ 5.26.

169. See *Continental Casualty Award*, *supra* note 147, at ¶ 195.

170. *Id.* at ¶ 192.

171. *Id.* at ¶¶ 187–282, 292–96, 299, 308, 343, 349, 413.

172. *Id.* at ¶ 199.

annulment.<sup>173</sup> The *Continental Casualty* annulment committee affirmed the distinction between Article XI of the BIT and the customary international law defense of necessity.<sup>174</sup>

Several reasons can account for the adoption of the “reasonable available” approach to evaluate the plea of the necessity of the measures. First, Article XX of GATT case law has developed the “reasonable available” approach to review essential security measures.<sup>175</sup> Article XI of the BIT derived from the U.S. Model BIT and the U.S. Friendship, Commerce and Navigation (FCN) treaties, which are supposed to derive from Article XX of GATT.<sup>176</sup> For this reason, it would be natural for the investment tribunals to follow the Article XX case law and adopt the “reasonable available” methodology to review essential security issues.

Second, since both GATT and WTO case law have extensively dealt with national treatment issues, it would be more appropriate to interpret necessity as an exception of national treatment according to the understanding of GATT and WTO case law. A common denominator in both the trade and investment treaties is the norm against discrimination.<sup>177</sup> For the national treatment norms across the WTO law and international investment law, the cases *SD Myers v. Canada*,<sup>178</sup> *Pope & Talbot v. Canada*,<sup>179</sup> *Occidental v. Ecuador*,<sup>180</sup> and *Methanex v. the United States*<sup>181</sup> illustrate how the WTO legal norms are used by international investment tribunals. And the application of like circumstances is to be found in trade treaties, and principles could be borrowed from international trade law when comparisons are made.<sup>182</sup> Therefore, it would be more appropriate to interpret the exception, necessity, according to the understanding of GATT and WTO case law.

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173. *Continental Casualty*, Annulment Proceeding, *supra* note 131, at Part V.

174. *Id.* at ¶¶ 127–28.

175. See PANEL REPORT, *supra* note 165, ¶ 7.104 (summing up the Appellate Body case law in the following WTO disputes: Korea–Beef, at ¶ 164; EC–Asbestos, at ¶ 172, U.S.–Gambling, at ¶ 306; Dominican Republic–Cigarettes, at ¶ 70).

176. *Continental Casualty Award*, *supra* note 147, at ¶192.

177. Both the WTO Agreement and international investment agreements contain clauses on Most-Favored-Nation principle and National Treatment principle, the basic principles against discrimination.

178. *S.D. Myers, Inc. v. Government of Can.*, NAFTA/UNICTRAL Trib., Partial Award, ¶¶ 244–47 (Nov. 13, 2000).

179. *Pope & Talbot Inc. v. Government of Can.*, NAFTA/UNICTRAL Trib., Award on the Merits of Phase 2, ¶¶ 45–72 (Apr. 10, 2001).

180. *Occidental Exploration & Prod. Co. v. Republic of Ecuador*, LCIA Case No. UN3467, Award, ¶¶ 173–77 (London Ct. Int'l Arb. 2004).

181. *Methanex Corp. v. U.S.*, NAFTA/UNICTRAL Trib., Final Award, ¶¶ 29–38 (Aug. 3, 2005).

182. Nicholas DiMascio & Joost Pauwelyn, *Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?*, 102 AM. J. INT'L L. 48, 49 (2008).

Third, the content of and the conditions to invoke Article XI defenses and customary international law defenses are different. Article XI has been defined as a safeguard clause, allowing states to escape from their commitments.<sup>183</sup> In customary international law, necessity is taken into account as a “ground for precluding the wrongfulness of an act not in conformity with an international obligation,” under certain strict conditions.<sup>184</sup> The conditions of application are also different. The strict conditions to which the ILC text subjects the invocation of the defense of necessity by a state is explained by the fact that it can be invoked in any context against any international obligation.<sup>185</sup> Therefore “it can only be accepted on an exceptional basis.”<sup>186</sup> This is not necessarily the case under Article XI of the BIT. Invocation of Article XI under the BIT, as a specific provision limiting the general investment protection obligations bilaterally agreed to by the contracting parties, is not necessarily subject to the same conditions of application as the plea of necessity under general international law.<sup>187</sup>

Fourth, trade and investment are closely associated on global value chains. With the rise of global value chains led by multinational corporations, trade and investment laws have similar ends through different regimes.<sup>188</sup> Both trade and investment frameworks, of a mutually reinforcing nature, are designed against discrimination and protectionism.<sup>189</sup> The two fields are closely interrelated, and many modern preferential trade agreements contain not only rules with respect to trade but also rules related to investment.<sup>190</sup> For this reason, it would be more appropriate to adopt a similar approach to review the non-self-judging clause between international trade law and international investment law.

In sum, the “reasonable available” approach is much more appropriate than the “only way” approach in determining whether the invocation of necessity embedded in essential security non-self-judging clauses is justified. The derivation of Article XI of the BIT, the similar function of necessity exceptions between the WTO and investment, the

183. Alan Sykes, *Protectionism as a “Safeguard”: A Positive Analysis of the GATT “Escape Clause” with Normative Speculations*, 58 U. CHI. L. REV. 255, 258 (1991).

184. See ILC Articles, *supra* note 148, at 201 (commentary to article 25).

185. ILC Article 26 states the exception as those “arising under a peremptory norm of general international law.” *Id.*

186. See ILC Articles, *supra* note 148, at 195, ¶ 14 (“to emphasize the exceptional nature of necessity and concerns about its possible abuse, article 25 is cast in negative language.”).

187. *Id.* at ¶ 21 (“as embodied in Art. 25, the plea of necessity is not intended to cover conduct which is in principle regulated by the primary obligations.”).

188. See Sungjoon Cho & Jürgen Kurtz, *Convergence and Divergence in International Economic Law and Politics*, 29 EUR. J. INT’L L. 169, 179–82 (2008).

189. *Id.*

190. See China–Australia Free Trade Agreement (ChAFTA), Austl.-China, Dec. 20, 2015, Ch. 9.

differences between the Article XI and customary international law defenses, and the interlinking of trade and investment all contribute to the preference of the “reasonable available” approach.

### B. Review of Self-Judging Security Clauses

A treaty only includes meaningful language; permissive wording would be included in a treaty only if it were thought of as necessary to overcome certain interpretative obstacles. Thus, it appears that an explicit self-judging clause fully empowers state parties as the sole arbiter to apply their own essential security measures. However, relevant WTO cases and NAFTA clauses reject this interpretation. WTO cases provide similar or even the same language with self-judging clauses in IIAs, while the regional agreement NAFTA provides specific regulation on international investment and essential security.<sup>191</sup> This Part will analyze relevant WTO cases and NAFTA clauses to explore whether a tribunal can review the explicit self-judging essential security clause.

#### 1. The Reviewability of Self-Judging Security Clauses

In international economic law, WTO cases and NAFTA provisions all provide some clue on the reviewability of the self-judging essential security clause. In the WTO Framework, GATT Article XXI offers reference on the nature of the self-judging essential security clause.<sup>192</sup> The self-judging nature of GATT Article XXI was first addressed in an early dispute between Czechoslovakia and the United States, concerning an import ban imposed by the United States on national security grounds.<sup>193</sup> In the *Request of the Government of Czechoslovakia for a decision under Article XXIII as to whether or not the Government of the United States of America has failed to carry out its obligations under the Agreement through its administration of the issue of export licences*, the United Kingdom representative asserted

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191. NAFTA, *supra* note 13.

192. The General Agreement On Tariffs and Trade, Jan. 1, 1949, art. XXI (Article XXI states: “Nothing in this Agreement shall be construed (a) to require any contracting party to furnish any information the disclosure of which it considers contrary to its essential security interests; or (b) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests (i) relating to fissionable materials or the materials from which they are derived; (ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment; (iii) taken in time of war or other emergency in international relations; or to prevent any contracting party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.”).

193. See *Summary Record of the Twenty-Second Meeting*, WTO, CP.3/SR2-II/28 (June 8, 1949).

that the ban would be justified since states would have the final say on issues relating to their own security.<sup>194</sup> However, this representative also pointed out that states should be prudent not to take measures undermining the General Agreement.<sup>195</sup> In the end, the contracting parties rejected Czechoslovakia's claim.<sup>196</sup> Therefore, the contracting parties considered their formal jurisdiction with regard to a defense made under Article XXI.<sup>197</sup>

The United States also invoked Article XXI of the GATT in relation to a claim by Nicaragua that an executive order issued by President Reagan prohibiting all trade with Nicaragua violated the United States' obligations under the GATT.<sup>198</sup> Due to the limitation of terms of reference, the panel could not consider the validity of the invocation of Article XXI(b)(iii) by the United States.<sup>199</sup> However, it raised more general questions:

If it were accepted that the interpretation of article XXI was reserved entirely to the Contracting Parties invoking it, how could the Contracting Parties ensure that this general exception to all obligations under the General Agreement is not invoked excessively or for purposes other than those set out in this provision? If the Contracting Parties give a panel the task of examining a case involving an article XXI invocation without authorizing it to examine the justification of that invocation, do they limit the adversely affected Contracting Party's right to have its complaint investigated in accordance with article XXIII:2?<sup>200</sup>

Recently, Article XXI of the GATT has been examined by a WTO panel in a dispute between Russia and Ukraine.<sup>201</sup> The report concluded that the WTO possesses "jurisdiction to determine whether the requirements of Article XXI(b)(iii) of the GATT 1994 are satisfied."<sup>202</sup> Accordingly, the panel held that it could review whether (1) the member invoking the exception has sufficiently articulated its essential security interests,<sup>203</sup> and (2) the measures implemented are plausibly related to the protection of such interests.<sup>204</sup> But this ruling can still be appealed to the WTO's Appellate Body with nonbinding

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194. *Id.* at 7.

195. *Id.*

196. *Id.*

197. See Stefan Ohloff & Hannes L. Schloemann, "Constitutionalization" and Dispute Settlement in the WTO: National Security as an Issue of Competence, 93 AM. J. INT'L L. 424, 432 (1999); Susan Rose-Ackerman & Benjamin Billa, *Treaties and National Security*, 40 N.Y.U. J. INT'L L. & POL. 437, 455 (2007).

198. Panel Report, *United States—Trade Measures Affecting Nicaragua*, ¶ 1.2, WTO Doc. L/6053 (adopted Oct. 13, 1986).

199. *Id.* at ¶ 5.13.

200. *Id.* at ¶ 5.17.

201. Panel Report, *Russia—Measures Concerning Traffic in Transit*, ¶¶ 3.2, 7.4, WTO Doc. WT/DS512/R (adopted Apr. 5, 2019).

202. *Id.* at ¶ 7.104.

203. *Id.* at ¶ 7.134.

204. *Id.* at ¶ 7.138.

effect. Thus, it could be inferred that measures taken under Article XXI of the GATT are subjected to review by tribunals.

Furthermore, NAFTA provisions support the review of self-judging clauses under “good faith.” NAFTA has a significant chapter on international investment. Article 2102 contains an explicit essential security exception.<sup>205</sup> Article 2102 also governs the extent to which a government may take action that would otherwise be inconsistent with the NAFTA in order to protect its essential security interests.<sup>206</sup> This article does not apply to energy trade between the United States and Canada or to measures related to government procurement.<sup>207</sup> Article 607 and 1018, respectively, establish specialized national security exceptions in those areas.<sup>208</sup>

According to the Statement of Administrative Action in the United States’ NAFTA Implementation Act of 1993, this exception is self-judging; however, it must be invoked with good faith:

Article 2102 governs the extent to which a government may take action that would otherwise be inconsistent with the NAFTA in order to protect its national security interests . . . The national security exception is self-judging in nature, although each government would expect the provisions to be applied by the other in good faith.<sup>209</sup>

Chapter 11 of NAFTA, dealing with investment, implies that Article 2102 is not entirely self-judging.<sup>210</sup> Article 1138 states that a decision about whether to permit or reject an investment on the basis of Article 2102 is not subject to the dispute settlement provisions of NAFTA.<sup>211</sup> However, there is no general exclusion from dispute

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205. NAFTA, *supra* note 13, at art. 2102. (“Subject to Articles 607 (Energy–National Security Measures) and 1018 (Government Procurement Exceptions), nothing in this Agreement shall be construed:

(a) to require any Party to furnish or allow access to any information the disclosure of which it determines to be contrary to its essential security interests;

(b) to prevent any Party from taking any actions that it considers necessary for the protection of its essential security interests (i) relating to the traffic in arms, ammunition and implements of war and to such traffic and transactions in other goods, materials, services and technology undertaken directly or indirectly for the purpose of supplying a military or other security establishment, (ii) taken in time of war or other emergency in international relations, or (iii) relating to the implementation of national policies or international agreements respecting the non-proliferation of nuclear weapons or other nuclear explosive devices; or

(c) to prevent any Party from taking action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.”).

206. *Id.*

207. *Id.*

208. *Id.*

209. Line Item Veto Act, 2 U.S.C. § 691 (2000).

210. NAFTA, *supra* note 13.

211. *Id.* at art. 1138 (1. Without prejudice to the applicability or non-applicability of the dispute settlement provisions of this Section or of Chapter Twenty (Institutional Arrangements and Dispute Settlement Procedures) to other actions taken by a Party pursuant to Article 2102 (National Security), a decision by a Party to prohibit or restrict



settlement for Article 2102.<sup>212</sup> Even though there is no case law on this point, one commentary argues that “if the Parties had agreed that Article 2102 were entirely self-judging, Article 1138 would not be necessary.”<sup>213</sup>

In sum, until now there has not been a specific case dealing with explicit self-judging essential security clauses in IIAs. Even though the explicit self-judging essential security clause appears to empower the state parties as the sole arbiter of the scope and application of their own essential security measures, the relevant WTO cases and NAFTA clauses support the review of self-judging clauses under a “good faith” standard.

## 2. The “Good Faith” Standard

Good faith is a general principle of international law that aims “to blunt the excessively sharp consequences sovereignty and its surrogates may have on the international society, in ever-increasing need of cooperation.”<sup>214</sup> In the context of treaties, the principle of good faith protects the object and purpose of the treaty against acts intending or having the effect of depriving it of its use.<sup>215</sup> Good faith is closely connected to the customary law principle of *pacta sunt servanda*<sup>216</sup> and is mentioned not only in Article 26 of the VCLT,<sup>217</sup> but equally in Article 31(1) of VCLT as a principle guiding the interpretation of treaties.<sup>218</sup>

Susan Rose-Ackerman has called for the good faith review of the explicit self-judging clauses on the basis of the WTO cases and NAFTA clauses.<sup>219</sup> Rose-Ackerman implies that the Decision Concerning Article XXI of the General Agreement could provide an example for the

the acquisition of an investment in its territory by an investor of another Party, or its investment, pursuant to that Article shall not be subject to such provisions.

2. The dispute settlement provisions of this Section and of Chapter Twenty shall not apply to the matters referred to in Annex 1138.2).

212. *Id.*

213. MEG N. KINNEAR ET AL., INVESTMENT DISPUTES UNDER NAFTA: AN ANNOTATED GUIDE TO NAFTA CHAPTER 11 1138–46 (Kluwer Law 2006).

214. See Robert Kolb, *Principles as Sources of International Law (with special reference to good faith)*, 53 NETH. INT’L L. REV. 1, 18 (2006).

215. *Id.* at 19–20.

216. See Nuclear Tests (Austl. v. Fr.), Judgment, 1974 I.C.J. 253, 268, ¶ 46 (Dec. 1974); Nuclear Tests (N.Z. v. Fr.), Judgment, 1974 I.C.J. 457, 473, ¶ 49 (Dec. 1974).

217. Vienna Convention on the Law of Treaties, art. 26, May 23, 1969, No. 18232 (“every treaty in force is binding upon the parties to it and must be performed by them in good faith . . .”) [hereinafter VCLT].

218. “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.” *Id.* at art. 31(1). The good faith principle finds further reflection in the Declaration on Principles of International Law concerning Friendly Relations and Cooperation among States in Accordance with the Charter of the United Nations. G.A. Res. 26/25 (XXV), at 1 (Oct. 24, 1970).

219. Rose-Ackerman & Billa, *supra* note 197, at 468.

“good faith” review of essential security issues in international investment law area, even though this decision is about international trade.<sup>220</sup> Stephan Schill and Robyn Briese claim that self-judging clauses do not provide the state invoking the clause with an unlimited and nonreviewable power.<sup>221</sup> The tribunals retain the power to implement a “good faith review.”<sup>222</sup> Akande Dapo and Williams Sope limit good faith review to establishing the genuineness of the reasons a state provides for the essential security measures taken.<sup>223</sup>

Schill and Briese suggest that an analogy could be drawn between “good faith review” by international tribunals and the standard of review applied by domestic courts in relation to discretionary decisions taken by administrative agencies.<sup>224</sup> Schill and Briese also assert that an international investment tribunal could borrow the idea of “good faith” applied in domestic administrative law.<sup>225</sup> International investment tribunals should grant a wide margin of appreciation to states when determining whether a state’s measures fall under the necessity defense.<sup>226</sup> Schill even asserts that investor–state arbitration is part of the emerging global administrative law and a “good faith” standard should be applied when interpreting essential security clauses in IIAs.<sup>227</sup>

William W. Burke-White and Andreas von Staden acknowledge that a “workable standard of good faith review has yet to be fully

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220. GATT Secretariat, *Decision Concerning Article XXI of the General Agreement*, GATT Doc. L/5426 (Nov. 30, 1982) (Considering that the exceptions envisaged in Article XXI of the General Agreement constitute an important element for safeguarding the rights of contracting parties when they consider that reasons of security are involved; Noting that recourse to Article XXI could constitute, in certain circumstances, an element of disruption and uncertainty for international trade and affect benefits accruing to contracting parties under the General Agreement; Recognizing that in taking action in terms of the exceptions provided in Article XXI of the General Agreement, contracting parties should take into consideration the interests of third parties which may be affected; That until such time as the CONTRACTING PARTIES may decide to make a formal interpretation of Article XXI it is appropriate to set procedural guidelines for its application; The CONTRACTING PARTIES decide that: 1. Subject to the exception in Article XXI: a contracting parties should be informed to the fullest extent possible of trade measures taken under Article XXI. 2. When action is taken under Article XXI, all contracting parties affected by such action retain their full rights under the General Agreement. 3. The Council may be requested to give further consideration to this matter in due course.).

221. Briese & Schill, *supra* note 20, at 61–140.

222. *Id.*

223. Dapo Akande & Sope Williams-Elegbe, *International Adjudication on Essential Security Issues: What Role for the WTO?*, 43 VA. J. INT’L L. 365, 396 (2003).

224. Briese & Schill, *supra* note 20, at 125–27.

225. *Id.* at 136.

226. *Id.* at 124.

227. Benedict Kingsbury & Stephan Schill, *Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law*, N.Y.U. GLOBAL ADMIN. L. SERIES 6 (2009).

developed,”<sup>228</sup> and that the paucity of cases on point means that “arbitral tribunals will have to develop their own approaches to whether the good faith requirement has been met.”<sup>229</sup> Burke-White and von Staden further develop the specific requirements for good faith and their underlying reasons. Drawn from the work of scholars and international organizations,<sup>230</sup> the “good faith” standard encompasses two basic elements: first, whether a host state has engaged in “honest and fair dealing”; and second, whether there is “rational basis” for the assertion of the essential security exception.<sup>231</sup>

### C. Rejection of the “Good Faith” Standard

Even though relevant international panels and noted scholars call for review of essential security under the good faith standard, this Article takes a dissenting view. This Article will set out the specific reasons for the rejection of the good faith test applied by international investment tribunals, including potential abuses by international investment tribunals, the uncertainty and ambiguity of the “good faith” standard, and the formal legal interpretation of self-judging clauses.

#### 1. Risk of Abuse of the “Good Faith” Test

While the good faith test may have advantages due to its flexibility in application, there is arguably a risk that it will not be robust enough to give states sufficient confidence that self-judging clauses will not be abused. First, there is a measure of unpredictability when international investment tribunals determine whether a state has invoked a self-judging clause in good faith. In *Shum v. Peru*, the tribunal pointed out that arbitrators or judges under any system of law are often confronted with the challenge of construing documents negotiated to create legal obligations at a particular place and time, but which must be given meaning at a later date and, perhaps, in a significantly different context.<sup>232</sup> The *Shum* tribunal clearly stated

228. William W. Burke-White & Andreas von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties*, 48 VA. J. INT'L L. 307, 378 (2008).

229. *Id.* at 378–79.

230. The first element based on the 1949 Draft Declaration on the Rights and Duties of States included such a standard at Article 13, the 1935 Harvard Research on the Law of Treaties. See Draft Declaration on Rights and Duties of States with Commentaries, G.A. Res. 375 (IV), art. 13 (Dec. 6, 1949). The second element based on United Nations Convention on the Law of the Sea, art. 300, 21 I.L.M. 1261 (Dec. 10, 1982) (“States Parties shall fulfill in good faith the obligations assumed under this Convention and shall exercise the rights, jurisdiction and freedoms recognized in this Convention in a manner which would not constitute an abuse of right.”).

231. Burke-White & von Staden, *supra* note 228, at 379.

232. Señor Tza Yap Shum v. Republic of Peru, ICSID Case No. ARB/07/6, Decision on Annulment, ¶ 130 (Feb. 12, 2015).

that one of the main tasks of an investment tribunal is to interpret legal text in different settings.<sup>233</sup> However, it is doubtful that investment tribunals can stand in states' shoes to understand states' essential security measures in an emergency. For this reason, it is unpredictable for the tribunals to interpret essential security clauses due to the practical complexity of various states, especially in the emergency context.

Furthermore, the international investment legal regime lacks certain mechanisms to ensure correct or consistent interpretations of IIA obligations in line with the intention of the contracting parties, in order to control the further development of investment law by arbitral tribunals.<sup>234</sup> For instance, with respect to the definition of "investor," the regulatory basis for the definition of investor is interpreted inconsistently. In *TSA v. Argentine*, the arbitral tribunal held that the nationality of a company is determined based on the provisions of Article 25(2)(b) of the ICSID Convention.<sup>235</sup> However, in contrast with *TSA*, in *Tokios Tokelés v. Ukraine*, the arbitral tribunal held that the nationality of a company is determined not based on the provisions of Article 25(2)(b) of the ICSID Convention but by the respective BIT.<sup>236</sup>

Moreover, if international investment tribunals possess too wide of a discretion to review the honesty and reasonableness of states' measures, significant restraints might be imposed on states to take essential security measures. These restraints may conflict with states' sovereignty on certain security issues. With the rise of sovereignty concerns, these restraints are not what states would expect.

## 2. Ambiguity of "Good Faith" Standard

Rose-Ackerman suggests a good faith requirement for international investment tribunal's review of essential security based on the relevant WTO cases and NAFTA provisions.<sup>237</sup> First, the report on *United States—Trade Measures affecting Nicaragua* relied by Rose-Ackerman has not been adopted.<sup>238</sup> Second, no other IIAs or international investment cases support this approach.<sup>239</sup> The statement on NAFTA Article 2102 particularly mentions that the self-

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233. *Id.* at ¶ 156.

234. See W. Michael Reisman, 'Case Specific Mandates' versus 'Systemic Implications': How Should Investment Tribunals Decide?: *The Freshfields Arbitration Lecture*, 29 ARB. INT'L 131 (2013).

235. *TSA Spectrum de Argentina S.A. v. Argentine Republic*, ICSID Case No. ARB/05/5, Award, ¶ 162 (Dec. 19, 2008).

236. *Tokelés v. Ukr.*, ICSID Case No. ARB/02/18, Decision on Jurisdiction, ¶ 71 (Apr. 29, 2004).

237. Rose-Ackerman & Billa, *supra* note 197, at 460–71.

238. Panel Report, *United States—Trade Measures Affecting Nicaragua*, WTO Doc. L/6053 (adopted Oct. 13, 1986) [hereinafter *Nicaragua II*].

239. Rose-Ackerman & Billa, *supra* note 197, at 460–71.

judging clause is under good faith review.<sup>240</sup> Furthermore, the WTO case *Rose-Ackerman* relied on is *United States–Trade Measures Affecting Nicaragua (Nicaragua II)*.<sup>241</sup> In *Nicaragua II*, the panel simply proposed a question without answer; this question is not a holding, nor even dictum.<sup>242</sup>

Last, international investment treaty arbitration “is not a subgenre of an existing discipline. It is dramatically different from anything previously known in the international sphere.”<sup>243</sup> Significant differences exist in the structures, assumptions, and normative commitments between international trade law and international investment law.<sup>244</sup> As to essential security, foreign investment can generate essential security-related problems in the post-establishment phase in host states.<sup>245</sup> Host states can regulate foreign investment after investment is made.<sup>246</sup> However, essential security issues in international trade law appear before goods are sold into states. After goods are sold into states, international trade law has no impact on goods themselves.<sup>247</sup> These structural differences between investment and trade provide different explanations to “essential security exceptions” between IIAs and GATT.

Burke-White and von Staden argue that these “honest and fair dealing” and “rational basis” elements offer several advantages to an arbitral tribunal assessing the invocation of a self-judging security clause.<sup>248</sup> First, they reflect the nature of the delegation power inherent in a self-judging security clause, namely that it is states that delegate limited power to IIAs to resolve the potential disputes.<sup>249</sup> Second, they explicitly avoid a tribunal’s second-guessing of government policy choices for which *ad hoc* tribunals may be poorly

240. NAFTA, *supra* note 13, art. 2102.

241. See *Nicaragua II*, *supra* note 238.

242. *Id.* at ¶ 5.17 (“If it were accepted that the interpretation of Article XXI was reserved entirely to the contracting party invoking it, how could the CONTRACTING PARTIES ensure that this general exception to all obligations under the General Agreement is not invoked excessively or for purposes other than those set out in this provision? If the CONTRACTING PARTIES give a panel the task of examining a case involving an Article XXI invocation without authorizing it to examine the justification of that invocation, do they limit the adversely affected contracting party’s right to have its complaint investigated in accordance with Article XXIII:2?”).

243. Jan Paulsson, *Arbitration Without Privity*, 10 ICSID REV.—FOREIGN INV. L.J. 232, 256 (1995).

244. Kurtz, *supra* note 6, at 757.

245. An example is that: foreign investors can suddenly withdraw their investments from host state to cause capital outflow and result host states’ economic instability.

246. In Argentina economic crisis, Argentina government enacted Emergency Law to regulate foreign investments after the admission of them.

247. When good are sold into states, those goods are in the hands of consumers or suppliers. International trade law only governs the phase of importing or exporting goods.

248. Burke-White & von Staden, *supra* note 228, at 379.

249. *Id.* at 380–81.

positioned.<sup>250</sup> Instead, the tribunal must review the honesty and rationality of the state's invocation of the self-judging essential security clause, which investment tribunals are much better positioned to determine.<sup>251</sup> Third, this standard still imposes significant restraints on the freedom of states to take essential security measures by reviewing the honesty and reasonableness of governmental measures, thereby balancing investor protection with state sovereignty.<sup>252</sup> Although Burke-White and von Staden propose "honest and fair dealing" and "rational basis," it is difficult to distinguish these two elements from good faith. It is even difficult to tell the difference between "honest and fair dealing" and "rational basis." It seems that Burke-White and von Staden play a game of words here.

Although Schill argues that arbitral tribunals can employ the concept of administrative law and defer to states' essential security decisions, it is difficult to draw the clear line between "review[ing] to establishing the genuineness of the reasons a state stated for the essential security measures taken" and "substantive review."<sup>253</sup> The underlying issue here is that the tribunals cannot simply assess the "good faith" standard unless the investment tribunals dig into the substance of the essential security measures to evaluate these measures. Then the tribunal might second-guess government policy choices, which *ad hoc* tribunals may be poorly positioned to do.<sup>254</sup>

### 3. Interpretation of Self-Judging Clause

Essential security is at the core of a state's right to exist. This obligation to provide peace and order is an essential obligation for a state. When a state binds itself through the conclusion of a treaty, it reserves the right to protect its essential security, even if this implies a departure from its treaty obligations. In this Part, this Article prepares to analyze the nature of the self-judging clause pursuant to Article 31 of VCLT.<sup>255</sup>

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250. *Id.* at 381.

251. *Id.*

252. *Id.* at 378.

253. See Kingsbury & Schill, *supra* note 227.

254. See GUS VAN HARTEN, INVESTMENT TREATY ARBITRATION AND PUBLIC LAW 95–102 (Oxford Univ. Press 2007) (Critics of the investment regime point out that such supranational second-guessing of members' measures to protect their "essential security" is in fact quite unlikely under the WTO regime for a number of reasons, including the fact that WTO dispute settlement, limited to states as claimants, is unlikely to present such opportunities for judicial intervention); see also Alvarez & Khamsi, *supra* note 22, at 383 (Many are astounded by the idea that three individuals, two of whom are party-appointed, in a case brought by a single foreign investor, who is not entitled even to be considered part of the greater democratic polity of a host state such as Argentina, can question how that government chooses to respond to a serious crisis, especially since, as the LG&E arbitrators put it, international law generally leaves such determinations to "the State's subjective appreciation").

255. VCLT, *supra* note 221, at art. 31 ("General Rule of Interpretation:

First, the plain legal text of self-judging clauses does not provide any room for interpretation. Self-judging clauses clearly assert that a state will consider the necessity itself, that is, “when *it* considers necessary.”<sup>256</sup> Michael Reisman suggests that arbitrators should focus on specific cases, not act as systemic developers of international investment law.<sup>257</sup> For this reason, based on the plain legal text, the tribunals have no competence to review self-judging essential security clauses.

In addition, by moving from non-self-judging clauses towards self-judging clauses, states are not willing to be interfered with by international investment tribunals with respect to their own sensitive essential security issues. This also accounts for the increase of self-judging clauses in recent years.<sup>258</sup> States would not move to the trend of self-judging clauses if there was no difference between the nature of non-self-judging clauses and self-judging clauses. If the international investment tribunals could jump into the sensitive essential security area and review the self-judging clause, even under good faith, there would be no meaning for the state parties to interpret particular self-judging clauses literally.

What is more, this interpretation reflects the nature of the delegation power inherent in self-judging security clauses, namely that it is states that delegate limited power to IIAs or international investment tribunals to resolve the potential disputes.

In conclusion, the potential risk of abuses by international tribunals, the ambiguity of a “good faith” test, and the interpretation of self-judging clauses pursuant to Article 31 of VCLT all account for the rejection of the “good faith” standard to review the essential security self-judging clauses.

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; (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.”).

256. *See id.* (emphasis added).

257. Reisman & Vinnik, *supra* note 7.

258. *See supra* Part II.B.

## V. ALTERNATIVE OPTION FOR NATIONAL SECURITY REVIEW IN THE INTERNATIONAL INVESTMENT LEGAL REGIME

What would happen if international investment tribunals asserted that the “essential security” exception applies as a defense, even under the aforementioned “reasonable available” approach to review non-self-judging essential security? Without a “good faith” review by international investment tribunals, how can states’ misuse of “essential security,” because of the discretionary nature of invoking essential security as a ground for restricting foreign investment, be prevented? This Part proposes that compensation should be paid for expropriation out of essential security measures. This compensation option internalizes states’ cost to make states more prudent when adopting essential security measures. Correspondently, this compensation option promotes states’ political efficiency.

### A. *International Tribunals’ Calling for Compensation*

The damage caused by expropriation or similar measures shall be compensated if these measures are nondiscriminatory, in due process, and for an objective related to the public interest.<sup>259</sup> An international investment tribunal can defer to a state to claim necessity out of good faith,<sup>260</sup> but require that just compensation be paid for the damage resulting from essential-security-related measures. This approach is recognized by the ILC Articles on State Responsibility.<sup>261</sup> Article 27 provides in pertinent part: “The invocation of a circumstance precluding wrongfulness [such as necessity] in accordance with this chapter is without prejudice to . . . (b) The question of compensation for any material loss caused by the act in question.”<sup>262</sup> The compensation can be deferred until the state claiming necessity has recovered from the emergency situation sufficiently to be in a position to compensate without impairing its essential interests.<sup>263</sup>

Furthermore, regarding the Argentina economic crisis, the *CMS*, *Enron*, and *Sempra* tribunals all indicated that they would still have required Argentina to compensate the claimants, even if they had accepted Argentina’s defense.<sup>264</sup> In *CMS*, the tribunal supported the

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259. Rosalyn Higgins, *The Taking of Property by the State: Recent Developments in International Law*, 259 RECUEIL DES COURS 267, 331 (1982).

260. See U.S.-Argentina BIT, *supra* note 18.

261. Report, Draft Articles on Responsibility of States for Internationally Wrongful Acts, International Law Commission A/56/10 (2001).

262. *Id.* at art. 27

263. Alan Sykes, *Economic “Necessity” in International Law*, 109 AM. J. INT’L L. 296, 320 (2015); see also Alvarez & Khamsi, *supra* note 22, at 459.

264. CMS Award, *supra* note 133, at ¶¶ 383–93; Enron Award, *supra* note 144, at ¶ 345; Sempra Award, *supra* note 146, at ¶ 394; see also Alvarez & Khamsi, *supra* note 22, at 455–60.



approach of compensation for measures out of necessity by citing the following cases: *Gabčíkovo-Nagymaros*,<sup>265</sup> *Compagnie Générale de l'Orinocco*,<sup>266</sup> *Properties of the Bulgar Greece*,<sup>267</sup> and *Orr & Laubenheimer*.<sup>268</sup> In *Enron* and *Sempra*, the tribunals pointed out that the matter of whether compensation should be paid should be agreed to by the affected parties, and the possibility of compensation for past events was not excluded.<sup>269</sup>

In the Annulment Committee in *Mitchell v. Democratic Republic of the Congo*, the tribunal stated that even if the tribunal had agreed that the measures undertaken were not wrong, it would not rule out the need for compensation.<sup>270</sup> In *BG Group v. Argentina*, the tribunal stated that a state was “entitled to adopt such measures as it deems appropriate to emerge from the state of emergency. However, it remains obligated to pay compensation.”<sup>271</sup>

Therefore, it can be concluded that the compensation approach to the damages caused by essential security measures is not only recognized under customary international law but also supported by some international investment tribunals.

### B. *The Advantages of Compensation Standard*

International investment tribunals can plausibly observe and verify the existence of necessity, but they are not in a proper position to assess whether abrogation of international obligations is a “reasonable available” option or the “only way” to address essential security concerns.<sup>272</sup> Likewise, where a state has contributed to the underlying necessity through imprudent policy choices, excusing obligations can encourage states to behave more imprudently.<sup>273</sup> To resolve this problem, the compensation option can force a state that deviates from its international obligations to internalize substantial costs, to eliminate the moral hazard problem, and to promote political efficiency.

265. *Gabčíkovo-Nagymaros Project*, Judgment, 1997 I.C.J. Rep. ¶¶ 152–53 (Sept. 25) (where the Court noted that “Hungary expressly acknowledged that, in any event, such a state of necessity would not exempt it from its duty to compensate its partner.”).

266. United Nations, *Company General of the Orinoco Case*, 10 REP. OF INT'L ARBITRAL AWARDS 184–285 (1905).

267. *Report of the International Law Commission to the General Assembly*, U.N. GAOR, 32d Sess., at 38, U.N. Doc. A/35/10 (1980), reprinted in 2 Y.B. Int'l L. Comm'n 38, ¶ 13, U.N. Doc. A/CN.4/SER.A/1980/Add.1 (1981).

268. U.N. Report, *Claims of Orr and Laubenheimer and the Post-Glover Electric Co.*, Vol. XV Vol. 37, 40 (1900).

269. Crawford, *supra* note 154, at 190.

270. *Patrick Mitchell v. Democratic Republic of the Congo*, ICSID Case No. ARB/99/7, Decision on Application of Annulment, ¶ 57 (Nov. 1, 2016).

271. *BG Group Plc. v. Argentine Republic*, UNCITRAL, Final Award, ¶ 409 (Dec. 24, 2007) [hereinafter *BG Group*].

272. *Alvarez & Khamsi*, *supra* note 22, at 383.

273. Sykes, *supra* note 263, at 319.

States will take risks that imperil them to an excessive degree if they can impose costs on others, although sometimes “what is saved is more valuable than what is lost.”<sup>274</sup> State parties would be incentivized to make a proper choice if there was a requirement that the defendant who acts out of essential security concerns must pay compensation.<sup>275</sup> This mechanism eliminates the inefficiencies that would arise if a state could conduct expropriation without paying just compensation. The compensation requirement leads state parties to calculate the costs and benefits of each decision. It encourages state parties to select the least expensive way to protect their interests.

Furthermore, the cost internalization that is brought about by a compensation requirement may be expected to incentivize politically efficient policy choices. In the international trade arena, internalizing the cost that trade barriers bring to foreign states results in politically efficient trade agreements.<sup>276</sup> “Politically efficient choices can have normative appeal.”<sup>277</sup> As loyal agents of the public, government officials would make choices to reflect peoples’ concerns to produce democratic legitimacy.

Furthermore, a compensation model leaves states’ sovereign right regarding national security untouched. On one hand, international investors have always been concerned with potential expropriation by host states.<sup>278</sup> On the other hand, countries need to attract foreign investment to develop their economy. This tension between safeguarding national security and attracting foreign investments is featured in international investment law. The compensation model enhances legal certainty by providing states a practical option while respecting states’ sovereign right. In *Sempra*, the leading international investment legal expert Michael Reisman opined that

of course governments in these circumstances must take measures to restore public order, but from the investment law standpoint—and this is for the future of all investments—international investment law says you may do it, but you must pay compensation. If exceptions are made for like these or other circumstances, the entire purpose of modern investment law, which is to accelerate the movement of private funds into developing countries for development purposes, will be frustrated.<sup>279</sup>

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274. *Id.* at 299.

275. This principle emerges from noted torts case *Vincent et al. v. Lake Erie Transp. Co.*, 124 N.W. 221, 221 (Minn. 1910) (holding that a boat owner who saves his boat from the storm by tying up to the plaintiff’s dock must pay for the damage to the dock).

276. Sykes, *supra* note 263, at 322.

277. *Id.*

278. See Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT’L L. 639, 664–66, 680–81 (1998).

279. *Sempra Award*, *supra* note 146, at ¶ 396.

In *BG Group Plc. v. The Republic of Argentina*, the tribunal asserted that the compensation mechanism met the purpose of international investment—inducing foreign investment.<sup>280</sup>

The approach of compensation is very feasible and practical. In a scenario that an IIA covers in the pre-establishment phase, the compensation will be zero in most cases if investors' investment is denied for security reasons in the pre-establishment phase. The underlying reason is that investors actually have not forged investment in host states, therefore the damage suffered by investors in this scenario is zero. In the post-establishment phase, if host states annul foreign investments out of security reasons, host states need to pay compensation that has been approved by host states in the first stage, the pre-establishment phase.

The most important attribute is that the approach of compensation preserves the rule-based international investment legal regime. If an international tribunal decides to review the national security rationale provided by the respondent, many states will find it a highly possible intrusion into their sovereignty. On the other hand, if an international tribunal decides that the national security exception is nonjusticiable, it will provide states discretion to impose measures on national security grounds and thereby shield them from investment challenges. The compensation proposal addresses and solves these aforementioned concerns—it allows states to address their concern and thereby reinforces the rules-based international investment legal regime without burdening international investment tribunals with legal questions for which they are not in a proper position to adjudicate.

The “police power” doctrine may counter the alternative compensation proposal here. A state’s police power is the “inherent power of a government to exercise reasonable control over persons and property within its jurisdiction in the interest of the general security, health, safety, morals, and welfare except where legally prohibited.”<sup>281</sup> A state is not responsible for loss of property or for other economic disadvantages resulting from states’ nondiscriminatory police power.<sup>282</sup> Two approaches emerge for the doctrine of police power. One is a radical approach, that is, any nondiscriminatory measure, with due process and for public purpose, is deemed proper.<sup>283</sup> In *Tecmed v. Mexico*, the tribunal pointed out that states exercising their sovereign powers, causing economic damage to investors, have no obligation to

280. *BG Group*, *supra* note 271, at ¶ 409.

281. *Police Power*, MERRIAM-WEBSTER’S DICTIONARY (2019).

282. See RESTATEMENT (THIRD) OF FOREIGN RELATIONS OF THE UNITED STATES § 712 (Am. Law Inst. 1987).

283. See *Methanex Corp.*, *supra* note 181, at ¶ 7. As an exception to this approach, the Tribunal recognizes that such a regulation can be deemed expropriatory and compensable in case “specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.” *Id.*

compensate these investors.<sup>284</sup> However, the tribunal in *Pope & Talbot v. Canada* opined that the radical approach of the police power doctrine creates a “gaping loophole in international protections against expropriation.”<sup>285</sup> The other approach is more nuanced. It states that besides the aforementioned requirements, the police power should also be proportional to the public interest and to the protection legally granted to investments.<sup>286</sup> But both approaches of the police power doctrine have not answered the critical issue here—when and whether a state can invoke this doctrine to justify its use of police power.

Another argument against this alternative compensation model is that making certain of compensation for foreign investors would seduce them to overinvest in host states at any risk. International investors should conduct due diligence, expecting and factoring national security risk into their *ex ante* risk assessment model and diversification strategy. However, when planning to invest in host states, foreign investors usually seek approval from a national security committee.<sup>287</sup> If their investment does not get approval from a host state’s national security committee, the amount of compensation to these foreign investments would be zero in most cases. If their investment plan gets approval, investors would invest in host states. If states later claim national security grounds to annul foreign investors’ investments, these investors can hardly expect this risk of national security claimed by states.

### C. The Calculation of Compensation

#### 1. The Distinction between Lawful Expropriation and Unlawful Expropriation

The distinction between lawful and unlawful expropriations has not caused attention in international investment law. Expropriation of property often amounts to its physical destruction or at least the destruction of its value. However, the destruction of the property or its value is not necessarily the consequence of every expropriation. In *ADC v. Hungary*, the Hungarian government had directly expropriated the claimant’s contractual rights to operate two terminals of the Budapest airport.<sup>288</sup> But the new owners, after the privatization of the airport, could operate the airport with notable commercial success.<sup>289</sup> As a

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284. *Técnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, ¶ 119 (May 29, 2003).

285. *Pope & Talbot Inc.*, *supra* note 182.

286. *El Paso Energy Int’l Co. v. Argentine Republic*, ICSID Case No. ARB/03/15, Award, ¶ 243 (Oct. 31, 2011).

287. *See supra* Part III.A.

288. *ADC Affiliate Ltd. v. Republic of Hung.*, ICSID Case No. ARB/03/16, Award, ¶¶ 210–18 (Oct. 2, 2006).

289. *Id.* at ¶ 496.

result, the value of the investment increased considerably after the date of the expropriation. The *ADC* tribunal found that this expropriation was unlawful because it violated the principle of due process and its nature was discriminatory.<sup>290</sup> The tribunal opined that the standard for lawful expropriations should not be applied in such a case.<sup>291</sup>

Besides bilateral and multilateral treaties, members of the World Bank may apply the World Bank Guidelines on the Treatment of Foreign Direct Investment (World Bank Guidelines) to private foreign investment in their respective territories.<sup>292</sup> World Bank Guidelines Part IV deals with expropriation.<sup>293</sup> It prohibits expropriation or measures having similar effects except when this is done in due process, out of good faith, and without discrimination.<sup>294</sup> Compensation is deemed appropriate if the compensation is “adequate, effective and prompt.”<sup>295</sup> Compensation is deemed adequate “if it is based on the fair market value of the taken asset as such value is determined immediately before the time at which the taking occurred or the decision to take the asset became publicly known.”<sup>296</sup>

International investment law allows states to take property by way of expropriation. The *Chorzow Factory Case* made a distinction between lawful expropriation and unlawful expropriation.<sup>297</sup> The Iran–United States Claims Tribunal in the *Amoco* case confirmed that the level of compensation depended on the legal qualification of the expropriation.<sup>298</sup> The cases *Santa Elena*,<sup>299</sup> *Goetz v. Burundi*,<sup>300</sup> and *Mondev v. United States of America*<sup>301</sup> adopted the same approach.

Lawful expropriation requires the following elements: (a) the expropriation is for a public purpose; (b) it is made according to due process of law; (c) on a nondiscriminatory basis; and (d) against prompt, adequate, and effective compensation. An expropriation only wanting fair compensation is considered to be a provisionally lawful expropriation, precisely because the tribunal dealing with the case will

290. *Id.* at ¶ 476.

291. *Id.* at ¶ 481.

292. *Guidelines on the Treatment of Foreign Direct Investment*, in 2 LEGAL FRAMEWORK FOR THE TREATMENT OF FOREIGN INVESTMENT 33 (World Bank, 1992) [hereinafter *World Bank Guidelines*].

293. *Id.* at IV.

294. *Id.* at IV.1.

295. *Id.* at IV.2.

296. *Id.* at IV.3.

297. *The Factory at Chorzow (Ger. v. Pol.)*, Judgment, 1928 P.C.I.J. (ser. A) No. 17, at 190 (Sept. 13) [hereinafter *Chorzow*].

298. *Amoco Int'l Fin. Corp. v. Iran*, 15 Iran-U.S. Cl. Trib. Rep. 189, ¶222–24 (1987).

299. *Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1, Final Award, ¶ 1 (Feb. 17, 2000) [hereinafter *Santa Elena*].

300. *Antoine Goetz et consorts v. République du Burundi*, ICSID Case No. ARB/95/3, Award, ¶ 1 (Feb. 10, 1999).

301. *Mondev International Ltd. v. U.S.*, ICSID Case No. ARB(AF)/99/2, Award, ¶ 1 (Oct. 11, 2002).

determine and award such compensation.<sup>302</sup> The World Bank Guidelines reinforce the notion that an expropriation only wanting fair compensation is lawful.<sup>303</sup> Irmgard Marboe, a professor of international law at the Law Faculty of the University of Vienna, asserts that the mere existence of a dispute about the amount of compensation does not render the expropriation unlawful.<sup>304</sup>

## 2. Standard of Compensation

With respect to lawful expropriation, the compensation standard is generally the standard of fair market value.<sup>305</sup> The World Bank Guidelines prescribe “the fair market value of the taken asset as such value is determined immediately before the time at which the taking occurred.”<sup>306</sup> The *Venezuela Holdings*<sup>307</sup> and *Tidewater* tribunals determined that the expropriation was lawful and that compensation should therefore be based on the market value of the investment at the point immediately prior to the expropriation.<sup>308</sup> The *CMS*, *Enron*, and *Sempra* tribunals based the fair market value on the discounted cash flow (DCF) method.<sup>309</sup> The three tribunals also decided that the loss to be compensated was the difference between the fair market value of claimants’ shareholdings, assuming Argentina had not taken its offending measures, compared to their value after the offending measures.<sup>310</sup>

With respect to unlawful expropriation, it is common for tribunals to be guided by the compensation principle established in the *Chorzow Factory* case that “reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.”<sup>311</sup> The *CMS*, *Enron*, *Sempra*, and *LG&E* tribunals all confirmed that the applicable standard for reparation was set out in the *Chorzow Factory Case* and codified at Article 31 of the ILC Articles,

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302. *Tidewater Inc., Tidewater Inv. SRL, Tidewater Caribe, C.A., et al. v. Bolivarian Republic of Venez.*, ICSID Case No. ARB/10/5, Award, ¶ 146 (Mar. 13, 2015) [hereinafter *Tidewater*]; *Conoco Phillips Petrozuata B.V., et al. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/30, Decision on Jurisdiction, ¶ 394 (Sept. 3, 2013).

303. *World Bank Guidelines*, *supra* note 292, at IV.

304. See generally IRMGARD MARBOE, CALCULATION OF COMPENSATION AND DAMAGES IN INTERNATIONAL INVESTMENT LAW (2009); see also RIPINSKY & WILLIAMS, DAMAGES IN INTERNATIONAL INVESTMENT LAW 68–69 (Brit. Inst. of Int’l and Comp. L. 2008).

305. *Id.* at 730.

306. *World Bank Guidelines*, *supra* note 292, at IV.3.

307. *Venez. Holdings, B.V. et al. v. Bolivarian Republic of Venez.*, ICSID Case No. ARB/07/27, Award, art. 6 (May 12, 2005).

308. *Tidewater*, *supra* note 302, at ¶¶ 151–52.

309. *CMS Award*, *supra* note 133, at ¶¶ 411, 416, 421; *Enron Award*, *supra* note 144, at ¶ 385; *Sempra Award*, *supra* note 146, at ¶ 416.

310. *Id.*

311. *Chorzow*, *supra* note 297, at ¶ 47.

namely that compensation must “wipe out the consequences” of the illegal act and, therefore, the standard of compensation is measured by the “loss suffered.”<sup>312</sup> The *LG&E* tribunal pointed out, however, that the measure of damages for wrongful acts should be different from that for compensation for lawful expropriation.<sup>313</sup> The tribunal indicated that the appropriate measure of damage was the “actual loss” incurred by the investors “as a result” of Argentina’s wrongful acts, and determined that this damage could be measured by the loss of dividends.<sup>314</sup>

When adopting nondiscriminatory and nonarbitrary essential security measures out of necessity, states’ measures would satisfy the lawful expropriation requirements since these measures are for the public purpose of protecting essential security. Thus, one way of valuing compensation for lawful expropriation out of essential security is to calculate the undertaking at the moment of dispossession. The DCF method could be applied to calculate the fair market value of this undertaking.

## VI. CONCLUSION

This Article systematically explores whether domestic courts or international tribunals can examine the process of national security review over prospective foreign investment. The answer for this issue depends on two factors. The first factor is whether states enjoy IIA treaty protection; the second factor is whether this treaty protection covers the pre-establishment phase or the post-establishment phase or both. This Article focuses exclusively on essential security measures out of necessity in two phases of international investment, the pre-establishment phase and the post-establishment phase.

Faced with the increasing concern over national sovereignty and the uncertainty of IIAs’ role in promoting economic development, states adopt two mechanisms to protect their sovereignty—the national security review regime, and the adoption of security related exception clauses in IIAs. Upon analyzing national security review regimes in the United States, China, United Kingdom, Canada, and Russia, including the composition of national security review committees and factors considered by national security review committees, this Article concludes that many states are trying to build a CFIUS-style national security review mechanism. Moreover, states have moved from non-self-judging security clauses to adopting self-judging essential security

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312. CMS Award, *supra* note 133, at ¶ 400; Enron Award, *supra* note 144, at ¶ 359; Sempra Award, *supra* note 146, at ¶ 400; LG&E Award, *supra* note 141, at ¶ 31.

313. LG&E Award, *supra* note 141, at ¶ 38.

314. *Id.* at ¶ 45.

clauses in order to protect their regulatory sovereignty and security interests.

In the absence of an international investment treaty, investors cannot enjoy IIA's protection. Any state could deny the admission of the investment or nationalize the property with compensation in accordance with its domestic law and the international minimum standard of treatment.

Within an international investment treaty framework, regarding the non-self-judging context, states could review the substance of essential security measures. This Article analyzes the relevant international investment law cases—*CMS v. Argentina*,<sup>315</sup> *LG&E v. Argentina*,<sup>316</sup> *Enron v. Argentina*,<sup>317</sup> *Sempra v. Argentina*<sup>318</sup> and *Continental Casualty v. Argentina*,<sup>319</sup> and it asserts that the investment tribunals have the competence to review non-self-judging essential security clauses. The “only way” test embedded in Article 25 of the ILC's Articles on State Responsibility and the “reasonable available” test developed by the *Continental Casualty* tribunal provide good reference to the standard of review by the investment tribunals. This Article asserts that the “reasonable available” approach is a better approach than the “only way” approach in reviewing non-self-judging essential security clauses because of the origin of non-self-judging essential security clauses, the differences of treaty and customary international law defenses on necessity, and the interlocking nature of international trade and investment.

For self-judging essential security clauses, building on the analysis of the pertinent GATT Article XXI cases, including *Czechoslovakia v. United States* in 1949, *Nicaragua v. United States* in 1984 (*Nicaragua I*),<sup>320</sup> *Nicaragua v. United States* in 1985–86 (*Nicaragua II*),<sup>321</sup> and the most relevant NAFTA provisions on security, this Article concludes that the investment tribunals tend to review the essential security issue in the self-judging clause under the “good faith” standard. Some distinguished scholars also argue for “good faith” review of self-judging clauses. Some scholars further provide the specific tests for “good faith” review. However, this Article takes a dissenting approach, arguing that international investment tribunals should not go through “good faith” review due to the ambiguity of this concept, potential abuses by tribunals, and the interpretation pursuant to VCLT 31. Instead, this Article proposes that states should pay compensation for the damage caused by essential security measures.

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315. CMS Award, *supra* note 133, at ¶ 1.

316. LG&E Decision on Liability, *supra* note 29, at ¶ 1.

317. Enron Award, *supra* note 144.

318. Sempra Award, *supra* note 146.

319. Continental Casualty Award, *supra* note 147.

320. Military and Paramilitary Activities in and Against Nicaragua (Nicar. v. U.S.), Decision on Jurisdiction and Admissibility, 1984 I.C.J. Rep. 392 (Nov. 26).

321. *Id.* at 14.



The feasible and practical compensation requirement could avoid moral hazard, improve political efficiency, keep states' options of adopting security-related measures open, and preserve the rule-based international investment legal regime.

With respect to compensation, there is a distinction between lawful expropriation and unlawful expropriation, which leads to different standards of compensation. When adopting nondiscriminatory and nonarbitrary essential security measures out of necessity, states' measures generally would fall under lawful expropriation. Lawful compensation generally adopts the standard of fair market value based on the DCF method.

The international investment legal regime is going through a phase of reorientation. With the rise of essential security self-judging clauses as well as the increasing number of IIAs, it is foreseeable that there will be some dispute about essential security clauses in the future. The issue of how to balance essential security interests and foreign investors' interests in the international investment legal regime has not been comprehensively resolved until now. This Article provides a novel and plausible path for dealing with essential security issues involving foreign investment.