

**Balancing and Sovereignty in International Law:  
Reviewing Convergences and Divergences in  
International Investment Law and Trade Law**

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by

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## **ABSTRACT**

### **Balancing and Sovereignty in International Law: Reviewing Convergences and Divergences in International Investment Law and Trade Law**

by Ying-Jun Lin

This study aims to advance the discussion of the relationship between international investment law and trade law. International lawyers have explored this issue by analysing the convergence and divergence of the treaty text and the practice. This study, however, moving away from the focus on the convergence/divergence dichotomy. It argues that the what is elementary to international law is how the States and adjudicators share the understanding of the governance of state practices and how the shared understandings shape the boundaries of sovereignty written in the treaty and interpreted by the practice. The argument leads the study to demonstrate how the change of political ideologies concerning the role of government on the market can shed light on the development of international investment law and trade law. This study offers an original interpretative approach to review the parallel between international investment law and WTO law in terms of balancing. It integrates the analysis of balancing into the discussion of international law to suggest the boundaries of sovereignty gradually shifting toward the reservation and expansion, and so is one of the comparative studies to attempt to suggest the unity of the two regimes. As a result, these analyses get a detailed discussion of a variety of a legal principle reflecting the interaction between the States and adjudicators in competing contexts.

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## Abbreviations

Abbreviations	Full title
AB	Appellate Body
ACP countries	African, Caribbean, and Pacific countries
APEC	Asia–Pacific Economic Cooperation
BITs	Bilateral investment treaties
CJEU	The Court of Justice of the European Union
CPTPP	The <i>Comprehensive and Progressive Agreement for Trans-Pacific Partnership</i>
CSR	Corporate social responsibility
DSB	Dispute Settlement Body
DSU	The <i>Understanding on Rules and Procedures Governing the Settlement of Disputes</i>
EU	European Union
FCN treaties	Treaties of Friendship, Commerce and Navigations
EEC	European Economic Community
ECtHR	The <i>European Court Convention on Human Rights</i>
ECHR	The <i>European Convention on Human Rights</i>
FET	Fair and equitable treatment
FTAs	Free trade agreements
FTAAP	Free Trade Area of the Asia–Pacific
FTC	Free Trade Commission
GATT	The <i>General Agreement on Tariffs and Trade</i>
GATS	The <i>General Agreement on Trade in Services</i>

ICA	International Court of Arbitration
ICC	International Chamber of Commerce
ICSID	The International Centre for Settlement of Investment Disputes
IISD	The International Institute for Sustainable Development
ISDS	Investor–State dispute settlement mechanism
LCIA	The London Court of International Arbitration
MAI	Multilateral agreement on investment
MFN	Most–favoured treatment
NAFTA	<i>The North American Free Trade Agreement</i>
OECD	The Organisation for Economic Co–operation and Development
RCEP	<i>The Regional Comprehensive Economic Partnership Agreement</i>
SCC	Stockholm Chamber of Commerce
SDGs	Sustainable–Development Goals
SPS Agreement	<i>The Agreement on the Application of Sanitary and Phytosanitary Measures</i>
TBT Agreement	<i>The Agreement on Technical Barriers to Trade</i>
TPP	<i>The Trans–Pacific Partnership Agreement</i>
TRIMs	<i>The Agreement on Trade–Related Investment Measures</i>
TTIP	<i>The Transatlantic Trade and Investment Partnership Agreement</i>



Treaty of Westphalia	The 1648 <i>Peace Treaty of Westphalia</i>
The WTO Establishing Agreement	The <i>Agreement Establishing the World Trade Organization</i>
UN	United Nations
UNCITRAL	The <i>United Nations Commission on International Trade Law</i>
VCLT (Vienna Convention)	The <i>Vienna Convention on the Law of Treaties</i> 1969
WTO	World Trade Organization

### List of investor–State arbitral awards cited and their abbreviations

Short title	Full title
<i>Abaclat v. Argentina</i>	<i>Abaclat and others (formerly Giovanna A. Beccara and others) v. Argentina</i> , ICSID Case No. ARB/07/5, Decision on jurisdiction and admissibility, 4 August 2011
<i>ADC v. Hungary</i>	<i>ADC Affiliate and ADC v. The Republic of Hungary</i> , ICSID Case No. ARB/03/16, Award, 2 Oct 2006
<i>ADF Group v. U.S.</i>	<i>ADF Group Inc. v. United States of America</i> , ICSID Case No. ARB (AF)/00/1, Award, 9 January 2003
<i>AWG v. Argentina</i>	<i>AWG Group Ltd. v. the Argentine Republic, ad hoc tribunal</i> , Decision on liability, 30 July 2010
<i>Azurix v. Argentina</i> <sup>7</sup>	<i>Azurix Corp. v. The Argentine Republic</i> , ICSID Case No. ARB/01/12, Award, 14 July 2006
<i>Cargill v. Mexico</i>	<i>Cargill, Incorporated v. United Mexican States</i> , ICSID Case No. ARB(AF)/05/2, Award, 18 September 2009
<i>Chemtura v. Canada</i>	<i>Chemtura Corporation v. Government of Canada</i> , UNCITRAL, Award, 02 August 2010
<i>Churchill Mining v. Indonesia</i>	<i>Churchill Mining PLC and Planet Mining Pty Ltd v. Republic of Indonesia</i> , ICSID Case No. ARB/12/14 and 12/40, Decision on jurisdiction, 24 February 2014
<i>CME v. Czech Republic</i>	<i>CME Czech Republic B.V. v. The Czech Republic</i> , UNCITRAL, Final award, 14 March 2003
<i>Daimler v. Argentina</i>	<i>Daimler Financial Services AG v. the Argentine</i>

	<i>Republic</i> , ICSID Case No. ARB/05/1, Award on Jurisdiction, 22 August 2012
<i>El Paso v. Argentina</i>	<i>El Paso Energy International Company v. the Argentine Republic</i> , ICSID Case No. ARB/03/15, Award, 31 Oct 2011
<i>Glamis Gold v. U.S.</i>	<i>Glamis Gold Ltd. v. United States of America</i> , Award, 8 June 2009
<i>Grand River v. U.S.</i>	<i>Grand River Enterprises Six Nations, Ltd., et al. v. United States of America</i> , UNCITRAL, Award, 12 January 2011
<i>Hochtief v. Argentina</i>	<i>Hochtief AG v. The Argentine Republic</i> , Decision on jurisdiction, 24 October 2011
<i>Impregilo v. Argentina</i>	<i>Impregilo S.p.A. v. the Argentine Republic</i> , ICSID Case No. ARB/07/17, ICSID Case No. ARB/07/17, Award, 21 June 2011
<i>Lemire v. Ukraine II</i>	<i>Joseph Charles Lemire v. Ukraine</i> , ICSID case no. ARB/06/18, Decision on jurisdiction and liability, 14 Jan 2010
<i>LG&amp;E v. Argentina</i>	<i>LG&amp;E energy and financial corp. v. Argentina</i> , ICSID Case No. ARB/02/1, Decision on liability, 3 Oct 2006
<i>MCI v. Ecuador</i>	<i>MCI Power Group, LC and New Turbine, Inc v. Republic of Ecuador</i> , ICSID Case No ARB/03/6, Decision on annulment, 19 October 2009
<i>Maffezini v. Kingdom of</i>	<i>Emilio Agustín Maffezini v. the Kingdom of Spain</i> ,

<i>Spain</i>	ICSID Case No. ARB/97/7, Decision on jurisdiction, 25 January 2000
<i>Marvin Feldman v. Mexico</i>	<i>Marvin Roy Feldman Karpa v. United Mexican States</i> , ICSID Case No. ARB(AF)/99/1, Award, 16 December 2002
<i>Metaclad v. Mexico</i>	<i>Metaclad Corp. v. Mexico</i> , ICSID Case No. ARB(AF)/97/1, Award, 30 Aug 2000
<i>Methanex v. U.S.</i>	<i>Methanex Corp. v. United States of America</i> , Partial Award, 7 August 2002
<i>Mobil v. Canada</i>	<i>Mobil Investments Canada Inc. and Murphy Oil Corporation v. Canada</i> , ICSID Case No. ARB(AF)/07/4, Decision on liability, 22 May 2012
<i>Mondev v. U.S.</i>	<i>Mondev International Ltd. v. United States of America</i> , ICSID Case No. ARB(AF)/99/2, Award, 11 October 2002
<i>Noble v. Romania</i>	<i>Noble Ventures, Inc. v. Romania</i> , ICSID Case No. ARB/01/11, Award, 12 October 2005
<i>Occidental Co. v. Ecuador</i>	<i>Occidental Exploration and Production Company v. The Republic of Ecuador</i> , LCIA Case No. UN3467, Final award, 01 July 2004
<i>Pope &amp; Talbot v. Canada</i>	<i>Pope &amp; Talbot Inc. v. The Government of Canada</i> , UNCITRAL, Award on the Merits of Phase 2, 10 April 2001
<i>Romak v. Uzbekistan</i>	<i>Romak S.A. (Switzerland) v. The Republic of Uzbekistan</i> , UNCITRAL, PCA Case No. AA280,

	Award, 26 November 2009
<i>Saluka v. Czech Republic</i>	<i>Saluka Investment BV v. Czech Republic</i> , Partial award, 27 March 2006
<i>S.D. Myers v. Canada</i>	<i>S.D. Myers, Inc. v. Government of Canada</i> , UNCITRAL, First Partial Award, 13 November 2000
<i>Siemens v. Argentina</i>	<i>Siemens A.G. v. The Argentine Republic</i> , ICSID Case No. ARB/02/8, Decision on Jurisdiction, 3 August, 2004
<i>Sociedad General de Aguas de Barcelona v. Argentina</i>	<i>Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v. Argentine Republic</i> , ICSID Case No. ARB/03/19, Decision on liability, 30 July 2010
<i>Tecmed v. Mexico</i>	<i>Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States</i> , ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003
<i>Thunderbird v. Mexico</i>	<i>International Thunderbird Gaming Corporation v. The United Mexican States</i> , UNCITRAL, Award 26 January 2006
<i>Total v. Argentina</i>	<i>Total S.A. v. Argentine Republic</i> , ICSID Case No. ARB/04/1, Decision on liability, 27 December 2010
<i>Waste Management v. Mexico</i>	<i>Waste Management v. United Mexican States</i> , ICSID Case No ARB(AF)/00/3, Award, 30 April 2004

**List of adopted WTO panel reports and the Appellate Body reports and their abbreviations**

Shot title	Full title
Panel reports	
Panel Report, <i>Argentina—Financial services</i>	Panel Report, WT/DS453/R, <i>Argentina—Measures Relating to Trade in Goods and Services</i> , adopted 9 May 2016
Panel Report, <i>Argentina—Poultry Anti-Dumping Duties</i>	Panel Report, WT/DS241/R, <i>Argentina—Definitive Anti-Dumping Duties on Poultry from Brazil</i> , adopted 19 May 2003
Panel Report, <i>US—Gambling Services</i>	Panel Report, WT/DS285/R, <i>United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services</i> , adopted 20 April 2005
Appellate Body reports	
Appellate Body Report, <i>Argentina—Financial services</i>	Appellate Body Report, WT/DS453/AB/R, <i>Argentina—Measures Relating to Trade in Goods and Services</i> , adopted 09 May 2016
Appellate Body Report,	
Appellate Body Report, <i>Brazil—Retreaded Tyres</i>	Appellate Body Report, WT/DS332/AB/R, <i>Brazil—Measures Affecting Imports of Retreaded Tyres</i> , adopted 17 December 2007
Appellate Body Report, <i>Colombia—Textiles</i>	Appellate Body Report, WT/DS461/AB/R, <i>Colombia—Measures Relating to the Importation of Textiles, Apparel and Footwear</i> , adopted 22 June

	2016
Appellate Body Report, <i>EC—Asbestos</i>	Appellate Body Report, WT/DS135/AB/R, <i>European Communities—Measures Affecting Asbestos and Products Containing Asbestos</i> , adopted 5 April 2001
Appellate Body Report, <i>EC—Hormone</i>	Appellate Body Report, WT/DS26/AB/R and WT/DS48/AB/R, <i>European Communities—Measures Concerning Meat and Meat Products</i> , adopted 13 February 1998
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*The Agreement on the Application of Sanitary and Phytosanitary Measures*

*The Agreement on Technical Barriers to Trade*

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*The Understanding on Rules and Procedures Governing the Settlement of Disputes*

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## Introduction

### 1. The rise of balancing in international investment law and WTO law

Trade and investment are two major economic activities. The two economic activities refer to the movements of all sorts of economic factors. Trade includes the movement of labours, goods and services. Investment names the movement of capital flows and other means of economic interests. While trade and investment mean separate economic activities, the coordination of trade and investment is essential to business and economic prosperity. For private companies, boosting the transition of products and reducing production cost by investing factory abroad are critical to developing the global strategy of the business. For governments, the issues of how to reduce trade barriers and to attract foreign investments are critical to structure economic policies. Due to the close relationship, international lawyers usually concern international investment law and trade law as two pillars to international governance of economic activities. The unity of international investment law and trade law has been a long-term issue.

In recent years, the discussion of the unity of international investment law and trade law focuses on the balancing approach. Commentators observe the balancing approach applied by investment arbitrators and WTO adjudicators to deal with conflicting interests and regulatory purposes. In international investment law, arbitrators applied the balancing approach to interpreting the term ‘indirect expropriation’ and to define the scope of the protection of legitimate and reasonable expectations of foreign investors. In WTO law, panels and the Appellate Body (AB) have announced the balancing analysis as the standard test to determine whether a disputed measure is ‘necessary to’ achieve the legitimate purposes. The similar

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experiences inspire commentators to argue that international investment law and WTO law converge to a certain point on the principle of balancing in the text and the balancing approach in practice.

There are two perspectives accessible to the studies of balancing in international investment law and WTO law. These studies mostly concentrate on the practice of dispute settlements.

One perspective is about the analytical function of balancing in interpretation and application of treaty rules. The specific issue is how to apply the balancing approach.

Some commentators compare the balancing approach by investment arbitrators and WTO adjudicators with other international authorities and with national judges. The ground for these comparative studies is the function of the balancing approach. They argue that whether international adjudicators and national judges, the balancing approach is an instrument to deal with conflicts of interests and regulatory purposes. For instance, Pirker takes comparative studies in line with the issue of judicial review in domestic and international legal systems. He compares the experiences of WTO law and international investment law with the practices in German and US constitutional law, as well as the *European Convention on Human Rights* and European Union law.<sup>1</sup> While he finds the differences and similarities of the practices, he believes that a common approach for the different issues is the process of balancing. As such, the comparison is to indicate a standard analysis structure and application of the balancing approach.

Another perspective is about systematic concerns. The systematic concerns are

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<sup>1</sup> Benedikt Pirker, *Proportionality Analysis and Models of Judicial Review* (Europa Law Publishing 2013).

two-fold. First, it emphasises the consistency and stability of the application of the balancing approach in each regime, i.e. international investment law and WTO law. For instance, in international investment law, Bücheler analyses how investment arbitrators apply an analytical framework to deal with conflicts between the interests between foreign investors and host governments in line with specific rules, such as expropriation provisions, the standard of fair and equitable treatment and non-precluded measures clauses.<sup>2</sup> Henckels narrows the discussion on the issue of indirect expropriation. While she agrees on the process of balancing critical to determine the scope of expropriation clauses, she questions the way that investment arbitrators applied the balancing process. Her reasons include the lack of structural analysis and consistent application and the margin of appreciation given to domestic decisions.<sup>3</sup>

Likewise, in WTO law, the conflict of trade interests and public interests was addressed for the first time by Richard McLaughlin. He addressed this issue in line with the conflict of regulatory purposes between trade liberalisation and environmental protection.<sup>4</sup> By exploring WTO disputes arising out of environmental measures, he suggested that the balancing approach developed in US laws can be learned to earn the regulatory space for environmental issues in WTO law. As to the similar issue of the regulatory freedom in WTO law, Axel Desmedt instead suggested the principle of proportionality developed in EU law could be learned.<sup>5</sup> His suggestion based on the

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<sup>2</sup> Gebhard Bücheler, *Proportionality in Investor-State Arbitration* (OUP 2015).

<sup>3</sup> Caroline Henckels, 'Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration' (2012) 15(1) *Journal of International Economic Law* 223; 'The Role of the Standard of Review and the Importance of Deference in Investor-State Arbitration' in Lukasz Gruszczynski and outer Werner (eds), *Deference in International Courts and Tribunals: Standard of Review and Margin of Appreciation* (OUP 2014) 113.

<sup>4</sup> Richard J. McLaughlin, 'Sovereignty, Utility, and Fairness: Using US Takings Law to Guide the Evolving Utilitarian Balancing Approach to Global Environmental Disputes in the WTO' (1999) 86 *Oregon Law Review* 855.

<sup>5</sup> Axel Desmedt, 'Proportionality in WTO Law' (2001) 4(3) *Journal of International Economic Law* 442.

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point that WTO provisions contained legal requirements that are similar to the requirement of proportionality. A critical requirement of WTO provisions is the term 'necessary to'. Other studies instead identify the balancing approach and the principle of proportionality as two interpretative approaches of WTO law.<sup>6</sup>

Second, some studies expand comparative studies into the international law system as a whole. Commentators argue that the balancing approach is a constitutional principle in international law. The practices of investor–State arbitration and the WTO dispute settlement mechanism are evidence of the constitutionalisation of the principle of balancing.<sup>7</sup> On the concern of the comprehension of the international law system, they suggest cross–reference of judicial experiences among international authorities. A reason for cross–reference is to standardise the application of the principle of balancing to ensure the stability and predictability of the consequences. In this respect, the practice of investor–State arbitration is often criticized as unstable and inconsistent. Investment arbitrators are suggested to refer to experiences of the WTO on the balancing approach.<sup>8</sup>

While the two perspectives focus on different dimensions of the balancing approach in practice, they share some understandings. A critical shared suggestion is a cross–reference of judicial experiences not only contributes to the consistency of the practice of the balancing approach in each regime but also favours the comprehension of the international law system in respect to the principle of balancing.

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<sup>6</sup> See, e.g., Mads Andenas and Stephine Zleptnig, 'Proportionality and Balancing in WTO Law: A Comparative Perspective' (2007) 20(1) *Cambridge Review of International Affairs* 71; Isabelle van Damme, *Treaty Interpretation by the WTO Appellate Body* (OUP 2009).

<sup>7</sup> Benedict Kingsbury and Stephan W Schill, 'Investor–State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law' *Institute for International Law and Justice (IILJ) Working Paper 2009/6*; William W Burke–White and Andreas von Staden, 'Private Litigation in A Public Law Sphere: The Standard of Review in Investor–State Arbitrations' (2010) 35 *Yale Journal of International Law* 283.

<sup>8</sup> Caroline Henckels (n 3) 223; Yasuhei Taniguchi and Tomoko Ishikawa, 'Balancing Investment Protection and Other Public Policy Goals: Lessons from World Trade Organization (WTO) Jurisprudence' in Julien Chaisse and Tsai–yu Lin (eds) *International Economic Law and Governance* (OUP 2016).

Nevertheless, these studies have not explained the operation of the cross–reference in detail. A specific issue is to what extent the experience of WTO disputes can apply to interpret the rules of an investment treaty and to settle the dispute between private parties and a host government. From the perspective of WTO law, how can the experience of investor–State arbitration apply to interpret WTO provisions which are binding multilateral membership and to settle the state–state dispute?

## 2. The variety of naming in the practice and research works

Another issue facing the current studies is variable ways of naming the balancing analysis.

For comparative legal studies, a common issue is where comparable bases are. The comparable bases are usually found in the similarities of the compared objects. Language is a useful indication. More frequently a word is used, it is highly possible that actors in different legal systems share a legal principle or concept. Moreover, from the communicative perspective, the same language implicates the shared understandings among different communities while they have divergent backgrounds and professionals.

On the other hand, the same language could refer to different things. It is also common in communication that different people can interpret the same word into different meanings due to the factual, social and political contexts. In this situation, a language somewhat confuses and hinders the exchange of understandings and experiences.

The contribution and limitation of languages explain the situation that current studies confront in the discussion of the balancing approach between international

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investment law and WTO law. On the one hand, the word ‘balancing’ and a similar concept ‘proportionality’ are the grounds by which commentators can study the differences in the application of the balancing approach by investment arbitrators and WTO adjudicators. On the other hand, the same language led commentators to ground their discussion on the assumption that there are a universal framework and approach for the balancing thing. That is because in practice the balancing thing usually applied to the issue of conflicting interests and regulatory purposes. The assumption explains why commentators advocate a cross-reference of the balancing approach between different branches of international law.

Nevertheless, this assumption limits the horizons of the balancing approach in practice. Commentators could overlook the possibility that the word ‘balancing’ can refer to different meanings and for various purposes. The normative and institutional frameworks which influence the way that adjudicators apply the balancing approach might also miss in the discussion. The differences in the textual arrangements, legitimate purposes of the treaty and the institutions of dispute settlement are critical to studying the relationship between international investment law and WTO law. The linkage with the textual and institutional differences, however, has not addressed well in the discussion of the balancing approach.

Current studies demonstrate that international lawyers have not shared understandings on the way to name the balancing approach. Some people directly name the analysis approach for the conflicting interests and regulatory purposes ‘balancing’, distinguishing from another similar legal concept ‘proportionality’.<sup>9</sup> Other lawyers

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<sup>9</sup> Donald H Regan, ‘The meaning of ‘necessary’ in GATT Article XX and GATS Article XIV: the myth of cost-benefit balancing’ (2007) 6(3) World Trade Review 347–69; Gabrielle Marceau and Joel P Trachtman, ‘A Map of the World Trade Organization Law of Domestic Regulation of Goods: The Technical Barriers to Trade Agreement, the Sanitary and Phytosanitary Measures Agreement, and the General Agreement on Tariffs and Trade’ (2014) 48(2) Journal of World Trade 351.

name the analysis approach involving the balancing thing ‘the principle of proportionality’ instead of the balancing approach.<sup>10</sup> Because of the similar functions, some studies integrate balancing and proportionality. They argue balancing as the analysis process of proportionality.<sup>11</sup>

The various names confuse balancing with proportionality in these studies. The mixed–use of balancing and proportionality in the discussion even creates an impression that international lawyers treat balancing and proportionality as the same principle and approach for treaty interpretation.

The mixed–use, however, could be a misunderstanding by international lawyers. It relates to the origin of the balancing approach and the principle of proportionality. Balancing and proportionality originated from national legal systems. While they were developed for the issues of administrative laws and constitutional laws, they were the products of different legal systems.<sup>12</sup>

Balancing is the approach developed in US constitutional law. US courts developed the balancing approach to determine the boundaries of the freedom of speech that is protected by US constitutional law. Proportionality, instead, is the approach developed in the jurisdiction of German laws. Germany judges applied the principle of proportionality to settle the conflicts of constitutional values.

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<sup>10</sup> Chad P Bown and Joel P Trachtman, ‘Brazil—Measures Affecting Imports of Retreaded Tyres: A balancing test’ (2009) 8(1) *World Trade Review* 85; Ursula Kriebaum, ‘Regulatory Takings: Balancing the Interests of the Investor and the State’ (2007) 8(5) *Journal of World Investment & Trade* 717; Isabelle van Damme (n 6); Caroline Henckels, *Proportionality and Deference in Investor–State Arbitration: Balancing Investment Protection and Regulatory Autonomy* (CUP 2015); Valentina Vadi, *Proportionality, Reasonableness and Standards of Review in International Investment Law and Arbitration* (Edward Elgar 2018).

<sup>11</sup> See, e.g., Ulrick Will, ‘The Extra–Jurisdictional Effects of Environmental Measures in the WTO Law Balancing Process’ (2016) 50(4) *Journal of World Trade* 611.

<sup>12</sup> Moche Cohen–Eliya and Iddo Porat, *Proportionality and Constitutional Culture* (CUP 2013); Jacco Bomhoff, *Balancing Constitutional Rights* (CUP 2015).

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The backgrounds explain the distinction between balancing and proportionality. They reflect the difference of the constitutional structure, constitutional values and the culture of judicial review in different jurisdictions. Because of the significant differences, the distinction between balancing and proportionality is meaningful and cannot be erased.

While international lawyers share the studies of public laws to a certain point, their references often miss the distinction between balancing and proportionality. The missing point enlightens the limitations of current studies of the balancing thing in international investment law and WTO law. Are balancing and proportionality shared the same function and purposes in different jurisdictions of international law? What are the consequences of balancing and proportionality? What are an institutional framework, normative conditions and the culture of judicial review reflected by the application of balancing or proportionality? Alternatively, can we argue that the distinction between balancing and proportionality is not necessary to international law because of the lack of constitutional values in the international society and the absence of centralised institutions with super-sovereignty authority?

### 3. The way that the thesis names the approach for the conflicts

I agree that balancing and proportionality have no significant differences in the purpose of treaty interpretation. Both of them are the methods in attempts to reconcile conflicting legitimate purposes and interests in a treaty. On the other hand, I believe that the way of naming an analysis approach reveals a user's focus and concerns on a specific issue. As such, the different names for the approach adopted for the conflicted legitimate purposes and interests are meaningful. They implicate that practitioners, adjudicators and commentators have different perspectives to one thing.



Between balancing and proportionality, the thesis instead uses the word ‘balancing’ and discusses relevant practices and analyses.

Several reasons are supporting the choice. First, proportionality has its limitations to theoretical discussion. Proportionality is more inclined to a scientific instrument for decision making. It lacks the conceptual nature to indicate the ideology of policymaking, law-making and international governance. In contrast, ‘balancing’ can be an indication of political ideologies and conceptual values. The conceptual flexibility of the word ‘balancing’ enables us to study the development of balancing from a multi-dimensional perspective rather than focusing on the dimension of an analytical approach. The relevant dimensions include institutional features for dispute settlements, textual arrangements of rights and obligations under treaties, and the international governance of national sovereignty.

Another reason is the usage of investment arbitrators and WTO adjudicators. Legal studies are not only aimed to advance theoretical development but more importantly, to respond to and solve the issues in practice. In order to strengthen the connection between the discussion and the practice, the study follows the usage of investment arbitrators and WTO adjudicators.

Reading legal reasoning of investor-State awards and WTO reports of panels and the Appellate Body, the word ‘balancing’ is more frequently used than the word ‘proportionality’. In investor-State arbitration, balancing is the word more frequently appeared in arbitral awards to address conflicting interests between foreign investors and host governments. In WTO dispute settlements, the word of balancing has become a standard part of the analysis approach to the requirement of necessity. Because of the

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overlap of balancing, I rather chose 'balance' as the topic of my research and use the word 'balancing' as the keyword for case studies.

The third reason is the interpretative effects of research results. As mentioned above, balancing has more conceptual flexibility than proportionality. The findings do echo the point. There are various meanings of balancing in legal reasoning. An ordinary meaning is an analytical framework and measurement for dispute settlements. Balancing is also used to implicate the duty of impartiality of international adjudicators, not taking a presumable preference to either side of disputing parties. At the end of the adjudicator procedure, balancing refers to a condition of results that are accepted by the participants. The requirement of a balanced result applies to the treaty relationship between the Contracting States as well.

In addition, balancing is an essential concept for international relations. The changes in international relations are driven by the desire for balancing and rebalancing the power relationship among nation-states. The balance and rebalance of power relationship among nation-states leads to the changes in international orders for state practices. Sustainable development policies characterise the focus of international law and policy in the contemporary era. The United Nations (UN) has indicated the content of sustainable development policies by seventeen goals. These goals together are named the 2030 Agenda of sustainable development.<sup>13</sup> They direct the future of international governance and national policies on the development issue.

In the context of international investment law, the United Nations Conference on Trade and Development (UNCTAD) had issued a policy paper named Investment Policy

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<sup>13</sup> UN, General Assembly, A/RES/70/1, *Transforming our world: the 2030 Agenda for Sustainable Development* (2015).

Framework for Sustainable Development (IPFS).<sup>14</sup> In this paper, the UNCTAD suggest international authorities and national regulators on how to adjust the existing investment policies and investment treaties to implement sustainable development policies. The IPFS highlights that balancing is a critical principle to the transformation of national policies and international investment law. In specific, Principle 4 addresses the balance of the rights of Contracting States and interested private parties. Principle 5 notes the necessity of the restoration of the right to regulate in investment treaties.

Balancing not only echoes the development of investor–State arbitration adopting the balancing approach to interpret the rules, but also reminds nation–states to note and adjust the asymmetric position of host States in existing investment treaties. These suggest implicating the essence of sustainable development policies is balancing. Sustainable development policies are ‘the balancing approach’ for international governance.

The thesis observes the wide acceptance of sustainable development policies in international law. It believes that the emergence of balancing in the practice of investor–State arbitration and WTO dispute settlements is not coincident. While the balancing approach is an individual practice, it implicates the trend of international law and policies as a whole. The whole picture is that the governance of the use of sovereignty at the international and municipal aspects is more inclusive to competing interests and values rather than dominated by a singular–dimensional thought.

#### 4. The meaning of balancing in the thesis

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<sup>14</sup> UNCTAD, *Investment Policy Framework for Sustainable Development* (2015), accessed 10 April 2019 at <[http://unctad.org/en/PublicationsLibrary/diaepcb2015d5\\_en.pdf](http://unctad.org/en/PublicationsLibrary/diaepcb2015d5_en.pdf)>.

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Different from other studies, the thesis does not assume that there is a universal application of the balancing approach. By contrast, due to the conceptual flexibility of the word 'balancing', the thesis aims to ask if there is extended use of balancing in practice. The extended use of sheds lights on the similarities and differences in the application of the balancing approach by investment arbitrators and WTO adjudicators. Moreover, the extended use of balancing echoes our viewpoint that balancing is a dynamic framework which is changing in various contexts and changed by the conceptions of adjudicators.

In order to highlight the dynamic nature of balancing, the thesis does not apply to balance to a fixed meaning. While the thesis discusses balancing by starting with the analyses of conflicting interests and regulatory purposes in practice, it attempts to reveal all possible meanings that the word 'balancing' has referred to in different contexts.

There are at least three contexts by which the thesis observes the word 'balancing' mentioned by investment arbitrators and WTO adjudicators.

The first context is the dispute settlement. Balancing is a legal approach used by adjudicators to settle the conflict of interests between disputing parties and the conflict of regulatory purposes facing the respondent state.

The second context is about the relation between the interested parties. In this situation, balancing means a condition in which the arrangement of rights and obligations is accepted and fair for the parties. Given the nature of dispute settlements, the relationship to be reviewed by investment arbitrators and WTO adjudicators is different. In investor–State arbitration, investment arbitrators would concern the relationship between the treaty parties and between the claimant investors and the host government. In the WTO adjudicative process, the relationship is concerned is among

member States.<sup>15</sup> While the reviewed relationships are different, investment arbitrators and WTO adjudicators have applied to balance to ensure the fairness between the concerned parties.

The last but not the least situation is about a political position. It means that balancing implicates the political position of international adjudicators. The situation is more common to investment arbitrators than WTO adjudicators. In this situation, investment arbitrators adopt balancing to imply their understanding of the purpose of investment treaties opposite to the conventional conception. Different from the conventional conception that prefers investment protection as the primary purpose of investment treaties, balancing emphasises an inclusive attitude toward the purpose of investment treaties. In specific, balancing makes arbitrators able to concern regulatory interests of host governments and to reserve the space for regulatory autonomy for host governments.

The political meaning of balancing is also found in WTO disputes. However, different from the usage of investment arbitrators, WTO adjudicators do not use balancing to express their own conceptions toward WTO agreements. WTO adjudicators often refer to balancing to the arrangements of rights and obligations for member States under a covered WTO agreement. In some cases, WTO adjudicators refer balancing to clarify the intentions of the Contracting States on conflicting interests.

While the motivations are different, the practice reveals that investment arbitrators and WTO adjudicators do share understandings on the inclusive attitude toward

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<sup>15</sup> In chapter five, the differences of the scope of concerned parties in dispute settlements are important in the discussion of the relationship between the Contracting States and adjudicators and the controlling power of the Contracting States over the adjudicative procedure of investment treaty disputes and of WTO disputes.

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competing interests and regulatory purposes under a treaty.

Because of the various use of balancing, the focus of each chapter is shifting along with the context in which balancing refers. I believe that the contextual analysis is better to capture a whole picture of balancing in the practice of international investment law and WTO law. The analyses provide the grounds to identify the causes of similarities and differences in the use of the concept of balancing by investment arbitrators and WTO adjudicators.

### 5. The topic of this study and research questions

While the focus of the thesis is the balancing approach, there are other two purposes that the thesis looks forwards on the analyses of the balancing approach in international investment law and WTO law.

There are two main purposes of the thesis. First, the thesis intends to apply the comparative study of the balancing approach to reviewing the meaning of convergences and divergences in international law.

The conventional wisdom of international law was mainly from the perspective of legal positivism. They believed that international law is an independent system. Its operation relies on the stability and certainty of state practices and practices of dispute settlement. Convergent legal principles, judicial experiences and state practices are critical to improve the relationship among various regimes and to facilitate the unity of international law. By contrast, different practices and divergent conceptions raise the risk of conflicts and strengthen the separation of international law. Compared with convergences, divergences are a problem for the international law system. Alongside the concerns of the unity of international law, convergences and divergences are easily framed in the duality conception and weighted differently. Expectations for

convergences also appear in current studies that pursue balancing as a constitutional principle with standard practice in international law.

However, the pursuit of the unity of international law seems like a utopia.<sup>16</sup> The desire is against the reality that international law is a fragmented system. The proliferation of treaties and the creation of international institutions in part result in the fragmentation of international law. International investment law and WTO law are two examples.<sup>17</sup> International investment law and WTO law are two separate regimes. Each has its legal principles, the model of treaty-making, membership, institutions of dispute settlement, and the community of adjudicators. The uniqueness is the ground of the separation of the two systems; it also explains the limits to cross-reference of judicial experiences and legal principles with each other.

Concerning the dilemma between theoretical discussions and reality, the thesis argues that convergences and divergences not in conflict. They are situations and consequences equally happening in the development of international law. The convergence of the balancing approach is not evidence of the unity between international investment law and WTO law. Likewise, different practices of the balancing approach are not necessarily a threat to the completion of international economic governance. The meaning of convergences and divergences must be adjusted.

While convergences indicate where participants of international society have cooperated for some goals, divergences reveal the differences rooted in each branch of

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<sup>16</sup> ‘Utopia’ is a significant metaphor that Martti Koskenniemi used to critically review the nature of international law as either an irrelevant moralist Utopia or a manipulable façade for State interests. Martti Koskenniemi, *From Apology to Utopia: The Structure of International Legal Argument* (CUP 2006).

<sup>17</sup> Chapter one addresses the origin of international investment law and trade law by the two factors i.e. the proliferation of treaties and the creation of international institutions.

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international law and international institutions. The cooperation and separation, however, are both causes of the progress of international law. They are equally important to explain how international law is evolutionary and what decisions were made by nation-states in response to international issues at different stages. In this respect, a direct cross-reference of judicial experiences and treaty practices between different regimes might not be the only answer to the unity of international investment law and WTO law. Neither is the pursuit of a universal standard of the balancing approach that fits in different regimes of international law.

The second purpose is to propose an explanatory framework. The explanatory framework is not to address practical issues in the application of the balancing approach. Instead, the thesis proposes the explanatory framework in the attempts to answer why different regimes emerge the same legal concept, why the development of international adjudication is corresponding to the evolution of international law, and how the interaction between adjudicators and nation-states shapes international governance of national sovereignty.

As to the two purposes, relevant research issues involve two dimensions. One dimension is about the practice of the balancing approach. The specific issues focus on the causes of the balancing approach in practice. For instance, what reasons are for investment arbitrators and WTO adjudicators to introduce the concept of balancing? What are the purposes that the concept of balancing is applied to a dispute? Do the motivations behind the application of the balancing approach lead to different consequences? Which part is shared by investment arbitrators and WTO adjudicators and which part is different? What are the causes for the differences?

Another dimension is about the constitution of international law in general. For



example, what are the common grounds of treaty interpretation and treaty negotiation? How do international adjudicators respond to the intentions of the Contracting States and vice versa? What are the essential issue of international law and international adjudication, while they are separate practices charged by nation–states and third parties respectively? Moreover, what is the implication of the emergence of balancing in international law, dispute settlement and international relations?

Here is the last but not the least point. The thesis has not intentions to underestimate the contribution of current studies. It appreciates these studies raising attention to the balancing approach in international investment law and WTO law. They also address practical issues caused in the application of the balancing approach through a series of comparative studies. The thesis does share the goal with these studies to deepen the understandings of balancing in international law. The difference is the analytical perspectives.

## 6. Research methodologies

Three points of research methods are worth making at this stage.

First, the thesis identifies the balancing approach as a conceptual framework changing along with the evolution of international investment law and trade law. The conceptual framework could be used for dispute settlement and the purpose of arrangements of rights and obligations between the Contracting States.

Concerning the arrangement of rights and obligations between the Contracting States, the thesis relies on the texts of investment treaties, the model BITs issued by nation–states and WTO agreements. As to the part of balancing in practice, the thesis refers to legal reasonings of judgements. In international investment law, the primary

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materials are awards and decisions of investor–State arbitration. In WTO law, the primary materials are reports of ad hoc panels and the Appellate Body.

I acknowledge that investor–State arbitration and the WTO dispute settlement system do not share a similar institutional structure. As chapter one will discuss later, investor–State arbitration rests on the network of ad hoc arbitration and institutional arbitration. The dispute settlement ends at the first instance. On the contrary, the WTO establishes a central institution for the disputes arising out between members. The dispute settlement system provides two stages of adjudication. Ad hoc panels decide the first instance of dispute settlement. The Appellate Body is responsible for reviewing the decisions, and legal opinions of panels appealed by disputing parties.

Nevertheless, the two dispute settlement mechanisms share functions. Both of them are not only for the function of dispute settlement but also to enforce treaty obligations that are imposed on the Contracting States by reviewing governmental actions of the exercising State. The general functions explain the public interest of investor–State arbitration, and the WTO dispute settlements and the similar issue confronted by investment arbitrators and WTO adjudicators i.e. conflicted interests and regulatory purposes. In respect to the balancing approach, the shared functions provide the grounds to discuss how institutional features shape the culture of judicial review and influence the application of balancing.

Second, the thesis studies the development of balancing in line with the interaction between nation–states and international adjudicators. It wants to argue that the emergence of the balancing approach is a result of the interaction between nation–states and international adjudicators on the issue of conflicting interests. In this respect, international adjudication is not only the enforcement of treaty obligations but also

contributed to the progress of international law. The viewpoint echoes the argument that contemporary international law is no longer dominated by nation-states but involved the engagement of non-state parties. International adjudicators, as the third party to a treaty, are an example of how non-state parties engage in the creation of international law. The legal reasoning of investor-State awards and WTO reports make us able to study whether international adjudicators share the understandings with nation-states on the issue of conflicting interests and regulatory purposes. As such, relevant analyses rely on the textual analysis of treaties and the discourse analysis of reasoning of investment awards and WTO reports of dispute settlement.

The third point of research methods is a historical perspective of the development of international investment law trade law. The thesis studies the changes in international investment law and trade law over time, not focusing on specific cases only.

The historical perspective has a two-fold meaning. First, reading history is to understand where we can from and where we will go. Likewise, studying the development of a specific legal approach in the historical perspective enables us to realise how the approach originated and what is its future. International adjudicators could invent a legal approach to settle a dispute because of its particular factual background. On the contrary, repeated application and cross-reference of experiences of a legal approach implicate what international adjudicators confront is not a particular case for one time but a systematic issue.

The balancing approach signals that conflicted interests and regulatory purposes are a systematic issue shared by international investment law and WTO law. The historical context of the balancing approach sheds lights on the continuity and change

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of interpretative approaches in the two regimes. In specific, what traditions are the balancing approach continuing and what changes caused by the balancing approach concerning the textual arrangements and treaty interpretation.

Moreover, the historical perspective stimulates us to notice the correlation and coordination between specific branches of international law and the international law system as a whole. Because the subject of individual treaties overlapped with the creators of the international law system, the development of specific branches of international law is the reflection of changes of the international law system. On the contrary, the overall trend of international law and policy directs the future of the development of specific regimes.

Exploring the correlation between individual developments and the systematic trend is essential. It provides an alternative aspect of reviewing the balancing approach in international investment law and trade law. The balancing approach is reviewed through the aspect of how the balancing approach shapes the international governance of trade and investment. To what extent the development of the balancing approach echoes the trend of international law and policy toward the reservation of regulatory sovereignty for nation states? How are the boundaries of national sovereignty on the governance of trade and investment changed by the application of the balancing approach? Moreover, what is the future of the balancing approach in international investment law and trade law by reading the trend of international law and policy in terms of the governance of regulatory sovereignty?

Because of the importance of the historical perspective, the study collected the awards/decisions of investor–State arbitration and WTO reports by panels and the AB during a timeline between 1995 and 2015. Concerning the limited research resources,

the study adopted a selective-collection method to narrow the scope of investment awards, decisions and WTO reports. In other words, the investment awards, decisions and WTO reports analysed by this study are the samples of the two jurisprudences.

While the collected judgements are sampling, this study designed a series of selection criteria to ensure the representativeness of these cases in international investment law and WTO law. Chapters two and three will explain the detailed criteria regarding investor-State awards/decision and WTO reports respectively.

## 7. Limits to the study and the limitations of findings

The thesis is ambitious. It explores various dimensions of the balancing approach such as the institutional features and the culture of judicial review. It also links the individual development of the balancing issues to the overall trend of the international law system. Based on the horizontal and vertical analyses, the thesis argues the influences of political ideologies on international law on the issue of defining the boundaries of national sovereignty.

Nevertheless, law and society are multi-dimensional and multi-variation systems. It is hard to explain the changes in legal systems and international society by unique variation and from a single dimension. As such, there are limits to the thesis and limitations of research results.

The first limitation is the gap between objective evidence and subjective perceptions. The mind-exploration issue causes the gap. As explained before, the thesis aims to identify the interaction between nation states and adjudicators on the balancing issues. A way to identify the decisions made by States and adjudicators is to read the text of treaties and legal reasoning made by investment arbitrators and WTO

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adjudicators.

The texts and legal reasoning are objective evidence of the decisions made by the Contracting States to a treaty and international adjudicators. However, it is arguable that to what extent that these objective materials reflect the subjective perceptions by either judicial person and natural person. A more serious problem is how to read. The difficulty is more complicated by interpretation of researchers. It means that what decision makers said might be polluted by or mixed with researchers' perceptions.

While the texts, arbitral awards and judgements are 'original sources' to legal studies, they could be interpreted into the different meaning and used to support different theories. The thesis also confronts the issue. It might be arguable whether the decisions of nation states and adjudicators the thesis identified are not the authentic ones.

Another limitation of the thesis is the representative issue. The representative issue has a two-fold meaning. The first meaning is the scope of research materials. The research materials are arbitral awards and decisions and WTO reports by panels and the Appellate Body.

A majority of analyses of the thesis rests on the analyses of case studies of investor-State arbitration and the WTO dispute settlement mechanism. The findings of the case studies are the basis of the discussion of the development of interpretative approaches in the two regimes, and the basis of the discussion of influences of institutional design on the application of interpretative approaches. As mentioned before, however, the case studies are conducted by selective collection.

The selective collection approach often raises the concern of whether the collected cases are representative of the development of a legal system as a whole. There could be a gap between research results and the reality of the practice. It is true that a small

number of samples cannot reflect society as a whole. However, sampling is still an effective and efficient approach for researches. As such, the thesis adopts a series of selection criteria in order to manage the limitation of sampling to the accepted degree.

Another factor of the generalisation of research results is the fragmentation of international law. One of the arguments is that the balancing approach in international investment law and WTO law mirror the overall trend of international law and policy. To concern, the balance of competing interests and regulatory purposes in investment disputes and WTO disputes is part of the shifting regulatory ideology. The ideology of international law and policy is shifting toward an inclusive attitude and giving more appreciation to regulatory sovereignty.

International investment law and WTO law are for the governance of trade relations and foreign investments. The developments happening in international investment law and WTO law might share with other branches of international law. A critical reason is the fragmentation of international law. The subject matters covered by the international law system are no longer international relations between nation states. The international law system covers a wide range of issues, including environmental protection, climate changes, maritime law and human rights. Almost every subject matter has developed its own legal principles and practice. It is possible that the legal principles and practice of one regime are not suitable for other regimes.

In this respect, it could say that the issues that confronted by investment arbitrators and WTO adjudicators might not happen in other international authorities. Accordingly, the argument that the balancing approach is the reflection of the changes of the international law system on the governance of regulatory sovereignty might raise the

concern of its generalisation.

I acknowledge that it is difficult to explore the mindset of interpreters and to describe subjective judgements and conceptions. The limits to the research methods would condition the interpretative effects of the findings and arguments of the thesis. As such, a cautious attitude must be taken to generalise the views of the study.

## 8. The structure of the thesis

This thesis contains six chapters. Chapter one is about history. It analyses the origin of legal principles concerning foreign investments and trade relations and the construction of international investment law and trade law. It discusses two points. First, the differences between legal principles and institutions result from the separation of international investment law and trade law. Second, the shared history and the general trend of governing the use of national sovereignty shed lights on the convergence of the two regimes. The development of international investment law and WTO law demonstrate that convergences and divergences coexist. The next question is whether the situation also happens in practice.

The following two chapters are about the practice. Chapter two first concentrates on the practice of investor–State arbitration. It analyses the interpretative patterns and interpretative approaches involving the concern of host States’ regulatory interests in investor–State arbitration. Chapter three shifts attention to the practice of the WTO dispute settlement mechanism. It studies the interpretative patterns and approaches concerning the balance of trade and non–trade interests in the WTO jurisprudence. The findings of the two chapters reveal that both investment arbitrators and WTO adjudicators employ the concept of balancing in the interpretation of treaty provisions. Nevertheless, differences exist in the application of the balancing approach and the



consequences.

Chapter four aims to explore the differences between investor–State arbitration and the WTO dispute settlements on the balancing approach. It first evaluates the relevance of the textual arrangements and the application of balancing in international adjudication. It then compares the application of the concept of balancing in investor–State arbitration and the WTO dispute settlement mechanism. The comparison answers the question proposed in chapter one. The experiences of the application of the balancing approach by investment arbitrators and WTO adjudicators do share some features, while differences exist. The differences implicate the meaning that the concept of balancing refers to and the culture of judicial review. Accordingly, I argue that international investment law and WTO law both confront the issue of conflicting interests and regulatory purposes. The balancing approach is an instrument to implement the rights and obligations arranged in treaty provisions. More importantly, the balancing approach is the way that international adjudicators respond to political intentions and decisions by the Contracting States to a treaty.

Chapter five also addresses the divergent practices of the balancing approach. Different in focus from chapter four, the discussion focuses on the institutional aspect. There are two reasons to explore the connection between institutional designs and behaviours of international adjudicators. First, it can explain why the way that investment arbitrators and WTO adjudicators respond to decisions of the Contracting States are different. Second, it reveals how institutional features and the power allocation between the Contracting States and third–party decision–makers shape the culture of judicial review, which further frame the behaviours of adjudicators. The institutional features include the design of a dispute settlement mechanism, adjudicative

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proceedings and the mechanisms the Contracting States have to control each process.

The analyses in previous chapters reveal that convergences and divergences between international investment law and WTO law coexist in the texts, institutional design and the practice. According to the finding, I argue that it is time to reconsider what is critical to the evolution of international law. To pursue convergences and to erase divergences, or to allow the two situations coexisted?

In the last chapter, I review the development of international investment law and WTO law on balancing by three issues. First, how the balancing approach is shaped by the interaction between nation states and adjudicators? Second, what are the general features of the construction of legal approaches in international law? Third, since international investment law and trade law is part of international law, individual developments should be influenced by and also reflect the overall trend of international law as a whole. In this respect, what is the trend of international law that is mirrored by the rise of the balancing approach in international investment law and WTO law?

These issues lead the study to propose a conceptual framework to reconstruct the progress of international law. The study argues three points. First, the balancing approach is the result of the interaction between the States and adjudicators. Because of the textual arrangement and institutional framework, the ways by which adjudicators interact with the States are various in different domains. Second, the parallel development of balancing in the text and the practice implicate that the States and adjudicators have shared understandings. The shared understanding is about the governance of state practices. Balancing singles that the governance of state practices is less intensive than the past where international law was dominated by the suspicion of governmental interference in the market. To the last but not the least point, the study

raises the concern of reasoning in the treaty negotiation and treaty interpretation. While the communication between the States and adjudicators drives the progress of international law, communication relies on the exchange of information. The reasoning is the source of information that is communicated by actors. Therefore, the States and adjudicators have the duty of reason-giving to justify their policy choices and interpretative decisions.

## **Chapter One**

### **The Concept of Sovereignty and the Development of International Law concerning Trade Relations and Investment Protection**

#### **1.1. Introduction**

International law is embedded in international politics. Whether treaties and customary international law, the content is the result of politics among the nation states. It could say that the history of international law witnessed a history of the relations between States. Given the closed connection, the change of the relations between the States caused the change of international law. The reason for the close relationship between international law and international relations is sovereignty. The concept of sovereignty entitled nation states the legal status and capability to establish relations with each other. As the political instrument for the state–state relations, international law defines the boundaries of sovereignty agreed by the States.

International law has a two–fold meaning for the governance of sovereignty. First, international law is constructed by the use of sovereignty for the function of establishing relations between nation states. Second, the content of international law defines the boundaries of regulatory sovereignty over domestic affairs that are agreed by the Contracting States. The two meanings implicate the impacts of international law including internal and external sovereignty. As such, the governance of sovereignty explains how international law originated and directs where international law will go.

The relations between the States are changing, so is international law. The nature of international law is not static but continuously evolutionary. Since the Peace Westphalia Convention established in 1648, international law experiences changes over time. Two significant changes are the growth of treaties and the creation of international

institutions.

This chapter will discuss the political ideology behind the two changes. The ideology is aimed to restrict national sovereignty both at the international and municipal levels. At the international level, State is required to delegate their sovereignty of dispute settlement and partial decision making to the institutions. These institutions mostly are administrated by non–state third parties. At the municipal level, States agreed to condition their use of regulatory sovereignty in their jurisdictions on specific issues. Any violation of the promises to a treaty will trigger states' responsibility. The formality of treaties and delegation of sovereignty to institutions lead international law into a rule–based system, different from the past system which rested on diplomatic relations and decisions by nation states.

The development of international investment law and trade law mirrors the history of international law. First, legal principles of the protection of foreign investments and trade relations originated from state practices and then are developed by treaties. A series of multilateral agreements even further established a global trading system, i.e. the WTO system. Second, investment treaties and the WTO provide institutions for the function of dispute settlements. Investment treaties even created investor–State arbitration to permit private parties to initiate litigations against the host government through international arbitration. The two changes are reasons for the rule–based feature of international investment law and trade law.

Under a similar trend, however, there are divergences in international investment law and trade law. These differences, involving both essential principles and institutional arrangements, establish the independence and uniqueness of the two regimes. They reveal that nation–states might invent different normative principles and

design different forms of dispute settlements in line with different subject matters. The specification of international orders results in the fragmentation of international law. As such, international investment law and trade law is close but separate branches of international law. The development of each regime could limit the integration of each other.

Nevertheless, to what extent international investment law and trade law are converged and different, and on which parts?

Reading history enables us to understand where we came from and where we will go. Therefore, before answering the issue, the chapter aims to outline the development of international investment law and trade law first.

There are three issues to explore in this chapter. What is the essence of international law, including international investment law and trade law? Is there a universal practice to arrange the texts and to design institutions of dispute settlements by nation states? Moreover, are international investment law and trade law independent from or embedded in international law?

This chapter contains three parts. In the first part, it explains the role of the concept of sovereignty on the construction of international law. Nation states usually gave their consent to international affairs through two forms, i.e. state practices and treaties. It also explores the changes in international law. It argues these changes leading international law into a fragmented system. The second discusses how the fragmented international law results in individual developments of international investment law and WTO, while the two regimes had a shared history in the colonial era. In the final part, it approaches the linkage between political ideologies regarding the governance of national sovereignty and the development of international law. The discussion focuses on two

ideologies, liberal economic policies under neoliberalism and sustainable development policies. It applies the parallel development of international investment law and WTO law and international law as a whole to advance a point. Individual developments are embedded in the international law system. It concludes that the trend of international law explains the convergences of international investment law and WTO law, and sheds lights on the future of the two regimes in general.

## 1.2. Two sources of international law and the notion of state consent

### 1.2.1. The concept of sovereignty and the origin of international law

The concept of sovereignty is the essence of the nation–states. It is a common understanding that the concept of sovereignty emerged from the growth of nation–states which was the result of a transformation of the political and economic system of medieval Europe. At that time, local rulers tried to establish their dominance and independent from the religious authorities in the fall of the collapse of the Holy Roman Empire.<sup>18</sup> In the course of the transformation of European societies from the feudal state–system into nation–states, the concept of sovereignty empowered the nation–states, conferring upon them the status of the supreme authority in their territory and independent from other States.<sup>19</sup>

The term of nation–states was first written in the *1648 Peace Treaty of Westphalia* (hereinafter ‘the *Treaty of Westphalia*’).<sup>20</sup> The conclusion of this Treaty marked the decline of a feudal state system founded on religion by which nation–states were born.<sup>21</sup> Nation–states replaced the church as the ruler. In this situation, the power relations

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<sup>18</sup> Malcolm N. Shaw, *International Law* (CUP 2014) 13–14.

<sup>19</sup> Ibid, 15.

<sup>20</sup> Alina Kaczorowska–Ireland, *Public International Law* (5th edn, Routledge 2015) 10.

<sup>21</sup> Malcolm N. Shaw (n 18) 15; Alina Kaczorowska–Ireland, *ibid*.

required to be reallocated between these new political units—the States. In the course of the new balance of power between these ‘new European States’, the Treaty of Westphalia witnessed the reallocation of power in Europe.

The *Treaty of Westphalia* developed several principles regarding the sovereignty of the States. It confirmed the legal status of sovereignty through the principle of sovereignty equality and the principle of non-intervention. It characterised the supremacy of sovereignty in accordance with the regional basis.<sup>22</sup> These principles materialised the core values of a sovereign State: independent status and the absolute power within the ruled territories.<sup>23</sup> These contributions explain why the Treaty of Westphalia established the foundation of international law.

The experience of the *Treaty of Westphalia* also illustrated the impact of international agreements on the ways that sovereignty is functional. There are two dimensions of sovereignty in action. One dimension is the external sovereignty which refers to the ability of a State to create relations with other States. Another dimension is about the internal sovereignty which means the ruling power of the State over domestic affairs.<sup>24</sup> The two functions of sovereignty explain that international agreements define the boundaries of sovereignty on specific issues, while the conclusion of this agreement outlines the relationship between the signatory States.

The interaction between the internal and external sovereignty further developed two pillars of international law: the principle of state equality and the principle of state consent. First, because of the equal position, every sovereign state can create

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<sup>22</sup> Alina Kaczorowska–Ireland (n 20) 10.

<sup>23</sup> Malcolm N. Shaw (n 18) 15.

<sup>24</sup> Richard N. Haass, former ambassador and director of Policy Planning Staff, US Department of State, ‘Sovereignty: Existing Rights, Evolving Responsibilities’, Remarks to the School of Foreign Service and the Mortara Center for International Studies, Georgetown University (14 January 2003) available at <<https://2001–2009.state.gov/s/p/rem/2003/16648.htm>> accessed 10 April 2019.



international relations with other States and make commitments. Second, the binding force of international law based on the consent of individual States and the agreement of those States in a particular relationship. The two principles justify the function of international law as defining boundaries of the exercise of external and internal sovereignty.<sup>25</sup>

On the other hand, the relativeness of sovereign power is the result of international law. The concept of sovereignty itself has implicated its limitation. The limitation is primarily due to the territorial idea. The scope of sovereignty depends upon the territory of the ruling party. The ruling party can exercise sovereign power to control over the people and affairs within the territory, while the effectiveness of sovereignty is limited to the territory. Therefore, what international law advanced is to deepen and specify the boundaries of sovereignty–restriction.

International law originated from the birth of sovereignty and served to indicate sovereignty–restrictions. As such, the history of international law mirrors the development of sovereignty.

#### 1.2.2. The notion of state consent

International law rests on the relative concept of sovereignty. The relativeness is usually characterised by the way that the supremacy of sovereignty is conditioned. There are four characteristics relating to the supremacy of sovereignty. They include supreme political authority and monopoly over domestic affairs within in the state’s territory; the

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<sup>25</sup> Krasner categorises the sovereignty into four situations in line with the power/rights distinction. In the four situations (Westphalian sovereignty, domestic sovereignty, Interdependence sovereignty, and international legal sovereignty), creating international relations and making commitments to a treaty belong to international legal sovereignty. However, this section refers the sovereignty to creating international relations and to govern domestic affairs to the external and internal dimensions of national sovereignty. See Stephen D. Krasner, *Sovereignty: Organized Hypocrisy* (Princeton Press 1999) 16–29.

capacity of regulating movements across its borders; the freedom of deciding foreign policies; and the freedom from external intervention.<sup>26</sup> Therefore, international law defines the relative use of sovereignty.

Nevertheless, the relativeness of sovereignty must base on the consent of the nation–states. This custom then develops the principle of state consent.

There are two reasons for the principle of state consent. One reason is the independence and the dominant position of sovereign states. Another reason is the lack of supreme authority in international society. The two reasons explain that international law is a system of law dominated by the will of sovereign states.<sup>27</sup>

In other words, the point that international law is the law of nation–states means that restrictions or regulations relating to the use of sovereignty must be based on the consent of States. The principle of state consent then legitimises international law.

### 1.2.3. The state consent in two forms

Before the creation of state–based international institutions such as the United Nations, the institutions which are superior to nation–states were absent in international society. In this situation, nation–states are bound to the rules only if they had given consent. As such, nation–states are the subject and also the object of the rules of state practices. International law is the law of the States.

The governance of state practices is usually formed in two ways: the custom of performances or written agreements. The custom of performances among the community of States then turned out customary international law. The written

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<sup>26</sup> John H. Jackson, 'Sovereignty: Outdated Concept or New Approaches', in Wenhua Shan, Penelope Simons, Dalvinder Singh (eds) *Redefining Sovereignty in International Economic Law* (Hart Publishing 2008) 8.

<sup>27</sup> Alina Kaczorowska–Ireland (n 20) 21.

agreements are the treaties. A treaty recorded the agreements between the signatory States on specific issues.<sup>28</sup> While the two ways have a difference in the specification and clarification, they are the primary sources of the rules concerning sovereignty. Customary law principles and treaties constitute the international law system.

Customary international law and treaties equally have binding force on the nation–states. With regard to customary law, its binding forces rely on the acceptance of the community of nation–states. All States are bound to the accepted performances regardless of whether a State participated in the process of the creation of the customary international law or whether a State gave consent to the creation of a customary law principle.<sup>29</sup> A State is not allowed to opt out of the application of a customary law principle if it had practised the principle and had a sense of legal obligation. In other words, the existence of state practices and the sense of legal obligation (also known as *opinio juris*) are the two factors of customary international law.<sup>30</sup>

The requirement of *opinio juris* to a certain point echoes the principle of state consent. The relation between the element of *opinio juris* and the principle of state consent rests on the meaning of the intention of a State. While the element of *opinio juris* refers to the subjective sense, the invisible feature should not hinder its competence

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<sup>28</sup> Louis Henkin, 'Human Rights and State Sovereignty' (1995) 25 Georgia Journal of International and Comparative Law 31, 35.

<sup>29</sup> Patrick Dumberry, *The Formation and Identification of Rules of Customary International Law in International Investment Law* (CUP 2016) 24 and 392. In recent years, the absolute and automatic effects of customary international law have been challenged by some writers. Curtis A. Bradley and Mitu Gulat explored the origin of the prevailing view by discussing a specific issue whether States have the right to withdraw from customary law and why. The works of Curtis A. Bradley and Mitu Gulat then raised a debate in the academic. See Curtis A. Bradley and Mitu Gulat, 'Customary International Law and Withdrawal Rights in An Age of Treaties' (2011) 21(1) Duke Journal of Comparative & International Law 1; Curtis A. Bradley and Mitu Gulat, 'Withdrawing from International Custom' (2010) 120(2) Yale Law Journal 202. Responses to Bradley and Gulat can be found in a special issue of Duke Journal of Comparative & International Law (issue 21, 2010).

<sup>30</sup> Roozbeh (Rudy) B. Baker, 'Customary International Law in the 21st Century: Old Challenges and New Debates' (2010) 21(1) European Journal of International Law 173, 173–74; Malcolm N. Shaw (n 18) 53.

of proving the existence of a state's voluntary consent to being bound to a customary law principle.

However, the non-requirement of express consent of States is challenged by newly independent States. The birth of these States is the result of the disintegration of the colonial empires.<sup>31</sup> They argue that the element of *opinio juris* does not answer why all States should be bound by customary international law even though they either 1) were not members of the international society at the time that the customary principle was developed; or 2) were not in a position to form the development of new customary law principles.<sup>32</sup> The historical background explains why many countries resist the acceptance of customary law principles because they might be against their interest.<sup>33</sup>

As to treaties, the legal documents recorded the results that the States agreed with each other through the process of negotiation. A treaty binds the signatory States because these States gave consent to the content. State consent has an important meaning. The States voluntarily agreed with the other parties to constrain the exercise of sovereignty. Because the commitments are voluntary sovereignty-restrictions, they construct a legal relationship between the agreed States. Therefore, the signatory States to a treaty are binding to a contractual relationship. The treaty rules are self-evidence of the state consent.

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<sup>31</sup> Malcolm N. Shaw (n 18) 27.

<sup>32</sup> Patrick Dumberry (n 29) 26.

<sup>33</sup> The resistance of the new States usually relies on the status of persistent objectors. The theory of persistent objectors provides an exception for a State to escape being bound by customary international law, if it objected to a rule at the early stage of this rule's formation and actively, unambiguously and persistently maintains such an objection even after this rule matures. However, by contrast to the common impression of a wide application of persistent objector status by developing countries, some writers argue that this theory is surprisingly limited in applied in the legal debates between States. There is only very weak judicial recognition of the theory of persistent objectors and there is no actual state practice supporting this theory. Ted L. Stein, 'The Approach of the Different Drummer: The Principle of the Persistent Objector in International Law' (1985) 26(2) Harvard International Law Journal 457; Patrick Dumberry, 'Incoherent and Ineffective: The Concept of Persistent Objector Revisited' (2010) 59(3) International and Comparative Law Quarterly 779.

While treaties are useful to minimise ambiguity and uncertainty in the existence of state consent, the contractual relationship limits the scope of application. Treaties are based on a contractual relationship. The content of a treaty only binds States that enjoy membership to the particular relationship and make those commitments to other member States.<sup>34</sup>

Despite the differences of formation of rulemaking and the scope of application, the relation between customary international law and treaties is close and critical to the development of international law. Treaty-based rules may codify the practices of customary international law, or clarify existing customary law principles. In some situations, treaties provide alternative approaches to customary international law.<sup>35</sup> In other words, treaty practice not only mirrors but also motivates the practice of customary international law.<sup>36</sup>

While the ways by which customary law principles and treaties are different, the two regulatory patterns interact with each other. Customary law principles might be integrated into the part of a treaty; the rules created by a treaty could become the customs accepted by the international community. The interaction between customary law principles and treaties explains the progress of international law. International investment law and trade law are also experiencing a different degree of correlation between the two legal sources. This issue will be addressed in later sections.

### 1.3. General patterns of the development of international law

#### 1.3.1. From the creation of international relations toward the creation of rules

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<sup>34</sup> Malcolm N. Shaw (n 18) 66.

<sup>35</sup> Alina Kaczorowska–Ireland (n 20) 29.

<sup>36</sup> Ibid, 38.

International law is evolutionary. The evolutionary feature reflects on the focus of the governance of state practices over time. In general, at the initial stage, international law was the result of the relations between the States. Along with the complexity of society, international law shifts the attention to regulate specific state practices.

As mentioned above, international law originated from the birth of nation–states. International law not only characterised the concept of sovereignty but also defined the relationships between the States. New relationship indicated the new balance of power between the States. At this stage, international law is the instrument of the politics between nation–states. The customary law principles were mostly related to external sovereignty such as the principle of State equality and the principle of non–intervention. These principles stabilised the community of States.

The stability of the relations between the States encouraged business transactions and interactions between people. The exchanges of people and business further increased the interdependence between the States. The closer the relationship, however, trigger more friction. The friction usually raised out of the different perspectives and different performances by the States. Therefore, the focus of international law shifted to identifying the accepted and agreed state practices.

History of international investment law exemplifies the transformation of international law.

The issue of the treatment of foreign investors has been part of the foreign policy of the States. The treatment of foreign investors not only relates to the economic development of one State but also influences the relationship with other States.<sup>37</sup> Therefore, the issue of foreign investments is also a prevalent issue of international

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<sup>37</sup> José E. Alvarez, *The Public International Law Regime Governing International Investment* (Brill/Nijhoff 2011) 2–3.

politics and treaty negotiation. Some colonial empires such as Spain, the Netherlands and the United Kingdom could protect the assets or interests of their nationals overseas by force. Under their gunboat policies,<sup>38</sup> these Western powers could protect their nationals' interests overseas by either complete political control of other States as colonies or by forcing other countries to negotiate unequal treaties after military attacks or threats. Under these political structures and treaty relationships, not only the tariff on goods was reduced but also excluded disputes involving foreigners from the jurisdictions of a host State. As such, these Western States had no need or intention to formulate norms to require each other to protect their people abroad.<sup>39</sup> This situation remained unchanged until the late nineteenth and early twentieth centuries.

The Western States altered their passive attitude and realised the need for the creation of rules for the protection of their nationals' interests abroad. The main reason for this change was a series of expropriations without compensation from several countries under the governance of communist parties. For instance, during the early part of the 20<sup>th</sup> century, the Mexican government practised mass nationalisation of US interests in the agrarian and oil business.

Likewise, there were large-scale expropriations enacted by Eastern European countries after the Second World War.<sup>40</sup> These national actions motivated capital-exporting States to develop principles to standardise the treatments of foreigners. These

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<sup>38</sup> In international politics, gunboat diplomacy refers to the pursuit of foreign policy objectives with the aid of conspicuous displays of naval power. The term comes from the nineteenth century the period of colonial imperialism, when Western States, particularly European States and the United States, would intimidate other, less powerful states into granting concessions through a demonstration of their superior military capabilities, usually naval power.

<sup>39</sup> M. Sornarajah, *The International Law on Foreign Investment* (3rd edn, CUP 2012) 19.

<sup>40</sup> Alexandra Diehl, *The Core Standard of International Investment Protection: Fair and Equitable Treatment* (Wolters Kluwer 2012) 146–47; Andrew T. Guzman, 'Why LDSs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' (1998) 38(4) *Virginia Journal of International Law* 639, 646–67.

customary law principles relating to the treatment of aliens were the origin of the standards of investment protection.

These historical experiences also explain why most customary law principles concentrate on expropriation. The principles respecting expropriatory actions include the responsibility for compensation, the requirements of compensation for expropriation, and the right to access to local remedies.

However, the capital-exporting States requested more comprehensive protection for the aliens instead of the individual issue. Their request customary law principles to establish a universal standard for the treatment of foreigners. The universal standard can guarantee the protection of foreigners having no differences between States and not jeopardised by the regulatory capability of the government.

The request of the universal standard has the effect of raising the regulatory level of the States, on the one side. On the other side, the request implied a presumptual bias. These capital-exporting States were also the pioneer of the birth of nation-states. They led the allocation of power between the States and also dominated the development of the orders to international society. As such, these States were usually conceived their performances exemplifying the model of civilised nations. Therefore, they worried and questioned other non-European States incapable of providing necessary protection and regulatory environment for people.<sup>41</sup> Their request for universal treatments for aliens was to fill the gap of the regulatory level between States. The history explains the origin of minimum standards of foreigners in customary

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<sup>41</sup> Patrick Dumberry (n 29) 64. This bias among conventional Western countries is preserved by the Statute of the International Court of Justice in terms of the definition of the sources of international law. Article 38(1) provides several sources of applicable laws. One of the sources is 'the general principles of law recognized by civilized nations'. However, neither this provision nor this Statute gives any explanation or definitions to the term 'civilized nations'.



international law.

The flexibility of customary law principles has the merit of responding to the demands of society. Flexibility instead raises the concern of certainty. The uncertainty in decentralised state practices leads international law into the next stage, the growth of treaties.

### 1.3.2. Toward centralised treaty rules

A difference between customary international law and treaties is their expressive format. Customary international law rests on the performances of States. Treaties rest on wording and language. As such, the rulemaking process in customary international law starts with the experiences of state actions and then is developed from general patterns. In contrast, treaties start with the rules and are elaborated by case law and individual state practice.

While a large part of treaty rules based on the practice of customary international law, the different normative implication drives international law into more reliance on treaty-based rules than customary law principles. The normative implication here refers to the certainty and specification of regulations.

#### 1.3.2.1. The inconclusive nature of customary international law

In customary international law, the certainty and specification of normative content face two issues. First, the time that the formation of specific norms requires depends upon the extent of divergence of state performances. While differences in state practices to a large point are related to the controversial nature and importance of the issue, the process of forming standard practices takes a long time. Second, to what extent that a customary law principle has proven its existence and acceptance by the community of

States is also a problem. The two factors usually lead to customary law principles to be inconclusive norms.

The development of the customary law principle of the minimum standard of protection illustrates the changing regulatory models. As discussed above, this customary law principle was developed to fill the gap caused by the lower standard of treatment for foreigners in some States. The concept of a minimum standard means that the treatment for foreigners by a host State should not be below the accepted standard. In some situations, the accepted standard might be violated even though discriminatory or arbitrary actions did not take place.<sup>42</sup> As the tribunal of *S.D. Myers v. Canada* stated, the principle of the minimum standard is a floor for the treatment of foreign investors.<sup>43</sup> However, what specific requirements are this standard applying?

According to a study by Martins Paparinskis, the evolution of the international minimum standard in customary international law can divide into three phases. It started with a focus on discriminatory treatment and the denial of justice for a foreigner, and then on non-discriminatory principles. It next referred to the neglect of duty or bad faith by the host States ‘to an outrageous degree’.<sup>44</sup> Besides the three phases, the principle of the international minimum standard also involved the issue of compensation for

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<sup>42</sup> However, developing countries challenged the principle of international minimum standard and the absolute responsibility of compensation for expropriation in customary international law. These countries questioned these customary law principles as the products of gunboat diplomacy of Western States. They were the extension of these Western countries’ inference in the domestic affairs of their original colonies. These developing countries then developed the Calvo doctrine to fight back against the principle of international minimum standard. The Calvo doctrine means that host States are not required to provide foreigners more favourable treatments than that accorded to nationals. Foreigners are also required to give up the right to receive diplomatic protection from their home States and the right to initiate international arbitration to settle their disputes against host governments. Wenhua Shan, ‘Calvo Doctrine, State Sovereignty and the Changing Landscape of International Investment Law’, in Wenhua Shan, Penelope Simons, Dalvinder Singh (eds) *Redefining Sovereignty in International Economic Law* (Hart Publishing 2008), 248–49.

<sup>43</sup> *S.D. Myers, Inc. v. Government of Canada* (*‘S.D. Myers v. Canada’*), UNCITRAL, First Partial Award, 13 November 2000 (J. Martin Hunter, Bryan Schwartz, Bob Rae) para 259.

<sup>44</sup> Martins Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (OUP 2013) 64.

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expropriation in the aftermath of a series of compensations for expropriation in the mid–1990s. This principle applied to support the absolute obligation of compensation for expropriation.

The inconclusive content and evolving definition of international minimum standards, nevertheless, blurs its scope of application with other principles such as fair and equitable treatment (FET) and full protection and security. The vagueness of these principles raises the issue of how to deal with the situation where the interpretation results by different tribunals conflict with each other. This issue explains one of the improvements in investment treaties. For instance, the 2004 US Model Bilateral Investment Treaty (BIT) expressly indicates that the scope of the minimum standard of treatment. Its article 5 defines that the fair and equitable (FET) standard and full protection and security are part of minimum standards of treatment for foreign investors. The Model BIT also defines the two standards respectively.

By contrast, international trade law overall has not experienced this transition in the same way as in international investment law. Instead, the original custom of negotiating treaties for trade relations has remained.

At the early stage of international trade law, commerce and trade had become one of the topics in negotiating international relations. In the colonial period, treaties involving amity and commerce were the critical means for Western countries to expand their markets. Treaties of Friendship, Commerce, and Navigation (FCN treaties) were a political instrument for the purpose. In this kind of treaties, trade and foreign investment were not separately negotiated by the States. They were together in the negotiation of international relationships as a whole.

The tradition lasted in the era of decolonisation. International agreements are still a useful instrument for the original colonising countries to maintain an economic relationship with their colonies. These economic agreements also integrated the issues of trade and investment into the content. They did not separate trade and investment into two independent agreements. For instance, certain European countries signed a trade and aid agreement with African, Caribbean, and Pacific (ACP) countries after the establishment of the European Economic Community (EEC), namely the *Lomé Convention*. The targeted developing countries are mostly former British, Dutch, Belgian and French colonies.<sup>45</sup> These agreements contain the provisions concerning trade relations and the protection of foreign investments.

The history demonstrates that the negotiation of trade agreements is the primary form of rulemaking for trade relations. Put differently, the principles regarding trade issues to a large part are developing by treaty practices rather than customary international law. It is evidence of the development of the principle of non-discrimination. Two pillars of the non-discrimination principle, i.e. most-favoured-nations (MFN) and national treatment, were initially treaty-based rules. Especially the MFN clause had functioned as the instrument to ensure equality between the Contracting States, during the stage that international law focused on the creation of international relations.<sup>46</sup>

The long-term treaty practice, however, creates the confusion of whether MFN clauses are part of customary international law.<sup>47</sup>

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<sup>45</sup> The ACP-EEC trade agreements have then been transferred into a comprehensive economic partnership agreement since 2000.

<sup>46</sup> John H. Jackson, *The Jurisprudence of GATT and the WTO: Insights on Treaty Law and Economic Relations* (CUP 2000) 57; William J. Davey, *Non-discrimination in the World Trade Organization: The Rules and Exceptions* (Brill/Nijhoff 2012) 64.

<sup>47</sup> In international trade law, it is still arguable whether the principle of non-discrimination (including the principle of MFN) is a customary law principle.

### 1.3.2.2. The proliferation of treaties in the 1990s

While customary international law impacts international investment and trade law to different degrees, nevertheless, the two regimes both experienced a trend of “treatification” in the 1990s. The proliferation of treaties in this period strengthened the dominant position of treaty rules in international investment and trade law.

The main reason for this trend of treaty-making during the 1990s was rapid changes in international society. These changes include the resurgence of market-oriented policies via the ideology of neoliberalism and the collapse of communist regimes. First, influenced by liberal economic policies, countries shared the political ideology that liberalisation of trade and capital flows are necessary for economic development. Second, these post-socialist countries that were mostly Eastern European and the Latin American States also transformed into a market mechanism in line with the liberal market programme.<sup>48</sup> The two changes led to the urge to strengthen the liberalisation of trade and raise the protection level for foreign investment to facilitate capital flows.

It is true that a bottom-up regulatory model allows customary international law the flexibility to reflect the diversity of national actions in different contexts. This model, however, is relatively passive to immediate and forward-looking normative needs. By contrast, treaties provide more active ways and more freedom for the nation-states to communicate the present issues and even to develop a framework for future development. For instance, a prerequisite for attracting foreign investment was to

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<sup>48</sup> Nina Bandelj, Matthew C. Mahutga and Kristen Shorette, ‘Signalling Demand for Foreign Investment: Postsocialist Countries in the Global Bilateral Investment Treaties Network’ (2015) 67 *Europe-Asia Studies* 870; Mitchell A. Orenstein, ‘What Happened in East European (Political) Economies? A Balance Sheet for Neoliberal Reform’ (2009) 23(4) *East European Politics and Societies: and Cultures* 479.

improve the regulatory environment and raise protections for foreign investment. For those developing countries that experienced the transformation of their political structure and market mechanisms, negotiation of BITs symbolise their commitment to creating an investment-friendly environment.<sup>49</sup> Likewise, commitments of trade liberalisation can only be characterised by the negotiation of treaties in detail.

As such, the effectiveness of addressing regulatory needs shifted the regulatory pattern toward treaty-making. The trend of treatification is evidence of the substantial increase of BITs during the 1990s and the early 2000s.<sup>50</sup> Empirical evidence also demonstrates that the post-socialist States concluded a large part of the newly signed BITs during this period in Eastern Europe.<sup>51</sup> In the meantime, international trade law witnessed the creation of regional trade agreements such as the *North American Free Trade Agreement* (NAFTA) and multilateral trade agreements associated with an international trade organisation, the WTO.

### 1.3.3. From integrated governance toward separate regulations

History of international investment and trade law marks another pattern of international law. It is the fragmentation of the international law system. The fragmented system means that international law divides into separate branches. Each branch governs specific issue and develops specific legal principles and institutions. A reason for the fragmentation of international law is the concern of functional differentiation.

In one sense, functional differentiation leads to the subject-specific regulatory model and urges treaty-making. In another sense, the proliferation of treaties, in turn,

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<sup>49</sup> Ibid.

<sup>50</sup> According to the statistics of UNCTAD (the United Nations Conference on Trade and Development), the number of BITs was increased from 385 at the end of the 1980s to 1,857 at the end of the 1990s. There was a sharp increase in such treaties concluded by developing countries and Central and Eastern European countries, rising from 63 at the end of the 1980s to 833 at the end of the 1990s. UNCTAD, UNCTAD/ITE/IIA/2, *Bilateral Investment Treaties: 1959–1999* (UN 2000) 1–2.

<sup>51</sup> Nina Bandelj et al. (n 48) 870; UNCTAD, *ibid.* 1–2.

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accelerates the specification and differentiation of international law. Therefore, one could say that the trend of treatification is the cause and impacts of the increasing specification of the international order. It explains the separation of international investment law and trade law.

Originated from the integrated governance in a joint agreement, trade and investment then divided into two subject matters of treaty negotiation. Trade relations and the protection of foreign investment are no longer negotiated together but by separate agreements. The growth of trade agreements and investment treaties then construct two separate legal systems of international law, i.e. international trade law and investment law.

As mentioned above, before the creation of stand-alone investment treaties, investment and trade were jointly addressed by the same agreement. A common form of treaties integrating investment protection and trade relations was FCN treaties.<sup>52</sup> Under FCN treaties, investment and trade were conceived as being under the general concept of ‘economic activities of foreigners’. As such, the rules of investment protection and trade issues were the rules regarding the protection of aliens. In general, the content of FCN treaties includes the protection of property rights, non-discriminatory treatment for foreigners and the privileged rights for foreigners such as employer choice provision or a blanket exemption from military service.<sup>53</sup>

Later on, trade separated from investment and referred to a specific aspect of the

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<sup>52</sup> The joint regulatory pattern has been revived recently through economic partnership agreements or free trade agreement with investment provisions.

<sup>53</sup> Gerald D. Silver, ‘Friendship, Commerce and Navigation Treaties and United States Discrimination Law: The Right of Branches of Foreign Companies to Hire Executives “Of Their Choice”’ (1989) 57 *Fordham Law Review* 765; John F. Coyle, ‘The Treaty of Friendship, Commerce and Navigation in the Modern Era’ (2013) 51 *Columbia Journal of Transnational Law* 302, 311.

cross-border movement of goods. The separation of trade and investment also reflected the separation of trade policies and the policies of foreigners. The change in national policies led to changes in international law. The change is the creation of stand-alone bilateral investment treaties.

Germany took the first step to sign stand-alone investment treaties with other countries in the 1950s. After this, other capital-exporting countries also joined the negotiation of BITs. For instance, Switzerland concluded a BIT with Tunisia in 1961. Netherlands signed a BIT with Tunisia as well in 1963. Sweden and Denmark also concluded BITs in 1965 with Côte d'Ivoire and Madagascar, respectively. One of the original colonising countries, the UK also signed its first BIT with the government of Egypt in 1975.

The traditional capital-exporting States almost all led these early BITs, most of them also original colonising countries. Because of the historical background, these BITs were critiqued as the extension of political and economic power by the colonising countries. The asymmetrical economic and political relationship between the Contracting States also raised the concern of fairness and justice in the content of these BITs. The content of BITs did have preferable favours for the interests of foreign investments. The larger part of obligations regarding investment protections are imposed on host States. Regardless of the political stigma, these BITs mark the negotiation of original investment treaties framed by the capital exporting and importing States model.<sup>54</sup> This model, to a certain point, reflects the conventional north-south divide of the global economy.

Nevertheless, the changing attitude of developing countries altered the old model.

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<sup>54</sup> Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Wolters Kluwer 2009) 43.



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Because of the influences of liberal economic policies and open markets, developing countries actively engaged in the negotiation of investment treaties during the 1990s. The various BITs between developing countries challenged the old image that BITs were for developed–developing or the north–south pattern.<sup>55</sup>

Because of the separation of trade agreements and investment treaties, investment treaties become the primary means of the formation of rules respecting investment protections and the liberalisation of capital flows. Trade agreements instead focus on market access and the reduction of tariffs and trade barriers.

It is true that in some situations the integrated governance of trade and investment remains. Statistics show that more than 300 trade agreements regulate the issue of foreign investments through the forms of an independent investment chapter and a series of provisions.<sup>56</sup> The WTO still attempts to negotiate multilateral rules for investment issues. Nevertheless, these individual practices have not replaced the separate models of investment treaties and trade agreements. For the government, the negotiations of investment treaties and trade agreements have a different meaning in its foreign policies and need different strategies.

#### 1.4. Divergences in the development of international investment law and trade law

While international investment law and trade law share similar patterns in development, there are differences in substantive principles and institutional structures. On the one hand, the differences justify the independence and separation of the two regimes. On the other hand, the differences are the reflection of the historical backgrounds of the two regimes. Put differently; these different features are not only the causes of international

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<sup>55</sup> UNCTAD (n 50) 2–3.

<sup>56</sup> United Nations, *World Investment Report 2017: Investment and the Digital Economy* (UN 2017) 22.

law in the process of functional differentiation and regulatory specification but also the consequences.

#### 1.4.1. The connection with customary law principles

The first and significant difference between international investment law and trade law is the relation with the customary international law.

While treaties have benefits of specification and efficiency over customary law principles, they are not isolated from each other. From the perspective of norm development, treaties have functions of either confirming or clarifying customary practices. In some situations, the customary principles are altered by and replaced with treaty-based rules. These functions explain that the connection with the customary international law exists in treaties. The difference is the extent and the influences of this connection in the textual arrangement of treaties. In general, investment treaties have a stronger relationship with the customary international law than trade agreements.

##### 1.4.1.1. A closed connection with customary law principles in investment treaties

Treaty practice reveals that investment treaties have a strong connection with customary law principles respecting the treatment of aliens. The connection is evidence for two points. First, a large part of investment treaties is similar to customary law principles. A set of standard rules for an investment treaty include international minimum standards such as FET standards and full protection and security, the notion of non-discrimination and the prohibition of direct and indirect expropriation without compensation.<sup>57</sup> These rules were initially been the principles regulating the treatment of aliens by host governments in customary international law.<sup>58</sup>

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<sup>57</sup> M. Sornarajah (n 39) 204–314.

<sup>58</sup> Nicholas DiMascio and Joost Pauwelyn, 'Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?' (2008) 102 *American Journal of International Law* 48, 67.

Second, these standard treaty rules have not changed much in the development of investment treaties; it has been half a century since the first investment agreement was signed in the 1950s, and rules in the original BITs are quite similar to newer agreements. Instead, they have become the essential rules of investment treaties. Schill has argued the high degree of similarity of substantive rules as the evidence of the multilateralisation and standardisation of treaty obligations respecting investment protection.<sup>59</sup> A significant difference between the early BITs and the modern BITs are the provisions of investor–State dispute settlements.

While the connection varies in individual treaties, the development of specific rules demonstrates two directions. Some part of treaty rules reflects customary law principles. Others evolve and even replace customary law principles. The two directions appear in the development of three categories of substantive principles: (i) the principle of international minimum standards; (ii) the prohibition of expropriation without compensation; and (iii) the notion of non–discrimination.

About the principle of international minimum standard, there is a blurred relation between treaty rules and customary law principles regarding the minimum standard of treatment. In the majority of investment treaties, the content involves a provision or a section respecting the minimum standards of treatment. The provision of the minimum standard of treatment stipulates essential protections for foreign investors and their interests. A common practice is to characterise the essential protection through two specific standards, namely the FET standard and full protection and security.<sup>60</sup>

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<sup>59</sup> Stephan W. Schill, *The Multilateralization of International Investment Law* (CUP 2009) 18.

<sup>60</sup> Some BITs provide the FET and/or full protection and security in the part of ‘promotion and protection of investments’. See, e.g., Argentina–Sweden BIT (1991), Article 2 (‘Promotion and Protection of Investments’); Germany–Nigeria BIT (2000), Article 3 (‘Promotion of Investments’); Austria–Bulgaria BIT (1997), Article 2 (‘Promotion and Protection of Investments’); Austria–Mongolia BIT (2001), Article

However, what is the substance of the two principles? Some BITs crystallise the FET and full protection and security by supplying other conceptual principles such as reasonableness, unfairness or non-discrimination.<sup>61</sup>

Other BITs stipulate the requirement of the minimum standard of treatment or the two principles by connecting them to customary international law. For instance, Article II(3) of the Morocco–US BIT (1991) states, ‘Investments shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law’. Article 6(1) of the Cameroon–Canada BIT (2014) provides, ‘Each Party shall accord to a covered investment treatment by the customary international law minimum standard of treatment of aliens, including fair and equitable treatment and full protection and security’.

The treaty-based references not only confirm the connection between customary international law and treaty rules but also that the content of this treaty rule is bound to customary state practices. Specifying sub-principles are aimed to ascertain the scope of relevant customary practices in the context of minimum standard of treatment. While the rule of the minimum standard of treatment or the principles of FET and full protection and security remain hardly defined, the fact there is treaty-based reference

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2 (‘Promotion and Protection of Investments’).

<sup>61</sup> See, e.g., Antigua and Barbuda–United Kingdom BIT (1987), Article 2(2) where the FET, full protection and security and the principles of reasonableness and nondiscrimination are appeared in a single provision without definitions and illustrations; Argentina–Sweden BIT (1991), Article 2 where provides the FET along with the unjustified or discriminatory principles but separated from full protection and security; Denmark–Morocco BIT (2003), Article 2(2) (‘Investments of investors of each Contracting Party shall receive a fair and equitable treatment and enjoy full protection and security, subject to measures strictly necessary for the maintenance of public order, in a non-discriminatory way. Neither Contracting Party shall in any way impair by unreasonable or discriminatory measures the management, use, enjoyment or disposal of investments, in its territory of investors of the other Contracting Party’); Mexico–Netherlands BIT (1998), Article 3(1) (‘Each Contracting Party shall ensure fair and equitable treatment of the investments of nationals of the other Contracting Party and shall not impair, by unjustifiable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those nationals. Each Contracting Party shall accord to such investments full security and protection’).

does influence practices.<sup>62</sup> The majority of arbitral tribunals tend to have recourse to the experiences of customary international law to interpret the FET standard or full protection and security.<sup>63</sup>

However, these practices also show that the presence of customary international law still raises the problem of treaty interpretation. A critical issue is whether customary practices are the floor or the ceiling when interpreting the content of the rules of the minimum standard of treatment. Without the advanced guidance of treaty interpretation, the obligation of the minimum standard of treatment could be interpreted as not exceeding the customary practices. Alternatively, by contrast, it could be interpreted as an obligation additional to the customary practices. In this situation, the term “minimum” is a treaty-based standard rather than the standard in customary international law.

The situation that treaty rules reflect the customary law principles also appears in the issue of the prohibition of expropriations. The requirements that investment treaties provide to regulate expropriatory actions almost always follow the practices of customary international law.<sup>64</sup> In customary international law, what matters is to define limits to the exercise of the power to expropriate private property. The relevant

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<sup>62</sup> *Mondev International Ltd. v. United States of America* (‘*Mondev v. U.S.*’), ICSID Case No. ARB(AF)/99/2, Award, 11 October 2002 (Ninian Stephen, James Crawford, Stephen M. Schwebel) paras 94–95; *ADF Group Inc. v. United States of America* (‘*ADF Group v. U.S.*’), ICSID Case No. ARB(AF)/00/1, Award, 9 January 2003 (Florentino P. Feliciano, Armand Demestral, Carolyn B. Lamm) paras 183–84; *Cargill, Incorporated v. United Mexican States* (‘*Cargill v. Mexico*’), ICSID Case No. ARB(AF)/05/2, Award, 18 September 2009 (Michael C. Pryles, David D. Caron, Donald M. McRae) para 268; and *Mobil Investments Canada Inc. and Murphy Oil Corporation v. Canada* (‘*Mobil v. Canada*’), ICSID Case No. ARB(AF)/07/4, Decision on liability, 22 May 2012 (Hans van Houtte, Merit E. Janow, Philippe Sands) para 135.

<sup>63</sup> Ralph Alexander Lorz, ‘Protection and Security (Including the NAFTA Approach)’ in Marc Bungenberg, Jörn Griebel, Stephan Hobe and August Reinisch (eds), *International Investment Law: A Handbook* (1st edn, Nomos/Hart 2015) 765; Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (OUP 2012) 161–163; Kenneth J. Vandeveld, *Bilateral Investment Treaties: History, Policy, and Interpretation* (OUP 2010) 248–56.

<sup>64</sup> UNCTAD, *UNCTAD Series on Issues in International Investment Agreements II: Expropriation* (UNCTAD 2012) 1; Borzu Sabahi and Nicholas J. Birch, ‘Comparative Compensation for Expropriation’, in Stephan W. Schill (ed) *International Investment Law and Comparative Public Law* (OUP 2010) 756–57.

restrictions include the existence of public purposes;<sup>65</sup> non-discriminatory exercise;<sup>66</sup> the payment of compensation; and the requirement of due process. These practices then transferred to treaty rules.<sup>67</sup>

On the other hand, the development of investment treaties advances the customary law principles in two ways. First, some investment treaties use the arguable Hull formula as the standard for the duty of compensation to expropriation actions. The Hull formula is not a customary law principle. The US Secretary of State Cordell Hull proposed the three conditions to the compensation after Mexico's nationalisation of US nationals' interests. Cordell Hull suggested that the compensation for lawful expropriation must be 'prompt, adequate and effective'.<sup>68</sup>

The Hull formula, however, faced strong opposition from the newly independent States. These States were mostly capital-importing countries. They questioned the Hull formula, saying it imposed an overdue burden on host governments. They instead proposed the concept of 'just and appropriate compensation' to against the Hull formula.<sup>69</sup> The opposition from capital-importing countries is an extension of the

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<sup>65</sup> Permanent Court of International Justice, Case concerning certain German interests in Polish Upper Silesia, Judgement No. 7 (1925), para 65 (The Permanent Court of International Justice, in the German Interests in Polish Upper Silesia case, stated that '... the only measures prohibited are those which generally accepted international law does not sanction in respect of foreigners; expropriation for reasons of public utility...').

<sup>66</sup> The Permanent Court of International Justice expressed the rule of non-discrimination in the application of general measures in its advisory opinion of the Treatment of Polish Nationals and Other Persons of Polish Origin or Speech in the Danzig Territory case, the Permanent Court of International Justice. In its words: 'the prohibition against discrimination, in order to be effective, must ensure the absence of discrimination in fact as well as in law. A measure which in terms is of general application, but in fact is directed against Polish nationals and other persons of Polish origin or speech, constitutes a violation of the prohibition'. Permanent Court of International Justice, Advisory Opinion No. 23 (1932).

<sup>67</sup> See, e.g., Benin-Canada BIT (2013), Article 11 ('A Contracting Party may not nationalize or expropriate a covered investment either directly or indirectly through measures having an effect equivalent to nationalization or expropriation ("expropriation"), except for a public purpose, in accordance with due process of law, in a non-discriminatory manner and on payment of compensation...'); Grenada-United Kingdom BIT (1988), Article 5(1); Chile-Poland BIT (1995), Article 6(1); Egypt-Viet Nam BIT (1997), Article 5(1); Austria-Mexico BIT (1998), Article 5(1).

<sup>68</sup> Restatement (Third) of Foreign Relations Law of the United States, § 712 (1987).

<sup>69</sup> UNCTAD (n 64) 5-7.

conventional North–South conflicts.

The arguable position of the Hull formula in customary international law, however, is solved by treaty–making. The principle of prompt, adequate and effective compensation is no longer exclusive to US BITs. Instead, it is popular in other countries’ BITs but differently worded.<sup>70</sup>

Another advancement by investment treaties is the scope of expropriatory actions expanding to indirect expropriations. Most investment treaties regulate indirect expropriations by the words ‘tantamount to’<sup>71</sup> or ‘equivalent to’ expropriation.<sup>72</sup> In some situations, their expansive scope is characterised by the terms of ‘the same nature and the same effect of expropriation’.<sup>73</sup> Other BITs have even adopted a more delicate model. They expand the governance of indirect expropriations but carve–out general regulatory measures from their scope.<sup>74</sup>

The last but not the least situation is the notion of non–discrimination. The rule of non–discrimination in investment treaties exemplifies how treaty rules evolve

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<sup>70</sup> See, e.g., United Kingdom–Yemen BIT (1982), Article 5(1) (‘against prompt, adequate, and effective compensation’); Czech Republic–Jordan BIT (1997), Article 5(1); Hungary–Sweden BIT (1987), Article 5(1); Chile–Czech Republic BIT (1995), Article 6(1). A 2007 survey by UNCTAD also points out that ‘the overwhelming majority of BITs provide for prompt, adequate, effective compensation, based on the market or genuine value of the investment’. An OECD report further states that ‘the Hull formula and its variations are often used and accepted and considered as part of customary international law’. However the statement in the footnote hardly nails down the Hull formula as a customary law principle in terms of the standard of compensation for expropriation. UNCTAD, *Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking* (UN 2007) 52; OECD, “Indirect Expropriation” and the “Right to Regulate” in International Investment Law”, *OECD Working Papers on International Investment* (OECD 2004) 2.

<sup>71</sup> See, e.g., Argentina–United States of America BIT (1991), Article IV(1); Denmark–Mexico BIT (2000), Article 5(1).

<sup>72</sup> See, e.g., Denmark–Latvia BIT (1992), Article 5(1); Grenada–United Kingdom BIT (1988), Article 5(1); Rwanda–United States of America BIT (2008), Article 6(1).

<sup>73</sup> See, e.g., Botswana–Switzerland BIT (1998), Article 6(1); Estonia–Sweden BIT (1992), Article 4(1).

<sup>74</sup> See, e.g., China–Colombia BIT (2008), Article 4(2) (‘Non–discriminatory measures of a Contracting Party designed and applied for public purposes or with objectives such as public health, safety, and environment protection, do not constitute indirect expropriation’); Austria–Tajikistan BIT (2010), Article 7(4); India–Saudi Arabia BIT (2006), Article 4(3); United States of America–Uruguay BIT (2005), Annex B(‘Expropriation’).

customary law principles.

In customary international law, the principle of non-discrimination was not the primary principle to the issue of the treatments of aliens. One of the main reasons was the presumable suspicion of the political and legal system of non-Western countries. The suspicion explains that customary law practices are more focused on establishing essential protections and treatments for foreigners rather than the requirement of non-discrimination. Because of lack of customary practices, in early BITs, the rules of non-discrimination, i.e. national treatment and MFN, were conceptual principles without substantive content.

The situation changed in the 1990s. Since the 1980s, developing countries or newly independent countries outside the European regions transformed into representative democratic systems. They were also committed to improving the rule of law and the regulatory environment. The changing reality has two meanings. First, it raises the importance of the requirement of non-discrimination. The international minimum standard is no longer sufficient for the protection of foreigners but must be supplemented by the requirement of equal treatment. Second, it implicates an alternative purpose of investment treaties as the promotion of foreign investments. The requirement of equal treatment ensures reciprocal benefits between the Contracting States in the liberalisation of capital flows.

Despite policy purposes, the provisions of national treatment and MFN also provide contributions to the expansion of substantive protections. Regarding national treatment, it controls the scope of the protected investments under a treaty. This is because the scope of investments largely depends upon the scope of national treatment. In general, there are five forms of the rule of national treatment. National treatment may apply to (i) limited post-entry investments, (ii) unlimited post-entry investments, (iii)



limited pre-entry investments, (iv) unconditioned pre-entry investments, and (v) both pre-entry and post-entry investments to a certain extent.<sup>75</sup> Each formulation indicates the extent that a host State is required to protect foreigners equal to the treatment received by nationals. Among the five situations, the first situation grants the narrowest extent of foreign investment, while the fourth situation provides the most liberal environment for foreign investment. The fourth situation often appears in US BITs.<sup>76</sup>

Regarding the principle of MFN, treaty rules indicate the limitation of the substantive protections through MFN clauses. The MFN provision generally provides exceptional situations, including the advantages granted by economic integration agreements such as free trade area, customs union, common market or regional economic organisations,<sup>77</sup> GATT/WTO agreements,<sup>78</sup> or double taxation agreements<sup>79</sup>. Another significant change is the expansion of MFN obligations to procedural issues. This change mainly relates to the right to access investor-State arbitration.<sup>80</sup>

The issue of expansion of MFN obligations to procedural rights results from the language of ‘all matters or treatments’. Some tribunals adopt a liberal attitude and interpret the scope of MFN clauses including investors’ procedural rights.<sup>81</sup> Others

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<sup>75</sup> UNCTAD, *International Investment Agreements: Key Issues, Volume I* (2004) 87–90.

<sup>76</sup> See, e.g., US–Haiti BIT (1983), Article II(1).

<sup>77</sup> See, e.g., Argentina–United States of America BIT (1994), Article II(9); Brunei Darussalam–Korea, Republic of BIT (2000), Article 3(4).

<sup>78</sup> See, e.g., Armenia–United States of America BIT (1992), Article II(9); Barbados–Canada BIT (1996), Article III(3).

<sup>79</sup> See, e.g., Argentina–Denmark BIT (1992), Article 4(1); Chile–Finland BIT (1993), Article 3(2); Denmark – Uganda BIT (2001), Article 4.

<sup>80</sup> Kenneth J. Vandeveld (n 63) 358–72; Yannick Radi, ‘The Application of the Most-Favoured-Nation Clause to the Dispute Settlement Provisions of Bilateral Investment Treaties: Domesticating the ‘Trojan Horse’ (2007) 18(4) *European Journal of International Law* 757.

<sup>81</sup> The broad interpretation was initiated by the tribunal in the *Maffezini v. Kingdom of Spain* case. *Emilio Agustín Maffezini v. the Kingdom of Spain* (‘*Maffezini v. Kingdom of Spain*’), ICSID Case No. ARB/97/7, Decision on jurisdiction, 25 January 2000 (Francisco Orrego Vicuña, Thomas Buergenthal, Maurice Wolf). Also see, *Siemens A.G. v. The Argentine Republic* (‘*Siemens v. Argentina*’), ICSID Case No. ARB/02/8, Decision on Jurisdiction, 3 August, 2004 (Andrés Rigo Sureda, Charles N. Brower, Domingo Bello Janeiro); *Impregilo S.p.A. v. the Argentine Republic* (‘*Impregilo v. Argentina*’), ICSID Case No. ARB/07/17, ICSID Case No. ARB/07/17, Award, 21 June 2011 (Hans Danelius, Charles N. Brower,

rather take a conservative attitude. They rather limit the scope of the MFN provision by separating the protection of investors from the protection of investments. They believe that the MFN provision is designed for substantive protections of investments and is irrelevant to investors' rights. A broad interpretation might intervene in the textual arrangement of an investment treaty.<sup>82</sup> While arbitral tribunals seem to share an understanding of taking the contextual analysis of this issue,<sup>83</sup> the variation and ambiguity of the wording of MFN provisions still raise uncertainty in their interpretation.

#### 1.4.1.2. A limited connection to customary law principles in trade agreements

The situation in international trade law is different. The influence of customary international law on trade agreements is limited. For instance, the long-standing principle of non-discrimination has been invented by the experiences of treaty making rather than the custom of state practices.

It is a common understanding that the MFN provision requires reciprocal benefits unconditionally applied between the Contracting States. This meaning, however, is the contemporary understanding as the result of the evolution of treaty experiences.<sup>84</sup> Before the post-WWII period, the meaning of MFN provisions changed in three stages. In the first phase, an MFN clause was an instrument of earning benefits for domestic industries in foreign markets.<sup>85</sup> The implementation was often in a unilateral way,

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Brigitte Stern).

<sup>82</sup> *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States* ('*Tecmed v. Mexico*'), ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003 (Horacio A. Grigera Naon, José Carlos Fernández Rozas, Carlos Bernal Vera); *Daimler Financial Services AG v. the Argentine Republic* ('*Daimler v. Argentina*'), ICSID Case No. ARB/05/1, Award on Jurisdiction, 22 August 2012 (Pierre-Marie Dupuy, Charles N. Brower, Domingo Bello Janeiro).

<sup>83</sup> See, e.g., *Hochtief AG v. The Argentine Republic* ('*Hochtief v. Argentina*'), Decision on jurisdiction, 24 October 2011 (Vaughan Lowe, Charles N. Brower, Christopher Thomas) para 67.

<sup>84</sup> Kenneth J. Vandewelde (n 63) 352–53; Rudolf Dolzer and Christoph Schreuer (n 63) 207.

<sup>85</sup> Tony Cole, 'The Boundaries of Most Favored Nation Treatment in International Investment Law' (2012) 33 Michigan Journal of International Law 537, 545.

meaning that the MFN treatment was a privilege rather than a standard of equal treatments. The privilege depended upon the political will of a State when negotiating commercial treaties with other States. In some situations, the privilege was granted under the influence of the asymmetric trade relation between the Contracting States.<sup>86</sup> At this stage, the scope of MFN benefits was expanded from the maintenance of existing treatments to the request for better benefits.<sup>87</sup> The unilateral MFN clauses were the product of beggar-thy-neighbour policies during the seventeenth century.<sup>88</sup> The idea that a State's gain was others' loss resulted in the meaning of the MFN clause as preferring domestic traders over other competitors in a bilateral trade relationship.<sup>89</sup>

At the second phase, the unilateral and asymmetric nature of MFN clauses was changed by the influence of global commerce. Under the rise of global economic interdependence, the purpose of MFN clauses was moved to the concern of reciprocity between the Contracting States in an agreement. It means that participating States expect similar concessions exchanged with each other in order to 'balance out' the exchange of benefits.<sup>90</sup> Also, the scope of the MFN treatment expands to future benefits.<sup>91</sup> At this stage, MFN clauses started to embrace the meaning of anti-discrimination.

The requirement of equivalent compensation, however, was implemented in two ways, conditional and unconditional. Keohane illustrates the difference between the two

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<sup>86</sup> Joost Pauwelyn, 'The Transformation of World Trade' (2005), 104 Michigan Law Review 1, 11–12; Thomas Cottier and Lena Schneller, *ibid.* 5.

<sup>87</sup> Eugene J. Conroy, 'American Interpretation of the Most Favored Nation Clause' (1927) 12(3) Cornell Law Review 327, 328–29.

<sup>88</sup> Diana Wood, *Medieval Economic Thought* (CUP 2002) 110.

<sup>89</sup> Thomas Cottier and Lena Schneller, 'The Philosophy of Non-Discrimination in International Trade Regulation', in Anselm Kamperman Sanders (ed), *The Principle of National Treatment in International Economic Law Trade, Investment and Intellectual Property* (Edward Elgar Publishing 2014) 5.

<sup>90</sup> John H. Barton, Judith L. Goldstein, Timothy E. Josling and Richard H. Steinberg, *The Evolution of the Trade Regime: Politics, Law, and Economics of the GATT and the WTO* (Princeton 2006) 40.

<sup>91</sup> Tony Cole (n 85) 546.

forms of MFN clauses via the notion of equivalence.<sup>92</sup> In the conditional form, the MFN benefits mean ‘specific reciprocity’ agreed to by the Contracting States. The specific reciprocity was often characterised by specific rights and duties granted to particular actors and the previous values of exchanged items. In contrast, unconditional MFN treatment embodies ‘diffuse reciprocity’. It means the equivalent benefits as standardised behaviours accepted by the Contracting States.

There were no conditions of calculating ‘equivalent compensation’ in exchange for the MFN benefits. While it was a common image that conditional MFN clauses were the products of US treaties, history shows that conditional and unconditional MFN clauses coexisted in the trade agreements of European countries made during the years 1830–1860.<sup>93</sup>

The difficulty of practical operation of conditional MFN clauses raised opposition. The hostility in conditional MFN clauses eventually led the US government to alter its trade policy. An executive agreement issued by the American government signalled its changing position; after that, the US government accepted an unconditional MFN clause as one of the standard rules of its trade agreements.<sup>94</sup>

The transformation of the US government's trade policy also reveals the contemporary significance of MFN treatment. First, MFN treatment ensures the diffusion of benefits implemented in unconditional and equal ways. The unconditional and equal nature makes MFN treatment become the embodiment of non–discrimination. The notion of non–discrimination is embodied in trade commitments and also in their implementation. Second, the feature of generalising mutual benefits provides the foundation for the establishment of multilateral agreements and the multilateral trading

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<sup>92</sup> Robert O. Keohane, ‘Reciprocity in international relations’ (1986) 40 *International Organization* 1.

<sup>93</sup> William J. Davey (n 46) 62.

<sup>94</sup> John H. Barton et al. (n 90) 39.

system. Reading the textual arrangements of WTO law, the notion of reciprocity is not only embodied in the negotiation of concessions to foreign markets,<sup>95</sup> but also the removal of concessions at the retaliation stage.<sup>96</sup>

In respect to the connection between treaties and customary international law, the development of MFN provisions points out the significance of international trade law. Essential principles of trade agreements are mainly produced through the process of treaty negotiations. The influence of the practices of customary international law is limited. One of the main reasons is the appearance of trade agreements at an early stage. Early trade agreements were largely composed of commitments to tariff reductions, not involving any specific government interventions or state practices. As such, the development of international trade law is independent of the customary international law.

The limited connection with the customary international law is also one of the features of the practices of WTO law. In the next chapters, we will address a critical feature of the interpretation of WTO provisions. The feature is the self-contained application and self-reference of legal opinions.

#### 1.4.2. The multilateralisation of legal principles and institutionalisation of dispute settlements

Another significant difference between international investment and trade law is the centralisation and institutionalisation of regulations. The centralisation of regulations means the existence of multilateral agreements which provide a set of standard

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<sup>95</sup> Ibid, 40.

<sup>96</sup> Chad P. Bown and Michele Ruta, 'The Economics of Permissible WTO Retaliation' (2008), *Staff Working Paper ERSD-2008-04*, World Trade Organization: Economic Research and Statistics Division.

principles for a specific issue. The institutionalisation of regulations refers to the existence of a united and central dispute settlement mechanism.

#### 1.4.2.1. The creation of the multilateral trading system and the central dispute settlement mechanism

While modern international investment and trade law is more reliant on treaties, the two regimes are experiencing different rates of progress. The creation of the WTO in 1995 was the most significant driver of this difference. The advent of the WTO signalled that international trade law has a multilateral governance system and the central dispute settlement mechanism. WTO agreements provide a set of standard principles for the governance of trade relations. Moreover, the WTO and WTO agreements function the baseline for the pursuit of trade liberalisation.

The success of the multilateral trading system is the result of hard effort over half a century. In the aftermath of the Second World War, the global economic and financial order was waiting to rebuild. The Bretton Woods Conference gathered delegates from forty-four countries. One of the first negotiation issues was the creation of international institutions for the governance of the economic and financial order. While the organisations for international financial orders were formed, i.e. the IMF and the World Bank, the creation of an organisation for international trade failed. The main reason for the failure was the disapproval of the US Congress. Nevertheless, the efforts of multilateral negotiations still produced the first multilateral trade agreement, the *General Agreement on Tariffs and Trade* (GATT). A series of negotiation rounds in the GATT eventually led to the establishment of the WTO.

The achievement of the WTO and relevant multilateral agreements has two-fold implications. First, it reveals the expansion of the scope of regulatory issues. In the early

GATT period, the focus of trade negotiations was about tariff reductions. The primary purpose was to create a global market through comprehensive market access and stabilisation of tariff rates. At that time, non-economic and social issues were not separated from economic policies. In contrast, economic policies were compromised with other public policies for the function of welfare States. Trade measures were conceived as useful and temporary instruments for economic transformation, industrial adjustment and social adoption by a government in response to the global competition.<sup>97</sup> As such, the negotiation of multilateral trade agreements was concerned more with the prevention of protectionism rather than the economic effects of a trade measure.<sup>98</sup>

The oil shock in the 1970s raised challenges to the role of government in the market.<sup>99</sup> Influenced by extremely liberal economic policies under the neoliberal ideology, presumptions about governmental interventions were changed. Governmental interventions were presumed suspicious as disruptions to competition and the efficiency of the market.

The suspicion of governmental actions on trade led the focus of negotiation issues shifting to non-tariff measures behind borders. This change was reflected by a series of *plurilateral agreements* in the Tokyo Round (1973–79).<sup>100</sup> These agreements were aimed to govern governmental actions such as anti-dumping measures, government procurement, technical barriers to trade and other non-tariff measures and prevent trade measures as disguised barriers to international trade.

The scope of governance covered measures for public purposes such as the

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<sup>97</sup> Andrew Lang, *World Trade Law after Neoliberalism: Reimagining the Global Economic Order* (OUP 2011) 221–222.

<sup>98</sup> Ibid, 226.

<sup>99</sup> Ibid, 221.

<sup>100</sup> Those agreements were also called the *Tokyo Agreements*.

protection of human, animal or plant life and health; the environment; and national security.<sup>101</sup> These plurilateral agreements then established the comprehension of WTO agreements concluded in the final GATT negotiation round (Uruguay Round, 1986–94).<sup>102</sup> Put differently, the rules regarding the negotiation of tariff reductions and trade–restrictive measures are multilateralised.

Another implication is the institutionalisation of dispute settlements. The establishment of the multilateral trading system not only leads to progress in the multilateralisation of regulations but also results in the creation of a central dispute settlement mechanism. The central dispute settlement mechanism provides the guarantee of the implementation and enforcement of WTO law.

While the first instance of the dispute settlement procedure is ad hoc panels, the WTO created a permanent institution in charge of the appellate review procedure. The Appellate Body (AB) is not only crucial to the certainty and consistency of legal interpretations but also evidence of the deeper institutionalisation of the WTO dispute settlement procedure. Moreover, the nature of the permanent and stand–alone institution marked that the WTO dispute settlement mechanism operated in a quasi–judicial and rule–based procedure.<sup>103</sup>

1.4.2.2. The network of investment treaties and decentralised investor–State arbitration

International investment law, by contrast, still rests on a network of investment treaties and other treaties involving the rules of investment protection.<sup>104</sup> The main reason for

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<sup>101</sup> R. W. Middleton, ‘The GATT Standards Code’ (1980) 14(3) *Journal of World Trade* 201, 201–02; Sungjoon Cho, *Free Markets and Social Regulation: A Reform Agenda of the Global Trading System* (Kluwer 2003) 92.

<sup>102</sup> Those *plurilateral agreements* then became part of *WTO Agreements* relating to trade in goods, binding all Member States of the WTO.

<sup>103</sup> Isabelle van Damme (n 6) 4.

<sup>104</sup> United Nations, *World Investment Report 2017: Investment and the Digital Economy* (n 56) 22.



the situation is the opposite positions between the States.

The international community, especially the traditional capital-exporting States, is always interested in the creation of multilateral conventions on the treatments of foreign investors and investments. This issue is a continuous project of several organisations, for instance, the Organisation for Economic Co-operation and Development (OECD). Investment is also a long-term issue of the WTO system since the GATT period. These efforts, however, experienced repeated failures.

According to the study of Stephan Schill, there were two major waves of multilateral rules creation governing the relations between foreign investors and host States. The first wave was associated with the proposed International Trade Organization as part of the Havana Charter in 1948, and with the 1967 *OECD Draft Convention on the Protection of Foreign Property*.<sup>105</sup> The first movement was motivated by the general trend of multilateralisation international orders after the end of the Second World War, the birth of newly independent States in the decolonisation era and the limitation of customary international law regarding investment protection.<sup>106</sup> However, these proposals confronted opposition from developing and new States. This opposition was the part of the resistance to customary international law by these countries. They questioned the proposals of multilateralising investment treaties as the extension of political controls by Western capital-exporting countries.

The second wave occurred during the late 1990s and the early 2000s. Two efforts drove the movement. First, the WTO attempted to reintroduce investment into the negotiation round and to complete the governance of investment issues.

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<sup>105</sup> Stephan W. Schill (n 59) 31.

<sup>106</sup> Ibid, 32.

In WTO agreements, investment issues were addressed, but only to a limited degree.<sup>107</sup> The *Agreement on Trade-Related Investment Measures* (TRIMs) only apply to investment measures related to trade in goods only. It does not address the issues of investment protection like other bilateral investment treaties. While the *General Agreement on Trade in Services* (GATS) provides the supplying mode of commercial presence (Mode 3), which touches the issue of access to foreign markets and foreign investments, but this protection is also conditioned. The protection of the GATS is limited by the specific and selective commitments by a host State (opt-in) and numerous exceptions. As such, the ambition of completing negotiations on investment protections under the WTO, member States even attempted to include investment issues in the Singapore Ministerial Meeting in 1996. Because of the resistance of developing members, the Singapore Declaration only stated the establishment of a working group on investment.<sup>108</sup> In the past decade, the negotiation for a general agreement on foreign investments within the WTO has not yet begun.

While the attempts of the WTO failed, several developed countries continued this project back to the OECD. The OECD in 1996 also launched negotiations for the *Multilateral Agreement on Investment* (MAI).<sup>109</sup> The content of MAI in the draft produced was similar to existing investment treaties. It covered a broad definition of investment, essential standards of treatment for foreign investors such as the prohibition of expropriation, the FET standard and full protection and security, and the provisions for investor-State arbitration.<sup>110</sup>

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<sup>107</sup> Jürgen Kurtz, 'A general investment agreement in the WTO?' (2002) 23 *University of Pennsylvania Journal of International Law* 713, 722.

<sup>108</sup> Eric M. Burt, 'Developing countries and the framework for negotiations on foreign direct investment in the World Trade Organization' (1997) 12(6) *American University International Law Review* 1015, 1049–51.

<sup>109</sup> Stephan W. Schill (n 59) 53.

<sup>110</sup> OECD, *The Multilateral Agreement on Investment, Draft Consolidated Text* (22 April 1998); UNCTAD, *Lessons from the MAI* (2000); Jürgen Kurtz (n 107) 756.

Except for the general opposition from developing countries, another reason for the failure of the MAI was the hostility to investment treaties from the public. While the content of the proposed MAI had no significant departure from the existing investment treaties and more and more developing countries engaged in negotiations of investment treaties, NGOs criticised the asymmetric positions of host States and the restrictive space for regulatory autonomy in the public interest.<sup>111</sup> They also questioned investor–State arbitration as undue international intervention in domestic policies and regulatory systems.

These repeated failures reveal that the development of international investment law remains in the shadow of the traditional North–South conflict, which has not been resolved by the engagement of developing countries in the capital–oriented economy and the existing investment treaties.

Another feature of the decentralisation of international investment law is the lack of a central dispute settlement mechanism for disputes between foreign investors and host governments. The investor–State dispute settlement mechanism (ISDS) is the product of modern investment treaties. It has a very young history, compared with other international authorities. The provisions for investor–State dispute settlements were widely accepted as a regular part of investment treaties not later than the 1990s.<sup>112</sup>

The ISDS mechanism provides an alternative channel for foreign investors to challenge the actions or decisions of host governments. Different from the conventional

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<sup>111</sup> Stephan W. Schill (n 59) 56.

<sup>112</sup> Gus van Hartan, *Investment Treaty Arbitration and Public Law* (OUP 2007) 25–26; Joachim Pohl, Kekeletso Mashigo and Alexis Nohen, ‘Dispute Settlement Provisions in International Investment Agreements: A large Sample Survey’ (2012) *OECD Working Papers on International Investment* 2012/02, 10–11.

approaches such as diplomatic protection or local remedies in the host States,<sup>113</sup> the ISDS provisions grant foreign investors the right to directly access international adjudication against nation–states. A popular approach of the ISDS is international arbitration.

The treaty practice also displays a common practice that the Contracting States gave the general consent to the investor–State arbitration when concluding an investment treaty.<sup>114</sup>

While the scope of the general consent to investor–State arbitration varies in treaties, it provides a ground for investor–State arbitration as the enforcement mechanism of investment treaties. Investment treaties usually contain the prerequisites of investor–State arbitration. The prerequisites are often characterised by the language of ‘any violation of the obligation [of either Contracting States] under this agreement’.<sup>115</sup> As such, investor–State arbitration is a treaty–based arbitration mechanism to evaluate whether or not any of the Contracting States as a host State violated its obligations under an investment treaty. In this respect, investor–State arbitration is evidence of the institutionalisation of international investment law to a certain extent.

However, the progress of institutionalisation is limited by the decentralised nature of investor–State arbitration. Investor–State arbitration faces the same problem as the development of substantive principles. The problem is the lack of a united arbitration procedure and the central institution to administrate the arbitration proceedings. While the International Centre for Settlement of Investment Disputes (ICSID) was created as

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<sup>113</sup> Rudolf Dolzer and Christoph Schreuer (n 63) 232–36; Jeswald W. Salacuse, *The Law of Investment Treaties* (2nd edn, OUP 2015) 397–99.

<sup>114</sup> Kenneth J. Vandeveld (n 63) 433.

<sup>115</sup> See, e.g., Canada–Latvia BIT (2009), Article XIII(1); Switzerland–Venezuela, Bolivarian Republic of BIT (1993), Article 9(4).

an international arbitration institution for investment disputes, it is open to nation–states to become member States. It means that not all the Contracting States to investment treaties have the membership in the ICISD. As such, the practice of investor–State arbitration relies on ad hoc arbitration and the network of local and international arbitration institutions.

On the other hand, the inconsistency of legal interpretations of investment treaties not only results from the lack of centralised dispute settlement mechanisms and institutions. However, more importantly, the consistency issue is the result of the lack of a multilateral investment treaty. In other words, the institutionalisation of dispute settlements and multilateralisation of substantive principles are the two sides of the centralisation of regulations. This point is critical to the current ambitious project of multilateral investment court by the European Union.<sup>116</sup> Without the support of a multilateral investment treaty, the success of an international investment court is questionable.

The next chapter will address the decentralised investment treaties and investor–State arbitration for another perspective. The discussion will take the perspective of the allocation of power between the Contracting States and arbitrators to enquiry how the relation defines the boundaries of external sovereignty and influences the boundaries of internal sovereignty as well.

### 1.5. The relevance of political ideologies to the development of international law

The development of international investment law and trade law mirrors the trend of international law. Both of the two regimes are experiencing the proliferation of treaties

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<sup>116</sup> European Commission, News, The Multilateral Investment Court project, available at <<http://trade.ec.europa.eu/doclib/press/index.cfm?id=1608>> accessed 10 April 2019.

and the creation of international institutions. The Contracting States to investment treaties and WTO agreements also adjust the texts regarding liberalisation of economic factors and sustainable development policies. The parallel evidence that international investment law and trade law is part of international law.

However, besides the same group of lawmakers, i.e. nation states, is any other factors for the situation?

The thesis believes that the changes in international law can shed lights on the issue. Reading the changes in international law over time, they are the results of changes in international society. The changes are mainly political ideologies. The political ideologies include the issues of international relations and national policies. At the origin of international law, nation-states negotiated treaties to define the allocation of power with each other, constructing new international relations. At the colonial period, nation states either actively negotiated or were forced to negotiate economic agreements to manage the trade relations and to decide how to protect the interests of national citizens abroad. In the post-WWII, investment treaties and trade agreements were two instruments to implement liberal economic policies. They facilitated the free movement of economic factors and opened the market, as well as the protection of interests of foreign investors. In recent years, nation states are adjusting the texts of investment treaties and WTO agreements toward sustainable development policies, while the adjustments are at different degrees.

These changes of the international society reveal that political ideologies concerning the boundaries of sovereignty at the external and internal aspects are shifting. Since the origin of international law till now, the ideologies are shifting from the restriction toward the reservation. The two directions are representative of liberal economic policies and sustainable development policies.

The reason to discuss liberal economic policies, especially under neoliberalism, and sustainable development policies is the nature of international law. International law is the results of power relationships among States. The content of international law defines national policies. The two-fold nature of international law is evidence of its history.

The origin of international law was because of the rise of nation states and the desire of establishing new relations among European countries. Customary international law and treaties are the instruments to define the boundaries of sovereignty over domestic affairs, while their contents are decided under the negotiation between States. In the context of trade and investment, the negotiation of investment treaties and trade agreements reflects political preferences and power relations among the Contracting States. While the subject matters of investment treaties and WTO agreements are economic activities, liberal economic policies and sustainable development policies are related to economic development of a country, the ideologies concerning national policies and power relationships are more influential to the textual arrangements and institutional design.

This section analyses the development of international law in line with neoliberalism and sustainable development. The thesis acknowledges that other theories and ideologies are affecting the evolution of international law and driving changes in international society. Neoliberalism and sustainable development cannot well explain the changes in international law and international society.

The reason for applying the two ideologies is that they are representative of two attitudes toward the role of government in the market. While neoliberalism is suspicious of governmental interferences, sustainable development highlights the regulatory

interests of the government. The opposite directions form a spectrum of governance of sovereignty in international law. Relevant measures led by the two ideologies also explain the changes in international investment law and trade law in line with the two opposite directions. The suspect of governmental interferences under neoliberalism led international law imposing restrictions on sovereignty. Respects of regulatory states under sustainable development led international law toward preserving more space for national sovereignty.

Between restriction and reservation, this section concludes that sustainable development policies are the new trend of international law which implicates the governance of sovereignty is now swinging toward the reservation of sovereignty.

#### 1.5.1. Neoliberalism and the restriction of sovereignty in international law

##### 1.5.1.1. The presumed detrimental impact of governmental actions in the market

Neoliberalism emerged in the 1970s as a result of the widespread problem of stagflation in Western countries. At the time, the prevailing view was that this disturbing economic reality resulted from overloaded governmental expenditure but without the support of taxation.<sup>117</sup> It raised the questions about the active role of government in the economy and social welfare that were emphasised by conventional Keynesian economic theory.

In contrast to the Keynesian belief in the necessity of governmental intervention, these challenges shifted attention to the function of the market. This historical background explained the resurgence of free-market liberalism via the new mask of neoliberalism.<sup>118</sup>

Neoliberalism appreciates the function of the market. It believed that the efficiency

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<sup>117</sup> Andrew Lang (n 97) 221.

<sup>118</sup> Ibid, 222.



The concept of sovereignty and the development of international law concerning trade relations and investment protection

and effectiveness of the market must rest on competition rather than the supervision of governments. This conception develops the primary policy prescription of privatisation of the public sector and the maintenance of a competitive environment in the market.

Regarding trade and investment, the neoliberal economic policies are characterised by the liberalisation of trade and capital flows and open markets.<sup>119</sup>

This suspicion of governmental intervention is transferred into two ideas of international investment and trade law. The first point is the pursuit of the liberalisation of trade and investment. In the preamble of the *Agreement Establishing the WTO* (hereinafter '*the WTO Agreement*'),<sup>120</sup> it stresses the importance and positive impacts of trade liberalisation. The liberal policy also expands the purposes of investment treaties to include the promotion of investment. In the aspect of substantive principles, liberal policies also justify the function of substantive rules as the instruments of reducing barriers to the liberalisation of trade and capital flows.<sup>121</sup> The second point is the restriction of national sovereignty. Under market-oriented policies, governmental actions are suspicious of barriers to the liberalisation of economic factors such as trade in goods and capital flows. This conception requires nation-states to adjust the regulatory system to prevent unnecessary intervenes or obstacles on the market. In this respect, the pursuit of liberalisation of trade and investment by international law might directly or indirectly condition the policy options and regulatory freedom of nation-states.

The relevance of the liberal economic policies on international law is evidence of

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<sup>119</sup> David Harvey, *A Brief History of Neoliberalism* (OUP 2007) 66.

<sup>120</sup> The *Agreement Establishing the WTO* serves as an umbrella agreement. This agreement sets out the role, structure and powers of the WTO.

<sup>121</sup> Brian R. Copeland and M. Scott Taylor, *Trade and the Environment: Theory and Evidence* (Princeton 2005) 110.

two changes. One change is the density of regulations regarding trade measures and regulatory measures on investments. Another change is the delegation of national sovereignty to international institutions regarding dispute settlements. The two changes are aimed to restrict the exercise of national sovereignty on trade relations and foreign investments.

#### 1.5.1.2. Restriction of national sovereignty by the rule of law in international law

The first change regarding the restriction of national sovereignty is about the substantive content of international law. International investment and trade law have both witnessed the increased density and expansion of governance. Specifically, investment treaties expand the regulatory objects from specific governmental actions to expropriatory actions and regulatory measures causing negative impacts on foreign investments. WTO agreements also expand the scope from tariff reductions to reducing trade-restrictive measures and regulatory measures for the public interest. This change shows that the two fields have strengthened control over the exercise of national sovereignty.

From the perspective of nation-states, the increased density and intensity of regulations means more restrictions imposed on the Contracting States. On the other hand, from the perspective of international governance, this change makes contributions to establish the rule of law in international investment and trade law.

Lord Bingham points out the importance of the principle of the rule of law. There are two places in which his viewpoints relate to the current discussion. One point is where the rule of law requires the legal system to be accessible and predictable. Another point is that the rule of law requires disputes to be resolved by the application of law rather than the exercise of discretion.<sup>122</sup>

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<sup>122</sup> Tom Bingham, *The Rule of Law* (Penguin 2010) 37, 48.

Taking these two points to review the initial changes of investment treaties and WTO agreements, the expansion and density of regulations indicate that the content of investment treaties and WTO agreements is more comprehensive and detailed. This comprehension and detailed content increase accessibility and predictability for the interested parties, including the Contracting States, the public and traders and foreign investors. In other words, the density of regulations echoes the need for the rule of law in international investment law and trade law.

The second point links the rule of law to other influences of liberal economic policies. It is the issue of the next section, the institutionalisation of dispute settlements.

The changes in line with the principle of the rule of law facilitate international law toward a rule-based system with stability and predictability, on the one hand. On the other hand, more regulations mean more restrictions on sovereignty imposed on the Contracting States. The restrictions of sovereignty are further tense by delegating the decision-making power to non-state parties.

#### 1.5.1.3. Restriction of national sovereignty by the delegation of powers to international institutions

Another impact of neoliberalism on the development of international law is about institutional aspects. It is the creation of international institutions for administration and dispute settlement. While the content of a treaty defines the boundaries of national sovereignty, international institutions ensure the implementation of the agreed boundaries. These institutions are independent of the Contracting States to assess whether one of the Contracting States exercising national sovereignty beyond the defined boundaries or not.

A delegation of power is the ground of international institutions. The Contracting States agree to delegate their power of decision making to other parties. The delegation has a two-fold meaning. From the perspective of the delegated parties, they have the authority of settling the disputes between the Contracting States. In most situations, dispute settlements involve the assessment of States' actions and decisions. From the perspective of nation-states, they are deprived of the power to settle their disputes arising out of the treaty by themselves once agreed on the creation of international institutions. The delegation of power not only restricts their sovereignty on adjusting the relation with the treaty parties but also allows international institutions to judge the legitimacy of their exercise of internal sovereignty. It seems that international institutions have the power to intervene a State's national policies and regulations.

Because of the two-fold restrictions of sovereignty, international institutions must ground on the consensus of the Contracting States. When nation-states are entering into a treaty, they not only make promises of sovereignty-restrictions but also delegate their power of decision-making to third parties, if the treaty creates the institutions for administration and dispute settlement.

Beside the function of sovereignty-restriction, the creation of international institutions of dispute settlement has political meaning. It means that the commencement and proceedings of dispute resolutions are out of the control of States. The process of dispute resolution is carried out according to rules rather than the political intentions of the States. Moreover, it implicates that final decisions are prevented from the political influence of the Contracting States. It ensures the operation of international law in line with the principle of the rule of law.

From the concern of the stability of the international law system, the allocation of power between nation-states and international institutions contributes to the progress

of the rule of law in international law. One of the points of the rule of law, as Lord Bingham stresses, is that the application of the law resolves disputes. According to the conventional state-centred conception, nation-states are the dominant party of international law. Nation-states are the rule makers of international law; national sovereignty is the object of international law. In this situation, disputes involving a State must be settled by States themselves. The results of dispute settlement are inevitably framed by the political intentions and discretion of States. As such, creating a third-party adjudication or arbitration mechanism means that dispute settlements are distant from the exercise of discretion by States but applied by law.<sup>123</sup> Consequently, the institutionalisation of dispute settlement constitutes another pillar of the rule of law in international investment and trade law.

On the other hand, the delegation of power to international institutions complicates the power allocation in international law. The power allocation not only exists in the horizontal relations between nation-states but also exists in the vertical relations between nation-states and international institutions. While the consent to a treaty defines the authority delegated to the institutions, the gap between exceptions and the reality might raise the tension between nation-states and international institutions. As Jackson points out, the institutionalisation of dispute settlements causes the tension between sovereign states and international institutions or third parties.<sup>124</sup>

To what extent the third parties are authorised to decide, and to what extent the Contracting States have the power to control over the institutions and the procedure of

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<sup>123</sup> While the institutionalisation of dispute settlements reduces the political discretion of the Contracting States, the issue of the discretion of adjudicators remains. This is because the engagement of third parties raises the concern of misuse or overuse of their interpretive and adjudicative authority. In other words, the issue of the exercise of discretion still exists but refers to different subjects.

<sup>124</sup> John H. Jackson, *The World Trade Organization, Constitution and Jurisprudence* (Routledge 1998) 33.

dispute settlements? These issues are more serious in treaty interpretation. The specific issue is whether adjudicators are bound to the interpretation by the Contracting States. These issues will discuss in the following chapters.

All things concerned, while the suspicion of governmental interferences under neoliberalism facilitates the implementation of the rule of law in international investment law and trade law, relevant changes impose restrictions on national sovereignty.

#### 1.5.2. The concept of sustainable development and the reservation of sovereignty in international law

The concept of sustainable development represents another ideology of the role of government. While sustainable development originated from the development concern of a State, its core ideas are opposed to neoliberalism. There are two significant differences. First, it recognises the role of government on the pursuit of economic development and the growth of a society. During the process of improving the prosperity of society, governmental interferences on the market are necessary. Second, it believes that the development of a society should not rely on economic values but rest on the balance of economic values and other values that are important to society as well.

##### 1.5.2.1. Challenges to the single development model dominated by economic values

The concept of sustainable development was developed in the late 1980s. At that time, the market-dominated policies under neoliberalism began to attract challenges.

Opponents questioned whether neoliberalism simplifies the development of a society into a single dimension that is dominated by economic values. However, economic development is only one of the multiple dimensions of society. The development and prosperity of society involve economic, social, environmental and

even cultural concerns.<sup>125</sup> The challenge of liberal economic policies then raised development concerns. Different from neoliberalism, development concerns picture the development of a society from an inclusive perspective. For instance, the concept of sustainable development was developed to stress the importance of environmental concerns in redefining the development of a society.

The term ‘sustainable development’ was first used in a report issued at the United Nations World Commission on Environment and Development in 1987.<sup>126</sup> The Brundtland Commission issued this report in an attempt to link the issues of economic development and environmental stability. This effort inspired this Commission to propose the concept of sustainable development. In this report, the pursuit of economic development was replaced by the concept of sustainable development. This concept means that development must meet ‘the needs of the present without compromising the ability of future generations to meet their own needs’.<sup>127</sup> Not only does the concept of sustainable development bridge the equity issues across and within generations,<sup>128</sup> but also functions as ‘a framework for the integration of environmental policies and development strategies’.<sup>129</sup> By emphasis on sustainability, the term ‘development’ was pictured in a broader sense.

Nevertheless, the concept of sustainable development is evolving along with society. This concept has expanded its scope to the social dimension and other social concerns such as poverty eradication and inequality. Several UN policy descriptions have illustrated the change. At the Rio+20 Conference in 2012, for example, the UN

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<sup>125</sup> Sonia E. Rolland, *Development at the WTO* (OPU 2012) 24.

<sup>126</sup> United Nations, General Assembly, *Report of the world commission on environment and development: Our common future* (1987).

<sup>127</sup> Ibid, para 43.

<sup>128</sup> Sonia E. Rolland (n 125) 28.

<sup>129</sup> United Nations, General Assembly (n 126) para 48.

gave a new definition of sustainable development. Sustainable development was defined as an inclusive approach to development concerns that encompasses different values and interests in the economic, social and environmental dimensions.<sup>130</sup> The statement confirmed the social dimension as the third pillar of sustainable development.

As such, the conception of development not only departs from the domination of economic policies and the conflict between environmental and economic concerns but further expands to the balance along three dimensions (economic, environmental and social dimensions).<sup>131</sup>

#### 1.5.2.2. Inclusive and balanced concerns under sustainable development policies

The concept of sustainable development re-conceptualises economic growth in a broader sense. The critical factor that drives the conception of development away from the framework of liberal economic policies is inclusive and balanced concerns.

The inclusive and balanced concerns require policymakers to expand the factors considered as broadly and comprehensively as possible. It does not presume to give priority to specific values or policy options. Instead, it believes that competing interests and values to a policy purpose are not necessarily exclusive to each other. They can reach a balancing point through a cooperative perspective. In other words, politicians and lawmakers are expected to consider all relevant interests and values in the decision making and try to manage adverse effects for the policy purpose. Moreover, if possible, the authorities should try all possible solutions that can transform the conflict of different regulatory purposes into cooperation for the same goal.

The cooperative premise makes the contemporary meaning of sustainable

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<sup>130</sup> United Nations, General Assembly, *The Future We Want*, A/RES/66/288 (2012) para 64.

<sup>131</sup> Rajendra Ramlogan, *Sustainable Development: Towards A Judicial Interpretation* (Nijhoff 2011) 19–20.



development different from liberal economic policies as well as its original version. Sustainable development does not mean longer favour of environmental values and against economic development. Instead, it concerns all issues of society, including social inequality, social capacity movement, climate changes, environmental protection, protection of cultural heritage, and liberalisation of trade and investment. The range of public concerns is characterised by the seventeen policy goals of the UN's *2030 Agenda for sustainable development* (hereinafter 'UN 2030 Agenda').<sup>132</sup>

#### 1.5.2.3. Renewing the right to regulate in international law

An important point of sustainable development policies is the concern of the right to regulate. In order to make the balance of competing interests to society, the balancing process must rely on the role of government. It means that governmental interferences on the market are no longer suspicious of a threat to the market but necessary for the comprehensive development of the society.

Besides the development of a society, the right to regulate is also critical to international law. The right to regulate involves two dimensions. First, it relates to the conflicting interests and regulatory purposes under a treaty. Because of an inclusive and balanced concern, treaties are required to make the Contracting States' right to regulate at the balancing point. The balancing point is the rights and obligations of the Contracting States. As such, treaties need to recognise that, when necessary, either side of the Contracting States has the right to adjust the priority of regulatory purposes by a treaty. Explicit terms and specific provisions must reflect the recognition.

Second, the right to regulate relates to the implementation of the UN 2030 Agenda.

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<sup>132</sup> United Nations, General Assembly, *Transforming our world: the 2030 Agenda for Sustainable Development*, A/RES/70/1 (2015), Preamble.

The implementation of sustainable development policies cannot rely on the changes in national policies. International orders are also essential to implement sustainable development policies. A direct and effective way is to include similar principles and relevant provisions as part of treaty obligations. By the binding effects of treaty obligations, the right to regulate is not the power of the Contracting States, depending upon their intentions and decisions. Rather, the right to regulate is an obligation of the Contracting States. These States are required to take actions for specific issues with implementing their treaty obligations.

The two dimensions demonstrate the dual nature of the right to regulate. On the one side, the right to regulate is the power of the States. Its exercise is the States' discretion, depending upon the States' intentions. On the other side, the right to regulate is an obligation for the States. It is an instrument to implement treaty obligations. Nevertheless, the two sides of the right to regulate require the transformation of international law.

First, the existing treaties and state practices have to refine the boundaries of sovereignty. The new boundaries must reflect the balanced relation between the Contracting States to a treaty and reveal the inclusive concern of a treaty over specific issues. Second, international institutions should also share the concern of the right to regulate, adjusting the attitude of assessing the legitimacy of governmental interferences. Moreover, the right to regulate also raises the issue of private–public relationship. While sustainable development policies require the exercise of sovereignty for reconstruction of national orders, the consequences are not necessarily conflicted with private interests or the interferences on private properties. In some situations, the exercise of regulatory sovereignty is to create a new market for private parties and to establish cooperation with private parties.

The rise of private–public relationship is another point critical to the transformation of international law. It might lead the existing treaties and rules to be replaced by voluntary standards or self–governance model by private parties.<sup>133</sup>

In the context of international investment law and trade law, the changes concerning the right to regulate also appear in investment treaties and WTO agreements. Nevertheless, in general, investment treaties have more progressive changes than WTO agreements.

*The expansion of objectives concerning sustainable development*

The influences have two features. The first is the expansion of the objectives of treaties. In WTO law, the preamble of the *WTO Establishing Agreement* indicates that the optimal use of the world's resources must be accordance with the objective of sustainable development and environmental protection and also consider particular needs and concerns. Member States in the latest Doha negotiation round restated the objective of sustainable development in line with the trade–development nexus.<sup>134</sup>

The expansion of objectives is also found in the development of investment treaties. The majority of investment treaties has expanded the objectives from investment protection to the concern of both interests of the Contracting States. Some investment treaties have included sustainable development policies such as environmental protection, public health and labour rights as the objectives to pursue

The change started in the late 2000s. However, a common form of sustainable

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<sup>133</sup> Steffen Hindeland and Markus Krajewski (eds), *Shifting Paradigms in International Investment Law: More Balanced, Less Isolated, Increasingly Diversified* (OUP 2016) 5; United Nations General Assembly (n 130) para 63.

<sup>134</sup> World Trade Organization, Ministerial declaration, WT/MIN(01)/DEC/1 (14 November 2001) available at <[https://www.wto.org/english/thewto\\_e/minist\\_e/min01\\_e/mindecl\\_e.htm](https://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm)> accessed 10 April 2019.

development policies is the preamble rather than specific provisions or explicit treaty obligations. It is evidence of the BITs led by developed countries such as Canada,<sup>135</sup> Austria,<sup>136</sup> and the European Union (EU).<sup>137</sup> Some investment treaties concluded between developing countries also join this change. For instance, Brazil has regularly included sustainable development in the preamble of its investment treaties.<sup>138</sup>

*Reservation of regulatory sovereignty in substantive content*

The second point is the reservation of regulatory autonomy in the substantive content. In investment treaties, the change mostly appears in the preamble. Some investment treaties appreciate the notion of the right to regulate through the preambular language. This language includes acknowledgement of the necessity of measures for public purposes and the purpose of investment protection not to be the relaxation of existing regulations or measures for the public interest.<sup>139</sup> Other BITs also directly express the notion of the right to regulate in the preamble. For instance, Article 12 of the *Mauritius–Swaziland BIT* (2000) clarifies that the Treaty does ‘not limit the right of either Contracting Party to apply prohibitions or restrictions or take any action’ for other regulatory objectives, such as the protection of the State’s essential security interests and the protection of protect human, animal or plant life, or health.

While these BITs reveal shifting attitudes respecting the adoption of regulatory

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<sup>135</sup> Sustainable development can be found in the preamble of Canada-led treaties since 2009. Those treaties are between Canada and other developing countries, including Benin, Burkina Faso, Cameroon, Côte d’Ivoire, Guinea, Jordan, Kuwait, Mali, Mongolia Nigeria, Peru, Senegal, Tanzania, Honduras.

<sup>136</sup> The Austria-signed treaties, for instance, are the Austria–Kazakhstan BIT (2010), Austria–Tajikistan BIT (2010), Austria–Nigeria BIT (2013) and Austria–Kyrgyzstan BIT (2016).

<sup>137</sup> In the EU’s investment treaties, sustainable development is a regulate part of the preamble of investment associate agreements. These agreements are concluded with the developing countries which belong to European Atomic Energy Community.

<sup>138</sup> The Brazil-involved treaties include the Brazil–Chile BIT (2015), Brazil–Colombia BIT (2015), Brazil–Malawi BIT (2015), Brazil–Mexico BIT (2015), and Brazil–Mozambique BIT (2015).

<sup>139</sup> See, e.g., Greece–United Arab Emirates BIT (2014), Preamble; United States of America–Uruguay BIT (2005), Preamble; Mozambique–Netherlands BIT (2001), Preamble; Iraq–Japan BIT (2012), Preamble; Georgia–Switzerland BIT (2014), Preamble.

measures, the preambular language raises the question of their mandatory effects. Some commentators argue that this language respecting regulatory autonomy and public purposes are more like soft obligations.<sup>140</sup> It means that the Contracting States are only required to do their best. The violation of these requirements will not cause legal consequences and state responsibility. As such, Catherine describes this change in recent investment treaties as ‘best efforts commitments’.<sup>141</sup>

By contrast, WTO agreements indeed insert the notion of the right to regulate in the substantive content. First, the notion of a right to regulate is materialised by the principle of progressive liberalisation.<sup>142</sup> While the WTO system serves the liberalisation of trade and economic factors, it also acknowledges trade liberalisation involving social, regulatory and industrial adjustments. While open markets can be beneficial to member States, but the openness means a change of the industrial and economic environment. The adjustments are the costs of a country facing global completion.<sup>143</sup> As such, the principle of progressive liberalisation has two meanings. First, it gives member States the discretion to decide the scope and scale of trade concessions in light of their respective needs and concerns at different levels of economic development. Second, it leaves member States the time and the discretion for necessary adjustments for more profound economic interdependence and intense competition.

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<sup>140</sup> Andrew Newcombe and Lluís Paradell (n 54) 509; Peter Muchlinski, ‘Trends in International Investment Agreements: Balancing Investor Rights and the Right to Regulate: The Issue of National Security’ (2009) in Karl P. Sauvant (ed), *Yearbook on International Investment Law and Policy 2008–9* (OUP 2009) 48.

<sup>141</sup> Catherine Titi, *The Right to Regulate in International Investment Law* (Nomos/Hart 2014) 104–105.

<sup>142</sup> Rüdiger Wolfrum, Peter–Tobias Stoll and Clemens Feinäugle, ‘Progressive Liberalization’ in Rüdiger Wolfrum, Peter–Tobias Stoll and Clemens Feinäugle (eds), *WTO–Trade in Services* (Brill/Nijhoff 2008) 433.

<sup>143</sup> World Trade Organization, *Understanding the WTO* (2015) 11.

Second, the notion of the right to regulate is also embodied in the provisions respecting technical standards of products or sanitary and phytosanitary measures. The *Agreement on the Application of Sanitary and Phytosanitary Measures* ('SPS Agreement') and the *Agreement on Technical Barriers to Trade* ('TBT Agreement') recognise the administrative needs to protect human, animal or plant life or health<sup>144</sup> or to protect the environment and prevent deceptive practices.<sup>145</sup> However, the exercise of regulatory sovereignty is not unlimited. The limits to the adoption of regulatory measures are defined by a series of legal requirements in the two agreements. These requirements are part of Member States' substantive obligations rather than exceptions for state responsibility. In this respect, it is the obligations of WTO members to exercise the right to regulate legally in the two agreements.

Another approach to reserve regulatory sovereignty is exceptions. Exception provisions can exempt treaty obligations in general or only exclude specific situations from the governance of a treaty. Compared investment treaties and WTO agreements, the second approach is not common to investment treaties.

It is not the tradition of investment treaties to negotiate general exceptions or specific exceptional clause. The custom is illustrated by the absolute obligation of compensation for expropriatory actions. It also explains why the distinction between lawful and unlawful expropriations does not give rise to significant differences in legal consequences. The lack of general exceptions for obligations of investment protections is one of the reasons why investment agreements are questioned as over-restriction and

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<sup>144</sup> The *SPS Agreement*, Preamble ('Reaffirming that no Member should be prevented from adopting or enforcing measures necessary to protect human, animal or plant life or health...').

<sup>145</sup> The *TBT Agreement*, Preamble ('Recognizing that no country should be prevented from taking measures necessary to ensure the quality of its exports, or for the protection of human, animal or plant life or health, of the environment, or for the prevention of deceptive practices, at the levels it considers appropriate...').

intervene with host governments' regulatory autonomy.

However, the situation has changed. More and more BITs provide general exception provisions or specific exceptions. For instance, the *Canada–Costa Rica BIT* (1998) and the *Canada–Latvia BIT* (2009) offer general exceptions to substantive obligations relating to the protection of foreign investment.<sup>146</sup> These provisions usually protect public health, environmental protection and national security interests as the grounds for exceptions.

In contrast to investment treaties, general exceptions are an essential part of WTO agreements. In the two pillars of the multilateral trading system, the GATT and GATS both leave the necessary space for national sovereignty. Article XX of the GATT stipulates a list of exceptional situations for a member State to exempt its responsibility from trade commitments and general obligations under this agreement. Article XIV of the GATS also provides general exceptions for the Member States. These provisions clarify the point that participating States are not deprived of their regulatory powers by joining WTO agreements.

These general exceptions share common requirements to define legitimate exceptions. The requirements include the non-discriminatory exercise, the existence of public interests and the requirement of necessity. These requirements prevent member States from regulatory measures as disguised restrictions on international trade.

## 1.6. Conclusion

History shows that international investment and trade law share convergences in

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<sup>146</sup> Canada–Costa Rica BIT (1998), Annex I ('General and Specific Exceptions'); Canada–Latvia BIT (2009), Article XVII ('Application and General Exception').

developing patterns. The convergences, however, do not diminish the rise of divergences. The lack of a multilateral convention of investment law and central institutions for administration and dispute settlements, as well as essential principles, all contribute to the separation of international investment law and trade law.

While international investment law and trade law are two independent branches of international law, the convergences and divergences between the two regimes both remark the changes of international law in general. On one side, international law is dominated by treaties and international institutions. On the other side, the proliferation of treaties and the creation of international institutions stimulates the fragmentation of international law.

Under the parallel developments, the thesis argues that political ideologies influence the overall trend of international law. The political ideologies concerning the role of government on the market explain the changes in international investment law and trade law on the textual and institutional aspects.

Liberal economic policies under neoliberalism and sustainable development policies explain a shift of international law from suspicion of the role of government toward respect of regulatory interests for non-economic interests. The shifting ideologies led international investment law and trade law adjusting the restrictions of sovereignty.

Moreover, sustainable development promotes an inclusive and balanced concern. The ideology also stimulates investment treaties and GATT/WTO agreements to review the relationship between the treaty parties and to refine the boundaries of regulatory sovereignty for non-economic interests.

The relation of political ideologies and international governance is critical to the



relationship between international investment law and trade law. While international investment law and trade law are developing legal principles and practices in line with their conditions, they still can find the ground to exchange experiences to shape common understandings for the same goal.

Besides the development of treaties, does the synchronous development between individual regimes and the international law system appear in practice as well? In addition, to what extent the existing differences between international investment law and trade law, including the nature of treaties, legal principles, the textual arrangement and institutional design, results in different experiences of dispute settlement?

To search the right answer must ask the right question. These issues are critical to understanding the application of the balancing approach in investor–State arbitration and the WTO jurisprudence. They can help us clarify whether different experiences are a problem of adjudicators’ behaviours or a result of the existing divergences between investment treaties and WTO agreements. If the difference is a problem of judicial review, a cross–reference of judicial experiences could be useful advice. If the difference is a result which is rooted in the divergences of international investment law and trade law, a cross–reference of judicial experiences or the pursuit of a standard practice would be unhelpful.

The next chapter will explore the application of the balancing approach in the two regimes separately and then address these issues through a comparative study.

## **Chapter Two**

### **Treaty Interpretation of Investor–State Arbitration and the Balancing Approach**

#### **2.1 Introduction**

The following chapters focus on the practice of international investment law and trade law, i.e. WTO law. The specific issue is whether the balancing concern emerged in practice and how it applied for treaty interpretation and dispute settlements.

Except for the application of the balancing concern in specific, this study also tends to explore the development of international adjudication in terms of treaty interpretation. Exploring the general picture of international adjudication enables us to understand the role of the balancing concern and its implications. Therefore, three issues will be addressed to analyse the case study of investment disputes and WTO disputes. The three specific issues are: what is the general pattern of treaty interpretation that international adjudicators adopted in different jurisdictions? Is the pattern continued or adjusted along with the changes of interpretative approaches? What is the role of the balancing approach in the continuity and change of interpretative approaches?

This chapter discusses the practice of international investment law. It contains three parts. The first part outlines the general interpretative pattern of arbitral tribunals. It categorises different situations in line with the interpretative elements provided by the 1969 *Vienna Convention on the Law of Treaties* ('the *Vienna Convention*' or the 'VCLT'). Because of the different situations, it argues that the interpretative pattern of investment arbitrators is flexible and lack of standard practice. In the second part, it explains how interpretative approaches impact the determination of the boundaries of regulatory sovereignty. It concentrates on two rules, i.e. expropriation clause and fair

and equitable treatment (FET). The last part advances the discussion of interpretative approaches on specific rules. It analyses the emergence of the balancing approach and its practical implications. It argues that the application of the balancing approach echoing the flexibility of treaty interpretation by investment arbitrators. The flexibility, nevertheless, raises the concerns about the quality of reasoning and consistency of interpretation results.

## 2.2 The research method

Before entering into the analyses, the study needs to explain the research methodology at this stage. It discusses the practice of international investment law by exploring the cases of investor–State arbitration. The main reason is the effectiveness of investor–State arbitration in international investment law.

Since the *Italy–Chad Bilateral Investment Treaty (BIT)* (1969) first provided provisions about the settlement of disputes between foreign investors and host governments; the investor–State dispute settlement mechanism has become an important instrument for investment protection. These provisions respecting investor–State dispute settlement mark a significant difference between the early BITs and modern BITs (especially those concluded starting in the 1990s). More importantly, they signify that investor–State disputes are shifting from diplomatic protection toward international arbitration.<sup>147</sup>

While there is a range of resolution approaches to settle disputes between foreign investors and host governments, international arbitration is the most popular. Since the

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<sup>147</sup> Anthea Roberts divides the evolution of investment treaties into three generations. In her categories, the investment treaties concluded in the 1990s are the second generation of BITs. Anthea Roberts, ‘State–to–State Investment Treaty Arbitration: A Hybrid Theory of Interdependent Rights and Shared Interpretive Authority’ (2014) 55 *Harvard Journal of International Law* 4–5.

International Centre for Settlement of Investment Disputes (ICSID) recorded the first investor–State dispute based on BITs in 1987,<sup>148</sup> the number of investor–State arbitrations has been annually growing multiple times over.<sup>149</sup> The average yearly number between 2006 and 2014 was nearly fifty cases. The number is still growing in the past two years, with 74 cases in 2015 and 62 cases in 2016.<sup>150</sup> While investor–State arbitration has attracted many critics as it intervenes in national sovereignty, there are no doubts that its popularity makes this mechanism critical to the implementation of investment treaties.<sup>151</sup>

Concerning the popularity of investor–State arbitration, this study decided to explore investor–State arbitral awards to discuss the development of interpretative choices and adjudicative decisions of international investment law.

This study employs the database provided by Investor–State LawGuide to collect investor–State awards. Among the hundreds of the published arbitral awards and decisions, this chapter limits its investigation to the awards which might invoke the balancing concern.

There are two sets of criteria for case selection and collection. The first set all invoke specific keywords. In order to observe the general interpretative patterns and the application of specific rules, the keywords include the interpretative rules of the VCLT, the rules of expropriation and the FET standard; and the principles of police power and legitimate expectation. The second set is about the case’s influence, i.e. the number of

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<sup>148</sup> UNCTAD, *Investor–State Disputes Arising from Investment Treaties: A Review* (UN 2005) 4.

<sup>149</sup> UNCTAD, *World Investment Report 2016 – Investor Nationality: Policy Challenges* (2016) 114.

<sup>150</sup> United Nations Conference on Trade and Development, Investment policy hub–ISDS navigator update (2016), <<http://investmentpolicyhub.unctad.org/News/Database/Home/537>> accessed 10 April 2019.

<sup>151</sup> While most investment treaties also provide international arbitration for state–to–state disputes concerning the interpretation and application of a treaty, the state–state arbitration is relatively less used by the Contracting States. Anthea Roberts (n 147) 6–7.

references to the case by other tribunals. The number of references is based on the information provided by Investor–State LawGuide. The importance of the number of references is that it indicates it is a leading case and the important legal opinion on a specific issue.

Nevertheless, the reference number has limitations to measure the influence of the legal opinions of an award. The limitation is rooted in the inherent timing–bias in that early awards are cited more times than the newer ones. Another limitation is the shortage of quantification of subjective perceptions. The reference number cannot tell the motivation of the reference of legal opinions of previous cases. In some situations, reference of previous cases means that arbitrators agreed and adopted legal opinions of the referenced case. However, there are some situations where arbitrators referred to previous cases in order to propose an alternative and opposite opinions. As such, a higher reference number is not equated with acceptance and popularities.

As to the limits of the reference number, we divide the timeline of case selection into two phases. The first phase is between 1995 and 2009; the second phase is between 2010 and 2015. The reference number is applied to the two phases in order to collect the influential legal opinions on specific rules. The separate application reduces the time–bias inherent to older awards and decisions. As to the gap between numbers and subjective perceptions, the thesis adopts case study to explore the concerns behind the reference of previous cases and the implications.

Because of the two phases of case collection, the collected awards/decisions divide into two groups. This first group is ‘big cases’. These awards or decisions were collected at the first stage without controlling for the date of dispute settlement. Seventeen awards/decisions belong to the group of big cases. Another group are the ‘follow–up

cases'. These awards were collected at the second stage, in which the date of dispute settlement fell within 2010 to 2015. This group covers fourteen awards/decisions. These awards and decisions are issued by the ICSID tribunals and ad hoc tribunals.

As a result, the discussion in this chapter based on twenty-three arbitral awards and eight decisions. The time scale covered is from 1995 to 2015.<sup>152</sup> The time scale applied to the case study of WTO law as well.

## 2.3 Patterns in treaty interpretation and the relevance of the Vienna Rules

### 2.3.1. The status of the Vienna Rules in investor–State arbitration

The interpretative rules of the *Vienna Convention* have widely regarded as the guides to treaty interpretation, namely Articles 31 and 32 (hereinafter 'the Vienna Rules').<sup>153</sup> It is a common understanding of the Vienna Rules that they codify principles of customary international law relating to treaty interpretation.<sup>154</sup> Because of the nature of customary international law, international courts and tribunals can apply the Vienna Rules to interpret any treaties regardless of the participant States having a membership to the Vienna Convention or not.<sup>155</sup>

The Vienna Rules are also widely applied in investor–State arbitration. Some arbitral tribunals acknowledge the dual nature of the Vienna Rules. For instance, the *Saluka* tribunal noted that '[it]... has to interpret Article 3 [the fair and equitable treatment] by the rules of interpretation laid down in the 1969 Vienna Convention on

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<sup>152</sup> Appendix A lists these investment arbitral awards/decisions.

<sup>153</sup> Alexander Orakhelashvili, *The Interpretation of Acts and Rules in Public International Law* (OUP 2008) 313.

<sup>154</sup> The viewpoint is supported by the International Court of Justice (ICJ). In *Guinea-Bissau v. Senegal*, the ICJ stated 'These principles are reflected in Article 31 and 32 of the Vienna Convention on the Law of Treaties, which may in many respects be considered as a codification of existing customary international law on the point'. Arbitral Award of 31 July 1989 (*Guinea-Bissau v. Senegal*) Judgment, [1991] ICJ Reports 53, at 70, para 48.

<sup>155</sup> Richard Gardiner, *Treaty Interpretation* (2nd edn, OUP 2015) 7, 17–20.

the Law of Treaties (the “Vienna Convention”). These rules are binding upon the Contracting Parties to the Treaty, and also represent the customary international law.’<sup>156</sup>

In the *Daimler v. Argentina* case, the tribunal advanced the importance of the Vienna Rules in the interpretation of investment treaties, having a systematic concern regarding the coherence of international law. In its words,

[s]ince all international treaty commitments arise from the same source (consent) all must logically be interpreted according to the same basic interpretive principles without distinction as to the type of treaty or type of commitment. This is precisely why the International Law Commission was able to codify into a single convention – with the acceptance of an overwhelming number of the world’s states the world’s states—the now customary law rules on the interpretation of treaties reflected in articles 31 and 32 of the Vienna Convention.<sup>157</sup>

Other tribunals instead apply the Vienna Rules as the general principles of international law regarding treaty interpretation. For instance, the *Noble v. Romania* award reasoned its reference to the Vienna Rules to be needed to interpret the umbrella rule of the *Romania–US BIT* (1994) (Article II(2)(c)). It believed that these provisions ‘reflect the customary international law concerning treaty interpretation’.<sup>158</sup> Accordingly, this tribunal indicated the interpretative structure. It stated that ‘treaties have to be interpreted in good faith by the ordinary meaning to be given to the terms of

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<sup>156</sup> *Saluka Investment BV v. Czech Republic* (*Saluka v. Czech*), Partial award, 27 March 2006 (Arthur Watts, Maître L. Yves Fortier, Peter Behrens) para 296.

<sup>157</sup> *Daimler v. Argentina*, Award (n 82) para 169.

<sup>158</sup> *Noble Ventures, Inc. v. Romania* (*Noble v. Romania*), ICSID Case No. ARB/01/11, Award, 12 October 2005 (Karl–Heinz Böckstiegel, Jeremy Lever, Pierre–Marie Dupuy) para 50. Likewise, the tribunal in *Mondev v. US* also expressed that ‘[t]hese are set out in Articles 31–33 of the Vienna Convention on the Law of Treaties, which for this purpose can be taken to reflect the position under customary international law’. *Mondev v. U.S.*, Award (n 62) para 43.

the treaty in their context and the light of the object and purpose of the Treaty'.<sup>159</sup>

The statement reveals the essential elements of Article 31(1) and (2) of the *Vienna Convention* that is usually used by arbitral tribunals in their interpretation of treaty terms. These elements include the text, the context, and the object and purpose of a treaty.<sup>160</sup>

### 2.3.2. The variation in the application of three interpretative elements

The Vienna Rules formulate a set of elements respecting treaty interpretation and indicate the analytical framework. Nevertheless, these rules cannot guarantee that the interpretative elements are applied consistently and produce scientifically verifiable results.<sup>161</sup> The case law of investor–State arbitration shows the variation in the application of these interpretative elements of the Vienna Rules. The variation ranges from a full application of the three elements to a short version of the application of these elements to non–application. A main reason for the variation is the ‘open–textured nature’ of these interpretative principles and elements.<sup>162</sup>

On the other hand, the variation of the application of interpretative elements indicates the structured degree. The situations of the interpretative structure range from a well–structured interpretation to a semi–structured interpretation to an unstructured interpretation.

The practice of investor–State arbitration reveals that to a large extent the application of interpretative elements leaves much to the discretion of arbitral tribunals, depending upon the experience of the arbitrators. The following sections introduce the three types of interpretive elements and the relation between their application and the

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<sup>159</sup> *Noble v. Romania*, Award (n 158) para 50.

<sup>160</sup> Ole Kristian Fauchald, ‘The Legal Reasoning of ICSID Tribunals—An Empirical Analysis’ (2008) 19(2) *European Journal of International Law* 304.

<sup>161</sup> Alexander Orakhelashvili (n 153) 309–10.

<sup>162</sup> Federico Ortino, ‘Investment treaties, sustainable development and reasonableness review: a case against strict proportionality balancing’ (2017) 30 *Leiden Journal of International Law* 71, 74.



interpretative structure.

### 2.3.2.1. A full application of three interpretative elements and the structured interpretations

Article 31(1) and (2) of the *Vienna Convention* provides three elements to determine the legal meaning of a treaty term or rule. The three elements suggest treaty interpretation starting with the texts and giving the ordinary meaning of the terms in their context and the object and purpose of the treaty. These elements indicate a logical way in which interpreters define and ascertain the legal meaning of a treaty term or legal principle. As such, a full application of the three elements up to a certain point guarantees the interpretative results from a structured analysis.

The *Methanex v. U.S.* award exemplifies the relationship between the full application of the three interpretative elements and the degree of structure to the argument.<sup>163</sup>

The *Methanex v. U.S.* award was an NFATA case. It arose out of the state of California's ban on the use and sale of the gasoline additive MTBE. As a primary supplier of methanol products, the Methanex company claimed that California's measures impacted its business of methanol production because methanol is an ingredient of manufacturing MTBE. As such, it invoked Article 1101(1) of NAFTA to argue its business was within the scope of the investments protected by NAFTA and was infringed upon by America's inconsistent measures, claiming compensation for its damages.

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<sup>163</sup> *Methanex Corp. v. United States of America* ('*Methanex v. U.S.*'), Partial Award, 7 August 2002 (V. V. Veeder, William Rowley, Warren Christopher).

Article 1101(1) of NAFTA defines the scope of the investment chapter (Chapter 11 NAFTA). This provision provides the term ‘relating to’ to control the scope of protected investments and investors. However, neither this provision nor the investment chapter gives a precise definition of the term ‘relating to’.

The *Methanex* tribunal started its interpretation by the plain meaning of ‘relating to’. The tribunal first referred to English dictionaries to define the word ‘relating’. However, it noticed the difference between a purely semantic meaning and the legal meaning of a word.<sup>164</sup> As such, this tribunal moved to the second stage, i.e. the elements of the context and the object and purpose of the investment chapter of NAFTA.

In consideration of the elements ‘context’ and ‘object and purpose’, the *Methanex* tribunal distinguished the element of context and the element of object and purposes. As to the ‘context’, this tribunal agreed with the investor’s assertion that Chapter 11 is the context in which Article 1101 is interpreted. However, it disagreed with the claimant’s opinion that the context of Chapter 11 led to a broad interpretation of the object and purpose of this Treaty Chapter.

As to the argument of the claimed investor that Chapter 11 had the aim of pursuing protection of investment protection, this tribunal believed the protection was not unlimited.<sup>165</sup> There must be limitations to the object and purpose of investment protection; otherwise, the extensive interpretation would produce a surprising result.<sup>166</sup> In this respect, the *Methanex* tribunal accepted the USA’s assertion of a reasonable limitation to the purpose of investment protection. As such, it interpreted the term ‘relating to’ as ‘a legally significant connection between the measure and the investor

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<sup>164</sup> Ibid, paras 135–36.

<sup>165</sup> Ibid, paras 137–38.

<sup>166</sup> Ibid, paras 138–39.

or the investment’.<sup>167</sup>

The statements relating to the term ‘relating to’ in the *Methanex v. U.S.* award exemplify a full application of the three interpretative elements. Moreover, it reveals that a full application contributes to the logical and rational structure in which interpretation results are produced.

The *Methanex* tribunal expressed in its reasoning that the interpretation of Article 1101 relied on the application of Article 31 of the Vienna Convention,<sup>168</sup> i.e. the three elements (text, the context, and the object and purpose of a treaty). It further indicated the textual grounds for the application of these Vienna Rules. This tribunal invoked Article 1131(1) NAFTA and Article 33(1) of the *UNCITRAL Arbitration Rules*.<sup>169</sup>

2.3.2.2. A short version of the application by merging the elements ‘the context’ and ‘the object and purpose’

While the full application of the three interpretative elements favours the rationality and the structure of treaty interpretation, however, not all arbitral tribunals have employed this method. Another popular situation is a short version of considering these interpretive elements. The short version of consideration often results from merging the elements ‘context’ and ‘object and purpose’ in consideration of the preamble of a treaty. The *Abaclat v. Argentina* award is an example.

The *Abaclat v. Argentina* case resulted in Argentina’s default of its debt and suspension of the payment on its sovereign bonds in 2001. While in 2005 Argentina launched a voluntary exchange offer for the defaulted bonds, there were bondholders,

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<sup>167</sup> Ibid, para 139.

<sup>168</sup> Ibid, para 147.

<sup>169</sup> Ibid, para 100.

initially numbering 180,000, who declined to participate in the exchange offer and filed a request for Arbitration with ICSID. In the end, over 60,000 Italian bondholders brought this mass claim.

One of the argued issues was the validity of the claimant's consent to the investor–State arbitration in the sense of Article 25(1) of the *ICSID Convention*. Article 8 of the *Italy–Argentina BIT* (1990), in particular paragraph (3), contemplates 'the parties' consent required under Article 25(1) of the ICSID Convention'.<sup>170</sup> The Respondent State asserted that Article 8 provides a mandatory three–step dispute resolution, which is supported by the conditions and requirements of Article 8(3) and 8(4). Especially Article 8(3) sets an 18–month timing–limitation for the initiation of an investor–State arbitration. In contrast, the claimed party contended that Article 8 aims to provide investors with different options of dispute resolution and does not institute a compulsory multi–layered, sequential dispute resolution system.<sup>171</sup>

As to the issue of the nature of investor–State dispute settlements, the *Abaclat* tribunal first indicated the Vienna Rules (Articles 31 and 32) as the guide to the interpretation of the relevant treaty rules.

With regard to the specific timing requirement of investor–State arbitration (Article 8(3)), the tribunal first examined the order, structure and wording of Article 8. It found that the text of this provision 'clearly indicate[s] that these three dispute resolution means were interconnected to some extent'. It believed that Article 8 did not aim to grant the freedom for the disputing parties to pick any of the means at any time. As such, the tribunal interpreted the meaning of Article 8 as creating an integrated

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<sup>170</sup> *Abaclat and others (formerly Giovanna A. Beccara and others) v. Argentina* ('*Abaclat v. Argentina*'), ICSID Case No. ARB/07/5, Decision on jurisdiction and admissibility, 4 August 2011 (Pierre Tercier, Georges Abi–Saab, Albert Jan van den Berg) para 430.

<sup>171</sup> *Ibid*, paras 556, 558.

system that contains a certain hierarchy or order of the three interconnected approaches of dispute resolution.<sup>172</sup>

The *Abaclat* tribunal instead noted that the wording of Article 8 of the BIT itself does not suffice to draw specific conclusions about the consequence of non-compliance.<sup>173</sup> As such, the tribunal moved to the elements of ‘context’ and ‘object and purpose’ to interpret the legal consequences of Article 8.

At the stage of the elements of context and object and purpose, the *Abaclat* tribunal has different practices from that of the *Methanex* tribunal. As we mentioned above, the *Methanex* tribunal referred, to determine the context of the treaty term, to the investment chapter of NAFTA. In this case, the *Abaclat* tribunal did not specify the context in which either Article 8 or the specific 18-month timing requirement located. As to the element of object and purpose, it narrowed the horizon to Article 8 itself.<sup>174</sup>

This tribunal interpreted the purpose of Article 8 as providing the disputing parties with a fair and efficient dispute settlement mechanism. As such, it indicated two principles, i.e. fairness and efficiency were essential to the interpretation and determination of whether this system is supposed to work and what the consequence is when the requirements were failed.<sup>175</sup>

However, the tribunal did not directly apply the interpretation results regarding the object and purpose of Article 8 to the specific requirement of the 18-month timing limitation. Instead, it further examined the object and purpose of this specific requirement. It interpreted that this requirement aimed to give the host government ‘the

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<sup>172</sup> Ibid, para 578.

<sup>173</sup> Ibid, para 579.

<sup>174</sup> Ibid.

<sup>175</sup> Ibid.

opportunity to address the allegedly wrongful act within the framework of its domestic legal system and to provide a chance to resolve the dispute in a potentially shorter period than international arbitration'.<sup>176</sup>

The interpretation results implicated the focus of consideration shifting from the perspective of investment protection to the perspective of giving appreciation to the host government. In respect, the point to evaluate the failure of the 18-month requirement is not whether the claimed investors are deprived of the right to access to justice. The real issue is whether Argentina was deprived of a fair opportunity to address the dispute within its domestic legal system because of Claimants' failure to meet the 18-month litigation requirement.<sup>177</sup> The shift of considering factor is the reflection of the balancing concern by the *Abaclat* tribunal.<sup>178</sup>

The *Abaclat v. Argentina* award in terms of the balancing concern has several implications. First, it reveals that the substance of the interpretative elements 'context' and 'object and purpose' varies case by case. The substance to some extent depends upon the legal issues in dispute and the specific terms subject to interpretation. Second, it reveals that the interpretative element of object and purpose might not be to confirm the legal meaning of a treaty term. Instead, it might contribute to determining the legal consequence of the rule.

The last point is about the distinction between the elements of context and object and purposes. McLachlan rightly points out that the two elements are usually merged to the preambular statements of a treaty. It is a common practice that arbitral tribunals do not explain the substance of the two elements in detail. As such, he questions the

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<sup>176</sup> *Abaclat v. Argentina*, Decision on jurisdiction and admissibility (n 170) para 581.

<sup>177</sup> *Ibid.*

<sup>178</sup> *Ibid.*, para 582.

determination of the element of object and purpose usually as a deceptive action.<sup>179</sup> The ambiguity of the element of context can be found in the *Abaclat v. Argentina* award. The recourse to the preamble to identify the object and purpose of a treaty is evidence of the *Methanex v. U.S.* award.

Alternatively, about the interpretative process, the *Abaclat* tribunal advanced the role of the element ‘object and purpose’. This tribunal divided the element of object and purpose into two lines. One is about the general purpose of Article 8 as the creation of an investor–State dispute settlement mechanism for the Italy–Argentina BIT. Another dimension is about the purpose of each specific legal requirement. The *Abaclat* tribunal then decided that the interpretation of treaty terms and requirements must in line with the balancing concern. The balancing concern, from the tribunal’s viewpoint, is the balance between the interests of foreign investors and the interests of the host government in the disputing framework.

The later sections will discuss the difference between the *Abaclat v. Argentina* award and other awards on the way to introduce the balancing concern.

#### 2.3.2.3. The unstructured interpretations

The last situation possible happens in the treaty interpretation is an unstructured interpretative process. It means that the interpretation results are produced not in a structured way. Compared with the former situations, the main reason for the structure of the interpretative process is the integrity of interpretative elements of the Vienna Rules.

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<sup>179</sup> Campbell McLachlan, ‘Investment treaties and general international law’ (2008) 57(2) ICSID Review 361, 371.

For instance, the tribunal in *Waste Management v. Mexico* neither indicated the interpretative principles nor rules in its interpretation of Article 1110 of NAFTA (the expropriation rule). Nor in its reasoning did it expressed the interpretative elements relevant to the determination of the concept of indirect expropriation.<sup>180</sup> This tribunal first directly interpreted this provision distinguishing direct or indirect expropriation and measures tantamount to expropriation. An indirect expropriation is still taking of property.<sup>181</sup> The tribunal also considered the textual structure of Article 1110 before reaching the interpretation result. It believed that Article 1110 has a connection with other provisions such as the phrase of ‘tantamount to nationalisation or expropriation’ of Article 1110(1) and the content of Article 1110(8) to interpret that Article 1110. These provisions instead contained a relatively broader scope by the term ‘tantamount to an expropriation’.<sup>182</sup>

Likewise, the *ADC v. Hungary* case was a claim arising from the construction and renovation of the airport terminals that was taken over by the Minister of Transport of Hungary. The investors contended Hungary’s governmental intervention amounted to expropriatory actions without compensation. The *ADC* tribunal did not express or indicate interpretative elements or rules relevant to the determination of expropriatory actions.<sup>183</sup> While the Respondent State contended that there is a distinction between the terms of deprivation and expropriation in terms of the meaning and scope, the tribunal believed that the language of Article 4 (the rule of expropriation) of the *Cyprus–Hungary BIT* (1989) was straightforward. In its words, ‘Article 4 says what it says, and there is no room for the Respondent to challenge its broad scope of coverage nor to read

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<sup>180</sup> *Waste Management v. United Mexican States* (*Waste Management v. Mexico*), ICSID Case No ARB(AF)/00/3, Award, 30 April 2004 (James Crawford, Benjamin R. Civiletti, Eduardo Magallón Gómez) paras 141–44.

<sup>181</sup> *Ibid.*, para 143.

<sup>182</sup> *Ibid.*, para 144.

<sup>183</sup> *ADC Affiliate and ADC v. The Republic of Hungary* (*ADC v. Hungary*), ICSID Case No. ARB/03/16, Award, 2 Oct 2006 (Neil Kaplan, Charles Brower, Albert Jan van den Berg) paras 426–45.



it down’.<sup>184</sup>

In the application of specific requirements of Article 4, the *ADC* tribunal did not give explanations of the meaning of treaty terms, i.e. ‘public interest’, ‘due process of law’ and ‘non–discrimination’. Nor did it explain the relevance of the other interpretative elements ‘context’ and ‘object and purpose’ toward the meaning of these legal requirements.<sup>185</sup>

Taking a close look at the reasoning, the statements reveal two approaches that are employed by arbitral tribunals to interpret and apply a treaty rule to a dispute. One approach is a reference to legal opinions of precedent awards or the practice of international law. For instance, in the *Waste Management v. Mexico* award, the tribunal noted the jurisprudence of NAFTA tribunals regarding the meaning of Article 1110 in terms of the word ‘tantamount to’.<sup>186</sup> It had recourse to the tribunals in *Pope & Talbot v. Canada*, *S.D. Myers v. Canada*, and *Metalclad v. Mexico*.<sup>187</sup>

After examining the way that these precedent tribunals interpreted and applied the term ‘tantamount to’, the *Waste Management* tribunal concluded that there was no need to reach conclusions about the meaning of this phrase. It rested its decision on the emphasis of the fact–specific analysis in the determination of regulatory taking.<sup>188</sup> These statements show that the reference to precedent cases is not employed to clarify the meaning of a treaty term but to confirm the decision made by the tribunal.

Another reason for the unstructured interpretive process is the point–by–point or issue–by–issue analysis. It means that a tribunal does not interpret a treaty term or a rule

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<sup>184</sup> Ibid, para 426.

<sup>185</sup> Ibid, paras 429–43.

<sup>186</sup> *Waste Management v. Mexico*, Award (n 180) paras 145–55.

<sup>187</sup> Ibid, paras 150–54.

<sup>188</sup> Ibid, para 155.

within it in terms of the treaty as a whole. Rather, the tribunal expresses its legal opinions in line with the legal issues or assertions argued by both disputing parties. The *ADC v. Hungary* award exemplifies this approach.

With regard to the issue of the existence of expropriatory actions, the *ADC* tribunal gave no detailed reasons and directly stated that the measures disputed in this case were obviously within the scope of Article 4 of the BIT. It also stated a strong belief that there was ‘no room for the Respondent to challenge [the] broad scope of coverage of [Article 4]’.<sup>189</sup>

What is interesting is just before the issue of expropriation, the *ADC* tribunal clarified its position towards the State’s right to regulate under the FET standard. It stressed that a State does not enjoy an unlimited right to regulate its domestic economic and legal affairs. For States having concluded an investment treaty, this tribunal believed that the treaty obligation of investment protection is binding.<sup>190</sup>

These statements imply that the *ADC* tribunal interpreted investment protection as the primary objective of the *1989 Cyprus–Hungary BIT*. The investment protection objective set the boundaries in the Contracting States, i.e. the respondent party of this case, of the right to regulate. The interpretational result in respect to the purpose of the treaty in dispute is supposed to have a contribution to the interpretation of the rule of expropriation regarding its meaning and scope.

However, the connection was absent in its reasoning regarding Article 4 (the expropriation rule). On the contrary, the *ADC* tribunal addressed the application of the rule of expropriation by the point-by-point approach. Except for the result of the broad scope of Article 4, the tribunal did not link the application of each requirement of this

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<sup>189</sup> *ADC v. Hungary*, Award (n 183) para 426.

<sup>190</sup> *Ibid.*

provision to the general meaning of expropriation, nor connect it to the investment protection objective of the treaty.

These cases demonstrate that the structure for treaty interpretation relies on the integrity of interpretive elements. The comprehension of interpretative elements also affects the rationality of the interpretation result. The rationality of interpretation results primary depends upon whether the relationship between the interpretative elements and the results exists or not. The relationship is the issue of the next section.

#### 2.3.2.4. The interpretative structure and the quality of reasoning

The Vienna Rules formulate a definitive set of elements of treaty interpretation. These interpretative elements form an analysis framework.<sup>191</sup> An analysis framework is a useful tool for interpreters in approaching the legal meaning and legal consequences of a treaty rule. The guiding effects on the formulation of interpretation results explain the critical role of the Vienna Rules.

It is a fact that the same rules could be approached differently. The experiences, professional backgrounds and personal preferences of interpreters are all influential toward the results.<sup>192</sup> As such, variations in the application of the suggested interpretative elements is not an issue.<sup>193</sup>

A real question is to what extent the integrity of the interpretative structure can guarantee the quality of the legal reasoning. The quality of reasoning means the rationality, persuasiveness and credibility of the reasons. The issue to this question is

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<sup>191</sup> Alexander Orakhelashvili (n 153) 309–10.

<sup>192</sup> Jan Klabbbers, ‘Virtuous Interpretation’ in Malgosia Fitzmaurice, Olufemi Elias and Panos Merkouris (eds), *Treaty Interpretation and the Vienna Convention on the Law of Treaties: 30 Years On* (Nartinus Nijhoff 2010) 31, 35.

<sup>193</sup> The term of ‘regime’ here follows a broad definition. It refers to the rules provided by treaties and shared norms and principles among tribunals and decision makers in a given area of international relations.

the ambiguous position of the interpretative element ‘context’.

Article 31 of the *Vienna Convention* does not give a precise definition or exemplification of the element ‘the context’. Commentators continue to attempt to clarify the meaning of the element ‘the context of a rule’ and confirm its function in treaty interpretation. For instance, Gardiner argues that this element has two functions. It is useful for either selecting the appropriate meanings from multiple possible interpretations or modifying the outcomes of a strictly literal interpretation.<sup>194</sup> Orakhelashvili highlights its function on the coherence of interpretation outcomes instead. He believes that the element ‘the context’ enables interpreters to pay due consideration to the rule as a whole.<sup>195</sup>

While these suggestions address the different dimension of the element ‘context’, they share a similar understanding. The ‘context’ in which a term or a rule located is essential to the appropriateness and accountability of interpretation results.

In this respect, comparing the *ADC v. Hungary* award with other two awards (*Methanex v. the U.S.* and *Abaclat v. Argentina*), the reasoning of the *ADC v. Hungary* award is less rational and persuasive than the other two. While the difference in part results from the integrity of the interpretative elements, a major reason is a context in which the interpretation results are grounded. The *ADC* tribunal did not give the context in which the broad scope of the expropriation rule originated, as well as the dominant position of the investment protection objective.

In contrast, while the *Abaclat* tribunal did not specify the context of the procedural rules in the application, the reasoning implicates that the interpretation results are placed within the investor–State dispute settlement mechanism as a whole. The interpretation

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<sup>194</sup> Richard Gardiner (n 155) 197; Alexander Orakhelashvili (n 153) 339.

<sup>195</sup> Alexander Orakhelashvili (n 153) 340–41.

results in a broad context that could be modified by a specific context in which each legal requirement is located.

Applying the two–layered contextual analysis by the *Abaclat* tribunal to examine *ADC v. Hungary* award, one could say that the *ADC* tribunal’s legal opinion that ‘no room for the Respondent to challenge [the] broad scope of coverage of [Article 4]’,<sup>196</sup> is questionable.

## 2.4 Interpretative approaches and the concern of host State interests

### 2.4.1. The determination of indirect expropriation

The history of investment treaties shows that the idea of prohibition of expropriations by host governments to a large extent motivated the development of the treaty rules. The essential concern of the issue of expropriation, however, has changed over time.

The rule of expropriation originated from the concern for the protection of the properties of aliens, then was influenced by liberal economic policies to focus on the governmental interventions against the interests of foreign investors and investments.<sup>197</sup> The changing concern also influences the scope of the rule of expropriation. Investment treaties have witnessed the expansion of the scope of the rule of expropriation from direct expropriatory actions to indirect expropriation and regulatory taking. The changes led arbitral tribunals to adjust interpretative approaches in response to the new reality and the issue of indirect expropriation.

There are two main interpretative approaches for the determination of expropriatory actions: the sole–effect approach and the doctrine of police power. A

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<sup>196</sup> *ADC v. Hungary*, Award (n 183) para 426.

<sup>197</sup> See the discussion in section 1.4.1 of chapter one.

significant difference between the two interpretative approaches is whether the policy objective of governmental actions is considered in decision making.

#### 2.4.1.1. The sole-effect approach

As to the issue of the determination of expropriatory actions, a traditional approach is to examine the effects of governmental actions or measures on the investor's property.<sup>198</sup> While other elements such as the form, intent and objective of the governmental actions are also relevant to the determination, they are not decisive.

The emphasis on the effects of government interventions or measures on foreigners' properties has two meanings. First, it is the common practice of international law. Second, it is an important instrument to expand the scope of expropriation to indirect expropriation. For instance, Article 5 of the *Argentina–United Kingdom BIT* (1990) uses the phrase 'measures affecting equivalent to nationalisation or expropriation' to refer to indirect expropriation. Likewise, Article VIII of the *Armenia–Canada BIT* (1997) also employs the same language to define indirect expropriation.<sup>199</sup>

The arbitral tribunal in practice also applies the effect-centric approach. For instance, the tribunal in *Metaclad v. Mexico* interpreted the concept of indirect expropriation of NAFTA as 'incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use of reasonably-to-be-expected economic benefit of property'.<sup>200</sup> Likewise, in the interpretation of the expropriation rule of the *Mexico–Spain BIT* (1996), the *Tecmed* tribunal also indicated a critical element to determine whether the claimed investor was

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<sup>198</sup> Andrew Newcombe, 'The boundaries of regulatory expropriation in international law' in Philippe Kahn and Thomas Wälde (eds), *New Aspects of International Investment Law* (Brill/Nijhoff 2007) 401.

<sup>199</sup> Article VIII of the *Armenia–Canada BIT* (1997) ('... subjected to measures having an effect equivalent to nationalization or expropriation').

<sup>200</sup> *Metaclad Corp. v. Mexico* ('*Metaclad v. Mexico*'), ICSID Case No. ARB(AF)/97/1, Award, 30 Aug 2000 (Elihu Lauterpacht, Benjamin R. Civiletti, José Luis Siqueiros) para 103.

deprived of the economical use and enjoyment of its investments is the effects. The effects are addressed by two points: (i) whether the assets involved have lost their value or economic use of their holder; and (ii) the extent of the loss.<sup>201</sup>

These cases demonstrate that the effects of government actions at issue are detrimental to the assessment. It explains why practitioners refer to this approach to the sole–effect approach.<sup>202</sup>

Besides the expansion of the scope of expropriation to regulatory measures, the sole–effect approach is evolved by the expansion of the scope of investment. Many investment treaties define the protected investment by including the physical properties and assets and intangible economic rights, values and beneficial use. As such, the factor ‘effects of governmental actions’ is characterised by two sub–issues: the affected object and the effect scale.<sup>203</sup>

As to the first sub–issue of the affected object, the case law has developed a range of interests of investors that might be capable of being expropriated. The affected object argued in cases include the legal title and ownership of the property, the management and physical control of the investment,<sup>204</sup> beneficial/economic use and economic rights of the investment,<sup>205</sup> and legitimate expectations of continuing the business activity<sup>206</sup>.

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<sup>201</sup> *Tecmed v. Mexico*, Award (n 82) (Horacio A. Grigera Naon, José Carlos Fernandez Rozas, Gabriela Alvarez Avila), para 115.

<sup>202</sup> Andrew Newcombe (n 198) 401.

<sup>203</sup> Esmé Shirlow, ‘Deference and indirect expropriation analysis in international investment law: Observations on current approaches and frameworks for future analysis’ (2014) 29(3) ICSID Review–Foreign Investment Law Journal 595, 616.

<sup>204</sup> *Marvin Roy Feldman Karpa v. United Mexican States*, ICSID Case No. ARB(AF)/99/1 (also known as ‘*Marvin Feldman v. Mexico*’), Award, 16 December 2002 (Konstantinos D. Kerameus, Jorge Covarrubias Bravo, David A. Gantz) para 108–9, 113; *Cargill, Incorporated v. United Mexican States* (‘*Cargill v. U.S.*’), ICSID Case No. ARB(AF)/05/2, Award, 18 September 2009 (Michael C. Pryles, David D. Caron, Donald M. McRae) para 360–8.

<sup>205</sup> *Tecmed v. Mexico*, Award (n 82) para 115.

<sup>206</sup> *International Thunderbird Gaming Corporation v. The United Mexican States* (‘*Thunderbird v. Mexico*’), UNCITRAL, Award 26 January 2006 (Lic. Agustín Portal Ariosa, Thomas W. Wälde, Albert Jan van den Berg), para 208; *Feldman v. Mexico* (n 59), para 179; *CME Czech Republic B.V. v. The Czech*

About the second issue, the effect scale, tribunals have developed several degrees of harm. The scale ranges from the total or substantial intervention<sup>207</sup> or to some other ‘more than minimal degree’ of impairment.<sup>208</sup>

While the two issues are considered separately, they are often combined to characterise the ‘effect’ of a measure. For instance, the *Metaclad* tribunal found the existence of expropriatory actions even though the claimed investor still maintained legal title and physical control of the investments in question. The tribunal reasoned this decision by finding that the measure deprived the claimant of ‘all beneficial use’ of its investment.<sup>209</sup>

On the concern of investment protection, the sole–effect approach can interpret the scope of expropriation in the broadest version and provide the protection level to the maximum extent.

Nevertheless, the broader protection scale is at the cost of regulatory autonomy by the host government. The tension between investment protection and regulatory autonomy is particularly severe in the issue of regulatory expropriation. If a tribunal employs the sole–effect approach to the maximum extent, any regulatory measures even for the essential needs of social and economic orders such as taxation could be considered as expropriation due to the negative impacts. The interpretation result has an internal contradiction with the common understanding that nation–states still reserve the right to regulate even if they enter into treaties.

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*Republic* (‘*CME v. Czech Republic*’), UNCITRAL, Final award, 14 March 2003 (Wolfgang Kühn, Düsseldorf, Stephen M. Schwebel, Ian Brownlie) paras 550, 572–3.

<sup>207</sup> For instance, the *Chemtura* tribunal employed the substantial level to assess the effects of Canada’s intervenes on the claimant’s business of lindane products. *Chemtura Corporation v. Government of Canada* (‘*Chemtura v. Canada*’), UNCITRAL, Award, 02 August 2010 (Gabrielle Kaufmann-Kohler, Charles N. Brower, James R. Crawford) paras 249, 262–64.

<sup>208</sup> Esmé Shirlow (n 203) 616.

<sup>209</sup> *Metaclad v. Mexico*, Award (n 200) para 148.



The rise of the regulatory expropriation raises the role of legitimate objectives of governmental actions on final decisions. The development leads to the change of interpretative approaches. The change is the application of the doctrine of police power.

#### 2.4.1.2. The doctrine of police power

The doctrine of police power has no precise meaning and content. It may refer to all forms of domestic regulations that are the exercise of sovereign powers and exist outside (in the context of treaty interpretation) the obligations of a specific treaty. It may also only refer to the specific measure that is the justification or excuse for the duty of compensation for expropriatory actions.<sup>210</sup>

In international investment law, the doctrine of police power is mainly invoked by a host government to defend its governmental actions in the allegation of indirect expropriation.<sup>211</sup> The difference from the sole–effect approach in terms of the expropriation rule is the concern of legitimate objectives of the government actions. Specifically, the police power doctrine raises the role of legitimate objectives and public interests on the determination of an expropriation action and the compensation obligation.

While the history of the doctrine of police power in customary international law is arguable, it is accepted that the doctrine of police power reveals an important understanding. The understanding is that ‘a State is not liable for an economic injury which is a consequence of bona fide regulation within the accepted police power of States’.<sup>212</sup> This understanding of the baseline for the treatment of aliens has accepted

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<sup>210</sup> Andrew Newcombe (n 198) 417–18; Alain Pellet, ‘Chapter 32: Policy Power or the State’s Right to Regulate’ in Meg Kinnear, Geraldine Fischer, et al. (eds), *Building International Investment Law: The First 50 Years of ICSID* (Kluwer Law International 2015) 447.

<sup>211</sup> Alain Pellet, *ibid*, 448.

<sup>212</sup> Alain Pellet (n 210) 451–52, citing *Sedco, Inc. et al. v. National Iranian Oil Co. et al.*, No. ITL 55–

by international authorities such as the European Court of Human Rights (ECtHR) and the Iran–US Claims Tribunals. The doctrine of police power that was introduced and accepted by arbitral tribunals.

The main reason that investment tribunals applied the doctrine of police power was to soften the traditional conception of investment treaties. As we discussed in chapter one, during the mid–1980s mainstream political thought was dominated by liberal economic policies. The suspicion of governmental intervention in economic activities led investment treaties to be mainly concerned with the interests of foreign investors and investments.<sup>213</sup> The investment–protection–priority policy resulted from the wide acceptance of the Hull doctrine regarding the requirements of compensation for expropriation in the text, as well as the sole–effect approach in practice.

A combination of the two changes may bring the consequence that any government action that caused the effect of expropriation is considered a violation of treaty obligations and entitled to the duty of compensation for whatever purpose the action was undertaken. As such, investment tribunals employed the doctrine of police power to prevent such an extreme consequence.

For instance, the tribunal in *Marvin Feldman v. Mexico* strongly highlighted the doctrine of police power in the determination of expropriation. This case arose out of Mexico's tax laws, which targeted the export of tobacco products. The investor, an exporter of cigarettes from Mexico, contended these tax laws infringed its benefits that exporters were used to that allowed certain tax refunds and constituted the violation of expropriation without compensation.

As to the issue of the distinction between expropriation and regulation under the

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129–3, Award, 28 October 1985, 9 Iran–US C.T.R. 248.

<sup>213</sup> See the discussion in section 1.4.1 of chapter one.

expropriation rule of NAFTA (Article 1110), the *Marvin Feldman* tribunal first had recourse to the *Third Restatement of the Foreign Relations Law of the United States* (1987) to notice several elements relevant to the exclusion of the compensation obligation. These elements included the non–discriminatory and bona fide nature of taxation.<sup>214</sup> This tribunal then referenced precedent NAFTA awards in an attempt to confirm the rationale that non–compensable government actions exist, while at that time only one NAFTA award, i.e. *Metalclad v. Mexico*, had ever discussed the idea of non–compensable regulations.<sup>215</sup> Nevertheless, its decision that Mexico’s tax laws did not constitute an expropriation, however, was on grounds other than the police power doctrine.

The *Marvin Feldman* tribunal also points out that the conventional position of investment–protection–priority is changing.<sup>216</sup> Investment tribunals have gradually recognised the regulatory freedom of the States to serve public interests. The police power doctrine is also employed to justify the adverse effects of regulatory actions for the protection of public order and morality, general welfare, and the protection of human health and the environment.<sup>217</sup>

The changing position in investment tribunals is reflected by two implications caused by the police power doctrine. First, the doctrine of police power raises the awareness of the distinction between expropriation and regulation in the expropriation rule. Investment tribunals have been aware that not all forms of governmental actions that invade investment interests are amount to direct or indirect expropriation. Second,

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<sup>214</sup> *Marvin Feldman v. Mexico*, Award (n 204) paras 99, 104–106.

<sup>215</sup> *Ibid*, para 107.

<sup>216</sup> *Ibid*, para 103.

<sup>217</sup> Andrew Newcombe (n 198) 421–22; Ioannis Glinavos, 'Investor Protection v. State Regulatory Discretion: Definitions of Expropriation and Shrinking Regulatory Competence' (2011) 13(1) *European Journal of Law Reform* 97, 102.

the doctrine of police power develops the concept of non-compensable governmental actions in investment treaties.

While the doctrine of police power has been accepted as a customary law principle by arbitral tribunals, it is still arguably what the legal consequence is.

It is a common understanding in investor-State arbitration that the police power doctrine is the justification for the expropriatory effects of a regulatory measure.<sup>218</sup> For instance, the *Methanex* tribunal stated that international law does recognise the exceptions of expropriation and compensation. In its words, the general principle requires ‘a non-discriminatory regulation for a public purpose which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless 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’.<sup>219</sup> As such, this tribunal concluded that the California ban on MTBE was made for a public purpose, was non-discriminatory and was accomplished with due process. It was a legal regulation and not an expropriation.<sup>220</sup>

The *Methanex* tribunal’s reasoning seems to suggest that the police power doctrine has dual functions. One is to disqualify the expropriatory nature of the exercise of sovereign power. Another is to justify the expropriatory effects of governmental intervenes on foreign investments.

The *Chemtura v. Canada* award advances the justification scenario. While the *Chemtura* tribunal found the existence of a contractual deprivation, it determined that

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<sup>218</sup> Ursula Kriebaum (n 10) 726.

<sup>219</sup> *Methanex v. U.S.*, Final award, 3 August 2005, Part IV – Chapter D, para 7.

<sup>220</sup> *Ibid*, para 15.

these measures<sup>221</sup> were a valid exercise of the respondent's police powers.<sup>222</sup> It rested this decision on several findings, such as the PMRA (the executive agency) taking measures within its mandate and a non–discriminatory performance.

The *Chemtura* tribunal did not question the motivation of these measures as well. It instead noted the increasing awareness of the dangers presented by lindane for human health and the environment. Concerning the impacts of human health and the environment, this tribunal concluded that Canada's intervention in the sale of lindane products did not constitute an expropriation<sup>223</sup> and Canada did not breach Article 1110 of NAFTA.<sup>224</sup>

In the *Saluka v. Czech* case, the tribunal further addressed the impact of the police power doctrine on a State's responsibility for compensation. This case arose out of the intervention of Czech's state–owned bank on an investor's banking enterprise. This tribunal noted that the *Czech Republic–Netherlands BIT* (1991) does not contain any exception for the exercise of regulatory power. However, it believed that the concept of deprivation of Article 5 (the expropriation rule) 'imports' the customary international law notion.

This notion is that 'a deprivation can be justified if it results from the exercise of regulatory actions aimed at the maintenance of public order'.<sup>225</sup> In recognition of the distinction between regulations and expropriation, the *Saluka* tribunal further clarified the legal consequence is that States are not liable to pay compensation to foreign

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<sup>221</sup> This dispute arose out of Canada's ban on the agro–chemical lindane. The investor contended this measure constituted an expropriatory action, while the Canada government defended this regulation a valid (and non–compensable) exercise of police powers for the concern of human health and environmental effects. *Chemtura v. Canada*, Award (n 207) para 97.

<sup>222</sup> *Ibid*, 266.

<sup>223</sup> *Ibid*.

<sup>224</sup> *Chemtura v. Canada*, Award (n 207) para 267.

<sup>225</sup> *Saluka v. Czech Republic*, Partial award (n 156) para 254.

investors for their exercise of regulatory powers if the exercise is ‘in a non-discriminatory manner and through bona fide regulations that are aimed at the general welfare’.<sup>226</sup>

While some commentators argue that arbitral tribunals have accepted the dual function of the police power doctrine in the application of the expropriation rule,<sup>227</sup> some tribunals still take a relatively restrictive attitude. As the *Tecmed* tribunal stated, ‘even if the governmental actions are legitimate or lawful or in compliance with the host government’s domestic laws, [the legitimate actions], from the standpoint of the ‘host government’], do not mean that they conform to the Treaty or international law’.<sup>228</sup>

#### 2.4.2. The identification of the substance of the FET standard

##### 2.4.2.1. A treaty-based rule or part of the customary international law?

The FET standard enjoys a broader scope than the expropriation rule. Different from the expropriation rule, the FET standard does not focus on a particular type of governmental actions, neither requires specific obligations for illegitimate measures. Because of the conceptual terms ‘fair’ and ‘equitable’, the FET standard can cover any form of governmental actions as long as they caused interventions and impairments to foreign investments that the interested investors conceived unfair or inequitable treatments.

Because of the different normative purpose, the central issues of the application of the FET are different from the expropriation rule. Arbitrators are required to define the content of the FET standard and to determine the existence of unfair and inequitable treatments. While the ambiguousness of the terms ‘fairness and equality’ is hard, a more

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<sup>226</sup> Ibid, para 262.

<sup>227</sup> See e.g. Alain Pellet (n 210) 456.

<sup>228</sup> *Saluka v. Czech Republic*, Partial award (n 156) para 120.

pressing issue is the nature of this standard. Is the FET standard the treaty–based standard or the part of customary international law?<sup>229</sup>

Some people argue the FET standard originated from customary international law; others suggest this standard as the creation of treaty practices. Between the two opinions, a shared understanding is the application of the FET standard influenced by the practice of customary international law. While some commentators argue the limited influences of customary international law on the formation of the FET standard, they agree that the text instead confuses with other legal concepts such as just, unbiased or legitimate, not clarifying the meaning of the FET standard.<sup>230</sup> As such, the customary international law sheds lights on characterising the content of the FET.<sup>231</sup> In practice, investment tribunals also rely on the practice of customary international law to determine the substance and scope of the FET standard.

The reliance on customary international law turns the FET standard into another evidence of the close relationship between customary international law and international investment law on the one hand. On the other hand, the close relationship with customary international law might dilute the nature of the FET standard a treaty–based obligation. It raises an issue of application. Are the interpretation results implementing the intentions of the Contracting States to a treaty or reflecting accepted state practices in international society? While the latter situation favours the

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<sup>229</sup> Campbell McLachlan (n 179) 395.

<sup>230</sup> Stephan W. Schill, 'Fair and Equitable Treatment under Investment Treaties As an Embodiment of the Rule of Law', *Institute for International Law and Justice (IILJ) Working Paper 2006/6*, 5–6.

<sup>231</sup> Jacob Stone, 'Arbitration, the Fair and Equitable Treatment Standard, and the International Law of Investment' (2012) 25(1) *Leiden Journal of International Law* 77, 80–81; Todd Weiler, *The Interpretation of International Investment Law: Equality, Discrimination and Minimum Standards of Treatment in Historical Context* (Martinus Nijhoff 2013) 190–91, 205, 214; Jeswald W. Salacuse (n 113) 227; Roland Klager, 'Fair and Equitable Treatment: A Look at the Theoretical Underpinnings of Legitimacy and Fairness' (2010) 11(3) *Journal of World Investment & Trade* 435, 43.

comprehension of international law as a whole, it might be against the principle that treaty interpretation aims to reflect and implement the intentions of the Contracting States.

#### 2.4.2.2. The equation of the content of the FET standard with customary international law

While the content of the FET standard is hard to define, the objective at least sheds lights on the interpretation. The FET standard is aimed to regulate the exercise of sovereignty powers by the host government. As the *S.D. Myers* tribunal stated, the requirement of FET is ‘in light of the high measure of deference that international law generally extends to domestic authorities to regulate matters within their borders’.<sup>232</sup> Therefore, the purpose of the FET standard is not to deprive the host government of regulatory sovereignty. It instead supervises whether the exercise of regulatory sovereignty is beyond the boundaries that the exercising government agreed to the treaty. The next instead is how to identify the boundaries in line with the FET standard under a treaty?

The question can be discussed from the aspects of the textual arrangement and treaty interpretation. As to the aspect of the textual arrangement, there are various ways that investment treaties provide the FET standard. While some treaties provide the FET standard as part of general treatments for foreign investments without explanations of its content, the majority of investment treaties links the contents of this standard to customary international law to different extents.

Some investment treaties stipulate the content of the FET standard to be interpreted in accordance with customary international law. Article II(2)(a) of the *Armenia–Canada*

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<sup>232</sup> *S.D. Myers, Inc. v. Government of Canada* (‘*SD Myers v. Canada*’), UNCITRAL, Partial award, 12 November 2000 (J. Martin Hunter, Bob Rae, Bryan Schwartz) para 23.



*BIT* (1997) is an example.<sup>233</sup> The US Model BIT 2012 demonstrates an alternative way of the relation between the FET standard and customary international law. It stipulates the FET standard as part of customary international law concerning the minimum standard of treatments for foreign investments.<sup>234</sup> This approach follows the regulatory model of NAFTA in terms of minimum standard of treatments for foreign investments via Article 1105.

Other treaties, instead, leave a vague space for the interpretation of the influences of customary international law. For instance, Article II(2)(a) of the *US–Argentina BIT* (1991) provides the FET standard as part of the general standard of treatments for foreign investments. It requires the host governments to provide foreign investments ‘accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law’. The text raises an issue of whether the FET standard must be accord with the scope required by international law or separate from the practice of international law. In *Azurix v. Argentina* case, the tribunal interpreted the requirement of no less than ‘an indication that permits the scope of the fair and equitable treatment interpreted ‘as [a] higher standard than required by international law’.<sup>235</sup>

In practice, the way that links the interpretation of the FET standard to customary international law and the practice of international law is known as the equation

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<sup>233</sup> The Armenia–Canada BIT, Article II (2)(a) (‘Each Contracting Party shall accord investments or returns of investors of the other Contracting Party,

(a) fair and equitable treatment in accordance with principles of international law, and...’).

<sup>234</sup> The US Model BIT 2012, Article 5 (Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security’).

<sup>235</sup> *Azurix Corp. v. The Argentine Republic* (‘*Azurix v. Argentina*’), ICSID Case No. ARB/01/12, Award, 14 July 2006 (Andrés Rigo Sureda, Marc Lalonde, Daniel Hugo Martins) para 361.

approach.<sup>236</sup> The equation approach sheds lights on clarifying the content of the FET standard on the one hand. On the other hand, it raises a question of whether the interpretation results reflect the intentions of the Contracting States to a treaty or not. A series of NAFTA arbitration in respect of minimum standards of treatment for foreign investments demonstrate the issue of the equation approach.

Article 1105 of NAFTA requires the Contracting States to provide ‘investments of investors of another Party treatment by international law, including fair and equitable treatment and full protection and security’. The text not only specifies the FET standard but also indicates the connection with customary international law when interpreting the scope of minimum standards of treatment.

The textual ground led the NAFTA tribunals to equate the interpretation of the FET obligation with the practice of customary law principles.<sup>237</sup> As the *Waste Management* tribunal summarised the shared opinions of precedent NAFTA tribunals, the FET standard is to be found by reference to international law.

Customary international law is not static, so is the minimum standard of treatment. The scope of the minimum standard of treatment is evolving along with the changing reality of society.<sup>238</sup> The tribunal in *Glamis Gold v. the U.S.* further clarified that the party who invoked a customary law principle must indicate the principle in specific and

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<sup>236</sup> Roland Klager (n 231) 439.

<sup>237</sup> While the equation approach was also employed by the tribunals in the early NAFTA cases, the Contracting States questioned that the automatic equation of customary international law with the content of BITs cannot reflect the evolution of international law. The Contracting States then issued an interpretative note to ‘correct’ the misinterpretation of Article 1105 by arbitral tribunals. In the following cases, the interpretative note by the Contracting States rather raises another issue. That is the binding effects of the interpretative note. The interaction between the Contracting States of NAFTA and investment tribunals will be addressed in detail in the later chapters. See the discussion in Section 5.3.2 of Chapter Five.

<sup>238</sup> *Glamis Gold Ltd. v. United States of America* ('*Glamis Gold v. U.S.*'), Award, 8 June 2009 (Michael K. Young, David D. Caron, Kenneth D. Hubbard) para 92.

prove the existence of the violation of said principle.<sup>239</sup>

While the equation approach was popular to the NAFTA tribunals, it has been questioned by the Contracting States. The NAFTA states had questioned the automatic equation of customary international law with the content of BITs not reflecting the evolution of international law. These States even issued an interpretative note to ‘correct’ the misinterpretation of Article 1105 by arbitral tribunals. While the interpretative note raises the tension between the Contracting States and arbitrators,<sup>240</sup> it advances the application of the equation approach to emphasise the evolutionary nature of international law. The change explains why the tribunal in *Glamis Gold v. the U.S.* interpreted that the scope of Article 1105 of NAFTA must evolve along with the development of customary international law.

The equation approach is also popular in non-NAFTA cases. In the case arising out of the *US–Argentina BIT* (1991), the *El Paso* tribunal analysed the legal opinions of precedent awards (including the equation approach and no less than approach).<sup>241</sup> It agreed that the FET standard of this Treaty has to be interpreted given international law. It also noted that the specific role played by both the general international minimum standard and the FET standard as found in investment treaties.<sup>242</sup> As such, it interpreted that ‘the FET of [this Treaty] is the international minimum standard required by international law, regardless of the protection afforded by the national legal orders’.<sup>243</sup>

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<sup>239</sup> Ibid, para 616.

<sup>240</sup> The tension between the Contracting States and arbitrators is reflected on the question of the binding effects of the interpretative note. This issue will be addressed in detail in the later chapters. See the discussion in section 5.3.2 of chapter five.

<sup>241</sup> While there is textual difference between the investment chapter of NAFTA and the Argentina–US BIT in terms of the FET standard, this tribunal did not specifically mention the difference or attempted to develop different approaches because of the textual difference.

<sup>242</sup> *El Paso Energy International Company v. Argentine Republic* (*El Paso v. Argentina*), ICSID Case No. ARB/03/15, Award, 31 Oct 2011 (Lucius Caflisch, Piero Bernardini, Brigitte Stern) para 336.

<sup>243</sup> Ibid, para 337.

According to the case law, several principles have identified to crystalise the substance of the FET standard. One of the principles is reasonableness. The principle of reasonableness is the one that requires the host States' actions and decision to be related to a legitimate objective.<sup>244</sup> The tribunal of *Waste Management v. Mexico* determined the reasonableness of the host State's action by asking whether the act was irrational or arbitrary.<sup>245</sup> In the same case, the *Waste Management* tribunal also employed the principle of due process to examine the judicial proceedings of the Mexican court. It found that the decisions of the Mexico court promptly arrived. The claimed investor won on key procedural points, and the dismissal in the second proceedings was without prejudice to its rights in the appropriate forum. As such, this tribunal concluded that '[t]here is no trace of discrimination on account of the foreign ownership of [the claimed investor], and no evident failure of due process'.<sup>246</sup>

Another principle is the requirement of consistency. The essential idea is to maintain the legal and business environment in which the investment has been made.<sup>247</sup> The reason to maintain the legal and business environment is basic expectations that had formed when foreign investors invested. The basic expectations rested on the consistent performances of governments. As such, the requirement of consistency characterises the stability of the legal and business framework as an essential element of fair and equitable treatment. The tribunal in *Tecmed v. Mexico* advanced the requirement of consistency by applying non-ambiguity and transparency to the decision-making regarding foreign investments.<sup>248</sup>

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<sup>244</sup> Kenneth J. Vandevelde, 'A Unified Theory of Fair and Equitable Treatment' (2010) 43 *International Law and Politics* 43, 54.

<sup>245</sup> *Waste Management v. Mexico*, Award (n 180) paras 129–30.

<sup>246</sup> *Ibid*, para 130.

<sup>247</sup> *Occidental Exploration and Production Company v. The Republic of Ecuador* ('*Occidental Co. v. Ecuador*'), LCIA Case No. UN3467, Final award, 01 July 2004 (Francisco Orrego Vicuna, Charles N. Brower, Patrick Barrera Sweeney) para 183.

<sup>248</sup> *Tecmed v. Mexico*, Award (n 82) para 154.

Other cases also identify the denial of justice, the arbitrariness, due process, anti–discrimination, the consistency and stability of the regulatory framework, and the doctrine of legitimate expectations as the substance of the FET standard.<sup>249</sup>

These principles share the goal of the quality of state performances and decisions. Their goal is to require host States to provide a minimum guarantee to foreign investors, regardless of the regulatory environment of the host State. Therefore, these principles are not only concerned with the decision–making process but also the consequences of the decision. In other words, the FET obligation supervises the procedure of decision–making and law–making. As the *El Paso* tribunal noted, in some situations the description of the FET obligation implicates good governance of the treatment for foreign investments and investors.<sup>250</sup> From the perspective of governance, the FET standard has the merit of the rule of law of international investment law.

#### 2.4.2.3. The issue of the equation approach

The equation approach provides indications to the content of the FET standard. However, we can see that neither the text nor the practice explains that whether the FET standard and international law concerning minimum standards of treatment are identical or separate and to what extent.<sup>251</sup>

The confusion to a specific point results in the uncertainty and inconsistency of the interpretation of the FET standard. Another issue is whether the result of the equation approach is an extension of the existing state practices in customary law or

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<sup>249</sup> Roland Klager (n 231) 440–43; Jacob Stone (n 231) 90–92; *Glamis Gold v. U.S.*, Award (n 238) para 616.

<sup>250</sup> See Benedict Kingsbury and Steph W. Schill, 'Investor–State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law' *Institute for International Law and Justice (IILJ) Working Paper 2009/6*.

<sup>251</sup> Stephen Vasciannie, 'The fair and equitable treatment standard in international investment law and practice' (2000) 70(1) *British Yearbook of International Law* 99, 143–44.

implementation of the FET provisions under a treaty.

Within the case law, several principles of international law have been identified as the substance of the FET obligation. These principles include the denial of justice, the arbitrariness, due process, anti-discrimination, the consistency and stability of the regulatory framework, and the doctrine of legitimate expectations.<sup>252</sup> These principles are also part of the standards of the treatment of aliens in customary international law. Concerning the overlap with customary law principles, some tribunals suggested that the obligation of FET should be interpreted as the standard providing ‘no more than minimal protection’ that has been a custom of international society.<sup>253</sup>

On the other hand, other tribunals believe that the FET standard is the treaty-based standard even though it has a connection with customary international law. The main reason for the viewpoint is the specification of a treaty.

As chapter one discussed, treaties have the merit of clarification and specification of the intentions of the States. An investment treaty is a conclusion between two or a limited group of States. The content of the treaty reflects what the Contracting States and their decisions concern issues. While customary law principles could be integrated into the content of the treaty, in the treaty relationship, they serve to the interests of the Contracting States rather than international society. Therefore, the ways to interpret the FET standard should be the same with other provisions. It must be interpreted in line with the objective and purpose of the treaty.<sup>254</sup>

In this respect, a reliance on customary law principles could generate the misinterpretation and misapplication of the FET standard of a treaty. Meanwhile, the

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<sup>252</sup> Roland Klager (n 231) 440–43; Jacob Stone (n 231) 90–92; *Glamis Gold v. U.S.*, Award (n 238) para 616.

<sup>253</sup> *Saluka v. Czech Republic*, Partial award (n 156) para 292.

<sup>254</sup> *Ibid*, para 293.

equation with customary international law could result in the interpretation result against the purpose of the treaty to implement new policies such as sustainable development policies and the reservation of regulatory sovereignty for public interests.

Between the two scenarios, some tribunals instead have an alternative viewpoint. They treat customary law principles as the supplementary to the FET standards as the rule of the treaty. For instance, the *Chemtura* tribunal highlighted the evolutionary nature of Article 1105 of NAFTA. It stated that ‘[the reference to customary international law] cannot overlook the evolution of customary international law, nor the impact of BITs on this evolution’.<sup>255</sup> In other words, the substance of the FET standard is not reliance on either the concern of the Contracting States or the practice of customary international law. Instead, it rests on the interaction between customary international law and investment treaties.

## 2.5 The emergence of the balancing approach

The case study reveals that interpretative approaches are evolutionary rather than static. It is common for arbitral tribunals to adjust the traditional interpretive approach or develop new approaches in response to the new legal issues. The new interpretative approaches have a shared feature. That is the consideration of the interests of the host government in the decision–making. Balancing is one of the new popular interpretative approaches.<sup>256</sup>

### 2.5.1. The determination of indirect expropriation

As to the expropriation clause, a conventional interpretative approach is based on the

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<sup>255</sup> *Chemtura v. Canada*, Award (n 207) para 121.

<sup>256</sup> *Anthea Roberts* (n 147) 13.

exclusive conception, focusing on impacts of governmental intervene on the interests of foreign investments and investors. While the effect-oriented approach is replaced with the doctrine of policy power in some cases, it shares the nature with the doctrine of police power. Both of the two approaches prioritise the interests between foreign investors and host governments by focusing on the negative effects of governmental intervene or emphasising regulatory power by the host government. Also, the prioritisation depends upon the understanding of arbitral tribunals in respect of the purpose of investment treaties. It can say that, under the prioritising approaches, the interests of foreign investors and host States conflict.

The tribunal in *Tecmed v. Mexico* case, however, introduced alternative approaches to the conventional ones. In the interpretation of the expropriation rule of *Spain—Mexico BIT* (1995), this tribunal developed a series of criteria to determine whether the government actions are expropriatory and raise the obligation for compensation. The criteria include determining whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments and to consider the significance of such impact to decide the proportionality.<sup>257</sup> According to the considering factors, the *Tecmed* tribunal neither resort to the sole-effect approach nor apply the doctrine of police power as a final factor. Instead, it attempted to include both the effects and purposes of the disputed measure in the decision making. The way that includes all relevant factors of the disputed measure before reaching final decisions is the balancing approach, while the *Tecmed* tribunal did not name it directly.

The *Tecmed* tribunal conducted the balancing approach by relying on the requirement of proportionality. It reconstructed the logical structure for expropriatory

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<sup>257</sup> *Tecmed v. Mexico*, Award (n 82) para 122.



actions. Three elements were proposed to determine the existence of an expropriatory action. They are (i) the relation between the measure and the claimed objective (or the protected interests); (ii) the existence of the impacts on foreign investments; and (iii) the impact scale.

The analytical structure enables the *Tecmed* tribunal to avoid the presumable preference on either side of the disputing parties on the one side, and on the other side, to give equal weights to the interests of foreign investors and host governments.

Following the balancing structure, the *Tecmed* tribunal evaluated the economic loss of the claimed investors due to the non–renewal decision and the political and legal conditions in which the public authority made the denial decision. It found that the effects of Mexico’s actions amounted to an expropriation, violating the expropriation rule of the 1995 *Spain–Mexico BIT*.<sup>258</sup>

In one of Argentina's series of investor–State arbitrations, the tribunal in *LG&E v. Argentina* also noted the dilemma of prioritising the sole–effect approach or the police power doctrine in the interpretation of expropriation.<sup>259</sup> In the interpretation of the expropriation rule, the *LG&E* tribunal first recognised the regulatory autonomy of the States under the 1991 *US– BIT Argentina*. It believed that the Contracting States still reserves the right to exercise its sovereign power to expropriate private properties to satisfy public interests if the exercise with due process and had compensation.<sup>260</sup>

A balanced approach led the *LG&E* tribunal to interpret the limitation to the police

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<sup>258</sup> Ibid, paras 144–51.

<sup>259</sup> *LG&E energy and financial corp. v. Argentina* ('*LG&E v. Argentina*'), ICSID Case No. ARB/02/1, Decision on liability, 3 Oct 2006 (Tatiana B. de Maekelt, Albert Jan van den Berg, Francisco Rezek) para 194 ('The question remains as to whether one should only take into account the effects produced by the measure or if one should consider also the context within which a measure was adopted and the host State's purpose').

<sup>260</sup> Ibid. para 186.

power doctrine. While the tribunal agreed with Argentina's argument that host governments have the right to regulate for public interests, it believed that there are limits to the right to regulate. The balanced approach is the way that arbitral tribunals define the limits to the right to regulate under an investment treaty. In respect, the *LG&E* tribunal clarified two considering factors for the determination of the violation of expropriation provisions. The two considering factors are the degree of the measure's interference with the right of ownership and the power of the State to adopt its policies.<sup>261</sup> In other words, according to the viewpoint of the *LG&E* tribunal, a balanced concern is reflected by consideration of the interests of the claimed investors and the host government.

Concerning the balanced approach in detail, the *LG&E* tribunal referred to the *Tecmed* tribunal to affirm the requirement of proportionality to bridge the reconciliation of investment protection and regulatory autonomy for public interests.<sup>262</sup> It found that the effect of Argentina's actions had not permanently affected the value of the Claimants' shares, and Claimants' investment had not ceased to exist. Because of the absence of a permanent loss, the *LG&E* tribunal concluded that severe deprivation of the claimant's rights access to its investment, or almost complete deprivation of the value of its investment did not constitute expropriation.<sup>263</sup>

While arbitral tribunals in the *Tecmed* case and the *LG&E* case both adopted a balanced concern, they reached different results. The result of balancing the interests of both disputing parties to an investor–State dispute is no guarantee of the result favouring of one side. Both the claimed investor and the respondent state can be the winner of investor–State arbitration.

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<sup>261</sup> Ibid, para 189.

<sup>262</sup> Ibid, paras 192–95.

<sup>263</sup> Ibid, para 200.

### 2.5.2. The doctrine of legitimate expectations

Another context in which the balanced concern is applied is the FET obligation. Arbitral tribunals often applied the balancing concern to interpret and apply the doctrine of legitimate expectations to determine the violation of the FET obligation.

While the *Tecmed v. Mexico* award is the first case in which the balanced concern applied to the interpretation of expropriation provisions, it is not the case where the balanced concern first applied to the interpretation of the FET standard.

In the same dispute, the tribunal was required to deal with legal issues concerning the FET standard. In addition to expropriation provisions, the claimed investor also invoked the FET standard to argue that the Mexican government infringed its legitimate expectations. The disputed actions violated Mexico’s obligation of the FET standard under the 1995 *Spain–Mexico BIT*.

In the interpretation of the FET standard, however, the *Tecmed* tribunal did not stress the balanced concern embedded in the Treaty. On the contrary, it focused on the purpose of investment protection as the goal shared by the Contracting States to the Treaty. By reading the preamble, the *Tecmed* tribunal interpreted the Contracting States intended to ‘strengthen and increase the security and trust of foreign investors that invest in the member States, thus maximising the use of the economic resources of each Contracting Party by facilitating the economic contributions of their economic operators’.<sup>264</sup> The FET obligation is critical to the purpose of investment protection. As such, the content of the FET obligation included the protection of legitimate expectations of investors. The tribunal then found that Mexico’s actions infringed

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<sup>264</sup> Ibid, para 156.

expectations of the claimed investor that were the ground of the investment projects in Mexico. The finding led the *Tecmed* tribunal to conclude that the Mexican government violated its obligation of the FET standard under the 1995 *Spain—Mexico BIT*.<sup>265</sup>

In the context of the FET standard, the balanced approach first appeared in the *Saluka v. the Czech Republic* award. The *Saluka v. the Czech Republic* award affirmed the balancing approach critical to the FET standard and the doctrine of legitimate expectation in specific. The practice is a result of the three-step interpretative method suggested by the Vienna Convention.

The *Saluka* tribunal noted the context of the FET obligation of the *Czech Republic—Netherlands BIT* (1991) in a broad sense. The interpretation of the FET obligation must in line with the preamble and the arrangement of rights and obligations under the Treaty.

The preamble of the Treaty provides the purpose of ‘stimulation of foreign investments and to the economic development of both Contracting States’.<sup>266</sup> By reference to the preamble and title of this Treaty, the *Saluka* tribunal interpreted the object and purpose indicating a more subtle and balanced concern. It believed that the investment protection is not the sole aim of this Treaty. Investment protection is rather a ‘necessary element’ for the overall aim of encouraging foreign investment and extending and intensifying the parties’ economic relations.<sup>267</sup> The interpretation result led the *Saluka* tribunal to indicate the balanced approach as the guide to the interpretation of all substantive provisions.<sup>268</sup>

The *Saluka* tribunal then applied the balancing approach to the doctrine of legitimate expectations at issue. The tribunal agreed that the FET standard is for

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<sup>265</sup> *Tecmed v. Mexico*, Award (n 82) para 151.

<sup>266</sup> *Saluka v. Czech Republic*, Partial award (n 156) para 289.

<sup>267</sup> *Ibid*, para 300.

<sup>268</sup> *Ibid*.

investment protection. However, protection is not unlimited. The determination of a violation of the FET standard neither exclusively rests on foreign investors’ subjective motivations and considerations. On the contrary, the expectations to be protected must ‘rise to the level of legitimacy and reasonableness in light of the circumstances’.<sup>269</sup> Specifically, whether frustration of the foreign investor’s expectations was justified and reasonable depends upon the host State’s legitimate right subsequently to regulate domestic matters in the public interest.<sup>270</sup>

The *Saluka* tribunal further established the analysis structure for the doctrine of legitimate expectations under the balancing approach. The structure is composed of three elements: (i) the investors’ legitimate expectations, (ii) the regulatory interests of the host State, and (iii) a reasonable relationship to rational policies not motivated by a preference for other investments over the foreign–owned investment.<sup>271</sup>

The statements concerning the balancing structure has a two–fold meaning. First, it elucidates the FET standard not imposing the host State an absolute obligation of investment protection. Second, the concern of the regulatory interests of the host government clarifies a misunderstanding. The FET standard is not to require the treaty parties to freeze their legal system in order to protect the investors’ basic expectations.

In contrast, the purpose of investment protection must be balanced with the regulatory needs of host governments. The *Total v. Argentina* award highlights the two points. As the *Total* tribunal highlighted, it is ‘[t]he balance between these competing requirements and hence the limits of the proper invocation of legitimate expectations in

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<sup>269</sup> *Saluka v. Czech Republic*, Partial award (n 156) para 304.

<sup>270</sup> *Ibid*, para 305.

<sup>271</sup> *Ibid*, para 307.

the face of legislative or regulatory changes'.<sup>272</sup>

### 2.5.3. The reconciliation of investment protection and regulatory autonomy in the dispute-settlement framework

The emergence of the balancing approach in investor-State arbitration signals a change in international investment law. The conventional assumption of investment treaties is altered. The interests of foreign investors and investment are no longer dominated by the interpretation and application of an investment treaty. By shifting the concern to the side of the host government, investment tribunals have gradually adjusted the unbalanced position of host States in investment treaties.

Besides the purpose of investment treaties, the balancing approach has the implications of the practice of dispute settlements. This approach creates the framework for investment tribunals to reconcile the interests of foreign investors and regulatory interests of host States. Moreover, it justifies the consideration of legitimate objectives of the government actions in determining the breach of the substantive provisions.

The thesis agrees that the concern of host governments is not started with the balancing approach. As Alain Pellet points out, the police power doctrine is evidence that investment arbitral tribunals attempt to reconcile the sovereign right of host States in terms of regulatory power over domestic social and economic activities.<sup>273</sup> In the application of the doctrine of police power, investment tribunals have paid respects to the right to regulate for host governments and taken regulatory interests into account.

Nevertheless, the thesis argues that the balancing approach has more powerful influences than the police power structure. One reason is the origin of the police power

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<sup>272</sup> Ibid, para 121.

<sup>273</sup> Alain Pellet (n 210) 447.

doctrine. The police power doctrine originated from the state practices concerning expropriatory actions. The essence of the police power doctrine is to justify expropriatory actions as legitimate exercises of sovereignty by host governments. It exemplifies what situations are amount to legitimate exercises of sovereignty in line with the prohibition of expropriation. The question is whether the identified situations are legitimate in other normative contexts as well.

Another reason is the nature of the police power doctrine. We argue that the doctrine of police power is the product of the prioritising conception.<sup>274</sup> Different from the conventional wisdom favouring investment protection, the doctrine of police power favours the interests of host States. While the doctrine of police power allows arbitral tribunals to give appreciations to regulatory interests of the host government, it raises the risk of violating the intentions of the Contracting States to a treaty that mainly concerns the benefits of investors and investments. By contrast, as an analysis structure, the balancing approach creates the room for all competing interests to a dispute even though the interests are conflicted and of non–disputing parties.

While the balancing approach is significant to the progress of international investment law, the change is slow.

It is true that the recent arbitral tribunals more frequently employed the balancing approach or discussed the balancing concern. Yet, the number is not as much as expected.

Through the case study, the thesis observes that arbitral tribunals have not widely applied the balancing concern and the balancing approach.<sup>275</sup> Among collected cases,

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<sup>274</sup> The viewpoint that the sole–effect approach is in the contradiction with the doctrine of police power is also argued by other commentators. See also, Santiago Montt, *State Liability in Investment Treaty Arbitration* (Hart 2009); Catherine Titi (n 141) 181.

<sup>275</sup> See the list of Appendix A.

the cases mentioning the balancing concern or employing the balancing approach have not reached one-third of all analysed investor-State arbitration. The ratio, however, is different among different groups. In the group of big cases, there are four awards/decisions mentioned the balanced concern and applied the balancing approach in total seventeen cases.<sup>276</sup> In contrast, the case involving the balancing concern increased in the follow-up cases. There are six awards/decisions of the total fourteen awards/decisions.<sup>277</sup>

There is another thing worth mentioning. The majority of the awards/decisions applied the balancing approach was settled during the period between 2010 and 2011. After the United Nations Conference on Trade and Development (UNCTAD) published the Investment Policy Framework for Sustainable Development in 2015, the situation of applying the balancing approach did not show significant growth as well.<sup>278</sup> Given limited information, the thesis has not determined other causes for the gap between international policies and the practice of international investment law yet.

## 2.6 The issues of legal interpretations and the balancing approach in investor-State arbitration

### 2.6.1 The flexibility and uncertainty in the interpretation

The balancing approach indirectly creates the discretion of arbitral tribunals. Arbitral tribunals are able to take the concern of regulatory interests of host governments in

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<sup>276</sup> The four awards/decisions are: *Daimler v. Argentina* (Award on jurisdiction), *LG&E v. Argentina* (Decision on liability), *Saluka v. Czech Republic* (Partial award), and *Tecmed v. Mexico* (Award).

<sup>277</sup> The six awards/decision include, *AWG v. Argentina* (Decision on liability), *El Paso energy co. v. Argentina* (Award), *Grand River v. U.S.* (Award), *Lemire v. Ukraine II* (Decision on jurisdiction and liability), *Merrill & Ring v. Canada* (Award), and *Total S.A. v. Argentina* (Decision on liability).

<sup>278</sup> In the policy paper of Investment Policy Framework for Sustainable Development, UNCTAD suggested the principle of balancing is a primary principle for arrangement of the rights and obligations in an investment treaty. The relationship between foreign investors and host governments is also required to adjusted in line with the principle of balancing. UNCTAD, *Investment Policy Framework for Sustainable Development* (n 14).



decision making on the one side. In specific, they enjoy the discretion of making decisions favouring each side of disputing parties. The inclusive attitude also prevents arbitral tribunals from giving preference to one side against the other. In other words, arbitral tribunals can respond to the demand of regulatory state in contemporary society and sustain the original purpose of investment treaties for investment protection under the balancing structure.

On the other hand, the flexibility of the balancing approach causes the issue of uncertainty. One reason is, as Andrew Newcombe argues, the lack of concrete guidance on the element of ‘reasonable relationship of proportionality’ for the balancing approach.<sup>279</sup>

This study argues other issues causing uncertainty as well. First, arbitral tribunal has not developed the standard of review for the balancing approach. Neither the standard of review universally applied for the balancing approach, nor the jurisprudence of investment arbitration establishes a series of the standard of review for different situations. Therefore, it is a common situation that the standard of review is absent in the reasoning while an arbitral tribunal identified several considering factors for the balancing analysis.

Without indicating the standard of review, it is hard to understand at which level governmental interferences for public interests was balanced with the interests of the claimed investors and reaching the balanced condition. In other words, the arbitral tribunal could simplify the discussion and the analysis by the name of balancing.<sup>280</sup>

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<sup>279</sup> Andrew Newcombe (n 198) 410.

<sup>280</sup> Here raises another issue of the quality of reasoning of investor–State awards. This issue will be discussed in chapter six.

Another issue is the nature of the balancing approach. It remains questioned whether the balancing approach is an interpretative approach for specific rules or a general interpretive principle for all provisions of a treaty. This issue results from the selective application of the balancing approach by investment arbitrators. For instance, the *Tecmed* tribunal applied the balancing approach to interpreting the meaning of indirect expectations. In the same dispute, the balancing approach instead was not applied to the FET standard. The selective application seems to suggest that the balancing approach is for specific rules rather than all provisions of the treaty.

The last but not the least issue is whose interests are primarily protected under the balancing approach. As discussed above, the balancing approach originated from the idea of limiting the scope of investment protection. This approach brings the consequence of altering conventional wisdom that investment treaties are for the interests of investors only. The balancing approach seems to require arbitral tribunal prevent from taking a single-minded method, either protecting the interests of foreign investors or concerning the needs of host governments.

On the other hand, the case study reveals the application of the balancing analysis depending upon the political preferences of arbitral tribunals.

There are two favourite positions. In some cases, the application of the balancing approach is under the shadow of investment-preference thought. Subjective expectations and commercial interests of foreign investors are definitive to the result of the balancing analysis. The tribunal in *Tecmed v. Mexico* is an example. The *Tecmed* tribunal introduced the balancing approach to interpret and apply the expropriation rule. The result, however, was in favour of the interests of foreign investors.

Other tribunals, instead, applied the balancing approach to defining the boundaries

of regulatory autonomy for host governments. The motivation behind the practice is to reserve the host States their right to regulate under investment treaties. For instance, the *AWG* tribunal expressed that interpreting standards of treatment for foreign investors must base on the conception that investment protection is the means for the economic prosperity of the host State rather than the end. The host government reserves the right to regulate unpredictable circumstances for public interests while the decision might cause distortion effects on foreign investments and investors.<sup>281</sup>

The *AWG* tribunal did not deny that the essence of the FET standard is to avoid the frustration of investors' legitimate and reasonable expectations by a host government.<sup>282</sup> However, different from the *Tecmed* tribunal, it clarified that the boundaries of the FET standard should not rest on the claimed investors' subjective expectations but rely on an objective and reasonable point of view. The *AWG* tribunal believed that the basic goal of the three Argentina's BITs not only for the interests of foreign investors but more importantly, for the concern of the Contracting States to foster economic cooperation and prosperity of each State.<sup>283</sup> The understanding led the tribunal to introduce the balancing approach to the interpretation of the FET standard and the determination of a breach of investors legitimate expectations. By referring to legal opinions of previous awards, the *AWG* tribunal agreed that the reasonableness and legitimacy of investors' expectations must take into account all circumstances such as the facts surrounding the

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<sup>281</sup> *AWG v. Argentina*, Decision on liability, 30 July 2010, para 236.

<sup>282</sup> Nevertheless, arbitral tribunals have not developed a universal understanding of the FET standard. Other tribunals have alternative conceptions. For instance, the tribunal in *Occidental Exploration and Production Co. v. Ecuador* interpreted the stability of the legal and business framework as an essential element of the FET standard. This conception is repeated in other cases which involved a treaty having the similar preambular language that fair and equitable treatment is desirable 'to maintain a stable framework for investments and maximum use of economic resources. *Occidental Exploration and Production Company v. The Republic of Ecuador*, UNCITRAL Arbitration, Final Award, 01 July 2004, LCIA Case No. UN 3467, para 183; *CMS Gas Transmission Company v. The Argentine Republic*, ICSID Case No. ARB/01/8, Award, 12 May 2005, para 274.

<sup>283</sup> *Ibid*, para 228.

investment, the existence of expectations, business risk or industry's regulatory patterns, and the political, socioeconomic, cultural and historical conditions prevailing in the host State.<sup>284</sup>

In this case, the *AWG* tribunal noticed that the concession contract regarding water distribution and waste water treatment was subject to the regulatory authority of the Argentine government. The tariff regime and the regulatory framework that the Argentine government agreed to the contract was the result of its right to regulate.<sup>285</sup> The finding inspired the tribunal to balance the legitimate and reasonable expectations of the Claimants with Argentina's right to regulate the provision of a vital public service.<sup>286</sup> The *AWG* tribunal identified the tariff regime stipulated in the concession contract and the regulatory framework as critical grounds by which the Claimants made their investments. By examining the Argentine government's actions by the stipulated procedures and regulations, the *AWG* tribunal found that Argentina failed its obligation of due diligence. The change in the Argentine laws for its economic crisis altered the economic position of the Claimant investors. The tribunal concluded that the failure of due diligence by the Argentine government constituted the abuse of its regulatory discretion.<sup>287</sup>

The statements implicate that the political preference of the *AWG* tribunal favours the host governments. It rested the balancing analysis on the behaviours by the host government, including the applicable laws to the investment contract and the consistent state practices, rather than subjective conceptions of the claimant investors. While the *AWG* tribunal decided Argentina failed the case, its decision based on the self-contradictory practice by Argentina, the exercise of internal sovereignty contradicting

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<sup>284</sup> Ibid, paras 229–230.

<sup>285</sup> Ibid, para 236.

<sup>286</sup> Ibid, para 236.

<sup>287</sup> Ibid, para 237.

that of external sovereignty.

The *El Paso* tribunal further clarified the state–concerned position. It stated that the appreciation that the tribunal gave to regulatory autonomy is not calling for the absolute sovereign powers. Rather, it believed that the balancing analysis contributes to define the scope of regulatory powers and to determine whether the use of regulatory autonomy violated the agreed scope under a treaty.<sup>288</sup>

These issues raise the question of what the concern of investment arbitrators in treaty interpretation: to fill up the gap in the text or to engage in the adjustment of the priority of policies in an investment treaty.

#### 2.6.2 The nature of the balancing approach: the gag–filling or the judicial law–making by investment arbitrators?

While the balancing approach gives the leeway for arbitral tribunals to take regulatory concerns into account, the uncertainty in the application raises the concern of legitimacy of arbitral awards. A specific issue is whether arbitral tribunals apply the balancing approach to fill a gap in a treaty or they exceed their interpretative authority to alter the intentions of the Contracting States to a treaty.

The question relates to the history of investment treaties. The development of investment treaties divides into three stages. At the initial stage, investment treaties focused on defining standards of treatment for foreign investments and refining the relationship between home States and host States. At the second stage, the treatment for foreign investments was extended to the issue of dispute settlements. Because of the desire of de–politicised of the disputes between investors and host governments,

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<sup>288</sup> *El Paso v. Argentina*, Award (n 242) paras 350, 356.

investment treaties focused on creating the dispute settlement mechanism for investor–State disputes. The issue of investor–State arbitration shifts the attention of investment treaties from the treaty relationship between home and host States toward the legal relationship between foreign investors and host States. The role of a host State as a treaty party then is often ignored in the frame of investor–State arbitration. The interests of foreign investors, instead, dominated the discussion of investment treaties and investor–State arbitration.<sup>289</sup>

Investment treaties now are entering into a new stage. A significant difference from the second stage is the desire to reviewing the role of host States in treaties. It bases on the conception that the investment treaties negotiated at the second stage were asymmetric to host States. A host State is in an asymmetric position, whether in the treaty relationship with a home State or the legal relationship with foreign investors. The retrospection led to a series of political decisions, including the withdrawal of the *ICSID Convention*, the suspension of investor–State arbitration clauses or the renegotiation of treaty rules.<sup>290</sup> All these actions aim to rebalance the rights and obligations among home and host States and foreign investors.

The practice faces difficulties to follow the textual reform of rebalancing the position of host States. A critical reason for the difficulty is the underlying principle of international agreements, the principle of state consent.

The principle of state consent has a two–fold meaning, as the thesis discusses in chapter one. First, the content of a treaty based on the consent of the Contracting States. As the UNCTAD’s analysis reveals, the majority of the invoked treaties date back to the 1980s and 1990s. These treaties are ‘old–generation’ treaties.<sup>291</sup> It means that these

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<sup>289</sup> Anthea Roberts (n 147) 5, 24.

<sup>290</sup> Ibid, 26–27.

<sup>291</sup> UNCTAD, *Investor–State Dispute Settlement: Review of Development in 2017*, available at

treaties have a different political ideology and regulatory modes from recent treaties. A significant difference is the old–generation treaties primarily concerned with the interests of foreign investors. The investment–preference policy led the content of an investment treaty mostly imposed obligations on the host State to provide favoured treatments for foreign investors. Neither home States nor foreign investors were rarely required to make commitments to the treaty relationship.

While the arrangement of rights and obligations between home and host States created an imbalanced position for the host States, is based on the consent of these States as the Contracting States. As such, the imbalanced position of a host State in the treaty relationship with other States and the disputing relationship with foreign investors was the result of its consent to the treaty.

The second meaning of the principle of state consent is the legislative role of nation states. States are the subject and object of international agreements. Because of self–commitments, the Contracting States are binding to international agreements and willing to restrict the boundaries of sovereignty on specific conditions. The self–commitments, on the other hand, only the Contracting States have the authority to amend and terminate the content of a treaty. While commentators urge that international law has no longer dominated by nation states but shaped by the engagement of individuals, however, they hardly deny that sovereign states remain their powers on defining international orders. The reality is reflected on the fact that the existing international agreements have not delegated the legislative authority to third parties unless nation states engaged in the operation to a certain extent.

The two meanings result in two consequences of international adjudication. First,

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<<https://investmentpolicyhub.unctad.org/Publications/Details/1188>> accessed 10 April 2019.

adjudicators are required to interpret and apply the rules of a treaty in accordance with the intentions of the Contracting States. If the treaties were primarily concerned with the interests of foreign investors, adjudicators are obligated to interpret the rules of the treaty to implement the investment–preferential objective. This is the primary principle of treaty interpretation that interpreters must reflect and implement what the Contracting States gave their consent to a treaty. Second, adjudicators have no authority to amend treaty obligations for either side of the Contracting States. The change is beyond the delegated authority of adjudicators.

Accordingly, in terms of an asymmetric relationship that host States involved in BITs, arbitral tribunals have no authority to take actions before the Contracting States exercise their legislative power to refine the objectives of the treaties and to amend the arrangement of rights and obligations between the treaty parties.

Reading the awards involving the balancing concern, the applied investment treaties do not contain the languages of ‘balancing’ and ‘right to regulate’; nor do they contain institutional norms for investor–State tribunals regarding the balance of competing interests or regulatory purposes. In the lack of the textual indication, the application of the balancing approach seems to reveal the political preference of tribunals of rebalancing the asymmetric situation of the host government, while the Contracting States had not amended the treaties.

The lack of textual supports raises the legitimacy issue of the decisions of arbitral tribunals. It is questionable whether the decision of applying the balancing approach is within the discretion of tribunals to fill gaps of the treaty rules, or is the result of judicial law–making that exceeds tribunals’ delegated authority of treaty interpretation and dispute settlement.



The critiques of judicial law–making are dangerous to the investor–State arbitration system.<sup>292</sup> This is because the delegated authority of investment arbitrators is also the results of the state consent made by the Contracting States. The delegated authority cannot and should not exceed the intentions of the Contracting States toward the dispute settlement provisions. States are only bound by what they have given their consent to be bound. Because of the principle of state consent, each Contracting State can question the legitimacy of decisions made by arbitrators by the reason that the decisions based on the misuse and even abuse of the delegated authority by arbitrators. The question of the legitimacy of the investor–State award will further trigger the trust issue of the investor–State system as a whole.

The severity of the legitimacy issue of the investor–State system has been reflected on a series of political and legal actions by nation–states, including the withdrawal of the consent to the investor–State arbitration and the suspension of investor–State arbitration provisions. The lack of textual indication instead explains the hesitation of investment arbitrators on widely applying the balancing approach.

## 2.7 Conclusion

The case study demonstrates that the balancing approach sheds lights on altering the conventional single–minded thought of the objectives of investment treaties. The balancing approach inspires investment arbitrators to pay more attention to the regulatory autonomy of a host government. The balancing approach to a certain point is the way that investment arbitrators indirectly adjust the imbalanced position of host States under the treaty relationship and the disputing relationship.

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<sup>292</sup> Richard Gardiner (n 155) 6; Alexander Orakhelashvili (n 153) 318.

Nevertheless, the practice of the balancing approach exists two issues, the uncertainty of the decisions and the legitimacy crisis. Uncertainty is caused by several factors such as the inconsistency of the balancing approach on the issues of the standard of review, the priority of considering factors and the political preference behind this approach. These issues might threaten the accountability of the investor–State system but also raises the concern of the stability of international investment law, while some tribunals have been aware of the importance of the systematic coherence of international investment law.<sup>293</sup>

The following chapter will shift attention to the practice of WTO law in terms of treaty interpretation and the balancing approach.

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<sup>293</sup> For instance, the tribunal of *Daimler v. Argentina* expressed institutional sensitivity. In respect of the issue of whether the MFN clause of the *Argentina–Germany BIT* (1991) applies to the dispute settlement clauses, it reviewed the nature of BITs under a broad horizon of the international law system. In its viewpoints, BITs, as international treaties, ‘constitute an exercise of sovereignty by which States strike a delicate balance among their various internal policy considerations’. *Daimler v. Argentina*, Award on jurisdiction (n 82) para 164.

## Chapter Three

### Treaty Interpretation of WTO Jurisprudence and the Balancing Analysis

#### 3.1. Introduction

International investment law rests on the network of bilateral investment treaties. By contrast, international trade law is a multilateral system. It covers a range of trade agreements, including bilateral and regional trade agreements, preferential trade agreement, economic partnership agreements, and multilateral agreements. While these agreements have differences on the membership and the degree of trade liberalisation, they constitute the multi-layered regulation system for trade relations. The creation of the GATT and the WTO, in particular, plays a critical role in the multilateral trading system.

Besides the membership, there are other differences from international investment law. First, the agreements associated with the WTO develop a series of united principles and rules for trade relations. These principles and rules then become the essential topics of the negotiation of other trade agreements. The commitments to the WTO also establish the baseline of market access and concessions for the States to negating new trade agreements.<sup>294</sup> Second, the membership of the WTO creates a centralised mechanism for dispute settlements. United procedural rules of dispute settlement and centralised institutions make the WTO dispute settlement mechanism more useful and functional than other dispute settlement mechanisms.

The effectiveness and popularity of the WTO dispute settlement mechanism

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<sup>294</sup> The requirement is about the exceptions of WTO obligations of most-favoured-treatment and national treatment to non-WTO trade agreements. Specific provisions include Article XXIV of the GATT [Territorial Application – Frontier Traffic – Customs Unions and Free-trade Areas] and Article V of the GATS [economic integration].

inspire commentators to claim the WTO as the constitutions of trade relations. The significance of the WTO system explains why the thesis focuses on the practice of WTO law to enquire the development of the balancing approach.

This chapter discusses the case study of WTO disputes by three issues. First, what are the general patterns of the interpretation and application of WTO provisions by panels and the Appellate Body? Second, what are the interpretative approaches developed by WTO panels and the Appellate Body in terms of the issue of conflicting interests and regulatory purposes? Third, is the concept of balancing mentioned and even applied by WTO panels and the Appellate Body in the interpretation of WTO provisions? If the answer is definite, what purposes are the concept of balancing applied?

The content of this chapter divides into three parts. In Section 3.2, we focus on the text of WTO agreements concerning the balance of trade interests and other public interests. We discuss two contexts in which WTO provisions indicate the balancing concern: (i) general exceptions of the GATT and the GATS; and (ii) substantive obligations of the SPS and the TBT Agreements. Section 3.3 then identifies features of the interpretation of WTO provisions in general. The analysis concentrates on two identified features: the standardisation of the interpretative structure and the reliance on precedent cases. Then, we move attention to the operation of interpretive approaches more specifically, i.e. the balancing approach. In Section 3.4, the thesis argues two features of the balancing approach in WTO cases. One feature is the distance from the engagement of a balancing act. WTO adjudicators tend not to involve substantive balancing. This tendency leads to the balancing approach applied in technical and formalist ways.

Another point is the boundaries of judicial review limited by the application of the technical balancing. This chapter concludes that the balancing approach is the

instrument that WTO adjudicators applied to implement their duty of dispute settlements. The method of weighing and balancing is aimed to maintain the balance of rights and obligations among member States.

### 3.2. The research method

The case study of WTO jurisprudence has two goals. It aims to explore the development of the concept of balancing in WTO law. It also provides the ground for the comparative study of balancing between international investment law and trade law. Concerning the two purposes, the research method has two points.

The first point is the timeline of WTO disputes. The timeline of WTO disputes is identical to the timeline set up for the case collection of investor–State awards and decisions.<sup>295</sup> As such, the panel reports and the AB reports collected were settled between 1995 and 2015. Second, like the case study of investor–State arbitration, the thesis also took a selective case method to target the WTO reports. Since the WTO created in 1995, the number of WTO disputes is increasing every year. Nowadays the average number of active disputes monthly in 2017 has reached 38.5.<sup>296</sup> Because of the time limits and research resources, the thesis only focuses on the WTO reports which are representative of legal opinions of panels and the Appellate Body on specific WTO provisions and particular issues.

Nevertheless, the ways to evaluate the influence of legal opinions of WTO panels and the Appellate Body are different from that in the case study of investor–State arbitration. The frequent reference of specific WTO reports relies on subjective measurement instead of real numbers. A critical reason is a database provided by the

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<sup>295</sup> See the research methodology of case study of investor–State arbitration in chapter two.

<sup>296</sup> World Trade Organization, *WTO Annual Report 2017* (2018) 128.

WTO not counting the reference number of the statements of WTO panels and the Appellate Body in respect to specific WTO provisions. In order to maintain the accountability and quality of the analyse, I also compare the observation with other studies to ensure the representativeness of the collected WTO reports.

There are nineteen WTO reports collected, including two panel reports and seventeen AB reports. One thing must be clarified here. Some panel reports and the AB reports are for the same dispute; some are not. This is because not all disputing parties decided to appeal the panel report. Moreover, the gap between panel reports and the AB reports results in the role of the Appellate Body. The AB has the authority to uphold, modify or reverse findings and decisions by the panel.<sup>297</sup> Because of the supervision function, legal opinions of the AB are more potent than the panels' opinions.

The case study of WTO jurisprudence mainly rests on the textual analysis and discourse analysis. The textual analysis is used to explore whether WTO provisions provide the textual indication of the balance of interests and the conflicted regulatory purposes. The discourse analysis is for the legal reasoning of WTO reports by panels and the Appellate Body. It aims to study whether the concept of balancing is applied by panels and the Appellate Body to interpret WTO provisions and how.

Before discussing the findings, the thesis needs to explain how to identify the balancing concern in practice.

### 3.3. The balance of interests and the notion of necessity

#### 3.3.1. The embodiment of the balancing concern in the treaty text

Like the case study of investor–State arbitration, the case study of WTO jurisprudence

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<sup>297</sup> The *Understanding on Rules and Procedures Governing the Settlement of Disputes* ('*The Dispute Settlement Understanding*'), Article 17:13.

also focuses on the way that WTO adjudicators interpret and apply WTO provisions to settle the conflicting interests and regulatory purposes. The texts of a treaty are usually the primary reason why adjudicators are obliged to develop approaches for conflicting interests and regulatory purposes. Likewise, the text is the initial point that the thesis searches the balancing concern in WTO law.

Different from investment treaties, WTO agreements have more explicit indications regarding the issue of how to deal with the conflict between trade interests and other values. Three places characterise the textual indications.

The first place is the general exception clauses. This is a significant difference between investment treaties and WTO agreements except for the membership and the subject matters. The custom of investment treaties was not to provide exceptional clauses for general treaty obligations and specific provisions. A possible reason is that the countries which led the negotiation of investment treaties were capital-exporting countries. They often negotiated investment treaties from the perspective of home States and from the concern of protecting their nationals' interests. While the situation is changing because of the vanish of the North-South line,<sup>298</sup> general exception clauses have not been a standard part of investment treaties yet.

General exception clauses instead are essential to WTO agreements. In the three-pillared agreements, i.e. the GATT, the GATS, and the *Agreement on Trade-Related Aspects of Intellectual Property Rights* (TRIPs), general exception clauses are all included while the regulatory models are different. Article XX of the GATT and Article XIV of the GATS list exceptional situations that might exempt legal responsibility of member States which is triggered by the violation of WTO obligations. In contrast,

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<sup>298</sup> UNCTAD, *Bilateral Investment Treaties: 1959–1999* (n 50) 2–3.

Article 3(1) of the TRIPs refer the exceptions to other international conventions regarding the protection of intellectual properties. The reference conventions include the *Paris Convention* (1967), the *Berne Convention* (1971), the *Rome Convention* and the *Treaty on Intellectual Property in Respect of Integrated Circuits*.

Another place is the provisions concerning substantive obligations. The multilateral agreement relating to sanitary and phytosanitary measures (*SPS Agreement*) is to regulate the exercise of SPS measures which might directly or indirectly affect international trade. On the one side, the *SPS Agreement* recognises member States the right to adopt SPS measures for the protection of human, animal or plant life or health and reckons these measures with potential distortion effects on international trade. On the other side, the *SPS Agreement* requires conditions for the adoption of SPS measures. In other words, a Member State must adopt SPS measures consistent with legal requirements. The inconsistent SPS measures will trigger legal responsibility of the exercising State under the *SPS Agreement*.

Likewise, the *TBT Agreement* recognises member States the right to take necessary measures for public interests such as human, animal or plant life or health, environmental preservation and the prevention of customers from deceptive practices. However, under the concern of trade liberalisation, the measures regarding technical regulations and standards of products must be consistent with a series of requirements. In other words, the right to regulate necessary measures is required to balance with the interests of international trade. The inconsistent measures will trigger legal responsibility of the exercising State under the *TBT Agreement*.

The last but not the least place is the preamble. The preamble is the place where usually contain objectives and political purposes of a treaty. Its binding effects, however, are not as strong as the provisions containing substantive obligations for the Contracting



States. This is because the preamble usually indicates the intentions and expectations of the Contracting States to the treaty. It functions as political announcements.

The preamble of a treaty plays a critical role in the application of the balancing approach. The discussion of chapter two has revealed that the balancing approach in investor–State arbitration also relies on the interpretation of the preambular language. The preambular language relevant to the balancing approach includes ‘the pursuit of mutual economic prosperity for the Contracting States’. The thesis also argues that the vagueness of the term ‘economic development’ raising the legitimacy issue of the balancing approach by investment arbitrators.

While WTO law stipulates the pursuit of economic development and the welfare of the society in the preamble, it instead provides explicit language to express the concern of balancing trade value and other concerns. The difference reflects in the *WTO Agreement*. The preamble of this agreement expresses that, the pursuit of trade liberalisation and economic endeavour must be by the objective of sustainable development and concerned with the protection and preservation of the environment.

Other agreements of the WTO also indicate the balancing concern in the preamble. For instance, the preamble of the *SPS Agreement* and the *TBT Agreement* recognises that member States are not prevented from taking measures necessary to ensure the quality of their exports, or for the protection of human, animal or plant life or health, and environment, and the prevention of deceptive practices.

It is true that the WTO does not directly use the language of ‘balance’ in specific provisions and the preamble.<sup>299</sup> The language issue is different from the situation of

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<sup>299</sup> However, it must clarify that the statement cannot conclude that the language of balance is not existed in WTO agreements. The langue of balance at least appears in two places. The first place is the GATT.

international investment law. The text of specific provisions and the preamble of WTO agreements have expressed the concern of reconciling multiple values and indicated how to practice.

### 3.3.2. The requirements of the balance between trade interests and other values

The drafters of the WTO have integrated the balance of trade interests and other values in substantive provisions. There are two popular places for the balancing concern: general exception clauses and the provisions involving the concern of non-trade values.

While general exception provision and other provisions have different normative meaning, they share some elements concerning the balance of trade and non-trade interests. First, they emphasise the regulatory autonomy of member States. For instance, the preamble of the *SPS and TBT Agreements* both recognise that members are not prevented from taking measures necessary to ensure the quality of its exports, or for the protection of human, animal or plant life or health, the environment, or the prevention of deceptive practices.<sup>300</sup> The general exceptions to GATT and GATS also clarify the point that these Agreements should not be construed to prevent the adoption or enforcement of measures for the protection of public interests.

Second, they provide a series of legitimate objectives that indicate the limits to members' commitments and concessions to international trade. The difference is the nature of the list. The lists provided by general exceptions of the GATT and the GATS are exhaustive.<sup>301</sup> The *SPS Agreement* also provides an exhaustive list of legitimate

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Article XII provides member States conditions 'to safeguard their external financial position and the balance of payments'. Second, Article 3(3) of the DSU expresses the functions of dispute settlements. One function is 'the maintenance of a proper balance between the rights and obligations of Members'.

<sup>300</sup> The AB report of *EC – Hormones* also highlighted the purpose of the SPS Agreement as the balance of trade liberalisation and the protection of the life and health of human and animals. Appellate Body Report, WT/DS26/AB/R and WT/DS48/AB/R, *European Communities – Measures Concerning Meat and Meat Products ('EC – Hormones')*, adopted 13 February 1998, para 177.

<sup>301</sup> GATT, Article XX; GATS, Article XIV.

objectives for conditioning the adoption of SPS measures.<sup>302</sup> By contrast, the list provided by the *TBT Agreement* is not exhaustive.<sup>303</sup> The non-exhaustive list, in theory, permits more room for member States' regulatory autonomy than the exhaustive list.

While the nature of the list of legitimate objectives is different, the listed legitimate objectives are quite similar. They usually cover from the protection of public morals, human, animal or plant life or health, to the environmental preservation and protection and the conservation of natural resources. The *TBT Agreement* also includes the concern of protecting customers from deceptive actions. Nevertheless, because of the non-exhaustive nature, Member States are supposed to argue other legitimate objectives except to the listed ones to exempt their treaty obligations under the TBT Agreement.<sup>304</sup>

Another common feature is legal conditions regarding the relationship between the exercise of regulatory autonomy and legitimate objectives. In specific, Article XX of the GATT defines the relationship between a trade measure and the achievement of its legitimate objectives through the requirement of necessity. The preamble of this provision also requires the trade measure must not constitute a means of arbitrary or unjustifiable discrimination between countries. In the GATS, Article XIV adopts similar requirements. It prohibits trade measures from being a means of arbitrary or unjustifiable discrimination between The Member States in the like conditions or a disguised restriction on trade in services. It also requires the measures affecting trade in services consistent with the necessity requirement.

The *SPS Agreement* and the *TBT Agreement* also provide the requirements of less

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<sup>302</sup> The *SPS Agreement*, Article 5.2.

<sup>303</sup> The *TBT Agreement*, Article 2.2.

<sup>304</sup> Markus Wagner, 'Regulatory Space in International Trade Law and International Investment Law' (2014) 36 U. Pa. J. Int'l L. 1, 62.

trade–restrictiveness, non–discrimination and necessity to draw the line between trade interests and other concerns. The difference is, the two agreements employ non–normative elements to define the relationship between the measures and legitimate objectives.

The *SPS Agreement* employs science–based requirements. Article 2.2 requires that SPS measures be ‘based on scientific principles’ and not maintained without sufficient scientific evidence’. In addition to science–relevant requirements, this Agreement also applies the requirement of necessity to define the causality between the measures and the protected interests.

The *TBT Agreement* demands that technical regulations and standards must provide a consistent line to improve the efficiency of production and facilitate the conduct of international trade.<sup>305</sup> Under the concern of harmonisation of state practices, this Agreement gives presumable deference to these measures by relevant international standards.<sup>306</sup> Article 2.2 also stipulates the notion of necessity to condition the extent of trade restrictiveness.

These requirements have a two–fold meaning. First, they indicate the line of how trade interests balanced with other values under the covered WTO agreement. Second, these requirements condition the boundaries of regulatory autonomy. They implicate that regulatory sovereignty of member States is not unlimited and absolute. The boundaries of regulatory sovereignty are relatively in line with different focuses of WTO law.

### 3.3.3. The notion of necessity and the necessity test

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<sup>305</sup> The *TBT Agreement*, the preamble.

<sup>306</sup> The *TBT Agreement*, Article 2.5.

Among these shared elements, the requirement of necessity is critical to define the balance between trade interests and non-trade values. General exceptions of the GATT and the GATS require trade measures must be necessary measures for the legitimate objectives. The *SPS Agreement* and the *TBT Agreement* also require SPS measures and technical regulations and standards of products must be ‘necessary for’ the protected interests.

There are two functions of the term ‘necessary to’ on the implementation of the balancing concern. First, the requirement of necessity demands causality between the adopted measure and the claimed objective. The exercising State is not only required to provide reasoning to justify its decision. Moreover, it must prove the adopted measure is the means sufficient to its claimed purpose or the protected interest. Second, the requirement of necessity indicates the extent to which the interests of international trade distorted is rational and reasonable. Whether the measure is necessary to the claimed objective or the protected interests must be determined by comparison. The elements are varying following the assessment stage. They include distortion effects caused by the measure on international trade, administrative and regulatory costs by the exercising State to adopt less trade-restrictive alternative measures, and benefits for the claimed objectives contributed by the measures. The popularity and importance of the term ‘necessary’ in WTO law develops relevant interpretative approaches in the WTO jurisprudence. These interpretative approaches are known as the necessity test in general.

The following sections discuss how WTO adjudicators interpret the necessity requirement in a different context and what the interpretative approach is developed.

### 3.4. The interpretations of the term ‘necessary to’

### 3.4.1. The interpretations in the context of general exceptions

#### 3.4.1.1. The general exceptions in GATT Article XX

The *Korea Beef* case is a leading case in the GATT jurisprudence in terms of the requirement of necessity.<sup>307</sup> Its significance results from two reasons. One reason is historical. This case gave WTO panels and the Appellate Body the first opportunity to approach the general exceptions in the aftermath of the creation of the WTO.<sup>308</sup> Another reason is the normative contribution. The panel and the Appellate Body developed the interpretative approach and the standard of review for the requirement of the necessity of GATT provisions.

The *Korea Beef* case involved South Korea's dual retail system for the sale of domestic, imported beef. Australia and the United States contended that those measures restricted the importation, distribution and sale of beef. Korea defended this dual retail system as being necessary to secure compliance with its Unfair Competition Act, and the disputed measures satisfied the exceptional situation of Article XX(d) GATT.

GATT Article XX(d) provides an exception for measures that are necessary to secure compliance with WTO-inconsistent laws or regulations. As to the specific requirement 'necessity to', the Appellate Body proposed several factors to consider. These factors include (i) the relative importance of the common interests or values protected; (ii) the contribution of a measure to achieve the end pursued; and (iii) the availability of alternative measures with lesser trade-restrictive impacts.<sup>309</sup> The Appellate Body further developed formula as to the application of these factors in a dispute.

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<sup>307</sup> WT/DS 161, *Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef* ('*Korea—Beef*').

<sup>308</sup> Appellate Body Report, *Korea—Beef*, adopted 10 January 2001.

<sup>309</sup> *Ibid.*, para 162.

First, if the public interests protected by the measure are vital or essential, the easier it would be to accept as necessary as a measure designed as an enforcement instrument. Second, if the measure has a more significant contribution to realise the claimed objective, the more easily it might be considered as a necessary measure. Third, if the measure causes less restrictive impacts on international trade (i.e. imported goods), the higher the chance it might be evaluated as a necessary measure.<sup>310</sup>

The series of standards set up the way to determine the necessary extent of a trade measure. Moreover, these standards reveal two focuses of the determination. The determination is not only concerned with the existence of the causality between the measures and the claimed objective, but also the degree of restrictive impact of the measure.

As to the appealing point of the restrictive extent, the Appellate Body of *Korea—Beef* upheld the panel’s practice. The panel adopted the alternative–measure analysis to determine the trade–restrictiveness effects of the measure. This determination method developed from the previous panel reports in the GATT period.<sup>311</sup> In the GATT period, the panel in the *United States—Section 337* case had suggested that the ‘necessary extent’ under the Article XX(d) GATT depends upon whether the exercising State had an alternative measure that could reasonably be expected to be employed and was consistent with other GATT provisions to achieve the same claimed objective.<sup>312</sup> According to the previous experiences, the Appellate Body developed the factors to help decide the balancing point between the commitments to trade liberalisation and regulatory autonomy.

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<sup>310</sup> Ibid, paras 163–64.

<sup>311</sup> Ibid, para 165.

<sup>312</sup> Panel report, L/6439–36S/345, *United States—Section 337*, adopted 07 November 1989, para 5.26.

Moreover, the Appellate Body of *Korea—Beef* clarified a general point as to the application of general exceptions provision. The point is the respect of Member States' right to regulate. In its words, 'it is a common understanding of GATT panels that Members of the WTO have the right to determine for themselves the level of enforcement of their WTO-consistent laws and regulations'.<sup>313</sup>

The statements reveal the difficulty of interpreting the conceptual term 'necessary to'. The panel and the Appellate Body did not give fixed definition to the term 'necessary to' in their reasoning. Rather, they developed the analysis structure and considered factors that help determine whether a situation amounts to a 'necessary situation' and within the exception scope of the GATT.

The following cases, whether the same exception or other exceptions, primarily referred to the legal opinions of the panel and the Appellate Body report of *Korea—Beef*. The reference of legal opinions includes the logical structure, considering factors and the standard of review to the term 'necessary to' of Article XX (d). The reference by the Appellate Body of *EC—Asbestos* is an example.

The *EC—Asbestos* case involved France's ban on asbestos and products containing asbestos. Canada alleged that these measures violated the provisions relating to technical regulations and standards set out in Article 2 of the TBT Agreement, the national treatment provision of Article III of the GATT, and the GATT prohibition on quantitative import restrictions. Canada did not contest the toxicity of asbestos which poses a health risk. What Canada argued is that the form of substance, chrysotile asbestos, was safe in circumstances of properly controlled use. This substance still allowed to be used in France, but the French government banned imports. The French

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<sup>313</sup> Ibid, para 176.



government, as the respondent, argued that the measures were for the protection of public health which was vital to the society.

The Panel found the disputed measures in a violation of national treatment of the GATT (Article III:4). Its reason was the measure specially treated chrysotile asbestos fibre less favourably than ‘like’ substitute fibre, constituting differential treatment for imports. On the other hand, the Panel found that the measure was justified by general exceptions of the GATT on the grounds of human health and the fulfilment of the chapeau of the same provision, Article XX. Canada appealed the Panel’s findings.

With regard to the issue of the necessity test of the GATT, the panel had recourse to the AB report of *Korea—Beef*. It assessed the necessary degree by considering the factors such as the existence of the legitimate objective, the causality between the measure and the protected interests and the restrictiveness of the measure. While Canada appealed the Panel’s decision, the Appellate Body upheld the panel’s practice. The Appellate Body did not question the Panel’s reference to the AB report of *Korea—Beef* to interpret the term ‘necessary to’ of GATT Article XX(b).<sup>314</sup>

In the appellate review, the Appellate Body repeated its legal opinions of the *Korea—Beef* case. It advanced the interpretation of general exception provision of the GATT in two ways.

First, it implicates that the textual and contextual differences of different exceptions to Article XX do not block the reference of legal opinions of the same term. In other words, in the Appellate Body’s viewpoint, the same treaty term of different

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<sup>314</sup> Appellate Body Report, WT/DS135/AB/R, *European Communities—Measures Affecting Asbestos and Products Containing Asbestos* (‘EC—Asbestos’), adopted 5 April 2001.

paragraphs is not required to interpret differently.

The *EC—Asbestos* case is another leading case. This case was raising out of subparagraph (b) of GATT Article XX. While there are textual and contextual differences in the two cases, the Appellate Body did not underestimate the reference value of the *Korea—Beef* case. Instead, the AB believed that the differences are not significant to deny the reference of its previous opinions in the *Korea—Beef* case. As such, it conducted a cross-reference of legal opinions between subparagraphs of the same provision.<sup>315</sup>

Second, the Appellate Body of *EC—Asbestos* emphasised the appreciation must be given to the legitimate objectives claimed by the exercising State, as well as to the chosen degree of exercise. It agreed that the importance of specific issues to society is different from country to country. One country has the regulatory autonomy to decide what interests are essential to protect. In this case, it respected that the France government decided the protection of human health from the risk of asbestos products is a vital and vital value for society. Because of the importance of public health, the Appellate Body also agreed with the level of protection decided by the France government as the highest degree.<sup>316</sup> The panel was required to assess the necessity of the disputed measure by France's highest degree of protection.

According to the chosen regulatory level by France, the Appellate Body decided the standard of review. The more vital or essential the common interests or values pursued, the easier it would be to accept as necessary measures designed to achieve those ends. It found that France could not reasonably be expected to employ an

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<sup>315</sup> Cross-provision and cross-agreement interpretation is common to WTO adjudicators. In the following section 3.5 of this chapter will discuss the practice of interpreting the same treaty term in the same way in detail.

<sup>316</sup> Appellate Body Report, *EC—Asbestos* (n 314) para 172.

alternative measure to achieve its chosen level of health.<sup>317</sup>

The repeated reference of legal opinions of the panel and the AB reports of *Korea—Beef* establishes the standard practice of interpreting and applying the term ‘necessary to’ in GATT cases.

#### 3.4.1.2. The general exceptions in GATS Article XIV

With regards to general exceptions of the GATS, panels and the Appellate Body do not tend to interpret the term ‘necessary to’ differently from that of the GATT. Panels and the Appellate Body frequently referred to the experiences of GATT disputes to interpret and apply general exceptions of GATS Article XVI in terms of the necessity test. Consequently, the GATS and the GATT share similar interpretation results of the term ‘necessary to’ of general exceptions.

The general exception provision of the GATS was first interpreted and applied by panels and the Appellate Body in the *US—Gambling Services* case. This case was raising out of US measures that prevented the supply of gambling and betting services from other WTO Members to the United States via a cross-border basis. Antigua and Barbuda (hereinafter also ‘Antigua’) claimed that these measures violated the US commitments on gambling and betting services under the GATS schedule. The US argued that the trade measures were concerned with the financial and social risks posed by remote-access gambling and betting services to its citizens. These measures were not only for the enforcement of US criminal laws concerning organised crimes but also for the protection of public morals. Because of the US defence, one of the legal issues of this case is whether the US measures applied subparagraphs (a) and (c) of Article

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<sup>317</sup> Ibid, paras 173–74.

## XIV.

Either Articles XIV (a) or XIV (c) provide the term ‘necessary to’ to determine the legality of trade measures. As to the issue of the term ‘necessary to’, the panel *US—Gambling Services* noted that there was no prior jurisprudence under GATS for the possible guidance of treaty interpretation.<sup>318</sup> This Panel recalled the Appellate Body of *EC—Bananas III* that confirmed the interpretation of analogous provisions between the GATT and the GATS.

Given the textual similarity and the joint function of GATT Article XX and GATS Article XIV, the Panel believed that the GATT/WTO jurisprudence about the former might be relevant and useful in the interpretation of the latter.<sup>319</sup> As such, the panel applied the legal opinions of the notion of necessity developed in GATT jurisprudence to interpret the requirement of necessity under GATS Article XIV.<sup>320</sup>

While both Antigua and the US appealed the findings of the Panel, the Appellate Body did not question the cross-reference of the GATT jurisprudence by the panel. In the appellate review, the Appellate Body neither overturned the panel’s opinions as to the requirement of the necessity of GATS Article XIV. By contrast, the Appellate Body confirmed that previous decisions under Article XX of the GATT are relevant to the analysis under Article XIV of the GATS. The necessity test is no exception.<sup>321</sup>

The following GATS cases repeated the practice of having recourse to GATT-based interpretations. In another GATS dispute, Argentina as the respondent State, invoked subparagraph (c) of Article XIV to defend its trade measures to secure

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<sup>318</sup> Panel Report, WT/DS /285/R, United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services (*US—Gambling Services*), adopted 20 April 2005, para 6.447.

<sup>319</sup> Ibid, para 6.448.

<sup>320</sup> Ibid, para 6.449.

<sup>321</sup> Appellate Body Report, WT/DS /285/AB/R, *US—Gambling Services*, adopted 20 April 2005, para 291.

compliance of national laws against money laundering and deceptive tax practices. The Panel of *Argentina—Financial services* recalled the AB's opinions in the *US—Gambling Services* case as to the cross-reference of the interpretation of general exceptions between the GATT and the GATS.<sup>322</sup> As such, it considered that the standard of review developed by the AB of *Korea—Beef* is relevant to the analysis of GATS Article XIV (c).<sup>323</sup>

In the appellate review, the Appellate Body did not question the panel's practice of analogy of legal opinions between the GATT and the GATS in terms of the necessity test.<sup>324</sup> The Appellate body had two reasons. First, both GATT Article XX and GATS Article XIV provide general exceptions for trade commitments. Second, the two provisions have the same working function as the gatekeeper of the exceptions. These common grounds suggest that there is no need for differentiating interpretation results as to the term 'necessary to'.

These cases demonstrate a popularity of reference to the GATT jurisprudence of general exceptions in interpreting the necessity requirement. The analogy of GATT-based interpretation has been a standard method for the interpretation of general exceptions of GATS. The next question is whether the cross-agreement reference also applied to the term 'necessary to' of the *SPS Agreement* and the *TBT Agreement*.

### 3.4.2. The interpretations in the context of positive obligations

#### 3.4.2.1. The term 'necessary to' in the TBT Agreement

The context of the term 'necessary to' in the *TBT Agreement* and the *SPS Agreement* is

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<sup>322</sup> Panel Report, WT/DS453/R, *Argentina—Measures Relating to Trade in Goods and Services* ('*Argentina—Financial services*'), adopted 09 May 2016, paras 7.585–86.

<sup>323</sup> Ibid, paras 7.593, 658–61.

<sup>324</sup> Appellate Body Report, WT/DS453/AB/R, *Argentina—Financial services*, adopted 09 May 2016.

different from that in the GATT and the GATS in terms of general exceptions. The main reason for the difference is the policy assumption behind the requirement of necessity.

The *TBT and the SPS agreements* assume that the technical standards or SPS measures are the legitimate exercises of regulatory sovereignty for the public interest. While these measures might cause distortion effects on international trade, they are legitimated if the exercise is consistent with the WTO requirements. The notion of necessity is one of the requirements for the legitimacy of these trade-restriction measures.

The policy assumption has a two-fold meaning. First, it suggests a broader space for regulatory sovereignty than in the context of general exceptions.<sup>325</sup> In the context of the *TBT Agreement*, panels and the Appellate Body even have the authority to consider other legitimate objectives outside of the listed purposes of Article 2.2 to assess the legitimacy of the disputed measure.<sup>326</sup> Second, it suggests the function of the term ‘necessary to’ is different from that in the context of general exceptions. The necessity test is not used to exempt the responsibility of WTO-inconsistent measures but to prove a measure is consistent with WTO provisions. Under these differences, the term ‘necessary to’ in the *TBT and SPS Agreements* is supposed to be interpreted differently from the results in the context of general exceptions.

Different policy contexts, however, do not lead to different interpretations in terms of the requirement of necessity.

In the context of the *TBT Agreement*, panels and the Appellate Body rely on the close relationship between GATT and the *TBT Agreement* on which to rest the

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<sup>325</sup> Lukasz Gruszczynski, *Regulating Health and Environmental Risks under WTO Law: A Critical Analysis of the SPS Agreement* (OUP 2010) 38.

<sup>326</sup> Appellate Body Report, WT/DS384/AB/R, *United States—Certain Country of Origin Labelling (COOL) Requirements* (‘US—COOL’), adopted 13 July 2012, paras 372–373.

interpretation of the necessity test on legal opinions of precedent GATT/GATS cases. The considering factors and assessment formula developing from the jurisprudence of general exceptions are also directly applied to the TBT disputes. For instance, the Appellate Body in *US—COOL* had recourse to the reports of *US—Tuna II (Mexico)* to decide on factors to consider as to the necessity test of Article 2.2 of the TBT Agreement.<sup>327</sup> It also emphasised that all considering factors must be weighed and balanced as the bases for the final decisions.<sup>328</sup>

A difference from general exceptions of GATT and GATS is the requirement of risk assessment. The *TBT Agreement* adds the element of the risks non-fulfilment created to limit the adoption of trade-restrictive measures. The additional element, instead, becomes the primary issues argued in the TBT disputes regarding the assessment of trade-restrictive impacts of the disputed measure.<sup>329</sup>

#### 3.4.2.2. The term ‘necessary to’ in the SPS Agreement

In the context of the *SPS Agreement*, panels and the Appellate Body also have not intention to interpret the requirement of necessity differently from that in the GATT and GATS cases. While the *SPS Agreement* adopts a science-based regulatory model, the regulatory approach is not significant enough for WTO adjudicators to alter the meaning of the notion of necessity developed from the GATT cases.

The science-based regulatory model, however, constrains the reference of legal opinions of previous cases in the GATT and GATS jurisprudences. The cross-reference of legal opinions in terms of the notion of necessity is not as popular as that in the TBT

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<sup>327</sup> Ibid, para 374.

<sup>328</sup> Ibid, ft 745 of para 374.

<sup>329</sup> Ibid, paras 376–77.

Agreement or the GATS. This is because panels and the Appellate Body focus primarily science-relevant elements requested by the *SPS Agreement*.

One of the science-relevant elements is a risk assessment. The requirement requests the exercising State to identify the existence of risk before adopting trade-restriction measures. In the *EU—Seal products* case, the Appellate Body highlighted the difference in the textual structure between Article XX(a) and (d) of GATT and the *SPS Agreement*. It noted that the concepts of ‘risk’ and ‘protection’ expressly written in the *SPS Agreement*. While the risk-relevant requirements are in favour of elaborating the application of GATT Article XX (b), they are not suitable for GATT Article XX (a). The difference is due to the subparagraph (a) of GATT Article XX referring to the protection of public morals or public orders. This exceptional situation is not relevant to the risk issue.<sup>330</sup>

The science-relevant elements indeed lead the panels and the Appellate Body to concentrate on the relationship between the measure and scientific evidence in the determination. As the Appellate Body of *India—Agricultural Products* stated, the determination of inconsistent SPS measures must consider the relationship between the measure and scientific evidence, the sufficiency of the scientific evidence and the adoption of risk assessment.<sup>331</sup>

The textual difference not only shifts the focus of the determination of inconsistent trade measures but also constrains the reference to legal opinions of GATT and GATS cases to the necessity requirement.

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<sup>330</sup> Appellate Body Report, WT/DS400/AB/R and WT/DS401/AB/R, *European Communities—Measures Prohibiting the Importation and Marketing of Seal Products* (‘*EU—Seal Products*’), adopted 18 June 2014, para 5.197–5.198.

<sup>331</sup> Appellate Body Report, WT/DS430/AB/R, *India—Measures Concerning the Importation of Certain Agricultural Products* (‘*India—Agricultural Products*’), adopted 19 June 2015, paras 5.11–5.29.



### 3.4.3. Small remarks

The context in which the requirement of necessity in WTO law is various. In a different context, the term ‘necessary to’ is associated with other requirements. While there are textual and contextual differences along with the term ‘necessary to’, the differences have limited influences on the interpretation and application. Panels and the Appellate Body tend to unify the interpretative approach and the meaning of necessity cross-agreement, but they clarify the scope of the term ‘necessary to’ varying in line with the covered WTO agreements.<sup>332</sup>

In the unification of the meaning of necessity, the GATT jurisprudence plays a leading role. The GATT jurisprudence develops the interpretative approach for the requirement of necessity, identifies the considering elements for determination, and proposing the standard of review for the necessity of trade measures. These elements are applied mainly to interpret the same term of other WTO agreements. The cross-agreement reference to a certain point ensures the consistency and comprehension of WTO law in terms of the term ‘necessary to’.

Nevertheless, the unification of interpretation results is at the cost of the flexibility of the term ‘necessary to’. Panels and the Appellate Body have not applied the contextual differences to develop a range of necessary measures that indicate the balancing policies in WTO law.

### 3.5. The patterns in treaty interpretation and the role of Appellate Body

The practice of the term ‘necessary to’ reveals several features of interpretative activities

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<sup>332</sup> Mads Andenas and Stefan Zleptnig raise the concern of the specific function and purpose behind the contextual difference and its impacts on the interpretation of WTO provisions. Mads Andenas and Stefan Zleptnig (n 6) 77.

by panels and the Appellate Body. There are two significant features: the tendency of standardising legal opinions and the emphasis of formality of legal interpretation, and the *de facto* precedent principle of previous cases.

### 3.5.1. The standardisation of interpretative approaches and the formality of interpretative activities

Panels and the Appellate Body tend to to unify their interpretative activities. The interpretative activities include the interpretative approach, the analysis structure, considering factors and the standard of review for a legal concept and treaty term. The cross-reference of GATT-based legal opinions mirrors the tendency of standardisation of legal interpretations by WTO adjudicators.

A critical factor to the tendency of standardisation of interpretative activities is the appellate review and the creation of the Appellate Body.

The WTO designs appellate review as the means of maintaining the consistency and integrity of legal interpretations of WTO provisions.<sup>333</sup> For the institutional function, the Appellate Body has authorised the power to uphold, modify or deny the findings and opinions of the panel. The authority of appellate review enables the Appellate Body to clarify ambiguous concepts and unify legal opinions in the application of WTO provisions. The practice of interpretation of the necessity requirement has revealed the role of the Appellate Body.

In the *Korea—beef* case, the Appellate Body at first proposed several legal opinions to the necessity requirement and the necessity test. These legal opinions include the meaning of the term 'necessary', the considering factors in determining the

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<sup>333</sup> Yasuhei Taniguchi and Tomoko Ishikawa (n 8) 77.

necessary degree, and the boundaries of discretion in the determination.

While the Appellate Body had recourse to the dictionary definition to the word ‘necessary’, it acknowledged that the legal meaning of ‘necessary to’ is not fixed to the literal meaning such as ‘indispensable’ or of absolute necessity’ or ‘inevitable’.<sup>334</sup> The term of necessary is an indicator of whether the disputed measures fulfil the requirements of a specific provision, i.e. Article XX (d) GATT in this case. As such, the Appellate Body clarified that the term ‘necessary’ refers to a range of degrees of necessity. Two ends of indispensable and contributing set this continuum. In the context of general exceptions of the GATT, necessary measures are closer to being indispensable.<sup>335</sup>

Concerning the variety of trade measures, the Appellate Body notes that the determination of the necessary degree must be conducted in line with the factual and legal background of the dispute. In *Korea—beef*, the Appellate Body proposed several factors for the determination of the degree of necessity.<sup>336</sup> These factors are (i) the relative importance of the common interests or values that the disputed measure is intended to protect, (ii) the contribution to realise the claimed objective; and (iii) the less restrictive impacts on international trade. These factors at least ensure that the logical structure will be the same in each dispute.

In addition, in this case, the Appellate Body also indicated the deference given to

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<sup>334</sup> Appellate Body Report, *Korea—Beef* (n 308) para 161.

<sup>335</sup> Ibid, para 162.

<sup>336</sup> The flexible and fact-specific interpretive approach is also applied to the term ‘relating to’ which is another requirement for legitimate exceptions of GATT. In the context of Article XX(g) GATT, the Appellate Body leaves flexibility in the interpretation and application of the term ‘relating to’. In *United States—Gasoline*, it accepted a measure because it presented a ‘substantial relationship’ i.e., a close and genuine relationship of ends and means, with the conservation of clean air. In *United States—Shrimp*, the Appellate Body accepted a measure because it was ‘reasonably related’ to the protection and conservation of sea turtles.

policy choices of the respondent State. It believes that trade measures are the result of regulatory sovereignty. There are three elements reflecting the space of regulatory autonomy: (i) the concerned or protected interests; (ii) the level of protection; and (iii) the instruments to be used to achieve the policy goal. The Appellate Body noted that the exercising State's commitments to the WTO are measurements for the legality of regulatory autonomy in action. Given the delegated authority, it believed that it and panels must give deference to the decision of a Member State. The deference covers the priority of national policies and the exercising measures chosen by the member State. In the context of the necessary trade measures, the extent is created by three elements: the protected interests, the level of protection, and the instrument for the legal purpose. The three elements constitute the ways how WTO adjudicators respect the right to regulate of member States in practice.

After proposing its legal opinions, the Appellate Body then repeated its legal opinions and applied to review the panels' interpretation results. While panels might depart from the opinions of the Appellate Body in some situations, the different practices will be corrected by the Appellate Body in appellate review. The process of clarification and correction results in the unity of legal opinions and standard practices to the necessity test.<sup>337</sup>

While the Appellate Body might refine or elaborate its legal opinions in the following cases, its legal opinions usually are the standard legal interpretation to the treaty term of WTO law. Therefore, the Appellate Body plays a critical role in the standardisation of legal interpretations of WTO law.

### 3.5.2. The high reliance on legal opinions of precedent GATT/WTO reports

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<sup>337</sup> Chapter five analyses how the Appellate Body employs its authority (power) to drive the process of standardisation of legal interpretations as the communication with panels and member States.

Except for the appellate review, the repeated reference to legal opinions of precedent cases is another reason for the unity of legal interpretation in WTO law.

The case law demonstrates that panels and the Appellate Body tend to refer to legal opinions of precedent cases to support their decisions. While the principle of precedent does not apply to WTO law, it is actually practised by panels and the Appellate Body through the repeated reference of previous GATT/WTO reports.

While commentators usually compare the necessity test of the WTO jurisprudence with the principle of proportionality developed by other international law,<sup>338</sup> they rarely mention where the principle of proportionality and similar approaches originated in WTO law. The practice shows that panels and the Appellate Body mentioned the experiences of other international regimes and authorities in the course of applying the necessity test. The situation suggests that the conservative attitude of the WTO adjudicators on the cross-regime reference shape WTO law as a self-contained system in practice. The repeated reference is the reason and also the result of the self-contained system of the WTO.<sup>339</sup>

This study proposes the other two reasons to explain the self-reference of legal opinions by panels and the Appellate Body.

The first reason is the emphasis on the textual approach. WTO adjudicators have

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<sup>338</sup> Nicolas F. Diebold, 'The Morals and Order Exceptions in WTO Law: Balancing the Toothless Tiger and the Undermining Mole' (2007) 11(1) *Journal of International Economic Law* 43; Mads Andenas and Stefan Zleptnig, 'Proportionality: WTO Law: in Comparative Perspective' (2007) 42 *Texas International Law Journal* 371; Gabrielle Marceau and Joel P. Trachtman, 'A Map of the World Trade Organization Law of Domestic Regulation of Goods: The Technical Barriers to Trade Agreement, the Sanitary and Phytosanitary Measures Agreement, and the General Agreement on Tariffs and Trade' (2014) 48(2) *Journal of World Trade* 351; Gisele Kaptein, 'A Critique of the WTO Jurisprudence on "Necessity"' (2010) 59 *International and Comparative Law Quarterly* 89, 91.

<sup>339</sup> However, Isabelle van Damme argues that the WTO system is not clinically isolated from the international law system. Isabelle Van Damme (n 6) 356–57. The openness of the WTO system will address in detail in chapter five which is about the institutional differences between international investment law and WTO law.

highly recognised the importance of interpretative rules of the *Vienna Convention*. The Appellate Body in *US—Continued Zeroing* stated that the customary rules of treaty interpretation codified by the VCLT ‘imposed certain common disciplines upon treaty interpreters, irrespective of the content of the treaty provision examined and irrespective of the field of international law concerned’.<sup>340</sup> The Appellate Body further standardises the method of interpreting WTO provisions in line with the three-step analysis (text, context, object and purpose) of Article 31 of the VCLT. In *India—Patents (US)* the Appellate Body stated that ‘[t]he duty of a treaty interpreter is to examine the words of the treaty to determine the intentions of the parties. This should be done by the principles of treaty interpretation set out in Article 31 of the Vienna Convention’.<sup>341</sup> The AB report of *EC—Hormones* also highlighted the role of the text. In its words, ‘[t]he fundamental rule of treaty interpretation requires a treaty interpreter to read and interpret the words used by the agreement under examination, not words the interpreter may feel should have been used’.<sup>342</sup>

Also, the textual approach is facilitated by the cautious attitude of framing the application of WTO provisions into a presumable way, as Isabelle Van Damme observes.<sup>343</sup> For instance, the panel in *Argentina—Poultry Anti-Dumping Duties* rejected the application of Article 31(3)(c) VCLT<sup>344</sup> for any purpose other than interpretation. While the panel acknowledged that this interpretative rule suggests other international laws as sources to interpret the WTO provisions, it stated that this provision could not make the panel ‘apply the relevant WTO provisions in a particular

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<sup>340</sup> Appellate Body Report, WT/DS350/AB/R, *United States – Continued Existence and Application of Zeroing Methodology* (*US—Continued Zeroing*), adopted 19 February 2009, para 237 (Here the Appellate Body quoted the statement in its previous report of *US—Hot-Rolled Steel*).

<sup>341</sup> Appellate Body Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products* (*India – Patents (US)*), adopted 16 January 1998, para 94.

<sup>342</sup> Appellate Body Report, *EC—Hormones* (n 300), para 181.

<sup>343</sup> Isabelle Van Damme (n 6) 365–66.

<sup>344</sup> Article 31(3)(c) provides that ‘any relevant rules of international law applicable in the relations between the parties’ shall be taken into account along with the context.

way'.<sup>345</sup>

The second reason for the self-reference is the institutional function of the Appellate Body. Compared with the GATT panels, the Appellate Body displays a higher institutional sensitivity in the decision making.<sup>346</sup> The institutional sensitivity is the importance of the coherence and consistency of legal interpretations. While the institutional sensitivity might not be relevant to the perspective of legitimacy, in the AB's viewpoints, the guidance effects have material meaning for the need of member States. The Appellate Body believes that previously adopted reports create legitimate expectations among WTO members. As such, the reason for the reference of legal opinions of previous GATT/WTO reports is the protection of the legitimate expectations of the Member States to a dispute.<sup>347</sup>

It is not questioned that reference to legal opinions of previous cases favours the consistency of interpretation results and the continuity of interpretative practices. What is questionable is the scope of the reference case. The reference cases are primarily limited to the WTO jurisprudence. This feature highlights the nature of the WTO as a closed system. WTO law is closed to member States instead of other non-WTO parties. Neither is for general interests of international society as a whole. Chapter five will address this point in detail.

### 3.6. The necessity test and the weighing and balancing analysis

#### 3.6.1. The meaning of the weighing and balancing analysis

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<sup>345</sup> Panel Report, WT/DS241/R, *Argentina—Definitive Anti-Dumping Duties on Poultry from Brazil* ('*Argentina—Poultry Anti-Dumping Duties*'), adopted 19 May 2003, para 7.41.

<sup>346</sup> Robert Howse, 'Adjudicative Legitimacy and Treaty Interpretation in International Trade Law: The Early Years of WTO Jurisprudence' in J.H.H. Weiler (ed), *The EU, the WTO and the NAFTA: Towards a Common Law of International Trade?* (OUP 2001) 64.

<sup>347</sup> Appellate Body Report, WT/DS8/AB/R, *Japan—Taxes on Alcoholic Beverages* ('*Japan—Alcoholic Beverages II*'), adopted 1 November 1996, 107–108.

The case law demonstrates that panels and the Appellate Body not only develop the united meaning of the term ‘necessary to’ but also develop the standard interpretative approach. The standard interpretative approach is the weighing and balancing analysis.

In the *Korea—Beef* case, the Appellate Body had developed the weighing and balancing analysis and addressed its role in the determination of the necessity test. The Appellate Body explained the weighing and balancing analysis as a process of consideration and analysis of relevant factors. The relevant factors had been identified by the Appellate Body, including (i) the contribution made by the compliance measure to the enforcement of the law or regulation at issue, (ii) the importance of the common interests or values protected by that law or regulation, and (iii) the accompanying impact of the law or regulation on imports or exports.<sup>348</sup> The Appellate Body stressed that these factors are concerned in a sequence rather than a random way. Instead, these factors are weighed and balanced by the panel in the factual and legal contexts.

The Appellate Body stressed the weighing and balancing analysis for two functions. First, the analysis process applies to assess the causality between the measure and the claimed objectives. Second, the analysis process applies to determine the availability of ‘WTO-consistent alternative measures for the same objective’.<sup>349</sup> The Appellate Body of *Korea—Beef* also announced that ‘the weighing and balancing analysis must be involved in every case’.<sup>350</sup>

Nevertheless, Ulrike Will questions the contribution of the weighing and balancing analysis to the development of normative principles of the WTO and international law.<sup>351</sup> She has two reasons. First, the terms ‘weighing and balancing’ is strange to the

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<sup>348</sup> Appellate Body Report, *Korea – Beef* (n 308) para 164.

<sup>349</sup> Ibid, para 166.

<sup>350</sup> Ibid, para 164.

<sup>351</sup> Ulrike Will, ‘The extra-jurisdictional effects of environmental measures in the WTO law balancing process’ (2016) 50(4) *Journal of World Trade* 611, 614.



authorities of international law. International law has not well developed the meaning of the weighing and balancing analysis. He questions that the sources that panels and the Appellate Body referred to support the creation. Second, Second, weighing and balancing are vague languages. The languages easily create an illusion that the interpretation results are a reflection of the balance of competing interests embodied in the covered WTO agreement. Nevertheless, legal reasoning of panels and the AB reports show that the weighing and balancing is applied as an analysis process. The conceptual process has limited contribution to clarifying the meaning of disputed provisions or uncertain terms.

Treaty interpretation is the enforcement of treaties. The process of interpretation not only provides the final answer to the dispute but also clarifies the meaning of treaty terms and unsettled legal principles. Because of the normative meaning of treaty interpretation, it is understandable why Ulrike Will expects the weighing and balancing analysis having a contribution to the development of the term 'necessary to' and the necessity test of WTO law.

The theoretical discussion, however, needs to connect the practice. International law is a decentralised system. Different regimes have their principles and regulations. International authorities also have the discretion of inventing analysis approaches that meet the needs of the particular regime. It is true that international law has not developed the principle of balancing like the balancing approach of US law. In addition, international law does not like the constitutional law of nation-states that have constitutional values for the conflicting decisions by public authorities. The differences are limits to the analogy between municipal law and international law in terms of weighing and balancing.

The Appellate Body repeatedly announces the weighing and balancing not a normative principle that added to WTO law. Instead, it develops the weighing and balancing analysis for the technical purpose, assisting panels in improving the quality of judicial review. As the Appellate Body stated in *Brazil—Retreaded Tyres*, ‘the weighing and balancing is a holistic operation that involves putting all the variables of the equation together and evaluating them about each other after having examined them individually, in order to reach an overall judgement’.<sup>352</sup>

After clarifying the meaning of the weighing and balancing analysis in the WTO jurisprudence, the next question is how panels and the Appellate Body apply in the process of analysis and judgement.

### 3.6.2. The function of the weighing and balancing analysis

The thesis argues that the weighing and balancing analysis is primarily for the technical function. The technical function is reflected in two points.

First, the weighing and balancing analysis is a framework for panels and the Appellate Body to take all relevant factors into account. In the *US—COOL* case, the Appellate Body clarified that the weighing and balancing is not a guideline that requires the panel to consider relevant factors in a fixed sequence. It is neither a standard answer for the interpretation and application of a particular term and provision. On the contrary, the weighing and balancing analysis is a framework. The framework assists the panel in taking a comprehensive and inclusive attitude toward treaty interpretation and dispute settlements.<sup>353</sup> As such, the AB report noted the flexibility inherent to the weighing and balancing analysis. The panel has the discretion to decide the weights of different

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<sup>352</sup> Appellate Body Report, WT/DS332/AB/R, *Brazil—Measures Affecting Imports of Retreaded Tyres* (‘*Brazil—Retreaded Tyres*’), adopted 17 December 2007, para 182.

<sup>353</sup> Appellate Body Report (Article 21.5), WT/DS384/AB/RW, *US—COOL*, adopted 29 May 2015, para 5.198.

considering factors in the factual and legal contexts of each dispute. The factual and legal contexts are varying in line with characteristics of the disputed measure, the importance of the claimed objective, and legal issues argued by disputing parties. The differences are all influential to the panel's consideration through the process of weighing and balancing.<sup>354</sup>

Another point is about the litigation strategy of appellate review. In the cases involving the term 'necessary to', a popular appellate issue is non-application or misapplication of the weighing and balancing analysis. Since the case, the Appellate Body has repeatedly noted the role of the weighing and balancing analysis on the necessity test. The AB's opinion then transfers into a specific appellate issue. Either side of the disputing parties might allege the panel is not applying or misapplying the weighing and balancing analysis by the panel. The allegation is usually on the ground of Article 11 of the DSU which provides the institutional duty of panels. Article 11 of the DSU requires panels to conduct an objective assessment in the interpretation and application of WTO provisions.

The Appellate Body usually adopts a formalist approach as to the appellate issue of the weighing and balancing analysis. It focuses on whether the panel had evaluated all considering elements and gave the weights of these elements before reaching the final decision. If the panel had considered all elements in the reasoning, the Appellate Body would assume that the panel adopted the weighing and balancing analysis and dismiss the allegation. On the contrary, if the panel did miss one of the considering elements in the reasoning, the Appellate Body might question the findings of the panel and announce the violation of Article 11 of the DSU.

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<sup>354</sup> Ibid, paras 5.205–06.

Nevertheless, the Appellate Body takes a lower standard of review to the weighing and balancing analysis. The standard of review for the weighing and balancing analysis focuses on the formality rather than the substantive content of the weighing and balancing analysis.

The technical functions highlighted by the Appellate Body reveals that the Appellate Body is cautious of involving the balancing act. The Appellate Body tends to directly apply WTO provisions to evaluate the balancing act by member States. Seldomly does it express what situation is the balanced situation.

Some commentators also notice the technical tendency of WTO adjudicators in terms of the weighing and balancing. For instance, Christiane Gerstetter suggests that the Appellate Body is inclined to leave the balance of competing values to member States to decide. She argues the practice revealing that the Appellate Body treats the balancing act not only the right inherent to the sovereignty of member States but also their responsibility to implement.<sup>355</sup> As such, she proposes that the weighing and balancing by panels and the Appellate Body more like ‘the technical balancing’, opposed to the opinion of Ulrike Will that WTO adjudicators engage in the balance of rights and duties for member States.

The thesis advances these studies to argue that the technical balancing by the Appellate Body is also related to its institutional sensitivity.

As discussed above, the Appellate Body is aware of its role in the WTO system. It is authorised to maintain the consistency and predictability of WTO provisions. Therefore, appellate review is for general interests of the WTO, not for the interests of

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<sup>355</sup> Christiane Gerstetter, ‘The Appellate Body’s “Response” to the Tensions and Interdependencies Between Transnational Trade Governance and Social Regulation’ in Christian Joerges and Ernst-Ulrich Petersmann (eds), *Constitutionalism, Multilevel Trade Governance and Social Regulation* (Hart Publishing 2011) 124.

disputing parties in specific. The institutional function reflects in two points. First, the membership of the Appellate Body must be broadly representative of the membership of the WTO.<sup>356</sup> Second, the decision for the dispute must maintain a proper balance between the rights and obligations of member States.<sup>357</sup> The AB report of *US—Stainless Steel* stressed that ‘the legal interpretation embodied in the adopted panel and Appellate Body reports becoming part and parcel of the *acquis* of the WTO dispute settlement system’.<sup>358</sup> The institutional design makes the Appellate Body rather take a conservative attitude on the balancing act over the conflicting interests and regulatory purposes of a dispute.

### 3.6.3. A standard framework for the degrees of necessity

While panels and the Appellate Body are inclined to standardise legal opinions of WTO provisions, they reserve the flexibility to conceptual terms. The flexibility is usually reserved through giving a range of degrees instead of a fixed definition. The WTO cases involving the term ‘necessary to’ exemplifies the flexibility embedded in the standard practice of treaty interpretation.

The Appellate Body in the *Korea – Beef* case has revealed the cautious attitude of giving direct definition to the term ‘necessary to’. It specifically addressed the gap between literal meaning and the legal meaning of a word. It clarified that ‘the legal meaning of ‘necessary to’ is not fixed to the literal meaning as ‘indispensable’, or ‘absolute necessity’, or ‘inevitable’.<sup>359</sup> The Appellate Body declined to answer whether there are other meanings alternative to the literal meaning. It rather used literal meaning

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<sup>356</sup> The *Dispute Settlement Understanding*, Article 17.3.

<sup>357</sup> The *Dispute Settlement Understanding*, Article 3.3

<sup>358</sup> Appellate Body Report, WT/ DS344/ AB/ R, *United States—Final Anti-dumping Measures on Stainless Steel from Mexico* (*‘US—Steel’*), adopted 30 April 2008, para 160.

<sup>359</sup> Appellate Body Report, *Korea—Beef* (n 308) para 161.

to define the spectrum for necessary measures within general exceptions of the GATT. As stated in the reasoning, the term ‘necessary’ means a range of degrees of necessity. The range of degrees is between two ends, indispensable for the objectives and contributing to the objectives.

Defining the term ‘necessary to’ as a range of degrees within a continuum has two merits. First, it reserves the flexibility for the contextual analysis of the term ‘necessary to’. As mentioned before, the term ‘necessary to’ is not only for general exception clauses but also the part of substantive obligations. It is true that panels and the Appellate Body tend to refer the term ‘necessary to’ to the GATT-based interpretation. The cross-agreement interpretation facilitates the consistency of interpretation results. However, the cross-agreement interpretations should not conclude that the Appellate Body completely ignores the contextual differences of WTO agreements. The AB report of *Korea – Beef* implicated the context of WTO provisions influential to the determination of the degree of necessity. In its viewpoint, the degree of necessity in the context of general exceptions of the GATT is closer to the indispensable degree.<sup>360</sup> In other words, the degree of necessity might be inclined to the degree of contributing to the claimed objective or in the middle between ‘indispensable’ and ‘contributing to’ in other WTO agreements.

Another merit is the fact-specific approach of dispute settlements. The term ‘necessary to’ implicates that trade interests must be balanced with other values such as environmental protection, customer protection and public health. However, there is no unified answer as to which value is concerned by society as critical to overall public welfare. For instance, the *EC—Asbestos* case shows that Canada and the EU have different levels of acceptance for human health risks caused by asbestos and relevant

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<sup>360</sup> Ibid, para 162.

products. The *US—Tuna* and *US—Shrimp* cases demonstrate that the US and other member States have different views on how to protect marine resources.

Therefore, defining the term ‘necessary to’ into the spectrum of degrees of necessity creates a space for the discretion of panels and the Appellate Body to consider the characteristics of trade measures in each case. As the Appellate Body stated in *Brazil—Retreaded Tyres*, ‘the weighing and balancing is a holistic operation that involves putting all the variables of the equation together and evaluating them about each other after having examined them individually, in order to reach an overall judgement’.<sup>361</sup>

The necessity cases are not the first place where panels and the Appellate Body did not give specific meaning to the treaty term rather than defining a spectrum of possible choices. This interpretive approach had adopted in the interpretation of the term ‘likeness’.

The term ‘likeness’ is a critical element to the obligations of most-favoured treatment and national treatment of the GATT and the GATS. The interpretation results of the term ‘likeness’ define the ground for the determination of treatments between imported and domestic products.<sup>362</sup> Like the term ‘necessary to’, the term ‘likeness’ is written in various contexts. It might refer to ‘like products’,<sup>363</sup> or ‘like or directly

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<sup>361</sup> Appellate Body Report, *Brazil—Retreaded Tyres* (n 352) para 182.

<sup>362</sup> Won-Mog Choi, *Like Products' in International Trade Law: Towards a Consistent GATT/WTO Jurisprudence* (OUP 2003) xx.

<sup>363</sup> GATT Articles I.1, *Ad I.4*, II.2(a), III.2/4, *Ad III*, *Ad V.5*, VI.1/4, IX.1, XIII. 1, XVI.4, *Ad XVI*, *Ad XVI.3*; the *Agreement on Implementation of Article VI of the GATT 1994*, Articles 2.1, 2.2, 2.6, 3.1, 3.2, 3.3, 3.6, 4.1, 5.2, 5.4, 5.8, 6.11; the *Agreement on Subsidies and Countervailing Measures*, Articles 6.3, 6.4, 6.5, 6.7, 11.2, 11.4, 12.9, 15.1, 15.2, 15.3, 15.6, 16.1, 27.9, 27.10, Annex I(g) and (h); the *Agreement on Agriculture*, Article 9.1; The *Agreement on Rules of Origin*, Article 1.2, fn 1; the *TBT Agreement*, Articles 2.1, 5.1, 5.2, Annex 3.D; the *SPS Agreement*, Annex C. 1(a) and (f).

competitive products’,<sup>364</sup> or ‘like or directly substituted products’<sup>365</sup>. It also refers to ‘directly competitive or substitutable products’,<sup>366</sup> and ‘identical or similar goods’<sup>367</sup>.

These provisions reveal the differences of regulatory contexts (i.e. the relationship between ‘like’ and ‘directly competitive or substitutable’) and normative obligations (i.e. anti-discrimination provisions or the maintenance of fair trade). While in some cases, such as Article 2.6 of the *Anti-Dumping Agreement*, the term of likeness is given a specific meaning, other WTO provisions mostly are lacking definitions.

According to the early GATT preparatory work, the drafters tended to leave the flexibility of the term ‘likeness’. ‘The expression of [likeness] had a different meaning in different contexts’ of the Agreement’.<sup>368</sup> The Appellate Body accepts the viewpoint. The Appellate Body agrees that ‘a word or term may have more than one meaning or shade of meaning, but the identification of such meanings in isolation only commences the process of interpretation, it does not conclude it’.<sup>369</sup> In this respect, the Appellate Body indicates the range of degrees of likeness in the GATT and other WTO agreements between two ends, identicalness or similarity. The degrees of likeness vary in line with a series of characteristics of the compared goods or services. The characteristics include (i) the properties, nature and quality of the products; (ii) the end-uses of the products; (iii) consumers' tastes and habits; and (iv) the tariff classification of the products. Health risks are also a considering element.

While panels and the Appellate Body provide the flexible spectrum for conceptual

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<sup>364</sup> GATT Article XIX.1; the *Safeguard Agreement*, Articles 2.1, 4.1; the *Agreement on Textiles and Clothing*, Article 6.2; the *SCM Agreement*, Annex I(d).

<sup>365</sup> GATT Article XI.2(c).

<sup>366</sup> GATT *Ad* Article III:2.

<sup>367</sup> The *Agreement on Implementation of Article VII of the GATT 1994*, Articles 2, 3, 5.1, 5.2, 7.2, 15.2, 15.3; *SCM Agreement*, Article 15.1, fn 46.

<sup>368</sup> UN Doc. E/PC/T/C.II/65 (1946) at 2, 3; EPCT/C.II/PV.12 (1946) at 7.

<sup>369</sup> Appellate Body Report, *US—Continued Zeroing* (n 340) para 268.



terms in order to favour the case-by-case analysis, however, Hudec questions they have not indicated what the spectrum of individual terms contains. He believes that the main reason is a disconnection between the assessment and the policy contexts.<sup>370</sup>

Hudec agrees with the Appellate Body's viewpoints that the same treaty term could have identifiable and describable differences in the policy contexts of WTO provisions in which this term used. What he questions is that panels and the Appellate Body miss the consideration of political contexts of individual WTO provision in the decision making. In practice, panels and the Appellate Body only focus the factual and legal contexts of the disputed measure. He argues the ignorance of the political context of the WTO provision in the application would dismiss the flexibility inherent to the term 'likeness', against the intention of panels and the Appellate Body. The consequence is the results of the determination at the risk of against the intention of the drafters on a specific issue.<sup>371</sup>

The Hudec's concern can apply to the interpretation of the necessity cases. The case law has shown that panels and the Appellate Body have not crystalised the content of the spectrum of necessary measures in WTO agreements yet.

### 3.7. Conclusion

The case study reveals that the concept of balancing is also developed for interpretation of the term 'necessary to'. Through the development of the term 'necessary to' and relevant WTO provisions, WTO panels and the Appellate Body tend to standardise legal opinions. The standardised content includes interpretative approaches, the meaning of

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<sup>370</sup> Robert E. Hudec, "'Like product': The differences in meaning in GATT Articles I and III" in Thomas Cottier and Petros C. Mavroidis (eds), *Regulatory Barriers and the Principle of Non-discrimination in World Trade Law* (UMP 2002) 102.

<sup>371</sup> Ibid, 103.

a treaty term and the analysis framework. The tendency of standardisation is a significant feature of the WTO adjudication, different from the practice of investor–State arbitration.

While WTO adjudicators adopt the concept of balancing in the interpretation and application of WTO provisions, however, their focus is different from that of investment arbitrators. WTO adjudicators more emphasise the technical function of the concept of balancing, assisting panels to consider all relevant factors to the dispute. Because of the technical focus, WTO panels and the Appellate Body limit the contribution of balancing into the normative meaning of the term ‘necessary to’ and of WTO provisions. Neither is the contribution to adjust the relationship between disputing parties and the arrangement of rights and obligations imposed on the respondent State.

The thesis argues that the practice of balancing by WTO panels and the Appellate Body to a large extent reflects the textual arrangement. The considering factors and the standard of review to the necessity requirement have indicated by the text of WTO provisions. The textual indications prevent panels and the Appellate Body from involving the balancing act.

The next chapter will address the similarity and differences between investor–State arbitration and the WTO jurisprudence in terms of the balancing approach/analysis. The topic of the discussion will focus on whether investment arbitrators and WTO adjudicators share the same understandings over the balancing approach.

## Chapter Four

### Balancing in the Adjudicative Process and the Adjudicative Modes

#### 4.1. Introduction

Investor–State arbitration and the WTO dispute settlement mechanism are two critical dispute settlement mechanisms in international law. One is for international investment law; the other is for international trade law. The number of disputes before the two dispute settlement mechanisms is increasing every year. According to the UNCTAD statistic, in 2017, at least 65 new investor–State dispute settlement cases were initiated under investment treaties. The total number of public investor–State disputes is around 855.<sup>372</sup> In the WTO system, the average of monthly active disputes has increased from 1.8 in 1995 to 38.5 in 2017.<sup>373</sup> The numerous cases constitute the case law system in the two domains.

Through the case law system, investor–State arbitration and the WTO dispute settlement mechanism are not only for the enforcement of investment treaties and WTO agreements. More importantly, they are critical to the construction of the rules of investment treaties and WTO law. Legal opinions by investment arbitrators and WTO adjudicators either clarify or refine the meaning of legal principles and terms of treaties. As such, legal opinions of investment arbitrators and WTO adjudicators are primarily a source of balancing in international law.

Previous chapters discuss the patterns of treaty interpretation in the two jurisdictions. While WTO adjudicators tend to standardise legal opinions and

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<sup>372</sup> UNCTAD, *Investor–State Dispute Settlement: Review of Development in 2017* (n 291).

<sup>373</sup> World Trade Organization, *Annual Report 2018* (WTO 2018) 128.

interpretative approaches, investment arbitrators have a relatively flexible practice of interpretation and application of investment treaties. The thesis argues that the difference rooted in the lack of multilateral conventions of the treatments of foreign investors and the institutional design. The WTO dispute settlement is usually the topic of the discussion and a favourite reference point by practitioners and commentators. The main reason is the stable pattern and consistent legal interpretations.<sup>374</sup> A specific suggestion even goes to urge investment arbitrators to learn from the experiences of WTO adjudicators in terms of the balancing approach.

Mutual reference of legal interpretations and judicial experiences is common to international authorities. The same concept or language is usually the ground for mutual reference. From the systematic concern of international law, mutual reference facilitates the communication between different institutions to develop shared understandings. Moreover, the shared experiences and legal opinions are the catalysts of the unity of international orders concerning state practices.<sup>375</sup>

Nevertheless, chapter one has argued the gap between the theoretical discussion and reality. International law is a fragmented system in which international investment law and trade law are two separate legal systems. Each system has its essential principles, institutional design and membership. In the separate situation, there are two issues to be concerned when taking reference of legal opinions and judicial experiences from one regime to another. What is the common ground supporting the mutual

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<sup>374</sup> See, e.g., Gebhard Bücheker, *Proportionality in Investor–State Arbitration* (OUP 2015); Benedikt Pirker (n 1).

<sup>375</sup> This idea is mostly argued by lawyers of public law and international administrative law. See, for instance, Benedict Kingsbury and Stephan Schill, ‘Investor–State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law’ (2006), *International Law and Justice Working Papers*; Yuval Shany, ‘Toward A General Margin of Appreciation Doctrine in International Law?’ (2006) 16(5) *European Journal of International Law* 907; Caroline Foster, ‘A New Stratosphere? Investment Treaty Arbitration as ‘Internationalized Public Law’ (2015) 64(2) *International and Comparative Law Quarterly* 461.

reference? To what extent legal interpretations of one domain can apply to another domain?

This chapter reviews the point of mutual reference of the balancing approach between investor–State arbitration and the WTO dispute settlement mechanism. It enquires whether the mutual reference is practical and how.

The content divides into four parts. First, it discusses the differences in the balancing analysis between investor–State arbitration and the WTO jurisprudence. The second part analyses the legal status of the concept of balancing in the arbitration procedure of investment disputes and the adjudication process of WTO disputes. Then it moves to the relevance of adjudicative modes on the balancing analysis. The thesis proposes investment arbitrators and WTO adjudicators representative of two modes, i.e. the mode of the problem–solving and the mode of order–keeping. The adjudicative modes reflect the textual and institutional differences in international investment and trade law. Given the differences, the thesis argues that it must be cautious of the context in which the mutual reference of the balancing analysis is discussed. It concludes that investor–State arbitration and the WTO dispute settlement mechanism are both critical to the development of international investment law and WTO law, while investment arbitrators and WTO adjudicators have different institutional sensitivities and confront different legal issues.

#### 4.2. The differences of the balancing analysis between investor–State arbitration and the WTO adjudication

##### 4.2.1. The textual grounds of the balancing analysis

While investment arbitrators and WTO adjudicators adopt the concept of balancing in

the interpretation and the application of treaties, their practices are different. The differences reflect on three elements: the connection between the text and the balancing analysis, the process of decision-making, and the consequences of the balancing analysis. This section focuses on the first point, the connection between the text and the balancing analysis.

This point is to the enquiry whether investment arbitrators and WTO adjudicators invent the balancing analysis. In other words, it is about the textual ground of the balancing analysis.

Investment arbitrators have applied the balancing analysis to specific rules such as the expropriation clause and the FET standard. The balancing analysis is to reconcile the interests of foreign investors and the regulatory needs of host governments. Investment arbitrators have identified a series of elements for the balancing analysis, while there are slight differences in line with the rules. For instance, in the context of expropriation clause, the elements identified include: (i) the effects on the interests of foreign investors and investments; (ii) the legitimate objectives of the disputed measures; and (iii) the relation between the disputed measure and the claimed objective (or the protected interests).<sup>376</sup> Likewise, investment arbitrators developed several elements for the balancing analysis under the FET standard. The considering elements are: (i) the investors' legitimate expectations; (ii) the regulatory interests of the host State; and (iii) a reasonable relation to rational policies, not motivated by a preference for other investments over the foreign-owned investment.<sup>377</sup>

While the balancing analysis and associated considering elements are the products

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<sup>376</sup> *Tecmed v. Mexico*, Award (n 82) (Horacio A. Grigera Naon, José Carlos Fernandez Rozas, Gabriela Alvarez Avila) para 133. Also, see the discussion of section 2.4.1 of chapter two.

<sup>377</sup> *Saluka v. Czech Republic*, Partial award (n 156) (Arthur Watts, Maître L. Yves Fortier, Peter Behrens) paras 304–307.

of the interpretation by investment arbitrators, however, the textual indication is ambiguous. As the thesis argues in chapter two, investment arbitrators who applied the balancing analysis were usually on the ground of the preambular language ‘economic development’. However, the term ‘economic development’ is not necessary for the balance between competing interests. As chapter one discusses, the development issue can be discussed through the economic–preference scenario or the balancing–concern scenario. Different scenarios would result in different regulatory methods. As such, while investment arbitrators interpreted the preambular language ‘economic development’ implicating the intention of the balancing concern of the Contracting States, the reasoning is insufficient. The specific provisions such as expropriation provisions and the FET standards neither contain the balancing idea nor the indications of the relevant considering elements.

Therefore, the thesis claims that the considering factors to the balancing analysis are primarily invented by investment arbitrators. The connection between the text and the interpretative approach and considering elements is weak than expected. Chapter two has raised the issue that the balancing analysis by investment arbitrators might exceed their interpretative authority.

In WTO law, the balancing analysis is applied to interpret and apply the necessity test of WTO provisions. Panels and the Appellate Body have developed several considering elements for the determination of the necessary extent. The elements include: (i) the relative importance of common interests or values protected by a measure; (ii) the relationship between the measure and the claimed objectives or protected interests; (iii) restrictive effects of the measure.<sup>378</sup> The Appellate Body also

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<sup>378</sup> Appellate Body Report, *Korea—Beef* (n 308) paras 163–64.

requires panels to analyse the trade–restrictiveness effects by asking if there is alternative measure, with fewer restrictiveness effects, which is reasonably available for the exercising State to achieve the desired level of protection for the same objective.<sup>379</sup> The Appellate Body also clarifies that these considering elements must be taken into account through the weighing and balancing analysis.<sup>380</sup>

These considering elements at the first glance are no different from that developed by investment arbitrators. Table one summarises the considering elements involved in or related to the concept of balance in the two jurisprudences.

Nevertheless, examining the reasoning of panels and the Appellate Body reports, these considering elements are republications of the requirements of WTO provisions. The requirements include the non–trade values to be protected, the relationship between the measure and the trade–restriction effects, and the measurement for the implementation of the non–trade measures. They have written in these provisions involving the necessity test such as general exception provisions and the SPS and the TBT provisions.

As such, what panels and the Appellate Body are not required to invent the considering elements to be balanced. Instead, their interpretations primarily elaborated the legal requirements logically and structurally. The logical structure for these requirements is the process of weighing and balancing. The study, therefore, suggests that the balancing analysis is primarily the extension of the text of WTO agreements. Either the considering elements or the interpretative approach has a strong connection with the text.

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<sup>379</sup> Appellate Body Report, *US—Gambling Services* (n 321) para 308. Also, see the discussion of section 3.2 of chapter three.

<sup>380</sup> See the analyses of section 3.4 of chapter three.



The difference in the connection between the text and the balancing analysis is part of the interpretative patterns between the two jurisprudences. On the other side, it reflects the attitudes of investment arbitrators and WTO adjudicators on treaty interpretation. While investment arbitrators conceive treaty interpretation as the means for dispute resolutions, WTO adjudicators are inclined to treat treaty interpretation as the means of maintenance of the orders of the WTO system.

The institutional sensitivity is critical to the ways that investment arbitrators and WTO adjudicators applied the balancing analysis. It is the point of the next section.

Table 1 The considering elements for balancing by WTO adjudicators and investment arbitrators

	Investor–State Arbitration	The WTO Jurisprudences
<i>The normative context</i>	Indirect expropriation; the doctrine of legitimate expectations of foreign investors	The term ‘necessary to.’
<i>Leading case</i>	The <i>Tecmed v. Mexico</i> award	The <i>Korea–Beef</i> case
<i>The intent of the exercising State</i>	No evaluation	No evaluation
<i>Legitimate objectives of the measure</i>	Evaluate regulatory interests	Evaluate value and objectives
<i>Restrictive effects</i>	Assess the infringement of interests of foreign investors and investments	Assess trade restrictiveness
<i>The relation between Measures and</i>	Evaluate the relation by the elements ‘proportionality’ and	Evaluate the relation in light of the chosen degree of achievement

<i>Legitimate Objectives</i>	‘reasonableness.’	
<i>Cost of Regulation</i> <i>(Reasonable available Alternatives)</i>	None	Assess reasonable availability of alternative (in light of the same legitimate objective and the degree of execution)
<i>Analytical method</i>	Balancing the interests between foreign investors and host States	The weighing and balancing analysis (not specified)

#### 4.2.2. The engagement in the balancing analysis

The practice of the balancing analysis shows that investment arbitrators have an active attitude on the invention of interpretative approaches and interpretative elements, while WTO adjudicators have a conservative attitude. The attitudes affect the ways by which they applied the balancing analysis. In general, investment arbitrators focus on the substantive content and purposes of the balancing analysis, while WTO adjudicators emphasise the formality and the technical aspect of the balancing analysis.

In investor–State arbitrations, the balancing analysis involves the substantive concern of the equilibrium between the disputing parties, i.e. foreign investors and host States. For instance, the *LG&E* tribunal stated that this treaty does not deprive the regulatory autonomy of the Contracting States when interpreting the indirect expropriation under the *Argentina—US BIT* (1991).<sup>381</sup> It noted that the Contracting State reserves the sovereign power to regulate its domestic affairs in the status of the host government. The host State is not required to provide unlimited protection to foreign investors. In another case raising out of the FET standard of the *Argentina—*

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<sup>381</sup> *LG&E v. Argentina*, Decision on liability (n 259) (Tatiana B. de Mackelt, Albert Jan van den Berg, Francisco Rezek) para 186.

*France BIT* (1991), the *Total* tribunal elaborated that the review of government intervention at issue must base on economic rationality, public interest, reasonableness and proportionality relevant to the disputed measure.<sup>382</sup> The infringement of legitimate expectations of the claimed investors is not conclusive to the final decision.<sup>383</sup>

The *Daimler* tribunal further applied the balancing concern to elaborate on the focus of judicial review before the investor–State arbitration. It stated that its jurisdiction is limited to whether the host government violated its commitments to the *Argentine–German BIT* (1990) in specific.<sup>384</sup> The Treaty at issue is not deprived of the host States of their right to regulate.<sup>385</sup> While the instruments of the Treaty requires the host government to provide guarantee and protection for foreign investors, foreign investors are not entitled to absolute protection. Instead, the focus of reviewing the state practice at issue is to evaluate the violation of the host government’s treaty obligation. In other words, the *Daimler* tribunal transformed the focus of the private–public dispute to the treaty dispute. This view justifies why this tribunal is required to consider the objectives and the effects of the measure at issue. The *Saluka* tribunal echoed this view. It announced that the purpose of the *Czech Republic–Netherlands BIT* (1991) is to pursue ‘more subtle and balanced purposes’.<sup>386</sup> Investment protection is a necessary element for the overall aim of encouraging foreign investment, and extending and intensifying the parties’ economic relations.<sup>387</sup>

These arbitral awards reveal that investment arbitrators concern whose interests

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<sup>382</sup> *Total S.A. v. Argentine Republic* ('*Total v. Argentina*'), ICSID Case No. ARB/04/1, Decision on liability, 27 December 2010 (Giorgio Sacerdoti, Henri C. Alvarez, Luis Herrera Marciano), para 333.

<sup>383</sup> *Ibid.*, para 121.

<sup>384</sup> *Ibid.*, paras 100–102.

<sup>385</sup> The *Daimler* tribunal referred to the statement of the *AES* tribunal which responded to a nearly identical assertion by the same respondent State, Argentina. *Daimler v. Argentina* (n 82) para 101.

<sup>386</sup> *Saluka v. Czech Republic*, Partial award (n 156) para 254.

<sup>387</sup> *Ibid.*, para 300.

are concerned and what is reviewed through the balancing analysis. The reason for these concerns, however, is to refine the position of the host States under the treaty and in the disputing relationship before investor–State arbitration. In other words, the arbitral tribunals applied the balancing analysis to resolve the conflict between the boundaries of sovereignty in word and the exercise of sovereignty in case.

The application of the balancing analysis in the WTO jurisprudence is different from that in investor–State arbitration. WTO adjudicators rarely question the position of the respondent State in the treaty relationship and the disputing relationship. Instead, what WTO adjudicators concerned primarily is how to maintain the relationships among member States in the WTO.

The Appellate Body has repeatedly noted that the content of the covered agreement is the balance of rights and obligations between member States. The focus of the judicial review is not to balance the interests between the disputing parties but to correct the infringement of WTO law. The systematic concern leads panels and the Appellate Body to highlight the formality of the decision–making process. In the view of the Appellate Body, the weighing and balancing analysis is an analytical standard for the interpretation of the term ‘necessary to’. The weighing and balancing analysis applies to not only the determination of the necessary extent of a trade measure but also the assessment of the reasonable availability of least–trade–restrictive alternative measures. Therefore, this analysis standard is not an instrument for WTO adjudicators to engage in the substantive action of balancing.

The study of Emily Barrett Lydgate echoes this view. She correctly points out that the act of weighing and balancing by panels and the Appellate Body does not answer

the unresolved political issue or present a solution to the disputing parties.<sup>388</sup> Neither does it refine the position of the disputing parties in the covered WTO agreements. The Emily's opinion is similar to the view of Christiane Gerstetter that WTO adjudicators develop the technical balancing.<sup>389</sup>

Bown and Trachtman, on the other hand, highlight the practice of balancing by the Appellate Body different from what it said. They argue that the balancing analysis did not explain how to decide the priority of purposes of the measure at issue and in the covered agreement, while the Appellate Body noted the balancing analysis is providing a framework for panels to consider relevant factors.<sup>390</sup>

Donald Regan further analyses the internal contradiction of the application of the balancing analysis by the Appellate Body.<sup>391</sup> In his points of view, the Appellate Body never engaged in the balance of trade and non-trade values, while they have stated the balancing test. What the Appellate Body did under the balancing test is to leave member States to choose their level of protection and refer the chosen level of protection to determine the legitimacy of the disputed trade measure. The process of decision-making indeed does not involve 'judicial review' of the trade-restriction effect of the measure at issue.

While Donald agrees that non-application of the balancing test by the Appellate Body, he raises the attention of the contradiction existed in the AB's conception of balancing. In specific, what the Appellate Body primarily concerned is the element of

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<sup>388</sup> Emily Barrett Lydgate, 'Sustainable development in the WTO: from mutual supportiveness to balancing' (2012) 11(4) World Trade Review 621, 637.

<sup>389</sup> See the discussion in section 3.6.2 of chapter three.

<sup>390</sup> Chad P. Bown and Joel P. Trachtman, 'Brazil—Measures Affecting Imports of Retreaded Tyres: A balancing test' (2009) 8(1) World Trade Review 85, 117 and 121.

<sup>391</sup> Donald H Regan (n 9) 347–69

less trade–restrictive alternatives, while it stated that all three elements of necessity must be weighed equally.<sup>392</sup> In other words, the process of weighing and balancing is not applied as the Appellate Body itself. Instead, the balancing process is the process of identifying the existence of less trade–restrictive measures rather than determining the cost and benefit of the disputed measure.<sup>393</sup>

While there is the logical contradiction in the balancing analysis, Donald agrees with the Appellate Body’s decision of non–engagement of balancing. The main reason is the institution function of the WTO dispute settlement mechanism. He argues that the cost–benefit balancing is against the virtue of the WTO system that member States have the right to decide policy priority and to choose the level of protection only if their actions are consistent with WTO provisions.<sup>394</sup> Therefore, he believes that it is not the duty of WTO adjudicators to balance the conflict between foreign interests and domestic interests over the member States.<sup>395</sup>

The thesis, on the other hand, argues that the impression of the logical contradiction is because of different perspectives of balancing. Balancing, in Donald’s viewpoint, refers to the substantive decision of competing values and the priority of policies. By contrast, the Appellate Body conceived balancing as a logical structure rather than an instrument for substantive decisions.

What the Appellate Body concerns are whether the panel took considering elements into account in the process of decision–making. As to which element is critical to the final decision, the Appellate Body leaves it to the discretion of the panel. This view explains why the Appellate Body might question the panel’s finding of the

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<sup>392</sup> Ibid, 356–57.

<sup>393</sup> Ibid, 358.

<sup>394</sup> Ibid, 366.

<sup>395</sup> Ibid, 367.

necessity test if the panel missed one considering element in the reasoning. The pattern of appellate review concerning the necessity test has discussed in chapter three.<sup>396</sup> The technical balancing is another balancing approach that the thesis identified.

Between the substantive balancing and the technical balancing, what Donald Regan argues is inclined to the substantive balancing while the practice of the Appellate Body is inclined to the technical balancing. As such, the gap indicates an issue of the discussion of balancing. Different perspectives result in different meanings of balancing. However, the dimensions of balancing have not explored well yet.

#### 4.2.3. The consequences and impacts of the balancing analysis

The last difference is the impacts of the balancing analysis. There is a variety of consequences caused by the balancing analysis. Interpreting treaty terms and settling international disputes are only two of the possible consequences. This section focuses on an alternative consequence. That is the relationships of the parties at issue.

##### 4.2.3.1. The impact on the relationship between disputing parties

As previous chapters mention, the majority of investor–State disputes is raising out of the old–generation investment treaties.<sup>397</sup> These treaties were under investment–preference policies. The investment–preference policies are characterised by the obligations imposed on the host States concerning the treatments for foreign investors. The legal means for enforcement is the creation of investor–State dispute settlements. Foreign investors and investments are entitled to initiate international arbitration against

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<sup>396</sup> See section 3.6.2 of chapter three.

<sup>397</sup> Anthea Roberts divides the ‘old–generation of investment treaties’ into two sub–stages. At the early stage the principles regarding foreign investments focused on the exercise of regulatory powers by nation states. At the second era of investment treaties in the 1990s, the focus shifted to the treatment of foreign investors in a host State. Anthea Roberts (n 147) 24–26.

the host government directly.

The content of these treaties, instead, did not impose any obligations upon home States and beneficiary investors on specific issues, while it usually announced the pursuit of economic development for home and host States mutually as the primary goal in the preamble. The regulatory approach resulted in an asymmetric relationship between the home and host States. The creation of investor–State arbitration further constrains the boundaries of the sovereignty of the host States.

The creation of investor–State arbitration further constrains the boundaries of the sovereignty of host States in terms of dispute resolutions. First, the host State is deprived of the right to initiate an international arbitration. According to the investor–State arbitration provisions, foreign investors are entitled to commence the arbitration proceedings and to claim their sufferings from the host government. The right to initiate the arbitration procedure is essential to the right of agenda–setting. The deprivation of the right of agenda–setting constitutes another limit to the sovereignty of the host State in terms of dispute settlements.

As chapter one discusses, investor–State arbitration is the result of the delegation of sovereignty from the Contracting States to third–party adjudicators. The delegation of sovereignty is not only about the power of making decisions but also the power of interpreting the treaty by the States themselves.

While investment arbitrators are authorised to settle the dispute between foreign investors and the host government, their decisions must base on the interpretation results. As such, the authority of dispute resolution includes the authority of treaty interpretation. It is true that the interpretative authority of third–party adjudicators do not deprive of the Contracting States’ right to issue joint interpretation to clarify their intentions.



However, it is datable of the effects of the joint interpretation by the Contracting States.

The limits to the sovereignty of the host States raise a delicate issue. How can the host government reserve the right to defend its exercise of regulatory powers for public interests and to exempt its responsibilities under the treaty? Several investment arbitrators had noted this issue. They clarified the importance to consider the interests of the host government when interpreting the treaty rules and determining the legality of the governmental intervention at issue. Their concern is reflected in the application of the balancing analysis.

Since the *Tecmed* tribunal proposed the principle of proportionality to examine the factors relevant to host governments' actions,<sup>398</sup> the idea of balancing the interests between the claimant investors and the host government is supported by other tribunals.

There are two approaches to balance the interests of foreign investors with the interests of the host governments.

One approach is to shift the focus of the judicial review. Some tribunals shifted the focus from the effects on the interests of investors and investments to the elements relevant to regulatory actions such as legitimate objectives and protected interests. For instance, in the interpretation of the FET standard of the *Argentina—France BIT* (1991), the *Total* tribunal stated that the legitimacy of a host government's intervention in the argued investment rests on the elements of economic rationality, public interest, reasonableness and proportionality.<sup>399</sup> The infringement of legitimate expectations of the claimed investors is not the absolute and primary measurement.<sup>400</sup> In respect to the

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<sup>398</sup> *Tecmed v. Mexico*, Award (n 82) para 133.

<sup>399</sup> *Total v. Argentina*, Decision on liability (n 382) para 333.

<sup>400</sup> *Ibid*, para 121.

issue of Argentina's right to regulate, the *Daimler* tribunal referred to legal opinions of previous cases to stress a point.<sup>401</sup> The instruments providing guarantee and protection for foreign investors do not deprive host States of their right to regulate in general. The jurisdiction of the tribunal is limited to whether the host government violated its commitments to the 1990 *Argentine—German BIT* in specific.<sup>402</sup>

Other tribunals shifted the focus of judicial review to the burdens of the claimant investors. They might either examine whether the claimed investors were aware of political risks of the investment projects or question whether the claimed investors had implemented their due diligence on business decisions. For instance, the *Maffezini* tribunal had clarified the function of investment treaties. It stated that '[b]ilateral Investment Treaties are not insurance policies against bad business judgments'. In this dispute, while the public authority and entities of Spain had flaws in the policies and practices, the tribunal believed that the flaws of the host government 'cannot be deemed to relieve investors of the business risks inherent in any investment'.<sup>403</sup>

Another approach is to clarify the function of investor–State dispute resolutions. The *Daimler* tribunal had pointed out that this mechanism not merely serving the asymmetric contractual relation between a sovereign state and a private foreign investor. Instead, the investor–State dispute settlement mechanism is for the assessment of the implementation of the commitments that the host State promised to the treaty. Moreover, the *Abaclat* tribunal stressed the fairness and efficiency of the investor–State dispute settlement mechanism resting on the balance of interests between the host government

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<sup>401</sup> The *Daimler* tribunal refereed to the statement of the *AES* tribunal which responded to a nearly identical assertion by the same respondent State, Argentina. *Daimler v. Argentina*, Award on Jurisdiction (n 82) para 101.

<sup>402</sup> *Ibid*, paras 100–102.

<sup>403</sup> *Emilio Agustín Maffezini v. The Kingdom of Spain* ('*Maffezini v. Spain*'), ICSID Case No. ARB/97/7, Award, para 64.

and foreign investors.<sup>404</sup>

The two approaches expose the ambition of investment arbitrators of rebalancing the relationship between foreign investors and host governments under the framework of investor–State arbitration.

#### 4.2.3.2. The impact on the relationship between treaty parties

Another relationship influenced by the balancing analysis is the relationship between the treaty parties. In the context of investor–State arbitration, the treaty relationship at issue is between the home and host States to an investment treaty.

Arbitral tribunals have recognised the imbalances between the Contracting States under an investment treaty. The *Daimler* tribunal, for instance, explained the nature of investment treaties as an exercise of sovereignty by which ‘States strike a delicate balance among their various internal policy considerations’.<sup>405</sup> ‘Sovereignty States are free to agree to any treaty provisions they so choose – whether concerning substantive commitments or dispute resolution provisions or otherwise—provided these provisions are not futile and are not otherwise contrary to peremptory norms of international law’.<sup>406</sup> Because of the sovereignty of treaty-making, the *Daimler* tribunal believed that the privileged places granted for foreign investments and investors, including dispute resolution clauses, are ‘a result of the treaty’s negotiation process’ while these privileged places are constituting ‘the imbalances between the interests of both parties’.<sup>407</sup> According to the principle of state consent, this tribunal stressed that tribunals must take care not to interpret the rules ‘beyond the bounds of the framework

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<sup>404</sup> *Abaclat v. Argentina*, Decision on jurisdiction and admissibility (n 170) paras 579–81.

<sup>405</sup> *Daimler v. Argentina*, Award on Jurisdiction (n 82) para 164.

<sup>406</sup> *Ibid*, para 198.

<sup>407</sup> *Ibid*, para 161.

agreed upon by the Contracting States’.<sup>408</sup>

The statements implicate the conventional wisdom that arbitral tribunal is bound to the agreements by the Contracting States under a treaty, even though they are imbalanced for the treaty parties.

As such, the balancing idea remarks an opposed conception of investment treaties. The change is reflected by the efforts of investment arbitrators to refine the objectives of an investment treaty.

The *Lemire* tribunal expressed the rejection of the assertion that the object and purpose of an investment treaty only concern the interests of foreign investments. Instead, it believed that an investment treaty is concerned with economic development for both signatory countries. It interpreted the concern of economic development for both signatory countries meaning that the treaty must ‘benefit all, primarily national citizens and national companies, and secondarily foreign investors’.<sup>409</sup> Accordingly, this tribunal believed that ‘the local development requires that the preferential treatment of foreigners be balanced against the legitimate right of Ukraine to pass legislation and adopt measures for the protection of what as a sovereign it perceives to be its public interest’.<sup>410</sup> Therefore, the *Lemire* tribunal agreed that the host government has the right to regulate its affairs and adopt laws to protect the common goods for its people. The desire of protecting national culture is within the regulatory sovereignty of Ukraine.<sup>411</sup>

In this regard, it could say that the balancing analysis is an instrument for the adjustment of the treaty relationship between home and host States.

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<sup>408</sup> Ibid, para 164.

<sup>409</sup> *Joseph Charles Lemire v. Ukraine* (*‘Lemire v. Ukraine II’*), ICSID case no. ARB/06/18, Decision on jurisdiction and liability, 14 Jan 2010 (Juan Fernández-Armesto, Jan Paulsson, Jürgen Voss) para 273.

<sup>410</sup> Ibid, para 273.

<sup>411</sup> Ibid, paras 505–06.

#### 4.3. The legal status of balancing in international adjudication

The balancing analysis not only generates a variety of consequences but also refers to a range of things. While the common situation of the balancing analysis is an approach for treaty interpretation, there are other situations that the balancing analysis developed in international adjudication. This section explores other dimensions of balancing.

##### 4.3.1. The state consent to the equilibrium between the Contracting States

The most popular situation of the word ‘balancing’ is about the essence of international agreements. In specific, balancing is used to interpret the principle of state consent as the foundation of treaties. The content of a treaty at issue is the result of the negotiations by the Contracting States. The outcome must be the balance of interests for both signatory States. Otherwise, they would not reach an agreement. In this respect, the preamble and substantive rules characterise the balancing point between the Contracting States.

In investor–State arbitration, investment arbitrators have noted the content of an investment treaty representative of the balance of rights and obligations between the Contracting States (i.e. home and host States).

The *Grand River* tribunal, for instance, interpreted the provisions of the investment chapter of the NAFTA as embodying a balance of rights and obligations for all member States. This balance is concerned with the protection granted to foreign investors.<sup>412</sup> Similarly, the *El Paso* tribunal interpreted the exceptional clause of the *Argentina–US BIT* (1991) as reflecting the balanced arrangement between the Contracting States on

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<sup>412</sup> *Grand River Enterprises Six Nations, Ltd., et al. v. United States of America* (‘*Grand River v. U.S.*’), UNCITRAL, Award, 12 January 2011, para 69.

the treatments for foreign investments and investors.<sup>413</sup> In the *Daimler v. Argentina* case, the tribunal elaborated this point by the principle of state consent and the influx of external and internal sovereignty by the States. It clarified that a treaty is representative of the policy decision made both of the signatory States. The policy decision includes the priority of domestic policies concerning economic development and the creation of relation with other States for the promotion and protection of foreign investments. Based on the policy decisions, the content of the treaty characterises the instruments that are chosen by the Contracting States for the promotion and protection of foreign investments. Therefore, the content of the treaty is not only the result of the state consent by the Contracting States but also the balancing point of domestic and international policies on the issue of foreign investments.<sup>414</sup>

With regard to the WTO jurisprudence, panels and the Appellate Body also assume that WTO provisions are the balance of rights and obligations among member States on specific issues. Different from investment arbitrators, this view is not merely a shared understanding among panels and the Appellate Body. WTO law has stipulated this point of view as a principle of dispute settlements.

Article 3.3 of the DSU provides the benchmark for the result of dispute resolutions. The benchmark is that the final result must maintain a proper balance between the rights and obligations of member States. The DSU further indicates the proper balance composed of several elements: 1) the result is consistent with the agreement at issue; 2) the result does not nullify or impair benefits accruing to any Member State under the agreement; 3) the result does not impede the attainment of any objective of the agreement at issue.

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<sup>413</sup> *El Paso v. Argentina*, Award (n 242) para 604.

<sup>414</sup> *Daimler v. Argentina*, Award on Jurisdiction (n 82) paras 162 and 164.

These provisions illustrate the essence of WTO law in two aspects. On one side, the essence of WTO law is the balancing point of interests between the signatory States. On the other side, the balancing point specifies the principle for political negotiations by the member States and judicial review by adjudicators. As the Appellate Body in *China–Raw Materials* stated, the preamble of the *WTO Establishing Agreement*, as a whole, reflects ‘the balance struck by WTO Members between trade and non–trade–related concerns’. The preamble concludes with the resolution to develop ‘an integrated, more viable and durable multilateral trading system’.<sup>415</sup>

However, the Appellate Body noted the effects of the preamble on treaty interpretation and dispute resolutions not as practical as expected. None of the listed objectives nor the balance between these objectives provides specific guidance on the interpretation and application of general exception provision of the GATT to the specific fact.<sup>416</sup>

The statement implicates the treaty text just the starting point of treaty interpretation. The final decision still relies on the analysis and evaluation by the panel. In other words, the balancing point that is decided by the panel and the Appellate Body is not necessarily equal with the balancing point in the subjective sense of the member States. The situation relates to the gap between the text and the practice.

#### 4.3.2. The interpretative approach for clarifying the meaning of treaty terms and legal concepts

Another meaning of the word ‘balancing’ is an instrument for decision–making. In this

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<sup>415</sup> Appellate Body Report, WT/DS394/AB/R, *China—Measures Related to the Exportation of Various Raw Materials* (‘*China–Raw Materials*’), adopted 22 February 2012, para 306.

<sup>416</sup> Ibid.

situation, balancing provides a framework for decision makers to take a comprehensive and inclusive attitude to the elements relevant to the disputed measure and the interests of the parties involved in the case. About international adjudication, the framework is the balancing approach. It refers to the ways by which international adjudicators reach their final decision.

The balancing approach is the topic of previous chapters. The analyses reveal the differences in the application of the interpretative approach between investment arbitrators and WTO adjudicators.

Investment arbitrators apply the balancing approach to make substantive decisions over the conflict between foreign investors and the host government. The balancing approach shifts the focus of judicial review from preferring the interests of foreign investors to giving attention to the concern of the host government. The change of the interpretative approach implicates the change of conceptions by investment arbitrators. Investment treaties are no longer the instrument for the protection of private interests of foreign investors. Instead, the instruments of investment protection are for the benefits of society as a whole.

WTO adjudicators, by contrast, adopt the balancing approach as the logical structure of judicial review. The logical structure ensures the due process of decision-making but not guarantees the content of the final decision. In other words, panels and the Appellate Body are cautious of engaging in the judgment of competing interests and the priority of policies. They leave the substantive decision to the member State at issue and all member States of the WTO. Concerning the difference, the thesis categorises the balancing approach into two types: the substantive balancing and the technical balancing.



#### 4.3.3. The institutional function of finding an optimal solution to the conflicts through the due process

Another meaning of the word ‘balancing’ relates to the duty of adjudicators as decision makers. Balancing refers to the institutional duty of adjudicators to finding the optimal resolution for disputing parties in an impartial attitude.

Investor–State arbitration and the WTO dispute settlement mechanism are the enforcement of international agreements (i.e. investment treaties and WTO agreements). A primary duty of investment arbitrators and WTO adjudicators is to apply the rules to settle the disputes.

Concerning the function of dispute settlement, the final decision is not only the maintenance of the balance of rights and obligations between the Contracting States, but also the correction of the unbalance of benefits between the disputing parties. As such, balancing, in this situation, refers to the optimal solution for the disputing parties.

Nevertheless, the final decision must be conducted through a due process. It means that international adjudicators must take an impartial position when reviewing the facts and considering the assertions from the disputing parties. The adjudicators should not have preferential assumptions to either side of the disputing parties.

WTO law imposed the duty of impartial review and objective assessments on panels and the Appellate Body. The DSU provides a range of procedural rules for the WTO disputes settlements. For instance, Article 11 of the DSU requires panels to conduct ‘objective assessment’ to review the factual and legal issues of a dispute. The Appellate Body further implements the duty of objective assessment by the weighing and balancing analysis to the necessity cases. It requires a panel to consider all factors

and evidence relevant to the disputed measure before reaching the final decision.

The majority of investment treaties, on the contrary, does not provide procedural rules to the duties of investment arbitrators. Nevertheless, investment arbitrators have developed a shared understanding of their institutional duties. As the tribunal of the *Daimler v. Argentina* case noted, arbitral tribunals have no preferential assumption when interpreting the provisions of a treaty. In its viewpoint, arbitral tribunals must adopt the *ex ante* neutral approach to interpret the rules of a treaty and to settle the dispute between the claimant investor and the respondent State. The *Daimler* tribunal also referred to the award of *Mondev v. US* to support its opinion.<sup>417</sup> In the words of the *Mondev* tribunal, ‘there is no principle either of an extensive or restrictive interpretation of jurisdictional provisions in treaties’.<sup>418</sup>

The *Daimler* tribunal also highlighted the *ex ante* neutral approach applying to all types of treaty rules or commitments universally. The interpretation result must be by the intentions of the Contracting States rather than the concerns either of the claimant investors or of the host government. In its word, the ultimate goal is to determine what the Contracting States consented to, neither taking presumably restrictive interpretation nor broad interpretation for the dispute settlement clauses.<sup>419</sup>

It seems that investment arbitrators and WTO adjudicators have a common understanding of their institutional norms. The next question is whether they did as what they said. Sometimes international adjudicators seem to know what they say and expect the audience to have the same understanding. In this situation, either the disputing parties or the public cannot assess the decision-making process of adjudicators because

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<sup>417</sup> *Daimler v. Argentina*, Award in jurisdiction (n 82) paras 170–71.

<sup>418</sup> *Mondev v. U.S.*, Award (n 62) para 43.

<sup>419</sup> *Daimler v. Argentina*, Award in jurisdiction (n 82) para 172.

of insufficient reasoning.

#### 4.3.4. The political instrument to adjust the position of the respondent State in the treaty relations and the disputing relations

The last but not the least thing of balancing is the political dimension. It concerns the relations which are created by a treaty and establish the institutions of dispute settlement. In specific, balancing means the situation where the treaty parties and the disputing parties are treated equally. The difference is that the balance situation is evaluated by adjudicators from the perspective of a third-party to the dispute and the treaty.

In the first situation, the equilibrium between the Contracting States under a treaty is a prior assumption of public international law. The assumption is from the perspective of international society and the community of nation-states. It bases on the thought of legal positivism that legal systems are isolated from political and social contexts. Whether or not the Contracting States have equal political and economic powers to proceed with a fair negotiation, the content of the treaty is assumed the result of voluntary commitments by the Contracting States. None of the parties has the authority to change the result except the treaty parties of the treaty, i.e. the Contracting States.

While the political meaning of balancing discussed here is a political assumption as well, on the contrary, it is the perspective of third parties. It means that the measurements for the balanced situation depend on the experiences, political position and perceptions of the contemporary society of adjudicators. In other words, it depends upon the subjective sense of balancing by adjudicators to determine whether the treaty relationship between the signatory States are in balance or not.

Reviewing the relationship between the treaty parties to a certain extent includes

the review of the relation between the disputing parties. The extension is because the majority of international agreements integrates the dispute settlement mechanism for the Contracting States to settle their conflicts and disagreements.

The third-party vision of balancing, however, primarily appears in investor-State arbitration. The case study of investment awards reveals that arbitrators tend adjusting the treaty relationship between the host and home States and the disputing relationship between foreign investors and the host government. For instance, the tribunal in *Daimler v. Argentina* noted that the clauses of investor-State arbitration of the Argentina-Germany BIT (1991) as ‘one of the privileged places where the imbalances between the interests of both parties are often precisely defined as a result of the treaty’s negotiation process’.<sup>420</sup> The *Lemire* tribunal stated that the concern of economic development for both signatory countries in the preamble indicates that it is ‘an objective which must benefit all, primarily national citizens and national companies, and secondarily foreign investors’.<sup>421</sup>

The statements disclose the tribunal’s conception of ‘the balanced situation’ for the host government. From the perspective of the *Lemire* tribunal, the content of an investment treaty as the balancing point for the Contracting States is because it guarantees the benefits of the society of both the States. Given investment treaties are concerned with the general interests of society as a whole, the dispute resolution needs to reflect the concern of public interests of the host government. This view explains why the tribunal advances the role of the regulatory autonomy of the host State in the determination.<sup>422</sup>

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<sup>420</sup> *Daimler v. Argentina*, Award on Jurisdiction (n 82) para 161.

<sup>421</sup> *Lemire v. Ukraine II*, Decision on jurisdiction and liability (n 409) para 273.

<sup>422</sup> The understanding also explains why the rising concern of regulatory sovereignty for host States in recent investment treaties is concerned the distortion on the ‘symmetrical structure’ of original BITs. Pedro J. Martinez-Fraga and C. Ryan Reetz, *Public Purpose in International Law: Rethinking Regulatory*

#### 4.4. The modes of judicial review reflected by the balancing analysis

This section argues the practice of balancing reflecting the modes of judicial review between investor–State arbitration and the WTO dispute settlement mechanism.

##### 4.4.1. The problem–solver mode v. the order–keeper mode

Investment arbitrators and WTO adjudicators are representative of two modes of international adjudication. Investment arbitrators focus more on the resolution of the individual dispute instead of the systematic consistency of international investment law and the arbitral practice.<sup>423</sup> On the contrary, WTO adjudicators are aware of their function of maintaining the consistency and predictability of the application of WTO provisions. Concerning the difference, this study argues that investment arbitrators are inclined to the mode of the problem–solution, while WTO adjudicators are inclined to the mode of order–maintenance.

Institutional identity sheds lights on the different mode of judicial review. Institutional identity is the ways by which decision makers conceive their institutional function. Self–Realisation affects behaviours. In other words, the mode of judicial review is the result and also the reflection of the institutional identity of adjudicators.

The thesis has argued the institutional identity of investment arbitrators and WTO adjudicators in previous chapters. The active engagement in the value judgement and policy choices over the conflicting interests by investment arbitrators indicates that investment arbitrators conceive their role as problem–solvers. In contrast, WTO

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*Sovereignty in the Global Era* (CUP 2015) 273; Anthea Roberts (n 147) 5, 24–26.

<sup>423</sup> However, it should not conclude that investment arbitrators have no awareness of the consistency of international investment law. As I mentioned in chapter two, some tribunals have the sensitivity of the systematic coherence of international investment law, while the number is few. The discussion here only wants to highlight the focus of international adjudication weighed by investment arbitrators relatively different from WTO adjudicators.

adjudicators are aware of their role as order-keepers. The institutional identity is reflected by the conservative attitude toward making a judgement of the priority of policies and non-challenge of the treaty relationship and the disputing relationship for member States. The Appellate Body's viewpoints reflect the institutional identity of order-keeper. As the Appellate Body stated in the compliance procedure regarding the US's ban on tuna imports,

'[w]e also consider it appropriate for WTO Members to seek guidance in the reasoning set out in adopted Appellate Body and panel reports when seeking to bring their inconsistent measures into compliance with their obligations under the covered agreements. Indeed, this contributes to the security and predictability of the multilateral trading system, as well as to the prompt settlement of disputes'.<sup>424</sup>

The institutional identity explains the distinction between the substantive balancing and the technical balancing between investment arbitrators and WTO adjudicators.

#### 4.5. The balancing analysis as the result of the interaction between the States and adjudicators

While commentators worry the different practice hindering the comprehension of international law, the thesis argues that the divergence is typical to international law. The different practice of the balancing approach is rooted in the division of international investment law and trade law (i.e. WTO law). Given the reality of international law as a fragmented system, balancing in variation is not a problem to the international law system.

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<sup>424</sup> Appellate Body Report (Article 21.5), WT/DS341, *United States—Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products* ('US—Tuna II (Mexico)'), adopted 3 December 2015, para 7.156.

However, how to review the convergence and divergence of the balancing analysis between international investment law and WTO law?

This section tends to propose an alternative perspective. It argues that the application of the balancing analysis is the result of the interaction between the States and adjudicators. The textual arrangement and institutional framework are influential to the ways that the States and adjudicators interact with each other. In other words, the interaction is between the decisions by the signatory States and the adjudicators. In this respect, balancing in variation reflects the features of the textual arrangement and the adjudicative proceedings in international investment law and WTO law.

#### 4.5.1. Unsettled issues in the advocates of cross-reference of the balancing analysis

The balancing analysis is the topic of comparative studies of international law. The main reason is the same language and the similar experiences of judicial review across international authorities. These elements inspire commentators and practitioners to make analogies of the balancing approach between branches of international law.

The practices of the Court of Justice of the European Union (CJEU) and the European Court of Human Rights (ECtHR) are favour reference points by commentators and practitioners in the discussion of the balancing analysis. They are also common to the studies of the balancing analysis in either investor-State arbitration or the WTO dispute settlement mechanism.<sup>425</sup>

Some studies also refer to the experiences of national courts to explore the origin of the balancing analysis. The principle of balancing developed in the jurisprudence of

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<sup>425</sup> Benedikt Pirker (n 1); Gebhard Bücheler (n 2); Benedict Kingsbury and Stephan W. Schill, 'Public law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest—the Concept of Proportionality' in Stephan W. Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010) 75; Caroline Henckels (n 3) 223.

American constitutional law or the principle of proportionality developed by Germany constitutional court are two favourite reference points.<sup>426</sup>

While these studies have different analytical perspectives, they are concerned with the comprehension of the international law system. Under the systematic concern, the pursuit of universal practice of the balancing analysis is usually the topic of the discussion. Especially for the scholars of global administrative law, they argue the potential of the balancing analysis as a constitutional principle for international law and international adjudication.<sup>427</sup>

As to the comparison of international investment law and trade law in specific, the flexibility of the application by investment arbitrators attract the critiques. The majority of the studies then urge investment arbitrators to learn from the experiences of the WTO to improve stability and certainty.<sup>428</sup> In this respect, mutual reference of legal opinions and judicial experiences are a useful instrument.

The thesis, however, argues some issues are missing in the advocate of the mutual reference of judicial experiences between the two regimes.

The first issue is whether the balancing analysis and the principle of proportionality are identical or different principles for judicial review. The distinction is vital for lawyers of administrative law and constitutional law.

The lawyers agree that the two legal principles have a similar function. Both of them are the ways by which national courts determinate the legality of decisions and

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<sup>426</sup> Benedikt Pirker (n 1); Gebhard Bücheler (n 2).

<sup>427</sup> Alec Stone Sweet and Jud Mathews, 'Proportionality Balancing and Global Constitutionalism' (2008) 47 *Columbia Journal of Transnational Law* 73–164; Alec Stone Sweet, 'Investor–State Arbitration: Proportionality's New Frontier' (2010) *Yale Law School Faculty Scholarship Series*; and Caroline Foster, 'A New Stratosphere? Investment Treaty Arbitration as "Internationalized Public Law"' (2015) 64(2) *International and Comparative Law Quarterly* 461; Benedict Kingsbury and Stephan W. Schill (n 443).

<sup>428</sup> See, e.g., Caroline Henckels (n 3) 223; Yasuhei Taniguchi and Tomoko Ishikawa (n 8).



actions by public authorities when the interests or regulatory purposes have conflicts. However, they argue that the consequences of the two principles are different. The main reason is the normative context and the culture of judicial review behind the two principles.

The principle of balancing originated from the jurisprudence of American constitutional law, which is raising out of the conflict between individual freedom public interests. It aims to prevent absolutism in rights protection and to define the boundaries of essential rights for an individual in public era. By contrast, the principle of proportionality rooted in the tradition of German administrative law. For the viewpoint of German judges, they believe that it is the essence of public authorities to maximise the protection of individuals' political and economic rights. Proportionality is the approach to determine the legality of the exercise of sovereignty in line with the harmonisation of constitutional values.<sup>429</sup>

Previous analyses have analysed the normative context and the culture of judicial review by which investment arbitrators and WTO adjudicators apply the balancing analysis. Learning from public law lawyers, the balancing analysis should mean differently for investor–State arbitrators and WTO adjudicators, while the concept is similar. International lawyers, nevertheless, have not explored the relevance of the judicial culture and the application of the balancing analysis yet.

Some commentators approach the principle of balancing through the tension between regulatory powers by nation–states and judicial review in international law.<sup>430</sup> Others highlight the technical function of the balancing analysis as a process of

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<sup>429</sup> See Moshe Cohen–Eliya and Iddo, *Proportionality and Constitutional Culture* (CUP 2013).

<sup>430</sup> For instance, Matthew Windsor, 'A Fine Balance? Delegation, Standards of Review, and Subsidiarity in WTO Dispute Settlement' (2008) 14 Auckland University Law Review 41.

decision-making and a method of law-finding.<sup>431</sup> Under the technical respect, international lawyers often mix the balancing analysis with the principle of proportionality. They either regard the principle of proportionality a method for pursuing a balanced decision; or, treat balancing as the part of the proportionality analysis.<sup>432</sup> There is no necessity to distinguish the balancing analysis and the principle of proportionality for the technical function.<sup>433</sup>

Nevertheless, these studies primarily based on the assumption that balancing and proportionality are the same principles and approaches for international adjudication. Given the assumption, they cannot explain whether balancing and proportionality refer to the same thing, nor explain what the culture of judicial review and the textual features relates to the application of balancing or proportionality.

Another unresolved issue is the extent to which the experiences of balancing in the WTO jurisprudence can be referenced to interpret the rules of investment treaties and to settle the investor-State dispute.

This study has suggested three differences between investor-State arbitration and the WTO dispute settlement mechanism in chapter one. First, investor-State arbitration serves for the private-public dispute, while the WTO dispute settlement mechanism only functions for the state-state dispute. Second, the institutions for investor-State arbitration rely on the network of ad hoc arbitration and institutional arbitration. By contrast, the WTO provides a centralised institution for appellate review and standard

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<sup>431</sup> Andrew D. Mitchell, *Legal Principles in WTO Disputes* (CUP 2011) 182–84; Gabrielle Marceau and Joel P. Trachtman (n 338) 405–11.

<sup>432</sup> Axel Desmedt (n 5) 441–80; Ilona Cheyne, ‘Proportionality, Proximity and Environmental Labelling in WTO Law’ (2009) 12(4) *Journal of International Economic Law* 927–52; Srikanth Hariharan, ‘Distinction Between Treaty and Contract: The Principle of Proportionality in State Contractual Actions in Investment Arbitration’ (2013) 14 *The Journal of World Investment & Trade* 1019–54; Caroline Henckels (n 3) 113–134.

<sup>433</sup> Richard J. McLaughlin (n 4) 855.

rules for the adjudicative proceedings. The last but not the least difference is the treaty text concerning the balancing idea. The vast majority of investment treaties does not indicate the policy choices by the Contracting States on the conflict between investment protection and other values. On the contrary, WTO agreements express the intention of the balance of trade and non-trade values by the drafters. These differences result in the variation in the pattern of treaty interpretation and judicial review of the two dispute settlement mechanisms.

On the other side, given the different patterns of judicial review, it is questionable whether the balancing analysis developed in the WTO jurisprudence is suitable for investment arbitrators to interpret an investment treaty in the context of private-public disputes.

Concerning these unresolved issues, the thesis departs from the pursuit of standard practices of balancing between international investment law and trade law, and in international law as a whole. By contrast, the thesis assumes the balancing analysis meaning differently in the jurisprudence of investor-State arbitration and WTO dispute settlements. Based on the premise, what concerned with is how the balancing analysis in each jurisdiction is shaped by the interaction between the Contracting States and adjudicators. About the application of balancing, balancing is the ways that adjudicators respond to the textual arrangement, the choices by the Contracting States, and the institutional framework.

The interaction between the text and the practice can be illustrated by three elements: political intentions of the Contracting States, legislative choices by the Contracting States, and the decision made by international adjudicators.

#### 4.5.2. Three indicators of the decisions of the Contracting States and international adjudicators

##### 4.5.2.1. Political announcements of the Contracting States on the issue of conflicting interests: the preamble of the treaty

In chapter one, the thesis indicates that treaties have dominated international law. The proliferation of treaties is critical to the development of international investment law and trade law. While the content of a treaty establishes the standards of state practices, it is the result of political negotiation between the Contracting States. As such, the intentions of the Contracting States are the initial point of searching the idea of balancing.

In a broader meaning, the structure and the content of a treaty determines are reflections of the intentions of the Contracting States. They characterise the issues that the contracting State gave consent. The content of the treaty, in turn, establishes the relationship between the States and draws the boundaries of regulatory powers on specific issues. Accordingly, if the Contracting States intend to balance the concerned interests with other values, their intentions are supposed to be reflected in all parts of the treaty, including the textual structure, the preamble, specific rules and even the appendix.

Different parts of the treaty have different legal binding effects. The binding effect directly relates to the interpretative activities by adjudicators. In general, the preamble is the place where the Contracting States announce the interests to protect and objectives to pursue. Because of the function of policy announcements, the preamble usually contains general ideas and conceptual language. Moreover, it is common to treaties that there is a gap between policy announcements and concrete actions by the Contracting

States. The gap means the general ideas written in the preamble are not transformed into specific rules or characterised by particular commitments.

Given different normative effects, the thesis specifies the political intentions of the Contracting States to the preamble of the treaty.<sup>434</sup> The specification is aimed to identify whether the idea of reconciling competing and conflicting interests merely is policy announcement or transformed into normative rules.

Previous chapters have identified a range of languages which express the idea of balancing over conflicting interests or regulatory purposes.

In investment treaties, it is not the tradition of States to express the idea of balancing the purposes of investment protection with other values and policies in the preamble. While some investment arbitrators interpreted the preamble language which concerns mutual economic development of the Contracting States as the ground of the intention of balancing by the signatory States,<sup>435</sup> as discussed above, the interpretation results are at the risk of exceeding arbitrators' interpretive authority. Influenced by sustainable development policies, however, the situation is changing over time. More and more nation-states are willing to express the idea of balancing competing interests in the preamble.

There are four popular forms of language by which an investment treaty carries the idea of balancing in the preamble. First, one refers to the concept of the 'right to regulate' via the terms 'regulatory autonomy' and 'policy space'. The second refers to sustainable

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<sup>434</sup> Some commentators refer the legislative balancing to the preamble as well. Pedro J. Martinez-Fraga and C. Ryan Reetz (n 422) 265–66.

<sup>435</sup> For instance, the *Saluka* tribunal stated, '[t]he protection of foreign investments is not the sole aim of the Treaty, but rather a necessary element alongside the overall aim of encouraging foreign investment and extending and intensifying the parties' economic relations. That in turn calls for a balanced approach to the interpretation of the Treaty's substantive provisions for the protection of investments'. *Saluka v. Czech Republic*, Partial award (n 156), para 300.

development. Another form is about social concerns, such as the protection of human rights and labour rights, the protection of human health, the concern of Corporate social responsibility and the pursuit of poverty reduction. The last approach refers to the resources to protect plant or animal life, the conservation of biodiversity and the concern of climate change.

In the WTO system, the drafters had expressed the idea of reconciling trade interests and other values in the agreements. First, the *WTO Establishing Agreement* is a comparatively short agreement that sets out the role, structure and powers of the WTO. In the preamble, it explicitly clarifies that the pursuit of trade liberalisation is not for trade interests only. The purpose must be balanced with other objectives such as sustainable development, environmental protection and preservation, and special needs for developing and least-developed countries.

The preamble of other substantive agreements also expresses the balancing concern by the drafters of the WTO. For instance, the preamble of the *SPS Agreement* clarifies that Member State is not prevented from adopting or enforcing measures necessary to protect human, animal or plant life or health, while these measures might cause distortion effects on international trade. Likewise, the *TBT Agreement* announces in the preamble that Member States reserve the right to adopt technical standards and regulations to ensure the quality of their exports, or for the protection of human, animal or plant life or health, of the environment, or for the prevention of deceptive practices.

These Agreements confirm that the drafters of the WTO did not create the WTO system exclusive to trade interests and economic value. On the contrary, they tended to make the WTO as an integrated system which serves for the balance among multiple interests and values.

4.5.2.2. The choices by the legislative States on conflicting interests and regulatory purposes: the treaty text

In some situations, the Contracting States did transfer the policy announcement into substantive legal actions. The legal actions include the stipulation of treaty terms, normative rules and the commitments to particular issues. Concerning the clarification and specification, the thesis distinguishes legislative actions from policy announcements. It identifies the treaty terms and provisions as the indicator of legislative choices by the Contracting States in terms of the balancing idea.<sup>436</sup>

In comparison, the balancing concern is more expressly embodied in the text of WTO law than the text of investment treaties.

In WTO law, legislative choices of the conflicting interests are reflected on general exception provisions. The pillared trade agreements contain general exception provisions, GATT Article XX and GATS Article XIV, for instance. The grounds for exceptions are mainly related to social and environmental concerns, such as the protection of public order and public morale, as well as the conservation of exhaustible natural resources. Moreover, certain positive obligations also contained legislative choices regarding the balance of interests. These provisions include the Agreements concerning sanitary and phytosanitary measures, and trade-restrictive technical regulations are such examples, i.e. the *SPS Agreement* and the *TBT Agreement*.<sup>437</sup>

The drafters of the WTO expressed their decisions of the conflicting interests through the double requirements. First, the drafters used the term ‘necessary to’ to

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<sup>436</sup> Mads Andenas and Stefan Zleptnig (n 338) 373–74.

<sup>437</sup> Meinhard Hif, ‘Power, Rules and Principles – Which Orientation for WTO/GATT Law?’ (2001) 4(1) *Journal of International Economic Law* 111, 120.

define the balancing point between trade and non-trade interests in specific provisions. Second, the drafters indicated the notion of dispute settlements in general. Article 3 of the DSU stipulates that dispute settlements of the WTO are ultimately concerned with a balance of rights and obligations for Member States.

These requirements then become the measurements for judicial review. They draw the boundaries for the authority of WTO adjudicators. Panels and the Appellate Body should not infringe the balanced situation that member States involved in the covered WTO agreement.

In investment treaties, by contrast, not all existing investment treaties provide exception provisions. The history of incorporating exception provisions in investment treaties is short.<sup>438</sup> The difference echoes the view of section 4.2.1 that the balancing analysis by investment arbitrators is disconnected with the text.

#### 4.5.2.3. The decisions by international adjudicators on the balance of interests: interpretative approaches and considering elements

The third form is known as the balancing approach in practice.

Section 4.2 has explored a variety of meanings that investment arbitrators and WTO adjudicators applied the concept of balancing to the dispute. As such, this study uses the term ‘adjudicative balancing’ to distinguish the balancing idea expressed by the States in the text.

The term ‘adjudicative balancing’ refers to the ways that adjudicators introduce, discuss, and apply the idea of balancing in the adjudicative process. For instance, the practice of investor-State arbitration demonstrates how arbitrators introduced the

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<sup>438</sup> Pedro J. Martinez-Fraga and C. Ryan Reetz (n 422) 258–89; Catharine Titi (n 141) 123–66.



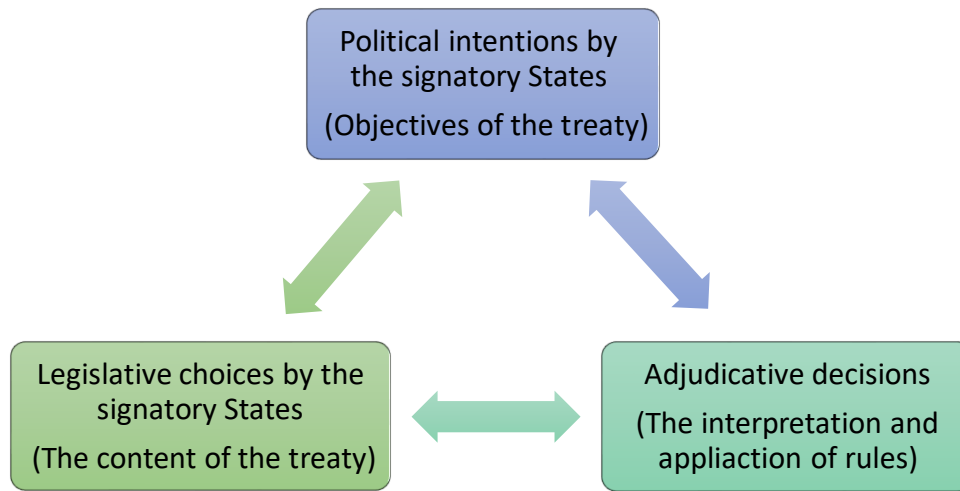
balancing analysis to determine the unsettled issue of the distinction between indirect expropriation and regulatory measures and to refine the scope of investment protection under the doctrine of legitimate and reasonable expectations of foreign investors, while there is lack of textual indication of the balancing concern.

#### 4.5.3. The interaction among political intentions, legislative choices and adjudicative decisions

According to the indicators of the decisions, the thesis proposes that the interaction among the three indicators illustrates the interaction between the States and the adjudicators. The interaction between the States and the adjudicators in terms of the conflicting interests shapes the concept of balancing in international law.

The thesis argues that the meaning of balancing is decided by the interaction between the States and the adjudicators. The interaction between the States and the adjudicators is varying from treaty to treaty. The variety of interaction between the two parties explains the variety of balancing in international investment law and WTO law. Figure 1 illustrates the interaction between the States and the adjudicators through communication among three indicators.

Figure 1 The three indicators for the interaction between signatory States and international adjudicators



Applying the interactive perspective, the practice of investment arbitrators and WTO adjudicators has a two-fold implication.

The first point is that, the more uncertain legislative decisions and political intentions of the States, the more active that adjudicators engage in the balance of conflicting interests and regulatory purposes. On the contrary, international adjudicators will take a conservative attitude over the balancing act if they detect the Contracting States having expressed their decision over the priority of policies.

The majority of investment treaties does not express the intentions of balancing investment protection against other values. Most nation-states did not transform the objective—the pursuit of economic development— as particular rules. While the host States are imposed the majority of obligations, these instruments are primarily concerned with the interests of foreign investments. Given the absence of clear political intentions and legislative choices, some tribunals raised the concern of balancing the interests between foreign investors and host governments.

While arbitral tribunals are active in the balance of treaty obligations for investment protection with other regulatory needs, they have an institutional sensitivity to their role in international law. Their interpretative choices and decisions cannot go beyond the intentions of the Contracting States to a treaty, according to the principle of state consent. Otherwise, their activities will cause the legitimacy issue. The acknowledgement reveals that those investment tribunals who introduced the balancing analysis tried to ground their interpretative choice with the treaty text such as the preambular language of ‘economic development’.

The WTO jurisprudence tells the opposite situation. Panels and the Appellate Body take a conservative attitude of engaging the balance of interests. They are cautious of initiating the issue of balancing interests but passively responding to the requirements and indications by the drafters. Given the textual indication, there is little room left for the discretion of WTO adjudicators. It explains why panels and the Appellate Body tend to leave the balancing act to the member State and regard the balance of internal policies as part of the regulatory autonomy of the Member State.

Another implication is that the more explicit intentions of the States in a treaty, the more restricted authority that the adjudicators enjoy in practice.

In international investment law, the balancing analysis in investor–State arbitration is not merely the approach for interpretation and application of the rules. The balancing analysis also involves the function of refining and altering the conventional understandings and legal opinions of the purpose of an investment treaty to a certain extent.

As previous chapters analyse, the balancing concern developed by investor–State

arbitration implies the assumption that the position of the host States, both in the treaty relationship with the home State and the contractual relation with the claimed investors, is needed to be rebalanced. This assumption is opposite to the conventional conception that investment treaties are serving for the interests of foreign investors primarily. The changing assumption of the purposes of investment treaties inspires investment arbitrators to improve the interpretative attitude and approaches to the determination of indirect expropriation and the doctrine of legitimate and reasonable expectations of foreign investors.

The practice of investment arbitrators raises the problem of the existing investment treaties. The progress of investment treaties is much slower than expected. While the States share sustainable development policies with international society, they have not taken effective action to amend the existing rules or to renegotiate the treaty. In this regard, the substantive balancing by investment arbitrators is a supplementary instrument for the laziness of legislative activities in the transition of international investment law.

The balancing analysis by WTO adjudicators, on the contrary, primarily serves for the technical function. The Appellate Body applies the balancing analysis to assess the due process of the panel's decision making and the quality of the panel's findings.

The limited scope of the balancing analysis by WTO adjudicators is because of the high specification of the political intentions and the legislative choices by the drafters on the issue of conflicting interests. The specification is reflected on the preamble of relevant Agreements, the terms 'necessary to' and 'relating to', and the exhaustive and non-exhaustive lists of non-trade concerns for regulatory autonomy. Accordingly, panels and the Appellate Body do not assume that the arrangement of rights and obligations among member States and the treaty relations under the WTO agreements

are needed to refine. On the contrary, the provisions and the terms implicating the idea of balancing had been the balanced result for member States.

Table 2 summarises the possibilities of the interaction between the Contracting States and adjudicators in terms of the application of balancing.

Table 2 The interaction of political intentions, legislative choices, and adjudicative decisions in terms of balancing

		<b>The clarity of political intentions</b>	<b>The specification of legislative choices</b>	<b>The involvement of adjudicative decisions</b>
<b>Balanced concern had embedded in the text</b>	An instrument to clarify uncertain textual indications	High	Low–Medium	Medium–High
	Reflecting a principle embedded in the text	High	High	Low–Medium
<b>Balancing is the product of treaty interpretation</b>	The adjustment of the unbalanced relations between the concerned parties	Low	Low	High
	A part of dispute settlement involving the contrast of regulatory	Low	Low	High

	purposes and interests			
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\* The text of treaties relating to political balancing and legislative balancing is categorised into different situations in light of the degree of specification. The involvement of adjudicative balancing is also categorised in light of the degree of discretion.

4.6. Conclusion

The negotiation of a treaty requires the States to invest much time, efforts and resources. Concerning the difficulty of the treaty negotiation, treaties are usually durable for an extended period. While the duration has the merit of the implementation and certainty of the treaty, it has disadvantages. One of the disadvantages is the content of the treaty hardly responding to the new demands of the society and echoing the new ideas. It results in the situation that the signatory States are binding to their old promises while they have changed their political ideologies and the priority of policies.

The binding effect of the promises by the signatory State applies to international adjudication. Given the delegated authority, international adjudicators must interpret the treaty text to apply to the dispute in line with the agreements by the signatory State to the treaty. The principle of state consent restricts the authority of adjudicators to respond to new issues and demands of society. While the signatory States have looked forward to the future, adjudicators are still binding to the promises in the past. The delegated authority explains why the courts or tribunals must identify the legal ground for their interpretative choices and legal opinions. The evolutionary interpretation also must be in line with the intentions of the Contracting States.

The experiences of investment arbitrators and WTO adjudicators in terms of balancing demonstrate the correlation with the States. The meaning of balancing to a large extent depends upon how adjudicators respond to the treaty text and exercise their authorities in the designed institutional framework. While the textual indication is essential to the application of the balancing analysis, some cases demonstrate that the balancing analysis involves the function of adjusting the treaty relationship. The adjustment function reveals the ambition of adjudicators to answer the contemporary issue.

Therefore, the thesis argues that international adjudicators are vital to the progress of international law.

Nevertheless, the thesis does not suggest that international adjudicators can replace the role of nation-states as the lawmakers of international orders. To explore the role of international adjudication on the development of the notion of balancing is aimed to raise attention to the interaction between the Contracting States and international adjudicators. What the thesis argues is the construction of international law no longer dominated by the political intentions of the States. Instead, it relies on the interaction and corporation between the States and adjudicators.

The following chapter will explore the interaction between the States and adjudicators from the perspective of the power relation. A specific issue is whether the States still reserve their political influences on the adjudicative proceedings and how.

## **Chapter Five**

### **Understanding Differences in Practice by their Institutional Contexts and the Power Relation between Adjudicators and the States**

#### **5.1. Introduction**

The study has analysed the balancing analysis of investor–State arbitration and the WTO dispute settlement mechanism. It observes that there are differences underneath the concept ‘balancing’. The differences result from the textual arrangements and the institutional framework of dispute settlements. Given the textual and contextual influences, the study suggests that the meaning of balancing depends upon the interaction between the States and adjudicators.

This chapter advances this view the perspective of the power relations between the two parties. The study approaches the power relations by institutional features which might offer opportunities for the States to control or influence the adjudicative proceedings.

The institutional features include the procedures for the engagement of non–disputing parties and the controlling mechanisms of the States over the adjudicative proceedings. The analysis based on a research premise that human behaviours are social products rooted in the relations of a community. In international law, the social context of adjudicators is formed by the adjudicative proceedings and the institutions of dispute settlement. The social context then shapes the relations between adjudicators and the States and disputing parties and influences their decisions.

International lawyers have analysed the interpretative activities of international courts and tribunals from the perspective of the relationship between institutions and behaviours. For instance, the work of Pauwelyn and Elsig concentrates on the



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behaviours of interpreters. They propose a demand–supply theory of interpretative choices.<sup>439</sup> Under their theory, interpretative choices are the result of the interpretative space left for interpreters. Institutional features are one group of interpretative incentives that defines the interpretative space and frames the interpretative choices.<sup>440</sup> The demand–supply theory sheds lights on the relevance of institutional features on interpretation choices.

The work of Pauwelyn and Elsig, however, does not explain the influences of the behaviours of the States. While the decision of international adjudicators based on the interpretation results of treaty rules, it also reflects the ways by which adjudicators respond to the decision by the Contracting States.

International adjudicators and the States are both decision makers of international law, while the nature of their authorities is different. Adjudicators are the decision maker of international disputes; the States is the decision maker of international orders. Given the common function, the evolution of international law does not merely rely on the actions by either international adjudication or treaty negotiation. On the contrary, it rests on the interaction between the States and adjudicators.

This chapter advances the understanding by two points. First, the dispute settlement mechanism is the social context which adjudicators involved. Their relations with the States and other parties affect their decisions. Social sciences have argued that human behaviours are influenced and directed by the environment where they stay and

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<sup>439</sup> Joost Pauwelyn and Manfred Elsig, ‘The Politics of Treaty Interpretation: Variations and Explanations across International Tribunals’ in Jeffrey L. Dunoff and Mark A. Pollack (eds), *Interdisciplinary Perspectives on International Law and International Relations: The State of the Art* (CUP 2013) 450–68.

<sup>440</sup> The alternative variables, in Pauwelyn and Elsig’s study, include a tribunal’s life span, the composition of its constituency, and institutional completion.

by whom they interact.<sup>441</sup> Power relations are vital to defining the social context. Based on the sociological insights, the thesis proposes that investor–State arbitration and the WTO dispute settlement mechanism constitute the social contexts for investment arbitrators and WTO adjudicators. The allocation of power between adjudicators and the States in terms of dispute settlements is a critical element to define the social context in which the adjudicators interact with the States.

Another point is about the scope of the authorities that the States reserved in the third-party adjudication. The States usually would not delegate the whole authority to adjudicators in terms of dispute settlement. The controlling mechanisms of the States over the adjudicative proceedings define the scope of the authority of adjudicators. They, in turn, implicate the space that the States reserve their political influences on the adjudicative procedure. In other words, the higher authority that adjudicators enjoy, the more restrictions imposed on the sovereignty of the States.

This chapter contains four parts. The first part categorises the centralised–decentralised institutions and proceedings relating to the WTO adjudication and investor–State arbitration. The second part discusses the openness of the WTO adjudication and investor–State arbitration regarding the engagement of other legal regimes and non–treaty parties and non–disputing parties. The third part analyses the controlling powers of the States reserved under the two dispute settlement mechanisms. The discussion focuses on the appointment of adjudicators, their authoritative interpretations and acceptance of the decisions. In these three sections, we argue the link between institutional features and the tendency of interpretative choices and adjudicative decisions in the WTO dispute–settlement mechanism and investor–State

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<sup>441</sup> Royston Greenwood, Christine Oliver, Roy Suddaby and Kerstin Sahlin–Andersson (eds), *The SAGE Handbook of Organizational Institutionalism* (SAGE Publications, 1st edn 2013) 308.

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arbitration. In the final part, the thesis reviews the conception that the third-party institution is the instrument for the depoliticisation of international adjudication. It concludes that international adjudication is still under the political control by the States.

## 5.2. The institution for dispute settlements: a centralised–decentralised variation

### 5.2.1. The shared nature of dispute settlements: the rule–based adjudication involving third parties as decision makers

Investor–State arbitration and the WTO dispute settlement mechanism are two efficient institutions in international law. Investor–State arbitration is the primary forum for investment disputes which are raising out of investment treaties. The WTO dispute settlement mechanism is essential for the settlement of cross–border trade disputes which ground in the WTO system.

While the two dispute settlement mechanisms are concerned with different subject matter, both of them share common features. The standard features include the engagement of third parties as decision makers and rule–based proceedings. The two features not only foundations the two dispute settlement mechanisms. But more importantly, they mark a change in international law in terms of the ways of settling the state–involved disputes.

In the aftermath of the Second World War, there were a series of changes which mark the features of modern international law. The changes are the creation of international institutions and organisations, the codification of customary international law, and the treatification of state consent.

Treaties contribute to specifying the norms and rules of state practices. International institutions provide the functions of administrating the treaties, monitoring

the implementation of treaty obligations and solving treaty disputes. From the perspective of the governance of state practices, the normative development and institutional change are both concerned with managing political pressures and influences on international law and dispute settlements.<sup>442</sup> The desire to depoliticise international adjudication explains the establishment of the WTO dispute settlement mechanism and investor–State arbitration. The two dispute settlement mechanisms are the third–party adjudication of international investment law and trade law.

Third–party adjudication means the States have delegated partial sovereignty to third parties in terms of dispute settlements.<sup>443</sup> It indicates that international disputes involving nation–states are no longer settled in diplomatic negotiations between States that depend upon political concerns of the States. The function of delegating power to third parties marks a significant feature of dispute settlements in modern international law.

While international authorities share common functions, however, there are differences in institutional designs of third–party adjudication. The differences include the institutional structure, the adjudication proceedings themselves and the controlling mechanism of the States. These institutional factors, on the one side, indicate the relation between the Contracting States and third–party adjudicators. On the other side, they define the discretion of the third parties on dispute settlements. The procedural rules characterise the differences in institutional structure and state control. The delegation of decision–making power and the legalisation of dispute settlement procedures facilitate the stability of international law.

On the other hand, these features challenge the dominant position of the nation–

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<sup>442</sup> Francisco Orrego Vicuña, *International Dispute Settlement in an Evolving Global Society: Constitutionalization, Accessibility, Privatization* (CUP 2004) 7–8.

<sup>443</sup> *Ibid*, 1–2, 5.

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states in international law.

Under the conventional state-centric theory, nation-states are the subject and object of international law. Because international law is concerned with the interest of nation-states and the exercise of national sovereignty, the international law system is not open to non-state parties.<sup>444</sup> Customary international law and treaties are aimed to arrange rights and obligations for State in light of the exercise of sovereignty, while they are different forms by which the States gave consent.<sup>445</sup> In the state-centric scenario, the settlement of international legal disputes is the part of the sovereignty of the States. Because of the result of dispute settlement may modify the arrangement of the boundaries of sovereignty, the power of dispute settlement should be excluded to the Contracting States.<sup>446</sup>

As such, international dispute resolutions rest in the political concerns of the interested States and are decided by them. International adjudication is the embodiment of international relations and the politics of States.

However, the times are changed. The complex of international society and the growing role of individuals challenge the state-centric scenario.<sup>447</sup> Nation-states are no longer the party having the power to control the international market. Instead, multinational corporations are gradually replacing nation-states to control the international market and set up the standards of the market. In the early 2000s, of the

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<sup>444</sup> Quincy Wright, *The Position of the Individual in International Law according to Grotius and Vattel* (Martinus Nijhoff 1960) 157–60.

<sup>445</sup> See James Crawford, *Brownlie's principles of public international law* (OUP 2012), chs 25 and 26; George Manner, 'The Object Theory of the Individual in International Law' (1952) 46 *The American Journal of International Law* 428, 428.

<sup>446</sup> Anne Peters, *Beyond Human Rights: The Legal Status of the Individual in International Law* (CUP 2016) 14.

<sup>447</sup> Andrew Clapham, 'The Role of the Individual in International Law' (2010) 21(1) *European Journal of International Law* 25–30.

top 100 largest economies in the world, the proportion of private corporations had exceeded that of nation–states (51 v. 49). The sales of some private corporations, such as General Motors and Ford, are higher than the gross domestic product of the countries in sub–Saharan Africa. By the growing economic power, corporations are gradually taking over from the state responsibility to provide healthcare and technology for schools and the community.<sup>448</sup> Moreover, the rise of human rights of individuals also changes the landscape of good governance of nation–states.

The increased complexity of regulatory issues and more profound economic interdependence across borders also raise concerns about the uncertainty and ambiguity of the traditional means for international governance, diplomatic negotiations. Either political negotiations between nation–states or the diplomatic protection for individuals all depend upon trade–offs of political interests between States.<sup>449</sup> It is hard to predict the results because of the changing positions and choices of the States.

Those challenges then urged the need for legalising politics in international law. Two changes characterise the trend of legalisation. First, treaties have become the primary instrument to codify principles for state practices and to ascertain state consent regarding the boundaries of sovereignty as well.<sup>450</sup> Second, diplomatic and political negotiations are no longer the only method to settle international legal disputes that are concerned with sovereignty. The conventional dispute resolution method is either replaced by or coexists with third–party dispute settlement mechanisms. It means that the States delegate part of the decision–making power to non–treaty parties concerning

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<sup>448</sup> Noreena Hertz, as a claimed economist, had argued how corporations across the world manipulate and pressure governments by legal and illegal means. Noreena Hertz, *The Silent Takeover: Global Capitalism and the Death of Democracy* (HarperBusiness, Reprint ed. 2003)

<sup>449</sup> Sol Picciotto, ‘The WTO’s Appellate Body: Legal Formalism as A Legitimation of Global Governance’ (2005) 18(3) *Governance: An International Journal of Policy, Administration, and Institutions* 477, 478–79.

<sup>450</sup> The trend toward treatification of trade relations and investment protections is discussed in section 1.2.2 of chapter one.

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dispute settlement. As such, the legalisation of adjudicative procedures defines the delegation of powers, on the one side. On the other side, legislative activities contribute to the treatification of international adjudication.<sup>451</sup>

The creation of third-party adjudication and the proliferation of treaties signal the rule of law in international law. International trade and investment law are no exception to the transformation of international law. The WTO dispute settlement mechanism has transformed from a political negotiation-oriented model toward an adjudicative model.<sup>452</sup> ICSID and *UNCITRAL Arbitration Rules* are the primary instruments to reduce political interventions by home and host States and the conventional role of diplomacy in the protection of foreign investments.<sup>453</sup>

There is no standard answer for third-party adjudication in international law. The ways of designing third-party adjudication are varying in different branches of international law. Investor-State arbitration and the WTO dispute settlement mechanism are representative of two types of third-party adjudication. The former is a decentralised system which relies on the network of ad hoc arbitration and institutional arbitration; the latter is a centralised system having the appellate review and standard proceedings. The following section discusses the institutional difference by two points: the legalisation of adjudicative proceedings and the institutionalisation of the decision-making process.

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<sup>451</sup> John Collier and Vaughan Lowe, *The Settlement of Disputes in International Law* (OUP 1999) 5–7.

<sup>452</sup> Michael K. Young, 'Dispute Resolution in the Uruguay Round: Lawyers Triumph over Diplomats' (1995) 29 *International Law* 389, 396–97; J.H.H. Weiler, 'The Rule of Lawyers and the Ethos of Diplomats Reflections on the Internal and External Legitimacy of WTO Dispute Settlement' (2001) 35 *Journal of World Trade* 191, 194; Edna Ramírez Robles, 'Political & Quasi-Adjudicative Dispute Settlement Models in European Union Free Trade Agreements: Is the Quasi-Adjudicative Model A Trend Or Is It Just Another Model?' (2006) WTO Staff Working Paper, 5–8.

<sup>453</sup> José E. Alvarez (n 37) 100–01; Farouk El-Hosseny, *Civil Society in Investment Treaty Arbitration: Status and Prospects* (Brill/Nijhoff 2018) 83–84.

### 5.2.2. The institutionalisation of dispute settlements and legislation of adjudicative proceedings

The first and significant difference between the WTO dispute settlement system and investor–State arbitration is the existence of central institutions in the former. The centralised–decentralised variation is the result and also a reflection of the density of legalised settlement procedures in the two regimes.

In the WTO system, dispute settlements are administrated and governed by the Dispute Settlement Body (DSB).<sup>454</sup> It is an organ of the WTO system, composed of the representatives of all Members. It along with the General Council functions as the highest–level decision–making bodies in the intervals between meetings of the Ministerial Conference.<sup>455</sup> It has overlapping members with the General Council. Also, the WTO has created a standing and central institution to manage the consistency of legal interpretations,<sup>456</sup> the Appellate Body. Because of the appointment procedure and the fixed term of members of the Appellate Body, this institution is also considered as an international trade court.<sup>457</sup>

By contrast, investor–State arbitration lacks a multilateral institution to administer arbitration proceedings and to maintain the consistency of legal interpretations of rules of investment treaties. Instead, the interpretation and application of treaty rules rests on different arbitration institutions and relies on the networking relationship of arbitrators. It is true that ICSID was created as an international arbitration institution for investment disputes. In practice, ICSID has functioned a norm–creating and practice–modelling role in international investment law but does not have a formal centrality.

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<sup>454</sup> The Dispute Settlement Understanding, Article 2(1).

<sup>455</sup> The Agreement Establishing the World Trade Organization, Article IV(3).

<sup>456</sup> The Dispute Settlement Understanding, Article 17.6.

<sup>457</sup> José E. Alvarez (n 37) 38.



The nature of ICSID is a membership convention. Nation–states are free to join the membership of ICSID or not. However, not all States having investment treaties have membership in ICSID. In other words, the case law of ICSID arbitration only has the effect of guidance but does not have a binding effect on all Contracting States unless they are the disputing party to a case. The institutional nature limits the role of ICSID as the central institution of investor–State arbitration. Also, ICSID was not created for the concern of the comprehension of international investment law, but from the concern of protecting and facilitating business activities of foreign investors.

The institutional nature of ICSID means that it does not function akin to the Appellate Body of the WTO. Although ICISD dominates the practice of investor–State arbitration,<sup>458</sup> its accountability has also been questioned by the States and the public. In the last decade, several countries have questioned the legitimacy of ICSID and decided to withdraw their membership in ICSID due to the suspicion about its pro–investor position.<sup>459</sup>

Another implication of the centralised–decentralised variation is the degree of the legalisation of adjudicative proceedings.

The WTO provides a set of procedural rules for different kinds of dispute resolution methods via the *Understanding on Rules and Procedures Governing the Settlement of Disputes*. The DSU is like a rulebook of WTO dispute settlements. It covers the detailed timeline of each stage of third–party adjudication, appellate review and compliance with rulings. Institutional norms relating to the interpretation and

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<sup>458</sup> UNCTAD, *World Investment Report 2016*, 104.

<sup>459</sup> For instance, Bolivia, Venezuela, Nicaragua and Cuba have announced withdrawal from *ICSID Convention*.

application of WTO provisions are also included.<sup>460</sup> Article 3.5 of the DSU also stipulates the underlying principle of dispute resolutions, either by political negotiation or through the adjudicative process. It requires the content of all solutions and recommendations to not nullify or impair the benefits of all member States under the agreement in dispute. This provision, along with the standard procedural rules, represents the rule-based nature of the WTO dispute settlement system.

By contrast, the degree of the legalisation of investment dispute resolutions in investment treaties is not as high as in WTO law. The majority of investment treaties do not provide detailed provisions for investor-State dispute settlements. While investor-State dispute provisions are a standard part of an investment treaty, their coverage is limited. They often cover three issues: the commencement of an investor-State arbitration, the binding force of final awards and the relationship with domestic remedies. The principles of legal interpretations, the procedural rules of the arbitration and the enforcement issue are often absent. Instead, those issues largely depend on the arbitration rules of specific arbitration institutions, as well as other international agreements such as *UNCITRAL Arbitration Rules* and the 1958 *Convention on the Recognition and Enforcement of Foreign Arbitral Awards* (also known as ‘the New York Convention’).<sup>461</sup>

Famous arbitration institutions include the International Chamber of Commerce (ICC), International Court of Arbitration (ICA), the London Court of International Arbitration (LCIA), and Stockholm Chamber of Commerce (SCC).<sup>462</sup> Those permanent organisations usually provide their own rules to administer the proceedings.

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<sup>460</sup> The Dispute Settlement Understanding, Articles 3.2, 3.3, 11 and 17.

<sup>461</sup> Rémy Gerbay, *The Functions of Arbitral Institutions* (Wolters Kluwer 2016) 13–14.

<sup>462</sup> Eloïse Obadia and Frauke Nitschke, ‘Institutional Arbitration and the Role of the Secretariat’ in Chiara Giorgetti (ed), *Litigating International Investment Disputes: A Practitioner's Guide* (Brill 2014) 81.

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In general, these arbitration rules stipulate the selection of arbitrators, the constitution of the tribunal, interpretation rules and applicable law, fact-finding and evidence disclosure, and the timeline for each phase of the proceedings. The detailed rules and terminology, however, differ slightly from institution to institution.<sup>463</sup>

The lack of central institutions and unified procedural rules lead the practice of investor-State arbitration to rely on the complicated and intertwined relationship between investment treaties, international agreements, private institutional rules and national arbitration laws. Arbitrators, who are the party primarily in control of procedural matters and the proceedings.

### 5.2.3. The centralised-decentralised variation in the institutions and the patterns of treaty interpretation

Investor-State arbitration and the WTO dispute settlement mechanism demonstrate the two extremes of international adjudication. The former is a decentralised system, relying on a network of arbitration institutions and cooperation with other international agreements and national laws. The latter is a centralised system, having its own procedural rules and institutional norms. The centralised-decentralised variation in institutions and dispute settlement proceedings reflects the ways of how States delegate their powers to third parties.<sup>464</sup>

The variance of the delegation of decision-making power to third parties explains the patterns of investment arbitrators and WTO adjudicators. In the WTO, centralised institutions and adjudicative proceedings have influences on the unification of legal

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<sup>463</sup> Rémy Gerbay (n 483) 12–13.

<sup>464</sup> John H. Barton and et al. *The Evolution of the Trade Regime: Politics, Law and Economics of the GATT and the WTO* (Princeton University Press 2006) 74; Kenneth J. Vandevelde, 'Of Politics and Markets: The Shifting Ideology of the BITs' (1993) 11 *International Tax & Business Lawyer* 159, 160–61.

interpretations and considering factors. Panels and the Appellate Body tend to have recourse to the legal opinions of previous cases. The repeated references not only constitute *de facto* precedents in the WTO jurisprudence; but it also contributes to the consistency of legal interpretations of WTO provisions.

However, *de facto* precedents might generate negative results. They set limits to the discretion of panels and the Appellate Body to search for alternative possibilities. In the construction of *de facto* precedent, the AB plays a critical role. The Appellate Body in several cases has repeatedly explained the importance and the guidance effect of previously adopted reports. Its reason is that previously adopted reports create legitimate expectations among WTO Members. The AB believes that that legal opinions of previous cases should be taken into account to a dispute because they are part of the legitimate expectations of the Member States to the dispute.<sup>465</sup> The authority delegated to the AB by WTO law is precisely the instrument to protect members' legitimate expectations. As the appellate review institution, the AB has the authority to uphold, modify and reverse legal findings and opinions of a panel. The function of correction is reflected in the interpretation of the necessity requirement.<sup>466</sup>

Because of the authority of correction by the Appellate Body, the *de facto* precedent instead reduces the incentive of panels to take evolutionary interpretations. Unnecessary judicial conservatism might hinder the function of dispute settlement of the WTO system.

The function of correction by the AB marks a critical difference from investor–State arbitration. The absence of a supervision institution is the reason for the flexibility

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<sup>465</sup> Appellate Body Report, *Japan —Alcoholic Beverages II* (n 359), pp 107–108.

<sup>466</sup> As to the way that the AB applies precedent cases, see the general discussion in chapter three, Section 3.3.2. About the role of precedent cases in the interpretation of specific rules, see the discussion in Chapter four, sections 4.3.2 and 4.3.3.

and uncertainty in the interpretation of treaty rules by investor–State arbitration.

While ICSID provides an annulment procedure, the annulment procedure is different from an appeal remedy.<sup>467</sup> There are two institutional factors to the distinction. First, ICSID’s annulment committees are ad hoc institutions.<sup>468</sup> They are not granted the authority to review the substance of the argued award, such as legal findings and interpretations. As the ad hoc Committee stated in *MCI Power Group v. Ecuador*, ‘the role of an ad hoc committee is a limited one, restricted to assessing the legitimacy of the award and not its correctness’. ‘The committee cannot, for example, substitute its determination on the merits for that of the tribunal’.<sup>469</sup>

Second, ICSID excludes the right to modify and reverse from the annulment committee authority.<sup>470</sup> An ad hoc Committee may annul an award in whole or in part, but it is not authorised to modify it. In this situation, only two options left for annulment committees: to annul or to confirm an award.<sup>471</sup> The limited authority constrains the ICSID annulment procedure to manage the consistency of legal interpretations.

While investment arbitrators enjoy more freedom of treaty interpretation and dispute settlement, their active engagement also raises the concern of instability and unpredictability of international investment law.

### 5.3. The structure of dispute settlements: a closed–open variation

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<sup>467</sup> Gabriel Bottini, ‘Present and Future of ICSID Annulment: The Path to an Appellate Body?’ (2016) 31(3) ICSID Review 712, 712.

<sup>468</sup> ICSID Convention, Article 52(3).

<sup>469</sup> *MCI Power Group, LC and New Turbine, Inc v. Republic of Ecuador* (‘*MCI v. Ecuador*’) ICSID Case No ARB/03/6, Decision on annulment, 19 October 2009, para 24. However, Bottini argues that the nature of ad hoc institutions are not necessarily equated with the restrictive authority of reviewing the substance of an award. Gabriel Bottini (n 489) 718–19.

<sup>470</sup> ICSID Convention, Article 52(1).

<sup>471</sup> Christoph Schreuer, ‘Commentary on the ICSID Convention, Article 52’ (1998) 13(2) ICSID Review 507, 662 (paras 369–70).

Another difference between investor–State arbitration and the WTO dispute settlement mechanism is the openness of the adjudicative proceedings.

Two factors approach institutional openness. One factor is what laws are interpreted. The openness of a legal regime influences the scope of applicable law in treaty interpretation and the involvement of other regimes and legal systems regarding compliance.<sup>472</sup> Another factor relates who can participate in the adjudicative procedure. The specific issue is whether the adjudicative procedure is open to non–treaty parties. Based on the two factors, this study proposes an assumption. The greater openness a dispute settlement mechanism has the more opportunities that other legal regimes and legal systems are involved, and the more diverse participants that attend the procedure.

### 5.3.1. The openness to other laws and legal systems

Whether a dispute settlement mechanism is open to other legal systems, to a large extent, links to the level of the legalisation of the mechanism. A higher degree of the legalisation of dispute settlements means more comprehension of institutional norms and procedural rules. In contrast, a lower degree of the legalisation of dispute resolutions implicates incomplete institutional norms and rules, either for treaty interpretation or compliance with the rulings. In this situation, it needs to rely on other legal systems to fill the void. The WTO dispute settlement mechanism and investor–State arbitration are examples of the two types of dispute settlements.

According to the DSU, the provisions cover a whole process of dispute settlements, starting from pre–adjudication methods to the establishment of panel and appellate review. This agreement also provides rules for retaliation mechanisms concerning the

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<sup>472</sup> The terms ‘regimes and systems’ are used under the conception that international law is a whole system. International agreements and treaties in line with the governed subject matters are specific regimes or specific laws in the international law system. The term ‘regimes’ is used in the situation where only international agreements are discussed.

implementation of panel reports and the Appellate Body reports, as well as the procedures for the claimant party to request compensation or suspension of concessions when the respondent State does not implement the rulings and recommendations.<sup>473</sup> One can see that the regulations and rules of the adjudicative procedure in the WTO are comprehensive and complete. Legalisation leads the WTO dispute settlement mechanism into being akin to a self-contained and self-sufficient system.

It is arguable that whether non-WTO treaties are applicable in the interpretation and clarification of WTO provisions since the DSU stipulates the purpose of the WTO dispute settlement mechanism as preserving the rights and obligations of Members under WTO agreements.<sup>474</sup>

At the early stage of WTO dispute settlements, commentators argued that ‘WTO-covered agreements’ should not be interpreted as *lex specialis* in the interpretation of WTO provisions, especially in disputes where a WTO member is also a party to other international treaties such as regional trade agreements and international environmental treaties.<sup>475,476</sup> However, this practice shows that panels and the Appellate Body are inclined to take conservative attitudes toward the application of non-WTO treaties as the ground of final decisions. Non-WTO treaties are usually considered as background

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<sup>473</sup> The Dispute Settlement Understanding, Article 22.

<sup>474</sup> There are two general scenarios. The first scenario argues the limited domain of WTO law. See Joel P. Trachtman, ‘The Domain of WTO Dispute Resolution’ (1999) 40(2) *Harvard International Law Journal* 333; ‘Book Review of *Conflict of Norms in Public International Law*’ (2004) 98 *American Journal of International Law* 855. The second scenario argues the openness of WTO law as part of public international law. See Joost Pauwelyn, *Conflict of Norms in Public International Law: How WTO Law Relates to Other Rules of International Law* (CUP 2003); ‘Bridging Fragmentation and Unity: International Law as a Universe of Inter-Connected Islands’ (2004) 25(4) *Michigan Journal of International Law* 903.

<sup>475</sup> The potential conflict with international environmental agreements is largely due to general exceptions on the concern of public health and environmental protection under the GATT, the SPS Agreement and the TBT Agreement.

<sup>476</sup> Lorand Alexander Bartels, ‘Applicable Law in WTO Dispute Settlement Proceedings’ (2001) 35(3) *Journal of World Trade* 499–519.

information to the factual and legal issues, not the grounds of final decisions.

The conservative attitude toward non-WTO law exists in the reasoning. As previous chapters discuss, panels and the Appellate Body tend to repeat and follow legal reasoning and interpretations developed in previous reports. From the perspective of the panel, the Appellate Body previously adopted reports are more persuasive than the experiences of other international authorities due to the correction function of the Appellate Body.

While the Appellate Body explains that previously adopted reports create legitimate expectations among member States and should be taken into account where they are relevant to any dispute,<sup>477</sup> the repeated references constitute a de facto precedent in the WTO's jurisprudence. Along with the conservative application of non-WTO treaties, the practice seems to echo the critiques that the WTO system is a self-contained regime isolated from the international law system in reality.<sup>478</sup> This point also echoes the view of chapter one that WTO law is disconnected with customary international law except for the principles for treaty interpretation.

By contrast to WTO dispute settlements, investor-State arbitration mainly relies on other legal systems. The openness to other international and national legal systems results from the incomplete legalisation of arbitration proceedings.

First, the majority of investment treaties does not provide self-contained rules relating to the challenge and enforcement of arbitral awards. Given the lack of self-contained arbitration rules, the treaties must refer to other arbitration institutions such

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<sup>477</sup> Appellate Body Report, *Japan—Alcoholic Beverages II* (n 359), pp 107–108.

<sup>478</sup> P.J. Kuyper, 'The Law of GATT as A Special Field of International Law: Ignorance, Further Refinement or Self-Contained System of International Law?' (1994) 25 *Netherlands Yearbook of International Law* 227, 252; MCEJ Bronckers, 'More Power to WTO?' (2001) 4(1) *Journal of International Economic Law* 41, 56–59.



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as ICSID. By incorporating other arbitration institutions, these treaties can proceed with the investor–State procedure by referring to the arbitration rules of these institutions.

Likewise, the challenge and enforcement of investment arbitral awards also rely on the reference of the rules developed by other institutions or legal systems. Disputing parties may challenge an award before national courts, i.e. in a court of a state in which an award was rendered; in the situation of enforcement, in a court of the state where enforcement is sought.<sup>479</sup> The freedom of choice of the court of enforcement and recognition triggers the complexity and uncertainty in the grounds of setting aside arbitral awards under domestic laws.<sup>480</sup> More importantly, it implies that national courts reserve the power to decide the recognition and enforcement of arbitral awards, while they usually cannot be reviewed on the merits.<sup>481</sup>

The international community is aware of the institutional stability of the investor–State arbitration. There are two significant efforts in response to the institutional issue. First, ICSID has provided stronger rules in respecting the recognition and enforcement of its awards. The *ICSID Convention* requires national courts of the member States to recognise and enforce monetary awards immediately. The decision of an ICSID award can be overturned only through the reviewing procedure under the *ICSID Convention* and on restricted grounds.<sup>482</sup>

The United Nations also provides the *UNCITRAL Model Law on International Commercial Arbitration* (1985) (‘the *UNCITRAL Model Law*’) to assist States in reforming

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<sup>479</sup> Taida Begic, *Applicable Law in International Investment Disputes* (Eleven International Publishing 2005) 187.

<sup>480</sup> *Ibid.*, 188.

<sup>481</sup> Lucy Reed, Jan Paulsson and Nigel Blackaby, *Guide to ICSID Arbitration* (Wolters Kluwer, 2nd edn 2010) 180.

<sup>482</sup> *Ibid.*, 180–181.

and modernising their laws on the arbitral procedure. Notably, the *UNCITRAL Model Law* provides a detailed framework for the resolution of international commercial conflicts. It enables lawmakers in national governments to adjust their domestic legislation on arbitration to ensure the arbitration process in line with global principles. As such, it contributes to increase the predictability of decentralised arbitration practices and to reduce uncertainty in the recognition and enforcement of arbitral awards. The adoption of the *UNCITRAL Model Law* is essential, especially for those non-Contracting States of the *New York Convention*, such as Taiwan, as well as those countries opposing investor-State arbitration, such as the Latin American countries.<sup>483</sup>

These standard grounds, however, may be practised differently because of the experiences and legal understandings of national courts.

The incomplete legalisation of arbitration proceedings further raises the issue of the scope of applicable law.

Most investment treaties do not contain the rules of choice of law. This issue often depends on the arbitration rules in the application. It is true that the issue of choice of law is addressed by the majority of favourite arbitration rules, including the *ICSID Convention* (including the *ICSID Additional Facility*), the *UNCTRAL Arbitration Rules*, and arbitration rules provided by the ICC, or the LCIA. However, the question is that these rules usually leave it to the discretion of arbitral tribunals. No specific guidance is proposed to ascertain the applicable law.<sup>484</sup> In this situation, arbitrators' experiences

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<sup>483</sup> The Congress of Argentina adopted an International Commercial Arbitration Act which is based on the UNCITRAL Model Law. This is a great progress for Argentina in terms of international commercial disputes since it was one of the countries that did not have a law regarding international commercial arbitration. Argentina. Gov., Official Press (05 July 2018) 'El Congreso Aprobó la Ley de Arbitraje Comercial Internacional', available at <<https://www.argentina.gob.ar/noticias/el-congreso-aprobo-la-ley-de-arbitraje-comercial-internacional>> accessed 10 April 2019.

<sup>484</sup> Jarrod Hepburn, *Domestic Law in International Investment Arbitration* (OUP 2016) 112–13.

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and knowledge of the domestic law are critical to the outcome.<sup>485</sup>

### 5.3.2. The openness to non–treaty parties

The openness of a dispute settlement mechanism also depends upon who has the right to access to the procedure or attend the proceedings.

Traditionally, only the parties to the legal relationship or a treaty are entitled to access to international adjudication. The principle of privacy means that no third–party has the right to attend the proceedings and hearings. On the other hand, the principle of privacy ensures that the final decision is only binding on the disputing parties. In this respect, the participation of non–disputing parties seems against the essential rule of international dispute settlements. The participation of non–state parties in international adjudication is further against the conventional, state–centric conception of international law. This is because non–state parties such as individuals, private juridical persons and civil societies were not usually entitled to legal standing under a treaty.

Nevertheless, the situation has been changed under the contemporary conception of international law. International law and adjudication are no longer excluded from nation–states but also including non–treaty parties and non–state parties. Therefore, this section uses the term ‘non–treaty parties’ to discuss who can attend the adjudication proceedings to the change of international law and adjudication. Two issues define the engagement of non–treaty parties: whether this party has a right to commence the procedure, and whether it is entitled to attend the procedure and hearings as a third party.

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<sup>485</sup> A thorough discussion of the interrelationship between public international law, national law and investment treaties in light of the protection of international investments, see Jeswald W. Salacuse, *The Three Laws of International Investment: National, Contractual, and International Frameworks* (OUP 2013) 35–50.

### 5.3.2.1. Who has the right to commence the procedure?

As to the issue of who has the right to access to international adjudication, the engagement of individuals marks a significant difference between the WTO dispute settlement mechanism and investor–State arbitration.

The WTO system does not give a remedy to private individuals or corporations suffering from inconsistent trade measures. Its dispute settlement mechanism is open only to member States to question inconsistent trade measures. It is modelled from the state–state arbitration procedures but with appellate review.

By contrast, the provision of investor–State arbitration in investment treaties grants foreign investors the right to bring claims against a host State when they believe the host State has denied their protection under the investment treaty.<sup>486</sup>

Like the ECtHR, the modern investment treaties invent investor–State arbitration as an alternative approach for private parties to enforce their rights against host governments. The engagement of private parties in disputes involving nation–states altered the landscape of international law regarding dispute settlements. International law was used as a system exclusive to the community of nation–states. The engagement of private parties disturbs the dominant position of States in international adjudication relating to investment protections.<sup>487</sup> The right to claim damages against host States entitles private parties the freedom of access to justice directly. It is also conceived as evidence of various human rights.<sup>488</sup>

However, the nature of the investors’ right to access to investor–State arbitration is debatable. It is not only related to the distinction between private rights in line with

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<sup>486</sup> Ibid, 153.

<sup>487</sup> Matthias Herdegen, *Principles of International Economic Law* (OUP, 2ed edn 2016) 478.

<sup>488</sup> José E. Alvarez (n 37) 5–75.

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investment protection and fundamental human rights.<sup>489</sup> The debate also exists in the distinction between a substantive right of investors and the beneficial interest of investors under a treaty.<sup>490</sup>

The engagement of individuals in investor–State arbitration has a definite meaning in international adjudication. First, it marks a high–level delegation of sovereignty from States in terms of dispute settlements. The decision–making power of States is not only constrained by the involvement of third parties as decision makers but is further restrained by granting the right of initiating international arbitration exclusive to foreign investors. Second, the restricted access to investor–State arbitration implicates a deeper depoliticisation of investor–State disputes. The privatisation of dispute settlement to a certain extent prevents the enforcement of investment treaties from the political influence by the Contracting States. The engagement of private parties, however, raises the concern that investor–State arbitration becomes the forum where investors pursue private interests by questioning domestic policies.<sup>491</sup>

#### 5.3.2.2. Who has the right to attend the procedure and hearings as third parties?

The diversity of participants in international adjudication also depends upon the participation of third parties to the dispute.

The experience of international courts and tribunals shows two approaches for non–disputing parties to attend a procedure. Non–disputing parties could attend the procedure using a formal third–party intervention procedure. International adjudication

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<sup>489</sup> Peters argues the distinction between investor rights and human rights because of the different protected interests (economic interests versus human rights) and the user of international adjudication (legal person versus natural persons). Anne Peters (n 468) 291–92, 318–21.

<sup>490</sup> The debate arises from the question of whether individuals are right–holders or just the beneficiary of a treaty. Anne Peters, *ibid*, 28–32, 291–93, 316.

<sup>491</sup> See Gus van Harten, *Investment Treaty Arbitration and Public Law* (OUP 2007) 95–96, 167–75.

might allow third parties intervention, which entitles any ‘person’ that is foreign to the dispute the right to be heard in the proceedings. The main reason for the third-party intervention is to provide the person whose interests might be influenced by the result of the dispute the opportunity to express their concerns.

Another opportunity for third-parties is the *amicus curiae* procedure. This procedure permits non-disputing parties to assist a court by providing relevant and helpful information to the tribunal.<sup>492</sup> Different from the formal third-party intervention, the participants through the *amicus curiae* procedure are more often representative of the public to raise adjudicators the concern of public interests that the dispute involved, while the distinction of private and public interests is blurring.

Either the procedure of third-party or the *amicus curiae* procedure functions to bridge the connection with the outsiders to fulfil the democratic deficit of international adjudication. In this respect, the two procedures together are ‘third-party intervention’ of international adjudication.

The two procedures have different requirements. These requirements define the scope of third-parties in an adjudicative procedure. An important requirement is the status of the participants.

In international law, third-party intervention is usually close to the signatory parties. This is because the results of international adjudication involve the arrangement of the rights and obligations between the treaty parties. The third-party procedure allows the treaty party which is not the disputing party has the opportunity to exchange understandings with other treaty parties. This point explains why the formal third-party procedure of international adjudication usually requires the participants as the party who

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<sup>492</sup> Farouk El-Hosseny (n 453) 18–19.

are foreign to a dispute but have the membership to the treaty.

By contrast, the *amicus curiae* procedure is for the concern of assisting adjudicators in collecting information and technical advice. The assistance function leads the *amicus curiae* procedure of international adjudication usually not containing the requirement of the membership for the *amicus curiae* submission.

In the context of investor–State dispute settlements, the engagement of non-disputing parties is restricted. While non-treaty parties are entitled to access international arbitration, the arbitration proceedings are closed to disputing parties.

One of the reasons is the tradition of commercial arbitration. An arbitration procedure is under the principles of privacy and confidentiality. Those principles highlight the value of party autonomy in the proceedings. Likewise, investment treaties have not tended to provide an exception to ‘non-disputing parties’ to engage in the arbitration proceedings.

However, the limitation of the engagement of non-disputing parties is challenged. The public is challenging the democracy and legitimacy of the existing investor–State arbitration. The challenge focuses on the issues of public participation and transparency of the arbitration proceedings for the public of the host State.<sup>493</sup> The two issues directly relate to the confidentiality of the arbitral proceedings.<sup>494</sup>

By the efforts of UNCITRAL, there have been some changes in international

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<sup>493</sup> N. Blackaby and C. Richards., ‘Amicus Curiae: A Panacea for Legitimacy in Investment Arbitration?’ in Michael Waibel, Asha Kaushal, Kyo-Hwa Chung and Claire Balchin (eds), *The Backlash Against Investment Arbitration: Perceptions and Reality* (Wolters Kluwer 2010) 273; Farouk El-Hosseny (n 475) 114–18.

<sup>494</sup> Gabrielle Kaufmann-Kohler and Michele Potestà, ‘Can the Mauritius Convention serve as a model for the reform of investor–State arbitration in connection with the introduction of a permanent investment tribunal or an appeal mechanism? Analysis and roadmap’ (CIDS 2016) para 57.

investment law. UNCITRAL first adopted the Rules on Transparency in Treaty-based Investor-State Arbitration (the ‘Transparency Rules’) as the partial amendment of original *UNCITRAL Arbitration Rules* in 2013. The Transparency Rules introduce the public disclosure of awards and other vital documents (Articles 2 and 3), open hearings (Article 6) and *amicus curiae* submissions by non-disputing parties (Articles 4 and 5). In order to expand its significance to existing BITs concluded before the Transparency Rules, UNCITRAL then transferred these rules into a multilateral convention. This convention was adopted by the General Assembly of the United Nations in 2014, namely the *Mauritius Convention*.<sup>495</sup>

ICSID has also adopted similar changes. Article 32(2) of *ICSID Arbitration Rules* entitles third parties the right to be heard in the proceedings unless either of disputing parties objects. Article 37(2) also grants tribunals the authority to accept *amicus curiae* briefs from non-disputing parties under a set of requirements.<sup>496</sup>

The practice responds to the textual improvements as well. These textual improvements raise the incentives for arbitral tribunals to accept *amicus* briefs from non-disputing parties.

In the early 2000s, the tribunal of *Aguas del Tunari v. Republic of Bolivia* had noted the US–Singapore BIT provided *amicus curiae* provisions.<sup>497</sup> However, *amicus* briefs from non-disputing parties were first accepted by the arbitral tribunal in the *Methanex* case. The *Methanex* tribunal applied the 1976 *UNCITRAL Arbitration Rules* concerning

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<sup>495</sup> The Mauritius Convention is applicable to investor–State arbitrations based on an investment treaty concluded before the date on which the Transparency Rules became effective (i.e. 1 April 2014).

<sup>496</sup> ICSID recently proposed the changes to the ICSID rules. The proposed rules show that the ICSID rules will even further enhance third-party involvement, including publication of information in proceedings and disclosure of any document generated in the conciliation to a non-party. See ICSID, ‘Proposals for Amendment of the ICSID Rules–Working Paper’ (2 August 2018), available at <[https://icsid.worldbank.org/en/Documents/Amendments\\_Vol\\_Three.pdf](https://icsid.worldbank.org/en/Documents/Amendments_Vol_Three.pdf)> accessed 10 April 2019.

<sup>497</sup> *Aguas del Tunari, S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Letter to NGO regarding petition to participation s amici curiae of 29 January 2003.



the discretion of tribunals to fit particular needs to agree to consider *amicus* briefs from local citizens of the influenced region of the respondent State and other NGOs.<sup>498</sup> Some subsequent arbitral tribunals have also welcomed *amicus* briefs. For instance, the tribunal in *Glamis Gold v. US* accepted *amicus curiae* submissions from civil society groups. It had recourse to Article 15(1) of the 1976 *UNCTRAL Arbitration Rules* to make their decision to accept them.<sup>499</sup>

As to the WTO system, the WTO stipulates procedural rules concerning third-party intervention via the collateral agreement, the DSU. According to the DSU, the WTO requires the parties attending the WTO adjudication in the standing of ‘third parties’ must be foreign to the dispute but have a membership to the WTO.

Article 10 of the DSU defines ‘a third party’ to the procedure as ‘any Member of the WTO’ that has a substantial interest in the dispute. It means that only member States who are parties to a dispute, or who have notified their interest in becoming third parties in such a dispute, can participate in the adjudication proceedings as third parties.

The legal rights entitled to ‘the third party to a WTO dispute’ include a right to make submissions to a panel and a right to have those submissions considered by the panel.<sup>500</sup> According to the DSU, Article 10, third-party procedures in WTO adjudication are exclusive to the nation-states that have memberships to the WTO.<sup>501</sup> In other words, the scope of third parties in the adjudication proceedings is equal with

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<sup>498</sup> Farouk El-Hosseny (n 453) 104–05.

<sup>499</sup> *Glamis Gold v. U.S.*, Award (n 238) paras 127–30; Farouk El-Hosseny (n 453) 128.

<sup>500</sup> The Dispute Settlement Understanding, Articles 10 and 12, and Appendix 3.

<sup>501</sup> Appellate Body Report, WT/DS58/AB/R, *United States—Import Prohibition of Certain Shrimp and Shrimp Products* (‘US—Shrimp’), adopted 6 November 1998, para 101; Appellate Body Report, WT/DS138/AB/R, *United States—Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom* (‘US—Hot-Rolled Lead’), adopted 7 June 2000, para 40.

the member States of the WTO.

However, it is arguable whether the WTO provides the *amicus curiae* procedure. While practitioners argue that Article 13 of the DSU paves the way to the submission of *amicus* briefs before a panel, the DSU does not explicitly provide the *amicus curiae* procedure. The textual difference raises the issue of whether the membership is necessary for *amicus curiae* submissions.

According to Article 13 of the DSU, a panel is authorised to seek information and technical advice from ‘any individual or body’ or from ‘any relevant source’ that it deems appropriate and relevant to the matter. However, compared with the terminology of Article 10, the term ‘any individual or body’ and the lack of the requirement of WTO membership seems to suggest an *amicus curiae* procedure. In practice, business groups and civil society groups have frequently applied these two provisions to request submission of their *amicus* briefs. Panels and the Appellate Body have also recognised and accepted the submission of *amicus* briefs in several cases.<sup>502</sup>

The membership of the third party not only constitutes the difference between the third-party procedure and the *amicus curiae* procedure. However, more importantly, it defines different institutional norms for WTO adjudicators. The WTO requires panels to accept and give due consideration to the submissions made by the parties and the third parties in a panel proceeding.<sup>503</sup>

The institutional norm, however, does not apply to *amicus* briefs. It is in the panel’s discretion to accept or reject *amicus* briefs.<sup>504</sup> The Appellate Body has repeatedly highlighted this difference. The main reason is the closed nature of the WTO

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<sup>502</sup> Farouk El-Hosseny (n 453) 219–21.

<sup>503</sup> Appellate Body Report, *US—Shrimp* (n 501) para 101.

<sup>504</sup> *Ibid*, 222.

adjudication.

The Appellate Body believes that the WTO adjudication is open only to member States. In the *US–Hot–Rolled Lead* case, the Appellate Body stated that ‘[i]ndividuals and organisations, which are not members of the WTO, have no legal right to make submissions or to be heard by the Appellate Body. The Appellate Body has no legal duty to accept or consider unsolicited amicus curiae briefs submitted by individuals or organisations, not members of the WTO’.<sup>505</sup> Accordingly, it can be seen that the WTO adjudication restrains the engagement of non–treaty parties.

The comparison of investor–State arbitration and WTO dispute settlements shows that the two jurisdictions both share a conservative attitude toward the participation of non–disputing parties in the proceedings. It also notes that nation–states are still the primary users of the two dispute settlement mechanisms.

### 5.3.3. The closed–open variation in the adjudication structure and the certainty of adjudicative decisions

The findings approve the proposed assumption proposed of this study. The greater openness a dispute settlement mechanism, the more opportunities that other legal regimes and legal systems are involved, and the more diverse participants that attend the procedure.

The centralised–decentralised variation between investor–State arbitration and the WTO dispute settlement mechanism, however, reveals a struggle in the design of international adjudication. The struggle is how to find the balancing point between the

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<sup>505</sup> Appellate Body Report, *US–Hot–Rolled Lead* (n 501) para 41.

inclusiveness of a system and the certainty of the practice.

The experiences of international investment law and trade law seem to disclose the two elements exclusive to each other. A more open system may include more parties but confronts a higher risk of uncertainty of legal interpretations and compliance. On the contrary, a more closed system seems to guarantee more stable and individual practices.

#### 5.4. The control mechanisms of the States

Investor–State arbitration and the WTO dispute settlement mechanism are created under the motivation of minimising political influence by the Contracting States. However, the purpose of depoliticising dispute settlements does not mean that nation–states completely lose control over the proceedings. In the two dispute settlement mechanisms, the Contracting States remain the governing parties over the proceedings and even the decisions, as discussed below.

While the controlling scale varies in the arbitration of investor–State disputes and the WTO adjudication procedure, it is somewhat limited and weaker than that under the conventional means of dispute settlements, political and diplomatic negotiations.

An enquiry to the controlling scale by the signatory States is whether that States' interventions are reduced to the pre–adjudication stage or the post–settlement stage. The division is also known as *ex ante* control and *ex post* control in international adjudication. The study indicates a series of factors to materialise the political control of the States. These factors include the appointment of adjudicators, the procedure of challenging decisions, and the right to issue an authentic interpretation.

##### 5.4.1. The right to appoint adjudicators

The first and significant indicator is the procedures for selecting and appointing

adjudicators.

In international investment law, investor–State dispute settlements mainly rely on the arbitration procedure. According to the underlying principle of arbitration, i.e. the principle of party autonomy, disputing parties are the ones who have the right to select and appoint arbitrators. Consent to the appointment of arbitrators and the composition of a tribunal is where the legitimacy of international arbitration is grounded.<sup>506</sup> It explains why the appointment procedure is in the control of disputing parties.<sup>507</sup> Investor–State arbitration is no exception to the practice.

An arbitral tribunal generally is composed of three arbitrators. The appointment is either by disputing parties or by a neutral appointing authority. For instance, the *ICSID Convention* provides that the Chairman of ICSID’s administrative council be authorised to appoint a missing arbitrator if the respondent defaults or the disputing parties have difficulties agreeing on a president.<sup>508</sup> While in theory, each disputing party has the right to give consent to the selection of the presiding arbitrator, in practice the presiding arbitrators are often appointed by a neutral appointing authority.<sup>509</sup>

Because of the split between disputing parties and treaty parties, the right to appoint arbitrators has a double meaning. From the perspective of the Contracting States that gave consent to the investor–State arbitration under a treaty, either party appointment or third–party appointment means that they cannot access to the selection and appointment process unless a respondent party to the dispute. In this respect, the

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<sup>506</sup> This argument is rooted in the discussion of legitimacy of international courts and adjudicative bodies. See Chiara Giorgetti, ‘Who Decides Who Decides in International Investment Arbitration?’ (2013) 35(2) *University of Pennsylvania Journal of International Law* 431, 440; Thomas, M. Franck, ‘Legitimacy in the International System’ (1988) 82 *The American Journal of International Law* 705, 705.

<sup>507</sup> Chiara Giorgetti, *ibid*, 440.

<sup>508</sup> *ICSID Convention*, Article 38.

<sup>509</sup> Chiara Giorgetti (n 506) 442.

controlling of the composition of arbitral tribunals by the States is restricted.

On the other hand, party–appointment is a primary reason that disputing parties prefer arbitration to litigation before referring it to national legal systems. It means that disputing parties have the direct power to appoint arbitrators. The strong connection between disputing parties and arbitrators is different from that of national court systems where the government appoints judges.<sup>510</sup>

The right to appoint arbitrators explains why disputing parties and their counsel are willing to spend time on reviewing the personality, skills and background of arbitrators to select the right person, as discovered by empirical studies and the insights of practitioners.<sup>511</sup> Empirical studies and practitioner insights have confirmed the influence of the appointment procedure on the final decision. Party–appointed arbitrators are more inclined to award the disputing parties (either the claimant or the respondent parties) something. The findings, however, do not support the critique of a tendency of grating compromise awards or ruling in favour of investors.<sup>512</sup> From the aspect of controlling the arbitration proceedings, the way that the treaty parties might influence the composition of arbitral tribunals is when they are the respondent party to the dispute.

In contrast, member States of the WTO have higher power and political influence in the appointment procedure. Generally speaking, the appointment of WTO adjudicators does not entirely rest on the autonomy of disputing parties. Instead, the

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<sup>510</sup> Won L. Kidane, *The Culture of International Arbitration* (OUP 2017); Doak Bishop and Lucy Reed, ‘Practical guidelines for interviewing, selecting and challenging party–appointed arbitrators in international’ (1998) 14(4) *Arbitration International* 395, 395.

<sup>511</sup> Claudia T. Salomon, ‘Selecting An International Arbitrator: Five Factors to Consider’(2002) 17 *MEALEY’S International Arbitration Report*, available at <<https://www.international-arbitration-attorney.com/wp-content/uploads/arbitrationlaw0405202743129.pdf>> accessed 10 April 2019.

<sup>512</sup> Daphna Kapeliuk, ‘The Repeat Appointment Factor: Exploring Decision Patterns of Elite Investment Arbitrators’ (2010) 96 *Cornell Law Review* 47, 83.

engagement of member States is critical to the constitution of panels and the Appellate Body. Engagement in the appointment of panellists and members of the Appellate Body is done to different degrees.

Regarding the constitution of a panel, the Secretariat has the authority to propose the nomination of panellists to the disputing parties. While the disputing parties can accept or reject the proposed panel, their discretion is restricted. First, the rejection must be for a whole panel rather than an individual member. Second, the rejection must be supported with compelling reasons.<sup>513</sup> If both of the disputing parties do not reach an agreement on the panellists within the requisite period, the WTO authorises the Director-General to appoint the missing panellists to constitute the panel. The appointment does not require the consent of disputing parties.<sup>514</sup> Compared with investor-State arbitration, the procedure respecting the constitution of a panel restricts the principle of party autonomy up to a certain point.

Compared with the GATT period, the WTO adjudication procedure reduces the political intervention by the treaty parties as well.<sup>515</sup> Unlike the ad hoc nature of panels, the Appellate Body is a permanent body of seven members. Because of its institutional nature and function of appellate review, the appointment of AB members does not apply the principle of party autonomy. Instead, the constitution of the AB rests on the consent of member States of the WTO.

There are two ways that member States engage in the appointment of AB members. The first point is about procedural participation. The Appellate Body is composed of

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<sup>513</sup> The *Dispute Settlement Understanding*, Article 8(6).

<sup>514</sup> The *Dispute Settlement Understanding*, Article 8(7).

<sup>515</sup> Jose Augusto Fontoura Costa, 'Comparing WTO panelists and ICSID arbitrators: the creation of international legal fields' (2011) 1(4) *Oñati Socio-Legal Series* 8.

seven persons with fixed four-year terms. Each person appointed by the DSB can be reappointed once for another four-year term. Its composition is the responsibility of the DSB.<sup>516</sup> The DSB is the political organ of the WTO, composed of all representatives of Member States. Through the meetings of the DSB, each Member has the right to attend and to appoint the members of the Appellate Body in theory. The appointment procedure is similar to the appointment of national judges. In the two situations, the decision makers are appointed by the political unit rather than the disputing parties. The appointment procedure also supports the image of the Appellate Body as an international trade court.<sup>517</sup>

The second point is about substantive influences. Under the consensus-based decision model, each Member State not only has a right to attend the procedure and express their voice but more importantly the right to give consent. The function of the Appellate Body explains the institutional design. The Appellate Body is not concerned with the conflict between the disputing parties, but for the systematic concerns of the WTO. Therefore, what the Appellate Body is concerned with are the interests of all member States to the WTO. The requirement also reflects the systematic concern that the membership of the Appellate Body is required to be broadly representative of membership in the WTO. Members of the Appellate Body are also prohibited from participating in any dispute that would create a direct or indirect conflict of interest.<sup>518</sup>

While in theory the appointment of AB members could be easily blocked by the dissent of a Member State, it is a rare situation that member States have ever used the veto right to oppose the (re)appointment of AB members.

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<sup>516</sup> The *Dispute Settlement Understanding*, Article 17(2).

<sup>517</sup> See Yuji Iwasawa, 'WTO Dispute Settlement as Judicial Supervision' (2002) 5(2) *Journal of International Economic Law* 287–305.

<sup>518</sup> The *Dispute Settlement Understanding*, Article 17(3).



However, the situation is changing recently. Since 2016 the US government has blocked any new appointment of AB members.<sup>519</sup> Because of the US's opposition, the WTO dispute settlement mechanism has confronted a severe institutional crisis. Three vacancies of the Appellate Body have not been filled yet.<sup>520</sup> The US argues that it aims to raise the concern of judicial activism by the Appellate Body. It contends the Appellate Body is tending towards creating new rights and making decisions on the issues not raised by the parties. However, other Member States question whether the American government is abusing its voting rights. Its dissents are not legitimate actions for the systematic concern but the political actions for its national interests.

This institutional crisis also reveals the shortcomings of the institutional design of the Appellate Body. There is no check on disapproval by any member States. While it is arguable whether it was the neglect or the intentional decision by the drafters, the rule of positive consensus associated with the (re)appointment of the AB members seems to be a loophole in the transformation of the GATT/WTO dispute settlements toward the reverse consensus rule.

While the consensus-based decision model reserves the controlling power to the Contracting States, it raises a long-term issue. The issue is about the struggle between democracy in an international institution and the prevention of political influences of nation-states on international adjudication.

#### 5.4.2. The right to issue legal interpretations

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<sup>519</sup> WTO News, 23 MAY 2016, WTO members debate appointment/reappointment of Appellate Body members, available at <[https://www.wto.org/english/news\\_e/news16\\_e/dsb\\_23may16\\_e.htm](https://www.wto.org/english/news_e/news16_e/dsb_23may16_e.htm)> accessed 10 April 2019.

<sup>520</sup> WTO News, 3 May 2018, 'Appellate Body chair calls for "constructive dialogue" on addressing dispute settlement concerns', available at <[https://www.wto.org/english/news\\_e/news18\\_e/ab\\_07may18\\_e.htm](https://www.wto.org/english/news_e/news18_e/ab_07may18_e.htm)> accessed 10 April 2019.

The decisions made by international adjudicators are not only a solution for the dispute but also includes legal interpretations of rules. The rules are primarily treaty-based. While the nature of investor-State disputes and WTO disputes is different, both of them are raising out of specific rule or obligations under a treaty. Given applicable law includes treaties and international agreements, the decisions of investment arbitrators and WTO adjudicators are not only a dispute resolution but also interpretation result.

While the authority of international adjudicators includes interpretative authority, the States are not deprived of the right to clarify their intentions to a treaty. It is a common understanding that signatory States still reserve the right to clarify, challenge or overturn legal interpretations by adjudicators. The right to issue legal interpretation is inherent to the States' sovereignty in terms of the relations with other States.

Treaty negotiations initially create international relationships between States. The treaty relation is not static. It can be modified along with the adjustment of the rights and obligations for the signatory States. Legal interpretation, legislative amendment and renegotiation of the rules are all possible ways to modify the content of the treaty. As such, the right to issue authoritative interpretation is an essential part of the external sovereignty of the signatory States to manage their treaty relation.

However, the right to interpret the treaty text is shared with third-party due to the delegation of sovereignty for the third-party adjudication. The division of interpretative authority, instead, raises the concern of conflicting legal opinions of a treaty. A specific issue is whether the legal opinions by international adjudicators are prior to the signatory States' opinions, or vice versa.

There are two main scenarios concerning the legal effects of joint interpretations by the signatory States.

The first scenario is a law-making scenario. It means that the authoritative interpretations are the result of the signatory States exercising their law-making powers.<sup>521</sup> The right to issue legal interpretations is one of the ways by which the signatory States to modify or suppress a treaty.<sup>522</sup> Therefore, the nature of the authoritative interpretation by the States is law-making. It is different from the legal interpretations by international adjudicators.<sup>523</sup> The legal interpretation by international adjudicators is for the implementation instead of the medication of the treaty. This scenario explains why the right to issue authoritative interpretation exclusive to the Contracting States. In this respect, authoritative interpretations are not supplementary to legal interpretations by adjudicators, but binding on adjudicators.

Another scenario treats the joint interpretation by the Contracting States as the supplementary materials of legal interpretations by adjudicators. The supplementary-interpretation scenario is the distinction between interpretative activities and legislative activities by the Contracting States. The creation of third-party adjudication is for the reduction of political interventions of the States in international adjudication. Concerned with the purpose, the delegation of decision-making authority to third parties includes delegating interpretative powers. While the joint interpretation by the Contracting States is a material for the interpretation and application of treaty rules, adjudicators enjoy the superior position on legal interpretations. In other words, the joint interpretation by the Contracting States is not binding to adjudicators unless the Contracting States deliberately exercise their legislative powers to issue the joint interpretations.

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<sup>521</sup> Katharina Berner, 'Authentic Interpretation in Public International Law' (2016) 76 Heidelberg Journal of International Law 845, 858.

<sup>522</sup> PCIJ, *Question of Jaworzina*, Advisory Opinion of 6 (1923), Series No. 8, 37.

<sup>523</sup> Tarcisio Gazzini, *Interpretation of International Investment Treaties* (Hart Publishing 2016) 337.

Before the battle happening in NAFTA in the early 2000s, the issue of authoritative interpretations by the Contracting States was not paid enough attention to the majority of investment treaties. The main reason is economic efficiency of bilateral relations. The States more easily negotiate and reach agreements with each other in bilateral relations than in plurilateral or multilateral relations. The membership scale explains why a treaty involving plurilateral or multilateral relations usually creates a joint administrative or central institution for the administration of the treaty. In contrast, the administrative institution is absent in bilateral treaties. The joint interpretation by the Contracting States lies in the state–state dispute settlements<sup>524</sup> or informal consultation.<sup>525</sup>

The NAFTA experiences show that the supplementary–interpretation scenario is more overwhelming than the law–making scenario.

NAFTA is a trade agreement with three countries. Given the wide range of subject issues, NAFTA created a central institution for the administration of the treaty, namely the Free Trade Commission (FTC). Article 1132 (1) stipulates interpretative notes as part of the FTC’s authority. At the early stage, NAFTA Members had not noted the potential conflict between the joint interpretation by themselves and legal interpretation by the adjudicators. The tension was then raising out of the interpretation of minimum standards of treatment in the NAFTA agreement (Article 1105).

In a series of NAFTA investment disputes during the late 1990s, the tribunal in the *Pope & Talbot* case interpreted that fair and equitable treatment and full protection and

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<sup>524</sup> See, e.g., the Mexico–UK BIT (2007), Article 21(1) (‘The Contracting Parties shall endeavour to resolve any dispute between them concerning the interpretation or application of this Agreement, by means of prompt and friendly consultations and negotiations...’); Article 21(2) (‘If a dispute is not resolved... the dispute shall be submitted... to an arbitral tribunal established..’).

<sup>525</sup> See, e.g., the Canada–Thailand BIT (1997), Article XIV (‘either Contracting Party may request consultations on the interpretation or application of this Agreement...’).

security are not part of, but additive to, customary law principles regarding investment protection.<sup>526</sup> This tribunal adopted the teleological and contextual analysis and concluded that the Contracting States of NAFTA had no intentions to have a more restrictive protection level for foreign investments than their practices in other agreements such as the GATT.<sup>527</sup>

Three months after the award was delivered, the Contracting States issued a joint statement in June 2001 (also known as ‘the 2001 Interpretation Note’).<sup>528</sup> They claimed that this joint interpretation was to clarify the relationship between customary international law and Article 1105.

This joint statement clarified the origin of minimum standards of treatments provided by article 1105 based on customary law principles. The connection with customary law principles applies to the provision as a whole. In other words, the interpretation of these provisions should not go beyond or in addition to the practices of customary international law. The limits to treaty interpretation also applied to specific standards, i.e. fair and equitable treatment and full protection and security.

While the joint statement was issued in the name of an interpretative note by the authority of the FTC, its legal effect is debatable. Commentators questioned the content of this interpretative note beyond the text of Article 1105. The interpretative note substantially modified Article 1105 by adding the connection with customary law principles. It instead constituted a legal amendment.<sup>529</sup> Moreover, NAFTA parties had

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<sup>526</sup> *Pope & Talbot Inc. v. The Government of Canada* (‘*Pope & Talbot v. Canada*’), UNCITRAL, Award on the Merits of Phase 2, 10 April 2001, para 110–13.

<sup>527</sup> *Ibid*, paras 115–18.

<sup>528</sup> NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions (31 July 2001), available at <[http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding\\_e.asp](http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding_e.asp)> accessed 10 April 2019.

<sup>529</sup> Charles H. Brower, II, ‘Why the FTC Notes of Interpretation Constitute a Partial Amendment of NAFTA Article 1105’ (2006) 46 *Virginia Journal of International Law* 347–63; Jeffery Atik, ‘Repenser

political actions right after the publication of the interpretation note. For instance, in the damage hearing of the *Pope & Talbot* dispute, the Canadian government requested this tribunal to revisit its award in liability in line with the 2001 Interpretation Note.<sup>530</sup> The American government also required arbitral tribunals to follow the interpretative note to interpret Article 1105 in ongoing investment cases. Concerning the series of political interventions by NAFTA parties, Todd Weiler argues that the right to issue authoritative interpretation seems to become an instrument for the Contracting States to pursue their political interests.<sup>531</sup>

As learned from the NAFTA experience, more and more nation-states are aware of the need to clarify the boundaries of the adjudicative authority in light of treaty interpretation. The awareness has been materialised in two ways. One way is to modify the substantive obligations to prevent potential interpretative issues. For instance, starting from the 2004 US Model BIT, the American government modified the provision of minimum standards of treatment in light of the 2001 interpretation note.<sup>532</sup>

Another way is to define the legal effects of a joint interpretation by the Contracting States. The *Mexico–UK BIT* (2007) is an example. Article 17(2) of this Treaty stipulates that ‘[a]n interpretation jointly formulated and agreed upon by the Contracting Parties about any provision of this Agreement shall be binding on any tribunal established under this section’. Compared with the voting rule and the numerous memberships of the WTO, it seems much earlier for the Contracting States

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NAFTA Chapter 11: A Catalogue of Legitimacy Critiques’ (2003) Loyola–LA Public Law Research Paper No. 2003–29; Gabrielle Kaufmann–Kohler, ‘Interpretive Powers of the Free Trade Commission and the Rule of Law’ in Emmanuel Gaillard and Frédéric Bachand (eds), *Fifteen Years of NAFTA Chapter 11 Arbitration* (Juris Publishing 2011) 175–94.

<sup>530</sup> Todd Weiler (n 230) 252.

<sup>531</sup> Ibid, 250–59.

<sup>532</sup> The 2004 US Model BIT, Article 5(2) (‘For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights...’).

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of a bilateral treaty to agree on joint interpretations.

In the WTO, the issue of legal effects of authoritative interpretation by signatory States, however, is not as arguably as that in international investment law. The main reason is that WTO law explicitly separates joint interpretations of legislative activities.

The *WTO Establishing Agreement* provides the Ministerial Conference and the General Council exclusive authority to adopt interpretations of all WTO agreements.<sup>533</sup> The distinction is not only reflected in the wording but also evidenced by the voting rules. An authoritative interpretation must base on a three–fourths majority vote.<sup>534</sup> The threshold is lower than a consensus rule for a statutory amendment.<sup>535</sup> Even with a lower voting threshold, the right to adopt legal interpretations by Member States has not been used in practice yet.<sup>536</sup>

While the boundaries between the principal authority and the delegated authority regarding treaty interpretation remain arguably in international law, the tension is not as severe as expected in practice. The main reason is the different degrees of effectiveness and efficiency between legal interpretations and legislative actions. If the conflict of legal interpretation arises, the Contracting States tend to use legislative power to clarify their ideas.

#### 5.4.3. The right to challenge the rulings

The last but not the least control mechanism over the third–party adjudication is the

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<sup>533</sup> The WTO Establishing Agreement, Article IX (2).

<sup>534</sup> The WTO Establishing Agreement, Article IX (3).

<sup>535</sup> The WTO Establishing Agreement, Article X (1).

<sup>536</sup> Gregory Shaffer and Joel Trachtman, 'Interpretation and Institutional Choice at the WTO' (2011) 52(1) *Virginia Journal of International Law* 103, 119. Nevertheless, the official meeting records give little information of whether the rejection–free practice is because of the failure of rejection in attempts or because of none attempts ever made since the creation of the WTO.

right to challenge the rulings. This right gives the contacting States the opportunity to accept or not the decisions by adjudicators. In other words, whether the rulings have binding effects is decided by the challenge procedure.

While the right to challenge the rulings is usually limited to the parties to the dispute, the rights-holder might expand to other treaty parties in some regimes. The latter situation is common in the treaty involving the plurilateral and multilateral relations. WTO law is a classic example.

In the WTO, panels and the Appellate Body are authorised as third parties to settle WTO disputes and give interpretations. Their reports, however, are not automatically binding on the disputing parties. According to WTO law, a panel report will be automatically adopted by a DSB meeting within 60 days after the report was circulated to member States unless a party to the dispute decides to appeal or the DSB decides not to adopt the report by consensus.<sup>537</sup> Likewise, an Appellate Body report must be circulated to all member States. The difference is, an Appellate Body report will be automatically adopted within 30 days unless the DSB made the denial decision by consensus.<sup>538</sup>

Therefore, the binding enforcement of the decisions by panels and the Appellate Body depends on the consensus of member States. The rulings by panels and the Appellate Body are not final and binding only if member States adopt them on the negative consensus.

The practice shows that the negative consensus rule to a large extent reduces the uncertainty in the adoption of WTO reports. The right to challenge the binding enforce and finality of rulings become a right in theory but with limited practical effects under

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<sup>537</sup> *The Dispute Settlement Understanding*, Article 16(4).

<sup>538</sup> *The Dispute Settlement Understanding*, Article 17(14).



the WTO. The main reason is the complex relationships among Member States of the WTO. However, the practice cannot deny that the right to challenge and adopt the rulings gives the Member States the substantive power to influence the result of third-party adjudication.

In international investment law, the finality of an arbitral award is not controlled by the Contracting States of the treaty. The Contracting States of an investment treaty have no right to express their voice and to reject the binding enforcement of investment awards unless they are the disputing party to the case.

The binding effects of investment awards usually have been pre-recognised by the Contracting States when entering into a BIT. The Contracting States usually give general certification to the finality and binding effects of arbitral awards to an investment treaty. The agreement of the finality and binding effects of the arbitral award is the part of the general consent that the Contracting States give to the creation of investor-State dispute settlements.

The provision concerning the general consent to investor-State arbitration has a two-fold meaning. First, it means that an investment award according to the treaty is recognised as a final decision to contested claims, binding the parties to the dispute. Second, it means a formal certification given by both Contracting States. Based on the agreement, any issues argued and decided by an award has a *res judicata* effect that may not be re-examined in national courts or arbitration proceedings within the territory of either of the treaty parties.<sup>539</sup> The enforcement provision of a treaty further secures the binding effects of investment awards. For instance, Article 34(7) of 2012 US Model BIT provides that '[e]ach Party shall provide for the enforcement of an award in its

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<sup>539</sup> Lucy Reed et al. (n 481) 179.

territory’.

While the Contracting States of a BIT are deprived of the right to object the result of investment awards, uncertainty remains at the enforcement stage. As we argued above, international investment law does not create standard rules and centralised institutions for investor–State arbitration. Given the principles of state consent and equal sovereignty, the general consent of binding enforcement in a treaty is not binding on other countries which are not the parties to the treaty. The role of national courts on enforcement of investment awards also increases the uncertainty of international investment law. The national court might also refuse to recognise or enforce international awards if the recognition or enforcement would either against the public policy of its country or violate the arbitrary requirement in line with the national arbitration law.

ICSID, as the dominated institution for investor–State disputes, it is aware of the certainty issue of investment awards. First, Article 53(1) of the *ICSID Convention* obliges the losing party—the State or investor—to comply with the award immediately. The award shall not be subject to any appeal or any other remedy except those situations provided by the *ICSID Convention*. Nevertheless, the provision only applied to decisions made in the form of award, not including procedural decisions.<sup>540</sup> Second, Article 54(1) imposes on all contracting States the obligation to recognise any award rendered under the *ICSID Convention* as binding and to be enforced as if it were a final judgment of a court in its territory. The application scope includes (i) pecuniary awards; (ii) non–pecuniary awards relating to declarations of rights and obligations; and (iii) orders of specific performance. The two provisions are attempts to establish an

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<sup>540</sup> Lucy Reed et al. (n 481) 181–82.

automatic recognition and enforcement mechanism for investment awards.<sup>541</sup>

One thing needs to be clarified. ICSID provides the annulment procedure for the disputing parties to challenge the legality of an ICSID award. The annulment grounds are exhaustive and are mostly concerned with the procedural aspects. While the annulment procedure entitles the disputing parties the right to argue the finality of an ICSID award, however, the procedure is different from the adoption procedure of WTO reports in the WTO system. The effectiveness of the annulment procedure of ICSID awards has attracted critiques by practitioners and international lawyers.

In conclusion, Member States of the WTO reserve greater controlling power at the stage of defining the legal effects of adjudicative decisions. On the contrary, the Contracting States of an investment treaty are constrained their political influences on the arbitration proceedings.

#### 5.5. The controlling power of the States and its implications: appointment of adjudicators, institutional culture, and adjudicative behaviours

Previous analyses point out the extent which WTO law and international investment law depart from a political and diplomatic model of dispute settlements. Among the three controlling mechanisms of the States, the right to appoint adjudicators is crucial to the connection between legislative States and international adjudication.

The institutional control instrument not only indicates the controlling powers of legislative States over the adjudicative proceedings but also impacts adjudicative behaviours. While previous chapters have tried to approach the relevance of institutional features and adjudicative modes in terms of the balancing analysis, how to

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<sup>541</sup> Ibid, 182.

assess the material impacts of the institutional control instruments remain debatable in theoretical discussion and empirical studies.<sup>542</sup>

The thesis argues that the principal–agent relationship explains the relation between institutional control mechanisms and judicial/adjudicative behaviours. The appointment and delegation relations explain why adjudicators are inclined to respond to the expectations of the parties.<sup>543</sup> The principal–agent relationship is a useful indicator of the extent that the Contracting States shape the institutional culture by collecting people with similar backgrounds and political understandings. In this respect, this section explores how the adjudicative modes are shaped by the preference choices of the States over the appointment of adjudicators.

#### 5.5.1. WTO adjudicators: a bureaucrat–dominated system driven by member States

At first glance, WTO dispute settlements and investor–State arbitration share institutional similarities. They are both concerned with international economic activities. WTO law and investment treaties also adopt common legal principles such as the principles of non–discrimination.

However, the overlap in adjudicators between the two regimes is not as popular as expected. Recently more and more empirical studies explore the segregation of two groups of adjudicators. Three variables reflect the segregation of the two groups of

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<sup>542</sup> Erik Voeten, ‘International Judicial Independence’ in Jeffrey L. Dunoff and Mark A. Pollack (eds), *Interdisciplinary Perspectives on International Law and International Relations: The State of the Art* (CUP 2013) 424.

<sup>543</sup> This viewpoint is echoed by the empirical finding that almost always dissenting opinions written by party–appointed arbitrators are out of preference for the disputing party who appointed them. Catherine A. Rogers, ‘The Politics of International Investment Arbitrators’ (2013) 12 *Santa Clara International Law Review* 223, 242; Albert van den Berg, ‘Dissenting opinions by party–appointed arbitrators in investment arbitration’ in Mahnouch H. Arsanjani, Jacob Cogan, Robert D. Sloane, and Siegfried Wiessner (eds), *Looking to the Future: Essays on International Law in Honor of W. Michael Reisman* (Martinus Nijhoff 2010) 824; Nael G. Bunni, ‘Personal Views on How Arbitral Tribunals Operate and Reach Their Decisions’ in Bernhard Berger and Michael E. Schneider (eds), *Inside the Black Box: How Arbitral Tribunals Operate and Reach their Decisions* (ASA 2014) 123.

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adjudicators, including the limited overlap in adjudicators, different practical experiences and professional backgrounds. This section first focuses on WTO adjudicators.

The first variable is the overlapping rate. This element is used to observe whether the two dispute settlement mechanisms share adjudicators, and thus may converge by shared experiences. There are two-fold comparisons. One comparison is between WTO panellists and ICSID arbitrators. Another one is between WTO's AB members with ICSID arbitrators.

Empirical studies reveal that the overall number of overlapping individuals is small, and there are differences in the two comparisons.<sup>544</sup> In the context of *ad hoc* panels, the data shows that only nine individuals have ever served as both an ICSID arbitrator and WTO panellist. Thus, the overlap rate is minimal between the 396 ICSID arbitrators and 251 WTO panellists. Gonzalo Biggs and Donald McRae are two of these nine individuals and were appointed to a WTO panel more than once.<sup>545</sup> The two adjudicators, however, are not influential arbitrators in ICSID arbitration, as Puig specifies.<sup>546</sup>

In the context of the standing Appellate Body, the overlapping situation with ICSID arbitrators is more frequent. According to Pauwelyn's data, twenty-five AB members were appointed in the first twenty years of the WTO. Ten of these members served on

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<sup>544</sup> The data in relating to the comparative study of WTO adjudicators and ICSID arbitrators is based on Costa's study and Pauwelyn's follow-up study. The timescale of the data collected by Costa is from 1995 to 2009. Pauwelyn expanded the timescale to 2014. Jose Augusto Fontoura Costa (n 515); Joost Pauwelyn, 'The Rule of Law without the Rule of Lawyers? Why Investment Arbitrators are from Mars, Trade Adjudicators are from Venus' (2015) 109 *American Journal of International Law* 761.

<sup>545</sup> Joost Pauwelyn, *ibid*, 768, ft 44.

<sup>546</sup> Puig identifies top twenty-five arbitrators who are prominent and have leading effects in investor-State arbitration. Sergio Puig, 'Social capital in the arbitration market' (2014) 25(2) *European Journal of International Law* 387, 415.

investor–State tribunals (either before ICSID or by *UNCITRAL Rules*). Three overlaps occurred in the first decade of the WTO; five happened in the second decade.<sup>547</sup> The overlapping situation is also remarkable between WTO panellists and the Appellate Body. Nine of the twenty–five Appellate Body members were also appointed as WTO panellists.<sup>548</sup> Pauwelyn also observes that investor–State arbitration also values the experience of AB members. More former or serving AB members have been appointed ICISID arbitrators recently.<sup>549</sup>

It can be seen that the Appellate Body is the critical place where adjudicators in investor–State arbitration and the WTO dispute settlement mechanism might share experiences. Given the leading position of the Appellate Body in the WTO jurisprudence, it assumes that a strong overlapping appointment between WTO’s AB members and ICSID arbitrators might contribute to the communication and convergence between the two jurisprudences. The material effects, however, remain arguable.

The second variable is the practical experiences of adjudicators. International law is not like the national legal system. There is a lack of standard requirements for the professionalism and quality of an adjudicator. As such, the practical experience of an adjudicator is a crucial factor that is valued by selectors in the appointment procedure. The practical experiences of adjudicators are usually categorised into four types: (i) governmental service; (ii) academic background; (iii) legal practitioners in the private sector; and (iv) judicial experiences in national legal systems.

The data shows that the majority of WTO panellists and the Appellate Body members have experience in governmental services. The number of individuals serving

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<sup>547</sup> Joost Pauwelyn (n 544) 768–69.

<sup>548</sup> Ibid, 769.

<sup>549</sup> Ibid.

in national court systems is the smallest.<sup>550</sup> This reveals that in the WTO system, the selectors prefer to appoint adjudicators from the pool of bureaucrats.

The experience of governmental service links to the third variable. It is the professional background of WTO adjudicators. As we argued above, the WTO dispute settlements are a rule-based system that which has codified the adjudication procedure and institutional norms. Legal issues of WTO law are complicated as well because of the multilateral relations and a wide range of subject matters.

Nevertheless, the legal expertise of WTO adjudicators is not required to be as high as expected. Costa finds that in the years 1995–2009, around forty–five percent of WTO panellists had no legal background or relevant professional activity.<sup>551</sup> Pauwelyn observes that the number of WTO panellists with a law degree has been gradually increasing during the following period between 2010 and 2014. The upward trend has also occurred in the membership of the Appellate Body.<sup>552</sup> However, he argues that to a large extent the increase is caused by the change of the profile of diplomats or government officials. As such, Pauwelyn notes that the finding should not conclude that legal expertise has become a necessary qualification of WTO adjudicators.<sup>553</sup>

These three elements disclose that individuals with government services and experiences are the favourite choice for WTO adjudicators. The preference implies that what the selectors are a concern with most in the appointment of WTO adjudicators are the social and political connections with member States.

In recent reappointment of AB members, one of the reasons that the American

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<sup>550</sup> Joost Pauwelyn (n 544) 774–75.

<sup>551</sup> Jose Augusto Fontoura Costa (n 515) 15.

<sup>552</sup> Joost Pauwelyn (n 544) 773–74.

<sup>553</sup> Ibid, 774.

government blocked the procedure is a strong opposing position of a nominee who was involved in several cases against the US measures. The fact echoes the viewpoint of Elsig and Pollack that member States are inclined to prefer candidates with non-controversial positions or have no strong opposition from powerful States.<sup>554</sup> Governmental background or the experiences of trade representatives in the WTO then becomes a useful indicator for the selector to determine whether or not a candidate's viewpoint is too distant from those of member States.<sup>555</sup> In other words, this element seems an indicative signal of an individual that is an 'insider', sharing specific social and political connections with member States.

Accordingly, the community of WTO adjudicators, as Weiler argues, remains dominated by the ethos of diplomats.<sup>556</sup> The feature results in WTO adjudicators are sharing a limited connection with the community of legal experts in trade law and other branches of international law.

#### 5.5.2. Investor-State arbitrators: an arbitrator-governing system within a closed network of legal practitioners

The profile of investment arbitration, however, is different from WTO adjudicators.

These studies disclosed that the majority of ICSID arbitrators are legal practitioners. They are either at law firms or in the private sector. Full-time academics present a relatively small number.<sup>557</sup> The number of arbitrators who have ever served in the public sector or had governmental experience is also the minority, representing

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<sup>554</sup> Manfred Elsig and Mark A. Pollack, 'Agents, Trustees and International Courts: The Politics of Judicial Appointment at the World Trade Organization' (2014) 20 *European Journal of International Relations* 391, 407–08.

<sup>555</sup> *Ibid.*

<sup>556</sup> J.H.H. Weiler (n 452) 201–202; Petros C. Mavroidis, 'Selecting the WTO judges' in Jorge A. Huerta-Goldman, Antoine Romanetti and Franz X. Stirnimann (eds), *WTO Litigation, Investment and Commercial Arbitration* (Kluwer 2013) 104.

<sup>557</sup> Jose Augusto Fontoura Costa (n 515) 23; Joost Pauwelyn (n 544) 776–77.



less than one-third.<sup>558</sup>

The priority of legal practitioners, in turn, demonstrates a higher threshold of legal expertise of investment arbitrators. The demand for legal expertise is at least evidenced by the finding that almost all ICSID arbitrators have at least a law degree.<sup>559</sup> It is true that a law degree is a rough indicator which might not equally reflect the legal profession of an adjudicator. However, the predominance of legal professionals implies that embeddedness of policy-making and the connection with the Contracting States is not the primary concern in the appointment of arbitrators.

On the other hand, the priority of legal practitioners indicates that in the appointment procedure of investment arbitrators, the networking relationship of legal practitioners plays a critical role in the composition of arbitral tribunals.

International arbitration is an important method for dispute resolutions alternative to national legal systems, diplomatic protection or other dispute resolutions. The dispute settlement mechanism is aimed to prevent the adjudication process from the influences of political concerns and choices by sovereign states. This concern explains that international arbitration is mostly composed of private actors rather than government officials or diplomats. In this situation, the quality and professionalism of arbitrators decide the quality of arbitration.<sup>560</sup>

To be independent of political intervention by home and host States, the community of investment arbitrators is like self-governing dispute settlement system. This system functions as a marketplace of legal service. Arbitrators are service-

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<sup>558</sup> Michael Waibel and Yanhui Wu, 'Are arbitrators political?' (2012) (working paper) (on file with authors), available at <<http://www.wipol.unibonn.de/lehrveranstaltungen-1/lawecon-workshop/archive/dateien/waibelwinter>> accessed 10 April 2019.

<sup>559</sup> Joost Pauwelyn (n 544) 774.

<sup>560</sup> Daphna Kapeliuk (n 512) 60.

suppliers who are in a competitive relationship. The competitiveness of arbitrators lies in personal characteristics, professional credibility, practical experience and reputations.<sup>561</sup> As a result, different from the political and bureaucratic nature of the WTO system, investor–State arbitration is a private market of legal practitioners.

While the appointment of investment arbitrators rests in the competition between individual arbitrators, the market of arbitrators relies on the networking relationship between legal practitioners.

As one of the pioneer empirical studies of transnational arbitration, personal characteristics, Dezalay and Garth observe that personal characteristics, professional credibility, practical experiences and reputations are the main contributing factors of an arbitrator to win the competition. These elements are the symbolic power of arbitrators that is constructed by the competition in international arbitration.<sup>562</sup> Advanced from the competition theory, Ginsburg further argues how the symbolic power of leading arbitrators drives the relationship of arbitrators into a closed networking culture.<sup>563</sup> The networking theory explains why the repetition of ICSID arbitrators is concentrated on several arbitrators while international arbitration is a competitive market.

Since then, more scholars have explored the interaction between arbitrators and the influences of leading arbitrators under the closed network of international arbitration. Puig, for example, applies social network analysis to confirm a dense network exists in arbitration practitioners, as shown by the number of arbitrators who have three or fewer

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<sup>561</sup> Yves Dezalay and Bryant G. Garth, *Dealing in Virtue* (University of Chicago Press 1996) 18–32.

<sup>562</sup> The concept of symbolic power was developed by French sociologist Pierre Bourdieu. This concept was used to describe how discipline is used to confirm individuals' placement in a social hierarchy and constitutes social habits and unconscious modes of cultural/social domination. It then is applied to explore the role of dominated social agents on shaping the perceptions, thoughts and social habits in a system/institution.

<sup>563</sup> Tom Ginsburg, 'The Culture of Arbitration' (2003) 36 *Vanderbilt Journal of Transnational Law* 1335, 1337.

ties with other arbitrators is higher than the number in the population of WTO panellists.<sup>564</sup> He also identifies the star arbitrators who dominate the network of ICSID arbitrators. Except for the conventional image of a giant old man's club,<sup>565</sup> Puig pictures the group of elite arbitrators including formidable women as well, although the gender diversity gap is still huge.<sup>566</sup>

On one side, networking theory suggests that the leadership of star arbitrators might play a critical role in the unification of legal understanding and adjudicative behaviours in the decentralised investor–State arbitration.<sup>567</sup> On the other side, the competition theory and the networking theory explain the weak position of the Contracting States on shaping the institutional culture of investment arbitrators. Investment arbitrators are more inclined to a self–governance and market–oriented system.

The culture of judicial review between investor–State arbitration and the WTO dispute settlement mechanism, as the thesis argues, shed lights on the behavioural patterns of investment arbitrators and WTO adjudicators.

### 5.5.3. Links between institutional cultures and decision patterns

The preferred choice of selectors explains the different profiles and backgrounds of adjudicators in investor–State arbitration and the WTO dispute settlement mechanism. The analyses discussed above demonstrate that investor–State arbitration is governed by legal experts, while the WTO dispute settlement system is under the ethos of

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<sup>564</sup> Sergio Puig (n 546) 419.

<sup>565</sup> Yves Dezalay and Bryant G. Garth (n 561) 34; Catherine A. Rogers, 'The Vocation of the International Arbitrator' (2005) 20 *American University of International Law Review* 957, 963.

<sup>566</sup> Sergio Puig (n 546) 407–08.

<sup>567</sup> *Ibid*, 422–23.

diplomats.<sup>568</sup> As a result, the management of investment arbitrators relies on a self-governing system within the network of legal practitioners. In contrast, WTO adjudicators are dominated by bureaucrats who have a strong connection with member States. The institutional cultures are the result and also the reflection of the uniqueness and separation between international investment law and WTO law.<sup>569</sup>

As to the issue of the connection between society and behaviours, social science studies have suggested that social preferences, relationships and social contexts are all influential to a person's behaviours and decision-making process. For instance, in the discussion of policy-making and development policies, the *World Development Report 2015* points out the biases within development professionals themselves. This paper agrees that communication and experience exchange are useful approaches to advance theoretical development and practices of the international development project. It is because the experts of international development studies share the same knowledge, languages and experiences. These factors constitute a specific social context.

On the other hand, the *World Development Report 2015* observes that communication between experts shapes some biases while exercising international development plans. The exchange of experiences further consolidates those biases. Given the path-dependence effect within the professional community, experts are unaware of their biases.<sup>570</sup>

The case study of international development experts implicates two things. First, it illustrates that personal behaviours reflect the self-realisation of specific issues such as professional background and experiences. Second, it reveals that personal behaviours

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<sup>568</sup> J.H.H. Weiler (n 452) 194.

<sup>569</sup> Jose Augusto Fontoura Costa (n 515) 22.

<sup>570</sup> World Bank Group, *World Development Report: Mind, Society and Behaviour* (2015), Chapter 10: The biases of development professionals, 181–92.

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are influenced by the interaction with other people in their environment.<sup>571</sup> Human beings are group-minded individuals.<sup>572</sup>

These sociological insights shed lights on the divergence of international adjudication. These ideas explain how legal understandings are formed and shared by the people in a community or institution.

From the perspective of the relationship between institutional contexts and behaviours, institutional cultures implicate the behavioural patterns of investment arbitrators and WTO adjudicators.<sup>573</sup>

A significant feature of the decision-making pattern of investment arbitrators is flexibility. During the search for resolution for disputes, arbitrators are more willing to use different materials and experiences of other international courts in the interpretation and application of treaty rules. Each legal interpretation implicates a possible solution for the disputing parties. The problem-solution tendency stimulates arbitrators to adopt an open attitude toward the evolutionary interpretation.

The flexibility instead implies the disconnection between the Contracting States and investment arbitrators. The Contracting States have limited controlling power over the proceedings and the result of arbitration unless they are the disputing party to the dispute. The limited connection with the Contracting States stimulates investment arbitrators to constitute their professional community. Within the community of professionals, arbitrators share the concern of solving the dispute between the claimant

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<sup>571</sup> Justin Parkhurst, *The Politics of Evidence: From Evidence-based Policy to the Good Governance of Evidence* (Routledge 2017) 89–91.

<sup>572</sup> World Bank Group (n 570) 42.

<sup>573</sup> The decision pattern here refers to the general decision pattern. It means that adjudicators of a dispute settlement mechanism are conceived as a whole tribunal. In this section the three groups are WTO panelists, the Appellate Body and investment arbitrators. The conception of general decision pattern is borrowed from the three-level decision pattern developed by Kapeliuk. See Daphna Kapeliuk (n 512).

investor and the respondent State. Some of them also believe that the resolution must be the balancing point between the disputing parties.

The confidence of the professionals might explain the flexibility of investment arbitrators' interpretative choices. As previous sections analyse, becoming an arbitrator requires a high threshold of legal expertise. While their majors might be different, it cannot deny that the majority of investment arbitrators has solid legal professionals. The strong legal background indicates that arbitrators are familiar with interpretative approaches and are confident of their decisions. The professional backgrounds also explain the self-governance of investment arbitrators.

The different professional background of investment arbitrators, on the other hand, causes a problem to the unification of legal opinions. Roberts has indicated the variety of the professional background of arbitrators and legal practitioners. It ranges from commercial arbitration and private international law to public international law and public law. These diverse backgrounds result in the clash of ideologies and legal understandings in the interpretation of investment protection treatments.<sup>574</sup>

These analyses reveal the dual aspects of investor–State arbitration. On one side, investor–State arbitration is an open system. The States are no longer the primary participants. The applicable law and relevant regulations are not exclusive to investment treaties but including national arbitration laws, customary law principles and other international agreements. Given the openness, investment arbitrators have a distance relationship with the Contracting States and enjoy great discretion of interpretative choices. They are also more willing to adopt evolutionary interpretations.

On the other side, the management of investor–State arbitration relies on the self–

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<sup>574</sup> Anthea Roberts, 'Clash of paradigms: actors and analogies shaping the investment treaty system' (2013) 107 *American Journal of International Law* 45–94.

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governance of arbitrators. A network of arbitrators is essential to the self-governance. The network of professional also constitutes the social context where the leadership of elite arbitrators shapes legal understandings and experiences. Nevertheless, the leadership of elite arbitrators has no function of correction. Their legal opinions shed lights on legal issues but have not binding effect on other arbitrators. Except for the lack of supervision institution, the diverse professional backgrounds accelerate the uncertainty of legal interpretations of investor-State arbitration.

In contrast, the social context of WTO adjudicators is not based on the network of professionals but framed by the preference of Member States.

First, the engagement of member States in the appointment of panels and the Appellate Body members explains the ethos of diplomats and officials dominated the community of WTO adjudicators. A relatively conservative attitude toward treaty interpretation not only bases on the ethos of diplomats and officials but also the close connection with the member States.

Second, the governmental experience of panels and the Appellate Body indicates the preference of member States over adjudicators. The profile of governmental experience explains why WTO adjudicators prefer to follow, rather than to question, developed legal interpretations and understandings. Moreover, panels and the Appellate Body tend to apply WTO provisions in the texts according to the bright and natural meaning. The formalist approach and rigid textual interpretation more easily exclude the debate about values from the interpretation and application of WTO provisions.<sup>575</sup>

The social and political embeddedness of WTO adjudicators on policy choices of

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<sup>575</sup> Sol Picciotto (n 449) 480.

Member States explain the interpretation choices of WTO adjudicators dominated by the order-keeper scenario. Especially the Appellate Body, it has a strong institutional identity as the gatekeepers for the outcomes of trade negotiations under the WTO. As such, the interpretative activities of WTO adjudicators are more stable and consistent than that of investment arbitrators.

While investor-State arbitration and the WTO dispute settlement mechanism are the two extremes of the power relation between adjudicators and the States, they confront the same issue. The specific issue is the legitimacy issue challenged by the States and the public.

#### 5.6. The legitimacy issue of international adjudication

International investment law and WTO law present a spectrum of legalisation and institutionalisation of world politics between the two ends of decentralisation and centralisation.<sup>576</sup> Investor-State arbitration and the WTO dispute settlement mechanism are the two examples of how nation-states establish the international relation on specific issues. Behind the different institutional features, the ultimate concern is depolitisation of dispute settlements.

While the WTO dispute settlement mechanism involves more stable and consistent interpretative activities and decisions, it also confronts the legitimacy challenges like the decentralised system of investor-State arbitration. The same problem raises the question of international adjudication. The specific issue is, what matters most to the accountability and acceptance of adjudicative decisions, the embeddedness of policy-making or professional backgrounds?

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<sup>576</sup> Kenneth W. Abbott, Robert O. Keohane, Andrew Moravcsik, Anne-Marie Slaughter, and Duncan Snidal, 'The Concept of Legalization' (2000) 54(3) *International Organization* 401–19.



5.6.1. Between the embeddedness of the policy-making and legal expertise, what matters?

There are two dimensions to discuss the legitimacy of international adjudication. One dimension is from the subjective sense of the insiders. It means the acceptance and confidence of the users concerning the rulings.<sup>577</sup> Another dimension is the viewpoint of outsiders. It relates to the issues of the transparency of the adjudication procedure and public participation of third parties such as civil society groups and NGOs in the proceedings.<sup>578</sup> The two dimensions explain the legitimacy challenges of investor–State arbitration and the WTO dispute settlement mechanism to different extents.

Nevertheless, the most crucial issue confronting the two dispute settlement mechanisms is the loyalty crisis of participants, especially the signatory States.

The reasons that the signatory States question the legitimacy of investor–State arbitration and the WTO dispute settlement mechanism focus on different issues. In the WTO, what member States question most is the transparency of the procedure and the quality of decisions by panels and the Appellate Body. These critiques are reflected in the recent institutional crisis of the Appellate Body, the vacancies of the AB members.

In international investment law, the accountability of investor–State awards is questioned by the community of States. The trust issue leads to the withdrawal of ICSID memberships, the suspension or renegotiations of provisions regarding investor–State arbitration. Moreover, the legitimacy issue raises the demands of reforming the existing investor–State arbitration into a different institutional design.

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<sup>577</sup> Yuval Shany, *Assessing the Effectiveness of International Courts* (OUP 2014) 138–40.

<sup>578</sup> Armin von Bogdandy, ‘The Democratic Legitimacy of International Courts: A Conceptual Framework’ (2013) 14 *Theoretical Inquiries in Law* 361–79.

The discussion of reforming investor–State arbitration discloses that more and more States are preparing to transform the decentralised system into a centralised system with standing institutions and standard procedural rules.<sup>579</sup> The tendency seems to suggest that between the WTO model and the investor–State–arbitration model, the former wins greater acceptance and confidence from the States.

While the States frequently question the uncertainty and the institutional bias of investor–State arbitration, however, their critiques cannot explain why the proposed institutional reform mainly prefer the WTO model. In my viewpoints, the critical reason is nations–states desiring to reserve their controlling power over investment arbitration.

Two reasons are supporting this argument. The first is about the foundation of the WTO dispute settlement mechanism. The WTO model of dispute settlements exemplifies a tendency toward unification and consistency of legal interpretations. A common point of view for this phenomenon is that centralised institutions and standard procedures are decisive factors to the stability of the WTO system. This viewpoint explains why the majority of the proposed reform of investor–State arbitration focuses on centralised institutions and unified procedures for investment disputes. The EU’s proposal of an international investment court is an outstanding example.

The centralised institutions and unified procedures, however, are the results of the agreement by member States of the WTO. Given the membership, the nature of WTO law is multilateral agreements. The multilateral agreements provide a standard set of substantive rules regarding cross–border trade relations. Accordingly, the procedures

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<sup>579</sup> The Comprehensive Economic and Trade Agreement between EU–Canada has reformed investor–State arbitration into a court system. The European Union also is promoting the creation of a multilateral investment court. European Council, Press release, 20 March 2018, Multilateral investment court: Council gives mandate to the Commission to open negotiations, available at <<http://www.consilium.europa.eu/en/press/press-releases/2018/03/20/multilateral-investment-court-council-gives-mandate-to-the-commission-to-open-negotiations/>> accessed 10 April 2019.

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and institutions of WTO adjudication is part of these multilateral agreements. In other words, what the WTO model of dispute settlements represents is not only the centralised institutions and adjudicative proceedings. More importantly, it reveals that multilateral memberships are the precondition of centralised institutions and standard rules of adjudicative proceedings.

The multilateral membership is that international investment law lacks. As chapter one mentions, international investment law rests in bilateral investment treaties and the investment chapter of bilateral and regional trade agreements. International investment law has to experience several failures in the creation of a multilateral agreement for foreign investment. Also, in the bilateral relation, economic efficiency explains that the States of BITs have fewer incentives to create centralised institutions for dispute settlements. As such, a proposal of permanent investment court without the support of multilateral memberships might be too unrealistic. The political relationship between the States would further hinder the institutional reform of the existing investor–State arbitration.

The second reason is a response to the question of institutional bias favouring investors in investor–State arbitration.

Institutional bias has been a long–term issue of international investment law.<sup>580</sup> Commentators argue that investment arbitrators are inclined to give merits to the interest of foreign investors and investments. The investment–preference bias results in

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<sup>580</sup> Nathalie Bernasconi–Oserwalder, ‘Who Wins and How Loses in Investment Arbitration? Are Investors and Host States on A Level Laying Fields?’ (2005) 6 *Journal of World Investment & Trade* 69; Van Aaken, ‘Fragmentation of International Law: The Case of International Investment Protection’ (2006) 17 *Finnish Yearbook of International Law* 91, 126; Gus van Harten, ‘Investment Treaty Arbitration, Procedural Fairness, and the Rule of Law’ in Stephan W. Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010) 627.

chilling effects on the domestic policies of the host government. The chilling effects create the impression that investment arbitrators exceed their authority to intervene in the regulatory freedom of host States.<sup>581</sup> Influenced by this point of view, more and more nation-states have decided to withdraw from the ICSID or suspend investor-State arbitration clauses.

The concern of institutional bias of investment arbitrators, however, is the lack of empirical evidence. Some commentators adopt quantitative methods and observe that investors enjoyed a relatively low success rate in investor-State arbitration cases.<sup>582</sup> Professor Pelc further argues a stable downward trend of the success of investor-States disputes by exploring the claim of indirect expropriation.<sup>583</sup>

While empirical studies reveal that pro-investment scenario is no longer a correct description of the outcomes of investor-State disputes, the conventional and incorrect perception remains among the community of nation-states. The suspicious perception motivates commentators and individual states to engage in the reform of investment dispute resolution. The most popular idea of institutional reform of investor-State arbitration is the WTO-like model which has centralised institutions and unified arbitration proceedings.<sup>584</sup>

Besides the counter-argument of empirical evidence, another perspective to

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<sup>581</sup> Stuart G. Gross, Note, 'Inordinate Chill: Bits, Non-NAFTA Mits, and Host -State Regulatory Freedom-An Indonesian Case Study' (2003) 24 Michigan Journal of International Law 893, 899; Lucien Dhooze, 'The North American Free Trade Agreement and the Environment' (2001) 10 Minnesota Journal of Global Trade 209, 273-78, 283.

<sup>582</sup> Susan D. Franck, 'Conflating politics and development: Examining investment treaty arbitration outcomes' (2014) 55 Virginia Journal of International Law 13, 52-53; Thomas Schultz and Cedric Dupont, 'Investment Arbitration: Promoting the Rule of Law or Over-Empowering Investors? A Quantitative Empirical Study' (2015) 25(4) European Journal of International Law 1148, 1157-58.

<sup>583</sup> Krzysztof J. Pelc, 'What Explains the Low Success Rate of Investor-State Disputes?' (2017) 71(3) International Organization 559, 561.

<sup>584</sup> Gus Van Harten, 'A Case for An International Investment Court' (2008) Society of International Economic Law (SIEL) Inaugural Conference Paper; EU's negotiating directives with respect to a multilateral investment court, available at <<https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1505306108510&uri=COM:2017:493:FIN>> accessed 10 April 2019.

review the merit of the WTO's centralised dispute settlement mechanism is its essential virtue, depoliticisation of international adjudication.

The centralised institutions (i.e. the Appellate Body and the Dispute Settlement Body) and procedural rules of the adjudicative proceedings, on the surface, create the impression that the WTO system support depoliticisation of WTO dispute settlements. The negative voting rule further reduces political influences by member States over the adjudicative proceedings.

However, as Costa points out, the function of depoliticisation of the WTO adjudication might not be as practical as expected. The main reason is the controlling mechanism of the member States. Member States can still function their interventions on the WTO dispute settlement proceedings through the appointment procedure of the AB members, and the adoption procedure of panel reports and AB reports. These procedural rights reserve the opportunity for member States to engage the adjudicative proceedings. The strong connection between member States and the WTO adjudication also implicates the premise of WTO adjudicators as the embeddedness of the policy-making of national policies and the WTO system. As such, the features of centralised institutions and standard procedures instead turn the WTO dispute settlement mechanism into a political field for the States to pursue their interests.<sup>585</sup>

International investment law and investor-State arbitration instead are decentralised. The decentralised nature results in the self-governance of legal practitioners and the disconnection between investment arbitrators and the Contracting States. Moreover, the requirement of legal professionals is also the guarantee of the independence of arbitrators. Legal professional at least ensures the final decision ruled

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<sup>585</sup> Jose Augusto Fontoura Costa (n 515) 22.

by law rather than by the States. As such, from the perspective of reducing political influences on international adjudication, investor–State arbitration seems to suggest a more effective institutional model than the WTO system.

If the ultimate concern of third–party arbitration is to depoliticise international dispute settlements, why do the States instead choose to reconstruct investor–State arbitration as the centralised system like the WTO dispute settlement mechanism, instead of improving the existing investor–State arbitration?

The thesis argues that between the independence of legal expertise and the embeddedness of policy–making with the Contracting States, the latter factor is still the prior concern by the States. The answer explains why institutional shortages and institutional bias are not sufficient reason for the proposals of an international investment court.

#### 5.6.2. The review of third–party adjudication as the instrument of depoliticisation of international adjudication

The EU recently is actively promoting the creation of an international investment court. The idea of an international investment court was first included in the free trade agreement between the EU and Canada. Under the ambitions of the EU, it seems no doubt that in the foreseeable future investor–State arbitration will transform into a centralised model under some regional economic agreements. This change seems to signal the advance of the rule of law in international investment law and investor–State arbitration.

However, as the thesis argues above, the reform of investor–State arbitration toward a centralised system involves the ambition of the States to restore their dominance over the adjudicative proceedings. The rebound of political control by the

States is characterised by the changes of these proposals of investment courts.

The changes include a central and permanent investment court, the right to appoint by the Member States without the engagement of private investors, the quality of adjudicators and a standard set of arbitration proceedings. These features are decisive to the creation of a centralised institution and standard proceedings for international adjudication. These instruments also function to rebuild the connection between institutions and the States.

In other words, the proposed instruments make the signatory States no longer in the passive position during the arbitration process. They instead can take positive actions to influence the proceedings of dispute settlements. The WTO experiences have displayed how centralised institutions and adjudicative proceedings are convenient for such political needs.

As such, the thesis argues that the development of investor–State arbitration echoes the state–centric theory of international law. The States still prefer the decision panel to be under their control.<sup>586</sup> One should be cautious of whether the rebound political control by the States will turn international investment court into another political field by which the States rearrange their power relation, as the WTO system experiences.<sup>587</sup>

The proposals of investment court also raise the concern of what the theory of international adjudication is. The conventional wisdom conceived that depoliticisation is the primary concern of international adjudication. Apolitical institutions must be functional for the concern of depoliticisation. The higher institutionalisation and

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<sup>586</sup> Catherine A. Rogers (n 543) 251–52; Jacob Katz Cogan, ‘Competition and Control in International Adjudication’ (2008) 48 *Virginia Journal of International Law* 411, 419.

<sup>587</sup> *Republic of Ecuador v. United States of America* (PCA Case No. 2012–5), Expert Opinion of Prof. W. Michael Reisman, April 24 2012, paras 24–25, 36–37.

centralisation of a dispute settlement mechanism, it implicates the greater stability and the rule of law in the legal system. The functionalist thought, instead, neglects the essence of international adjudication as the result of the interaction between the adjudicators and the States. As the primary two groups of decision-makers, the interaction between the adjudicators and the States, in fact, is the reflection of their power relation. The power relation to a large extent is defined by the controlling mechanisms of the States on the adjudicative proceedings.

In this respect, international adjudication is embedded in the politics of international law. International adjudication is part of the political relationships within the States and between the States and third parties. The point of view echoes previous analyses of this study. The study proposes interpretative choices and adjudicative decisions framed by the institutional contexts. The institutional features and the rules concerning the adjudicative proceedings characterise the uniqueness of the contexts for third-party adjudication. As such, interpretative choices and adjudicative decisions not only reveal how the adjudicators respond to the intentions of the signatory States. More importantly, they are the political choices by adjudicators that are framed under specific institutional contexts.<sup>588</sup> Accordingly, different adjudicative modes are the result and also the reflection of the relations between the adjudicators and the signatory States.

## 5.7. Conclusion

Different institutional designs reflect the choices by the States regarding delegating their decision-making power to third parties. The institutional features are the framework of interpretative choices and decisions by adjudicators, shaping the preference of adjudicators and developing shared values and understandings within the adjudication

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<sup>588</sup> Chapter six will address the social meaning of institutional contexts of third-party adjudication in international investment law and WTO law.



Understanding differences in practice by their institutional contexts and the power relation between adjudicators and the states

community.

These insights shed light on the fragmentation of international law. While treaty interpretation can be part of the solution to fragmentation, the answer is incomplete. The fragmentation of international law not only results from the legal activities of adjudicators but more importantly, from the interaction between adjudicators and legislative States. In this respect, interpretative choices and decisions are not only the results of legal activities but also political choices by adjudicators who may share or refine political understanding of the States. The interaction between adjudicators and legislative States drives the evolution of international law in line with the governance of state practices. This argument is essential to find out the shared meanings from the fragmentation.

While institutional features explain and contribute to the fragmentation of treaty interpretation, there is no right answer to international adjudication. The ongoing reform of investor–State arbitration instead is beginning to resemble a WTO–like model with centralised institutions and court–like functions.<sup>589</sup>

The thesis believes the new development signalling that international adjudication remains under the shadow of state–centric thought. The States tend to rebound their

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<sup>589</sup> Helfer and Slaughter identify several functions shared by international courts and tribunals. These functions include receiving petitions from complaints, reviewing submissions, finding facts, interpreting legal rules and issuing nonbinding decisions or recommendations. They argue these functions constitute the juridical nature of international courts and tribunals. Investment arbitral tribunals share some of these functions. See Laurence Helfer and Anne–Marie Slaughter, ‘Why states create international tribunals: A response to professors Posner and Yoo’ (2005) 93(3) *California Law Review* 899, 923; Stephan W. Schill, ‘Crafting the International Economic Order: The Public Function of Investment Treaty Arbitration and Its Significance for the Role of the Arbitrator’ (2010) 23(2) *Leiden Journal of International Law* 401, 423–24.

However, the thesis disagrees that investor–State arbitration functions like a standing judicial institution like national courts. A main reason is their institutional purpose. The essential purpose of investor–State arbitration is dispute resolution rather than the consistency of international investment law. Investment arbitrators conceiving their role as problem–solvers rather than order–keepers also support my viewpoint.

political control over the arbitral proceedings. The desire of controlling over international adjudication raises out two struggles. One struggle is between centralised institutions and functions and decentralised adjudicative activities. Another struggle is between transparency and independence of the proceedings and the engagement of the States.<sup>590</sup> In this respect, international adjudication has never departed from but embedded in the politics of international law.

In the next chapter, the thesis proposes a conceptual framework for the construction of international law. The proposed framework highlights the joint function of adjudicators and the States on constructing international orders. It illustrates how the interaction between adjudicators and the States colours the dimensions of balancing in international investment law and trade law.

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<sup>590</sup> Francisco Orrego Vicuña (n 442) 124.

## Chapter Six

### A Conceptual Framework for the (Re)Construction of International Law

#### 6.1. Introduction

Previous chapters have analysed the similarities and differences of the application of the balancing analysis of investor–State arbitral awards and the WTO dispute settlement.

The findings have two implications. First, it reveals that international investment law and WTO law have not unified the balancing analysis for treaty interpretation and dispute settlement. While investment arbitrators and WTO adjudicators share legal understandings to a certain point, they develop different interpretative choices and the patterns of judicial review. Second, it implicates that to pursue a unified practice of a legal concept and principle is difficult in the separation of international investment law and WTO law. While current free trade agreements adopted the combined regulatory model that integrates the treatments of foreign investment along with the trade commitments, the unite of investment–protection rules and trade commitments only works within the individual agreement. We must be cautious of exaggerating individual development as the unity of international investment law and trade law in general.<sup>591</sup>

While the study observes that convergences and divergences are both familiar to the text and the practice between the international investment law and WTO law, other studies seem to pay more attention to the different practice.<sup>592</sup> The sense of certainty is

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<sup>591</sup> Mark Wu, ‘The Scope And Limits of Trade’s Influence in Shaping the Evolving International Investment Regime’ in Zachary Douglas, Joost Pauwelyn, and Jorge E. Viñuales (eds), *The Foundations of International Investment Law: Brining Theory into Practice* (OUP 2014) 196–207.

<sup>592</sup> The ILC stresses the risks of fragmentation on international law and also discusses how to alleviate these risks. International Law Commission, ‘Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law’ (13 April 2006) UN Doc A/CN.4/L.682.

the main reason for unequally weighing the two situations (convergence v. divergence).

Divergent legal interpretations and experiences, at first sight, create an image of uncertainty. Uncertainty is against the fundamental principle of the legal order. As Lord Bingham points out, the principle of the rule of law is the foundation of a legal system. In his point of view, two conditions characterise the principle of the rule of law. First, the law must be accessible and in so far as possible, intelligible, transparent and predictable.<sup>593</sup> Second, questions of legal right and liability should ordinarily be resolved by the application of the law and not the exercise of discretion.<sup>594</sup>

These statements all revolve around the notion of certainty in the law. Given the concern of certainty, the uncertainty caused by divergences could hinder the progress of law. Therefore, divergences must be eliminated if the law is to be correctly applied.

It is a common understanding that the notion of certainty is the underlying principle of international law. Certainty is the guarantee of the unity and comprehension of international law as a whole system. The pursuit of certainty explains why divergences are conceived as the noise to the comprehension of international law. Division in legal opinions and legal interpretations is also amount to a threat to the stability and certainty of international law.<sup>595</sup> Under the systematic concern, convergences and divergences seem to direct two extremes of international law: unity or fragmentation. Concerning the certainty of the international law system, the two situations are opposite and exclusive to each other.<sup>596</sup>

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<sup>593</sup> Tom Bingham (n 122) 37.

<sup>594</sup> Ibid, 48.

<sup>595</sup> Andrea Bianchi, 'Looking Ahead: International Law's Main Challenges' in David Armstrong (ed), *Routledge Handbook of International Law* (Routledge 2009) 392, 404; Michael Waibel, 'Interpretive Communities in International Law' in Andrea Bianchi, Daniel Peat, and Matthew Windsor (eds), *Interpretation in International Law* (OUP 2015) 154–60.

<sup>596</sup> As José E. Alvarez states, 'fragmentation is generally seen as the "dark side" of treatification'. Under the convergence/divergence dichotomy, the 'treatification' that Alvarez mentions in this article is representative of the end of convergence. José E. Alvarez, 'A BIT on Custom' (2009) 42 N.Y.U. J. Int'l

The convergence/divergence distinction explains why the advocates of the unity of international law urge to codify constitutional principles by treaty-making and standardising practices in treaty interpretation. The promotion of cross-fertilisation between international investment law and WTO law is also developing under this train of thought.

Nevertheless, the pursuit of convergences might not be the right answer for the fragmented reality of international law. The separation of international investment law and trade law exemplifies the virtue of modern society as the functional individualism. The functional individualism, in turn, deepens the division of legal principles and the divergence of legal interpretations in international investment law and trade law (i.e. WTO law). If divergences are inevitable in the fragmentation of international law, is there any other perspectives to review the development of international law beyond the convergence/divergence dichotomy?

As to the issue, the thesis proposes the first step of giving equal weight to all possible situations. Convergences and divergences are only possible situations in the development of international law. The two situations are not necessary to the unity and stability of international law. Instead, what is vital to international law is the process of communication that the States and adjudicators involve to drive the progress of the governance of state practices. While the performances are changing, the structure of the communication of opinions and experiences concerning the governance of state practice is not changed.

The discussion is composed of four parts. The first part discusses the limitation of the convergence/divergence distinction to explain the evolution of international law and

the unity of the international law system. In the second part, the thesis applies cognitive and sociological insights to propose a framework for the construction of international law. The conceptual framework approaches legislative activities by the States and interpretative activities by adjudicators as the communication process based on the social relations of either of the parties. The thesis identifies three elements for the communication process: self-realisation, the contractual relationship and the engagement of the international community. The thesis then moves to the next issue. The information exchanged and constructed through the communication process is the boundaries of sovereignty. It argues that the interaction between the States and adjudicators shapes the idea of the governance of state practice. The change of the governing idea shapes the boundaries of sovereignty agreed by the States and defined by adjudicators at different stages. The argument echoes the view of chapter one that the history of international law is the history of the concept of sovereignty. This chapter concludes that adjudicators share the function with nation-states as the decision makers of international law.

## 6.2. A dilemma faced by the convergence/divergence dichotomy

Certainty is the foundation for a legal system. The stability of the legal system relies on the predictability and stability of the implementation of regulations. International law as a system is no exception. It is also not the aim of the study to question this view. What this study tends to challenge is what elements are vital to the stability of international law.

As chapter one mentions, modern international law rests in the specification and proliferation of treaties, all of which pursue diverse values. The division in subject matters results in the fragmentation of international law. It means that international law divides into several branches. Each branch has developed its legal principles and

international institutions for the management and dispute settlements. International investment law and trade law exemplifies how international governance of economic activities divide into two sub-systems.

The separation of international investment law and trade law reflects the virtue of modern society as the functional individualism, on one side. The functional individualism, on the other side, deepens the division of legal principles and the divergence of legal interpretations in international investment law and trade law (i.e. WTO law). While divergences are inevitable in international law, they do not hinder the growth of international law. The international law system is still developing and functional to international society.

The advocates of standardising principles and legal interpretations usually adopt the concern of pursuing stability, certainty and predictability in international law. They believe that standard rules and practices favour building up systematic values of international law. Under the concern of certainty, the standardisation of legal principles and legal interpretations facilitates the convergence/divergence distinction.

The convergence/divergence distinction also applies to the discussion of the balancing approach in international investment law and WTO law. As previous chapters analysed, some commentators promote the cross-reference of the balancing approach between the WTO jurisprudence and investor-State arbitration. The suggestion is more concerned with the practice of investment arbitrators. The main reason is the practice of WTO adjudicators more stable and consistent than investment arbitrators. This point of view explains why the advocates pay more attention to how to improve the certainty of the balancing analysis in investor-State arbitration. Their suggestion of mutual reference to judicial experiences also reflects the ambition of the unity of international

investment law and WTO law.

However, the thesis argues that the convergence/divergence distinction cannot be compromised with the reality of international investment law and WTO law. Instead, the separation of international investment law and WTO law raises the question the extent to which the experiences of WTO adjudicators can be referenced to interpret investment treaties and to settle the dispute between foreign investors and host State.

There two points against the view the links the stability of international law with standard practices by two points. First, the thesis argues that the process of standardisation is the process of exclusion. Standard principles and practices of international law implicate that the States, practitioners and adjudicators have shared understandings and experiences to a certain point. While the shared understandings might naturally emerge in practice, the unified and standard practices are identified by practitioners. In other words, the process of standardisation in the theoretical discussion is a process of identification. As such, the identification process is a process of exclusion rather than union.

During the process of identifying, some practices and legal opinions are chosen and decided as the standard answers to a specific issue. It means that some experiences are superior to others. The process of identification is the process of distinction. Some experiences are defined as valid, while others are regarded as invalid and need to be adjusted. While the standardisation process contributes to the homogeneity of legal opinions and practices, it could deepen the division and separation in international law.

Before identifying standard answers to a legal issue, we must be cautious of whether the excluded practices are the misapplication of legal principles or the reflection of different contexts by which a legal principle applied. The analyses of



previous chapters have pointed out how the textual and institutional contexts result in the divergence of the balancing approach between international investment law and WTO law.

The second point is about the gap between international law and international society. There is an issue missing in the advocate of standard legal interpretations and practices of international law. The issue is how constitutional principles and standard practices respond to the diversity of international society in terms of interests, values and demands.

As the thesis mentions before, standard practices and legal opinions are the results of the process of identification. The identification process could confuse the legitimate activity with misapplication and misunderstanding of a legal principle. Therefore, the pursuit of unifying legal principles and experiences is at the expense of the diversity of international society.

Under the convergence/divergence distinction, different practices and legal opinions usually amount to a threat to the unity of international law. The convergence/divergence distinction differentiates the consequences. Convergences are the positive impacts on the development of international law, while divergences are the negative ones. As such, the process of standardisation provides the opportunity to identify some experiences and exclude others. The identified practices are the benchmark to correct the excluded ones. The exclusion process consists of three steps: identification, exclusion, and correction.

The three steps of exclusion constitute the discussion of unifying the balancing approach between investor–State arbitration and the WTO jurisprudence. The advocates

first identify the balancing approach as the approach for the conflicting interests and regulatory purposes in an international dispute. They observe that several international courts and tribunals have developed their experiences of applying the balancing approach to settle the dispute. Among these experiences, they identify the experiences of the ECtHR the origin of the balancing approach of international law. The ECtHR develops a three-step structure for the balancing approach. Therefore, the experience of the ECtHR is identified as the standard model of the balancing approach.<sup>597</sup> Accordingly, the commentators apply the identified model to assess the ‘correctness’ of practices by other international tribunals, including investor–State arbitration and the WTO dispute settlement mechanism. Given the departure from the standard experience in investor–State arbitration, the commentators suggest investment arbitrators learn from the experiences of the WTO jurisprudence and other international authorities such as the ECtHR.

Nevertheless, the advocates do not explain how the mutual reference practised in the division between international investment law and WTO law which result in the textual and institutional differences.

If the development of international law mirrors the evolution of human society, diversity is inherent to the practice of international law. This is because, since the industrial revolution, human society has transformed in line with the functional specification and differentiation. Several features remake the industrial modernisation and development: increased structural differentiation, functional specification and autonomy. The structural–functional differentiation is the process whereby subsystems divide into two or more units.<sup>598</sup> Likewise, international law divides into several

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<sup>597</sup> See, e.g., Benedikt Pirker (n 1); Gebhard Bücheler (n 2); Caroline Henckels (n 10).

<sup>598</sup> Industrial Systems Research, *Industry and Enterprise: An International Survey of Modernization and Development* (ISR Economic growth and performance studies Book 3) (Revised electronic edn, ISR 2013) 19.

branches. Each branch develops its essential principles and institutions for the management and dispute settlement. While the division of subject matters results in the fragmentation of international law, it expands the horizons of international law. This explains why the thesis argues the convergence/divergence dichotomy conditioning the horizons of the progress of international law. As such, the thesis proposes to recognise the diversity of international society and international authorities.

The main idea of this study is to shift attention from the appearance to the structure by which legal principles and understandings are constructed and what is concerned under the construction of international law. It argues that interpretative choices by adjudicators and legislative choices by the States are both vital to international law. They share the function of defining the boundaries of sovereignty. In this respect, divergences of legal opinions and experiences are not misunderstandings, misapplications or misuses of discretion by adjudicators. Instead, they implicate a legal principle or interpretative approach varying in different regimes in line with the specific context.

Whether convergence or divergence, all consequences are equally crucial to understanding the progress of international law. What we must do is not distinguish the consequences but to categorise them into a spectrum of the governance of state practices. Under the spectrum, the flexibility to answer the diverse interests and demands of international society is reserved for each domain.

Accordingly, the thesis refines the convergences/divergences dichotomy. The part of convergence remarks which part of international law reserves and continues to functional, while the part of divergence reveals the change of collective understandings and the reality of international society. Both of the two parts reflect how nation–states

and international adjudicators respond to the changes and adjust the boundaries of sovereignty over time.

The thesis advances the view of chapter four that balancing as the result of the interaction between the States and adjudicators. It proposes a conceptual framework to visualise the interaction. This proposed framework approaches the relations which influence the States and adjudicators to reach their decisions. The interaction within the dimensional relations is communication of legal opinions and experiences. In other words, what the States and adjudicators interact with each other is an exchange of opinions concerning the governance of state practices. The development of international law rests on the communication process.

### 6.3. The communication process for the construction of international law

#### 6.3.1. The process of decision making as a communication process

The study has mentioned in chapter one that the third-party adjudication is an alternative to the conventional dispute resolution method such as political negotiations for the state-state disputes and diplomatic protection for investor-State disputes. The transformation of dispute resolution methods is evident in the creation of investor-State arbitration and the WTO dispute settlement mechanism.

While the two institutions target different international disputes, they share the function of restraining political influences of the States on the adjudication process. With this regard, they are part of sovereignty-restrictions that the States agreed to investment treaties and WTO agreements. The principle of state consent explains the creation of these third-party adjudications as for the result of the delegation of the sovereignty of the States.

The delegation of sovereignty constitutes the relationship between adjudicators

and the Contracting States as the principal–agent relationship under the third–party adjudication. The principal–agent relationship instead defines the different function of adjudicators and the States. Adjudicators are interpreters and problem–solvers of international law; the States are legislators of international law.

From the perspective of the construction of international law, the different function is not server as expected. On the contrary, adjudicators and the States share the function as decision makers. While adjudicators are the decision makers of international disputes, the States are the decision–makers of rules and regulations. As such, treaty negotiation and treaty interpretation are the major decision-making processes for the States and adjudicators. However, what is the nature of the decision-making process?

Physical and cognitive–sociological studies have shown that while the world is divided into physical and mental parts, the difference between the two parts is not as significant as we imagine. At the micro–level, in some ways, the composition of physical objects and mind–sets is the same. The operating principle of the two parts is also similar. Both physical objects and mind–sets rests on information.<sup>599</sup> The way that information is constructed and collected varies from people to people. The critical factor is the social context by which the observer stays. The social context rests on the network of the personal, familial and social interaction of the observer.<sup>600</sup> In other words, communication is vital to society and the world is sensed and conceived.

The physical and cognitive–sociological insights advance the understanding of international law from the sociological perspective, as discussed in chapter five. In this

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<sup>599</sup> Carlo Rovelli, *Reality is Not What It Seems: The Journey to Quantum Gravity* (Penguin Books 2017) 116; Dan Sperber and Hugo Mercier, *The Enigma of Reason: A New Theory of Human Understanding* (Penguin Books 2018) 183, 211–12.

<sup>600</sup> Carlo Rovelli, *ibid*, 227; Dan Sperber and Hugo Mercier, *ibid*, 182–83.

section, the thesis proposes a framework to reconceptualise the construction of international law as a result of the communication process of legal opinions and experiences.

The proposed framework based on two premises. First, international law is composed of information concerning the governance of state practices. Treaty negotiation and treaty interpretation are two processes by which the States and adjudicator produce relevant information within their community and to each other.

Second, treaties and international adjudications are the two significant forums channelling social interaction. Within the individual process of decision making, however, the way to communicate information is different. The main reason for the difference is the relations that the States or adjudicators involved. The relation involves three dimensions: self-realisation, the arguments with peers and counterparties and the influence of the society as a whole. As such, the conclusion of treaties and interpretative choices are social products which are produced through the communication of opinions on specific issues.<sup>601</sup>

While the communication process is functional to information exchange, it also involves social interactions. Through the exchange of information, the participants not only define the basic norms, conceptions and practices within an individual domain<sup>602</sup> but also shape the common understanding for the same goal. The process of information exchange, however, is influenced by the relations that the decision makers involved. In other words, the social interactions channel information being exchanged and communicated.

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<sup>601</sup> Nancy Krigger, 'The Making of Public Health Data: Paradigms, Politics, and Policy' (1992) 13(4) *Journal of Public Health Policy* 412, 413.

<sup>602</sup> The discussion is borrowed from Parkhurst's study in the context of the sociological meaning of evidence for policy-making. Justin Parkhurst (n 571) 112–13.

The thesis identifies three dimensions of the decision-making process. Each dimension represents the relation that the States and adjudicators might involve. In different relation the ways by which the States and adjudicators produce their legal opinions are different. The three relations complete the decision-making process as a whole. Figure 2 presents the dimensional relations embedded in the decision-making process.

The identified dimensions of the communication process are as follows.

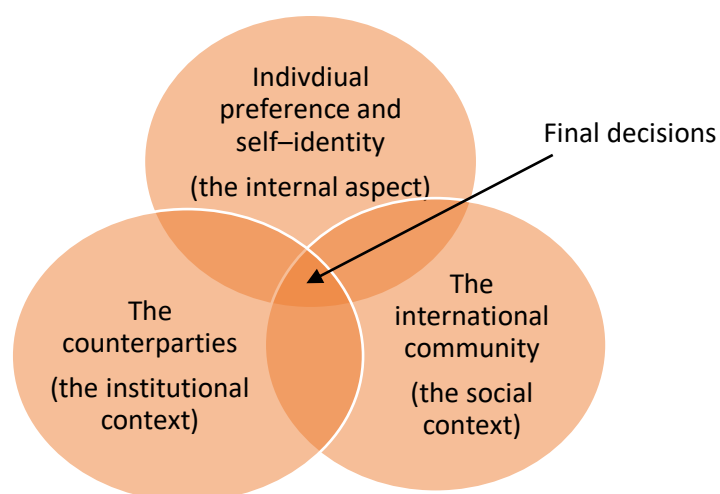
- 1) The internal context: This stage is the initial stage by which a decision maker starts to form its opinions by self-communication and self-realisation. At this stage, professional backgrounds and experiences are critical to frame personal opinions and understandings. In other words, the legal opinions primarily reflect individual preference and self-identity of the decision maker in its domain.
- 2) The institutional context: The institutional context refers to the legal relation which the States and adjudicators have their influences on shaping international orders. For the States, the institutional context is the treaty relations. The counterparties that a State interacts under the treaty relation are the other Contracting States. For the adjudicators, the institutional context is the disputing relation. Under the disputing relation, the counterparties that an adjudicator responds to include disputing parties and the Contracting States to the treaty at issue.
- 3) The social context: The social context here refers to the narrower version. It specifies the community by which the States and adjudicators stay, i.e. the community of nation-states and the community of adjudicators respectively.

The thesis argues that each dimension of the communication process characterises the

relation that a decision maker involved. For either the States or adjudicators, the ways by which they form their legal opinions and experiences rely on the exchange of information. Given communication is a social activity, the communication process rests on the interaction among the States, adjudicators and other parties. Therefore, the final decision not only the result of the communication of process but also the reflection of the social interaction at dimensional relations.

According to the conceptual framework, the communication process consists of self-realisation, the interaction with the counterparties and the influences of collective understandings in the community. These dimensional relations channel the final decision by either the State or an adjudicator.

Figure 2 The multidimensional communication process for making decisions



Besides the analytical function, another reason for this study proposing the framework is to advance the studies which review the development of international law from the sociological perspective.

For instance, Cho applies the constructivist approach to explain how member State behaviours are shaped by the norms and institutional arrangements under WTO law. He



describes the WTO as constituting a community of world trade, by identifying characteristic features during the exchange of legal opinions between member States in different forums under this institution.<sup>603</sup> Studying the participation of member States in informal meetings, Cho finds that institutional arrangements channel behaviours of the individual members and impact their interaction with each other in pursuit of their interests. The social interactions are materialised by the process of reason-giving and the communication of opinions.<sup>604</sup>

Likewise, Hirsch also explores the social interactions among the arbitration community in international investment law. He not only echoes the importance of communication of opinions but also indicates two principal mechanisms to the communication. One mechanism is the collection of information to support personal choices. Another is the confirmation or denial of choices by colleagues.<sup>605</sup>

These works apply a relatively narrowed sense of social relations to explain the construction of WTO law and international investment law. The social relations they focus on are within individual communities. In specific, Cho focuses on the interaction between member States of the WTO. Hirsch concentrates on the responses of the community of investment arbitrators. While their works illustrate the argumentation and evaluation of legal opinions within a community of subject, they have not explained the interaction between a different community of actors in detail.

What the thesis argues is the communication process not only between different parties but also including the self-recognition and self-realisation. By the linkage

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<sup>603</sup> Sungjoon Cho, *The Social Foundations of World Trade: Norms, Community, and Constitution* (CUP 2015) 101–19.

<sup>604</sup> Ibid, 74–75, 104–05.

<sup>605</sup> Moshe Hirsch, *Invitation to the Sociology of International Law* (OUP 2015) 118–19.

between the personal dimension and social relations, we can understand how the decision is framed by the profiles of adjudicators and the background of the States and the interaction with other parties.

The following sections apply the conceptual framework to explore the process of decision-making by the States and adjudicators separately.

### 6.3.2. The communication process of the decisions by the States: treaty negotiation

Chapter one has discussed that international law originated from the desire of international negotiation relations by sovereign States. Establishing international law is the way to (re)allocate the power relations among the community of nation-states. The purpose of international law, however, is changing to identify accepted state practices and define the boundaries of sovereignty over domestic affairs and international relations. The proliferation of treaties is remarkable for the change in international law.

Given that treaties dominate international law, the process of negotiating a treaty is the primary way that the States made their decisions over the priority of policies at the international level.

While the negotiation of treaties is one of the political decisions by the government, it involves complex and intertwined considerations. There are at least three relations influential to the States' decisions. The three relations include the national political environment of a State, the relation with the treaty parties, and the influences of international society.

#### 6.3.2.1. The communication with the society: the priority of national policies

History of international law shows that the political consideration behind treaty negotiations is changing. At the initial stage, the States negotiating treaties were

primarily for the establishment of the relations with others. The political consideration then is shifting to specific subjects such as economic activities or environmental protection. About economic activities, the focus of treaty negotiations is to boost the economic development of society and upgrade competitiveness in the international market. The changing focus explains trade agreements and BITs becoming the instruments for economic development of a State. Treaty negotiation is not only the means for foreign policies but also part of national policies for economic development.<sup>606</sup> As such, the decision to proceeding treaty negotiation is the decision over the priority of national policies. The decision involves political and economic considerations.

Two points address the political consideration for treaty negotiations. The first point is the allocation of resources of the society. Trade agreements and investment treaties are concerned with the transitions of goods and services and capital flows. The content of a treaty not only defines the boundaries of sovereignty over domestic affairs but also influences economic policies of the society such as the development strategy, industry adjustment and allocation of the economic resource. These factors lead the State to evaluate the necessity and contributions of a trade agreement or investment treaty before proceeding negotiation.<sup>607</sup>

The propriety of policies is not limited to the economic and industrial dimension but also involved constitutional values. Vandevelde has argued that the US–leading BITs largely reflect the political virtue of the American government. The political virtue

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<sup>606</sup> Shayerah Ilias Akhtar and Vivian C. Jones, *Transatlantic Trade and Investment Partnership (TTIP) Negotiations*, Congressional Service Report, Report R4387 (2014) 3.

<sup>607</sup> Timm Betz and Andrew Kerner, 'The Influence of Interest: Real US Interest Rates and Bilateral Investment Treaties' (2015) 11(4) *The Review of International Organizations* 419–48; Jürgen Kurtz, *The WTO and International Investment Law: Converging Systems* (CUP 2016) 27.

is a liberal political philosophy. He analyses the history of the investment treaties concluded by the American government since the FCN era. He found that the US BITs are concerned with the principles of due process, the requirement of transparency and the rule of law. These principles are essential to liberal political ideology. He explains the close relation reflecting that the American government believes that these liberal principles are fundamental to the democratic way of life. As such, the American government insisted on incorporating these liberal political principles in the treaties concerning economic activities.<sup>608</sup>

The priority of national policy in the American government is experiencing several changes. First, the priority is shifting to the concern of environmental protection and other social issues. The change in the priority of policies also leads the American government to modify its Model BIT to integrate the provisions regarding public policy and general exceptions. Second, the concern of trade deficits changes the priority of US' foreign policies on trade agreements and investment treaties. Trade deficits explain why the Trump Administration has proceeded a series of renegotiations of US free trade agreements with other countries such as Japan, China and the treaty partners of the NAFTA.<sup>609</sup>

The American government's action threatens the trade relations with its trade allies such as Russia, Mexico, Canada and the EU.<sup>610</sup> While several countries are proceeding the renegotiation of trade agreements with the American government after the US's

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<sup>608</sup> Kenneth J. Vandeveld, *The First Bilateral Investment Treaties: U.S. Postwar Friendship, Commerce, and Navigation Treaties* (OUP 2017) 19–20.

<sup>609</sup> M. Angeles Villarreal and Ian F. Fergusson, 'CRS Report: NAFTA Renegotiation and Modernization', 27 February 2018, available at <<https://fas.org/sgp/crs/row/R44981.pdf>> accessed 10 April 2019; James K. Jackson, 'CRS Report: Trade Deficits and U.S. Trade Policy', 28 June 2018, 1, available at <<https://fas.org/sgp/crs/row/R45243.pdf>> accessed 10 April 2019.

<sup>610</sup> The New York Times, 'White House to Impose Metal Tariffs on E.U., Canada and Mexico' (31 May 2018), available at <<https://www.nytimes.com/2018/05/31/us/politics/trump-aluminum-steel-tariffs.html>> accessed 10 April 2019.

tariff threat, including the EU, Canada, Mexico, Norway, Switzerland and those countries that faced 25 per cent tariffs on steel and 10 per cent on aluminium, have initiated WTO dispute complaints against US arbitrary steel and aluminium duties.<sup>611</sup>

Another point is the political environment. Two dimensions usually shape the political environment. One dimension is the political pressure from interested parties such as industry groups and civil societies. Opinions of these groups sometimes influence the negotiation issues of a treaty and the priority. The pressure is reflected in the incorporation of the provisions concerning the protection of intellectual property rights, the concern of labour rights and the protection of food safety and public health. The second dimension is about the relationship between governmental departments. The tension between the executive and legislative departments, in many situations, is decisive to the progress of treaty negotiation and the enforcement of the treaty.

In general, a more complicated and ambitious a treaty is, the more intensive political pressures the government confronts. For instance, at the early stage of negotiation of the *Comprehensive and Progressive Agreement for Trans-Pacific Partnership* (CPTPP, the successor of the TPP) the policy ambition as a model for a new generation of regional trade agreement was reflected in the content of thirty chapters. These chapters covered the issues ranging from market access (such as the elimination of tariff and non-tariff barriers) to specific trade-related issues (including labour and environment standards and regulatory issues). Especially the regulatory issues targeted the transparency of standard-setting procedures and the policy-making

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<sup>611</sup> This trade war might not cease in the foreseeable future, because the American government decided to fight back by launching five dispute claims to challenge retaliatory tariffs imposed by China, the EU, Canada, Mexico and Turkey. WTO News, 'United States initiates dispute complaints against five members over duties on US products' (WTO, 19 July 2018), available at <[https://www.wto.org/english/news\\_e/news18\\_e/ds557\\_to\\_561rfc\\_19jul18\\_e.htm](https://www.wto.org/english/news_e/news18_e/ds557_to_561rfc_19jul18_e.htm)> accessed 10 April 2019.

of national policies such as sanitary and phytosanitary measures and anti-corruption. The wide range of issues indicates the ambition of this Treaty to provide comprehensive and high standards for trade and investment liberalisation.<sup>612</sup>

The broad and ambitious content, however, raises challenges to these countries whose regulatory systems are not as reliable and comprehensive as those in developed countries such as the U.S. These countries could face huge administrative, political and legislative costs in adjusting and reforming local regulations in order to implement their obligations under this Agreement.

These points highlight the importance of communication between the government and the public. While the government has the authority to decide the strategy of foreign policy and economic development, it must communicate the policy choices with society.

However, the experiences show that the government either neglected the importance of communication with the society or took insufficient actions to persuade society to accept its treaty negotiation plan. The feature of confidentiality still dominates the negotiation process of trade agreements and investment treaties. For example, in the policy assessment report for the US Congress, the Administration directly stated that the US–EU negotiations on the *Transatlantic Trade and Investment Partnership* (TTIP) are not public. All information and analysis in the policy paper relating to the negotiation issues only include the ‘publicly available’ information.<sup>613</sup> The statement implies that the ‘public information’ is incomplete.

The public has questioned the lack of transparency and public participation in the negotiation of economic agreements constituting the constitutional crisis. In some

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<sup>612</sup> Ian F. Fergusson, Mark A. McMinimy, and Brock R. Williams, *The Trans-Pacific Partnership (TPP): In Brief*, Congressional Service Report, Report R44278 (2015) 3.

<sup>613</sup> Shayerah Ilias Akhtar and Vivian C. Jones (n 639) 2.

countries, the constitutional issue of treaty negotiation even results in the political crisis for the ruling government and changes national politics.<sup>614</sup> The constitutional crisis threatens the feature of confidentiality of the negotiation of trade agreements and investment treaties.

#### 6.3.2.2. The communication with treaty parties

The second dimension of relations is the relationship between the parties to a treaty. The treaty relationship is like a contractual relation between the signatory States because the content of the treaty rests on the commitments made by the Contracting States to each other.

The contractual relationship has a two-fold meaning for the communication between the treaty parties. First, before and during the proceedings of negotiation, the contractual relationship between the negotiating States is their interaction concerning political and economic issues. The interaction depends upon the international politics and the economic power of the States, as part of the social relations of the States. The economic and political relations can channel the States to proceed with the decision over trade negotiation. These considerations not only direct the State to target the potential treaty party, to make the strategy for trade negotiation but also to decide the

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<sup>614</sup> In the early of 2014, when the Cross-Strait Agreement on Trade in Services, which was part of the Economic Cooperation Framework Agreement between Taiwan and China, was in the ratification process in the Taiwan legislature, this agreement raised and initiated a large-scale student protest (also known as 'Sunflower student movement'). A major reason for the protests was the confidential negotiation of this agreement. However, the ruling government at that time tried to convince the public by two points. First, the nature of this agreement was a trade agreement. It was irrelevant to and did not involve sensitive political issues. Second, it is an international custom that the negotiation of trade agreements is non-disclosure to the public before submitting to the legislature to ratify. Nevertheless, the protesters were afraid that this kind of economic agreement would allow China to gain greater political control over Taiwan due to the asymmetric political and economic powers between the two regions. This protest lasted one month and changed Taiwan's politics. The ruling party eventually lost its control in the mayoral election in the end of 2014. In the following general election in 2016, several leaders of this protest were elected and still have still considerable influence on domestic politics at present.

negotiation issues. Because of the absence of the institutional framework, the state–state communication is not merely the exchange of opinions but also the battle of economic and political powers between the States.

Another meaning is the legal relationship between the States when they conclude a treaty. At this stage, the treaty relation transforms the social interaction between the treaty parties to a legal binding relation. The treaty parties are bound to the arrangement of rights and obligations that define the boundaries of sovereignty–restriction. Their political influences are also constrained by the creation of institutions for the administration of the treaty and dispute settlements. As such, the content of a treaty is the decision made by both the Contracting States which tended to formalise and regularise their interactions.

The focus of this section is the stage at which the States are preparing to proceed with a treaty negotiation. It aims to picture how the international relationship between the States influences the States' decision over treaty negotiation.

International economic agreements (i.e. trade agreements and investment treaties) have accelerated economic interdependence between the States in the last decades. The efforts of these economic agreements lead international society into the globalisation era. The strong economic relation, however, also relies on the stable politics of international society.

Given the intertwined relation between economic and political relations, the decision of the negotiation of investment treaties and trade agreements involve the economic and political considerations by the States.

With regard to economic considerations, there are two points critical to the negotiation of investment treaties and trade agreements. The first is to consolidate the



existing economic interests and economic relations. The second is to open new markets by creating new economic relations. While two purposes are correlated, treaty practice shows that the concern of deepening economic integration is weighted more. It means that countries prefer to negotiate economic agreements with their major trade partners or the countries that had a close economic relationship. As such, the complexity of a trade agreement to a large degree often reflects the scale of economic activities and trade transitions between the States, as well as the complexity of the economic relations that participating countries are expecting to achieve.<sup>615</sup>

The negotiation of trade agreements and investment treaties also involves the political considerations by the participating States. Political considerations provide explanations for the situation that a State decided to negotiate agreements with counterparties that are minor trading partners. Influenced by the political considerations, investment treaties and trade agreements have turned to the instruments to secure strategic objectives of a State on its foreign policy.<sup>616</sup> As such, negotiating trade agreements and investment treaties are no longer under an economic–preference idea but including political aspects.

For instance, it is familiar to the American government to adopt the strategic thought to evaluate the economic and political implications of treaty negotiation. The conclusion of US–Israel and US–Jordan FTAs was aimed to consolidate the political influence of the American government in the Middle East, while Israel and Jordan were not the US’s top trade partners.<sup>617</sup> The desire of sustaining its political influences in the

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<sup>615</sup> William H. Cooper, *Free Trade Agreements: Impact on U.S. Trade and Implications for U.S. Trade Policy*, Congressional Service Report, Report RL31356 (2014) 2.

<sup>616</sup> Ann Capling, ‘Preferential Trade Agreements as Instruments of Foreign Policy: An Australia–Japan Free Trade Agreement and Its Implications for the Asia Pacific Region’ (2018) 21(1) *The Pacific Review* 27, 28.

<sup>617</sup> Howard Rosen, ‘Free Trade Agreements as Foreign Policy Tools: The US–Israel and US–Jordan FTAs’

Asian region also stimulated the American government to participate in and lead the negotiations of the *Trans-Pacific Partnership Agreement* (TPP), while the Trump administration decided to withdraw from the TPP.

Ann Capling also discloses the political intentions behind the negotiation of the *Australia–Japan Trade Agreement*. She argues that the primary goal of this Agreement is to create a closed relationship between Australia and Japan.<sup>618</sup> The political intention is evident by the scale of market access under this Agreement is not as expanded as expected, according to the level of economic development between the two countries. Ann believes that Australia and Japan both are desired to reserve their political interests in the Asia–Pacific region by increasing the number of allies. In other words, what the *Australia–Japan Trade Agreement* is concerned is political implications rather than economic contributions.

The influences of political considerations are more critical in recent years. It is evident by the expansion of the scale of political considerations from the bilateral aspect to the regional dimension. The assessment of the political implications of a treaty also shifts from the interaction between the participating States to a geo–economic and geopolitical aspect. The geo–economic and geopolitical concern explains the rise of mega–regional trade agreements or economic partnership agreements.

The cooperation and competition between old economic bodies and new trading blocs is the main reason for the negotiation of regional economic agreements.<sup>619</sup>

The countries in North American and western Europe constituted several major

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in Jeffrey J. Schott (ed), *Free Trade Agreements: Us Strategies and Priorities* (Peterson Institute for International Economics 2004) 51.

<sup>618</sup> Ann Capling (n 650) 31–36.

<sup>619</sup> Michael J. Green & Matthew P. Goodman, ‘After TPP: The Geopolitics of Asia and the Pacific’ (2015) 38(4) *The Washington Quarterly* 19, 22–28; Philippe Martin, Thierry Mayer and Mathias Thoenig, ‘The Geography of Conflicts and Regional Trade Agreements’ (2012) 4(4) *American Economic Journal: Macroeconomics* 1, 26–30.

regional economic bodies in the world, dominating the global market and international politics. Rising new trading blocs such as Russia, China and several countries in South America, however, are threatening their dominating positions. The competition and cooperation between these regional trading blocs explain the development of regional and cross-regional trade agreements.

The EU has made efforts to strengthen its cross-regional relationship with Asian and Pacific countries. For instance, it is actively negotiating investment treaties and trade agreements with Mercosur states (Argentina, Brazil, Paraguay and Uruguay). The EU also concluded investment treaties with certain Asian countries such as Japan and Singapore.

Before withdrawing from the negotiation of the TPP, the reason for the American government joining the TTP is to maintain U.S. geopolitical interests in the Asia-Pacific region. The ruling government at that time believed that leading the negotiation of the TPP would be in favour of crafting global trade rules in the Asia-Pacific region.<sup>620</sup> By this way, the American government and its allies could compete with the growing power of China. The competition of regional economic blocs also stimulated the America government to negotiate the TTIP with the EU. It aimed to strengthen their existing relationship between the two regions in order to confront the challenges of the competition from new trading blocs, especially Russia and China.<sup>621</sup>

As the new trading bloc in the global market, China has promoted a series of bilateral and plurilateral economic cooperation agreements negotiated with Asian countries. Except for the 'one-belt-one-road' policy, one of its ambitious projects

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<sup>620</sup> Ian F. Fergusson et al. (n 646) 3.

<sup>621</sup> Shayerah Ilias Akhtar and Vivian C. Jones (n 639) 6.

is the creation of the *Asia–Pacific Free Trade Area* (FTAAP).<sup>622</sup>

The tension between these regional blocs and leading countries will be accelerated by the proposal of new regional agreements, such as the *Regional Comprehensive Economic Partnership* (RCEP) led by APEC countries.

#### 6.3.2.3. The influence of collective understandings of international society

The third dimension is the influence of international society. The influence mainly relates to the ideas of substantive rules and the design of institutional capability.

Chapter one has addressed this issue. The thesis takes from the historical perspective to argue that the changing political ideologies are critical to the evolution of international investment law and trade law. Political ideologies are the collective understandings of society.

Chapter one identifies neoliberalism and sustainable development policies having dominated the change of international law. The shift of political ideologies remarks the changing understandings of the role of government on the market and international economic order over time. In the last decade, the rise of sustainable development policies is driving international investment law and trade law toward the reservation and expansion of the boundaries of sovereignty.

#### 6.3.3. The communication process of the decisions by adjudicators: treaty interpretation

As to international adjudication, the decision made by the adjudicators primarily reflects on the interpretative choices and the resolution for a dispute. Like the process of treaty

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<sup>622</sup> Yong–Shik and Kwangkug Kim, ‘Tripartite Free Trade Agreement among China, Korea, and Japan: A Step towards Economic Integration in Northeast Asia?’ in Jiaxiang Hu and Matthias Vanhullebusch (eds), *Regional Cooperation and Free Trade Agreements in Asia* (Brill 2014) 126–30, 135–38.

negotiation by the States, the process of treaty interpretation by adjudicators involves three dimensions.

The first dimension is about the interaction with other colleagues within the same community. The connection is vital for an adjudicator and tribunal to establish its legal opinions. The reference of legal opinions of previous cases exemplifies the interaction within the community of adjudicators. The second dimension is about the interaction between adjudicators and legislative States. It commonly exists in search of the intention of the Contracting States to a treaty. The third dimension is the interaction between adjudicators and people outside of the legal regime. Non-disputing parties, non-treaty parties and other adjudicative communities are all outsiders in this respect. The communication is usually channelled by judicial borrowing between international court and tribunals, as well as by the third-party submissions and amicus briefs. The following sections address these dimensions respectively.

#### 6.3.3.1. The dialogue within the same community: the principle of precedent

The practices of investor-State arbitration and WTO disputes share a situation in terms of treaty interpretation.<sup>623</sup> Investment arbitrators and WTO adjudicators are used to referring to legal opinions of precedent cases to affirm the interpretation results. Therefore, commentators argue that investment arbitrators and WTO adjudicators have established a *de facto* principle of precedent to different degrees.

Nevertheless, neither investment treaties nor WTO law applies the principle of precedent. It means that investment arbitrators and WTO adjudicators are not bound to precedents as the doctrine of *stare decisis* suggests.

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<sup>623</sup> See the analyses of chapters two and three.

The principle of precedent is developed in common-law systems. A common law system relies on court decisions to form the body of law, as opposed to a civil law system whose law is formed through statutes or written legislation. Given the lack of statutory laws, the principle of precedent requires the lower courts to follow the decisions of the higher courts in order to maintain the stability and predictability of the common law system.

While the international law system is similar to the common law system that lacks federal regulations, it does not apply the principle of precedent to international adjudication. The main reason is that there is no hierarchy between international courts and tribunals.<sup>624</sup> Moreover, the majority of international dispute settlements is completed in one instance. It is a rare situation that international adjudication contains two or more levels in one branch of international law. Because of the different framework for judicial review, the principle of precedent is not applied to international law. The jurisprudence of investor-State arbitration is no exception.

The WTO dispute settlement mechanism is an opposite case for the institutions of third-party adjudication. The WTO provides the two-layered adjudicative procedures and authorities with the Appellate Body the power to manage the consistency of legal opinions of WTO law. Moreover, the WTO consists of a series of the multilateral agreement which formed statutory regulations for all member States. The two features (appellate review and multilateral conventions), in theory, provide the grounds for the principle of precedent.

WTO adjudicators are cautious of creating an impression of the application of the principle of precedent. They repeatedly highlight that legal opinions of previous cases

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<sup>624</sup> Ruth Mackenzie, Yuval Shany and Philippe Sands, *Manual on International Courts and Tribunals* (Butterworths 1999) 94–99.

are only cited for their persuasive effects and do not bind future cases.<sup>625</sup> While WTO adjudicators recognise the principle of precedent having the merit of consistent legal interpretations, they are aware that the WTO dispute settlement mechanism is not a supranational institution. The disputing States only binds the result of a dispute, not for other non-disputing member States, neither by the future panels.

While the reference of legal opinions of previous cases is the condition of the principle of precedent, the practice does not mean that the principle of precedent is applied. Therefore, we must be cautious of the effects caused by the *de facto* precedent in investor-State arbitration and the WTO dispute settlement mechanism.

This study instead reviews the practice of *de facto* precedent from the communication perspective. It argues that the reference to previous cases is the ways that adjudicators communicate with others in a dispute settlement mechanism. The institutional framework constitutes the social context for the adjudicators as a community of professionals. In the social context, they can exchange legal opinions and experiences with each other and shape the collective understandings. The repeated reference of legal interpretations is an example.

In the WTO dispute settlement mechanism, panels are not only communicating with other their peers but with the Appellate Body. Because of the supervision authority of the Appellate Body, the communication between panels and the Appellate Body is the primary source for the standard answer to the application of WTO law. The reason for the effectiveness of communication is the revising power of the Appellate Body. The revising power enables the Appellate Body to indicate what the right answer to

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<sup>625</sup> Stephan W. Schill, 'Crafting the International Economic Order: The Public Function of Investment Treaty Arbitration and Its Significance for the Role of the Arbitrator' (2010) 23(2) *Leiden Journal of International Law* 401, 414.

legal issues. It creates the function of correction of legal interpretations in the WTO jurisprudence, as this study discusses in chapter four.

While panels enjoy the discretion to develop possible interpretations, their ‘different opinions’ could be revised by the Appellate Body. In some situations, the Appellate Body might confirm the interpretations of the panel whether the revision or confirmation in the appellate review is the signals to the future panels. The future panels are aware of what the accepted interpretation is and inclined to follow the instructions of Appellate Body to avoid revisions. In the end, the path–dependence effect merges the divergence of legal opinions between panels and the Appellate Body.

Opposed to the WTO dispute settlement mechanism, international investment law lacks a supervision institution for arbitral awards. Given the lack of supervision institution, there is no hierarchy between arbitral tribunals. Arbitral tribunals are independent of each other. The independence, however, results in the divergence of legal opinions and the diversity of institutional identity. The flexibility of legal interpretations raises the question of whether there is shared legal opinions in the community of investment arbitrators.

The analyses of the balancing approach in previous chapters disclose that reference of legal opinions of previous cases is also common to investment tribunals. The repeated reference results in the emergence of leading cases on specific issues. As analysed in chapter two, the legal issues include indirect expropriation, the fair and equitable treatment and the scope of the MFN treatment to dispute settlement provisions.<sup>626</sup> Several arbitral awards also become the leading cases for the balancing approach such as the awards of *Tecmed v. Mexico*, *Saluka v. Czech Republic* and *El Paso v. Argentina*.

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<sup>626</sup> Ibid, 415.



The existence of leading cases to a certain extent favours the consistency of legal opinions among the community of investment arbitrators.

However, the effects are debatable. The main reason is institutional sensitivity. Some tribunals believe that the primary mission of investment tribunals is to resolve the present dispute between the disputing parties. They pay little attention to the issue of whether their legal interpretations and decisions might influence future disputes.<sup>627</sup> Other tribunals are aware of this issue in a series of consistent cases, while they agreed that the principle of precedent does not apply in investor–State arbitration. The tribunal in *Churchill Mining v. Indonesia*<sup>628</sup> expressed systematic concerns.<sup>629</sup> It held that ‘[i]t must contribute to the harmonious development of investment law, to meeting the legitimate expectations of the community of States and investors towards certainty of the rule of law’.<sup>630</sup> The statement demonstrates that through treaty interpretation, arbitrators exchange their understandings with their colleague in the same community, as well as with the community of States.

While the debate remains, it is no doubt that the reference of previous cases creates communication between investment arbitrators. While the path–dependence effect of investment arbitrators is not as strong as the interaction between WTO panels and the Appellate Body, it at least sheds lights on the shared understandings in the community of arbitrators. In this respect, the thesis argues that the communication function is paving the way of the consistency of legal opinions in decentralised systems such as

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<sup>627</sup> *Romak S.A. (Switzerland) v. The Republic of Uzbekistan* (‘*Romak v. Uzbekistan*’), UNCITRAL, PCA Case No. AA280, Award, 26 November 2009 (Fernando Mantilla–Serrano, Noah Rubins, Nicolas Molfessis) para 171.

<sup>628</sup> *Churchill Mining PLC and Planet Mining Pty Ltd v. Republic of Indonesia* (‘*Churchill v. Indonesia*’), ICSID Case No. ARB/12/14 and 12/40, Decision on jurisdiction, 24 February 2014 (Gabrielle Kaufmann–Kohler, Michael Hwang, Albert Jan van den Berg).

<sup>629</sup> *Ibid.*, para 85.

<sup>630</sup> *Ibid.*

investor–State arbitration.

#### 6.3.3.2. The communication with the States and disputing parties: the intention of ‘parties’

Another relation involved in international adjudication is the relationship between adjudicators and disputing parties. In the adjudicative proceedings, third parties to the dispute are also the parties that interacted with the adjudicators.

One thing needs to be clarified. The interested parties that the adjudicators interacted in the adjudication process are not limited to the nation–states. The equation between the disputing parties and the Contracting States to a treaty is changing.

In the conventional international law, the disputing parties are limited to the signatory States to the treaty. This is because the state–centric scenario concerns nation–states are dominating international law. The States are the subject and object of international law. Therefore, only the States are entitled to the right to access international adjudication. The function of international adjudication is for resolving the dispute between the States.

Along with the mounting position of individuals and the growing power of multinational companies, the engagement of private parties is also critical to the construction of international law. As the thesis analyses in chapter one, the change of international law results in the expansion of international adjudication for the dispute between private parties and the States. Investor–State arbitration is an example. The private–public dispute breaks the assumption that the disputing parties are the treaty parties, i.e. the signatory States.

If the States are no longer the primary parties to initiate the adjudicative proceedings, the disputing parties of an international adjudication case might be

different from the Contracting States to the treaty. In other words, it is necessary to distinguish the treaty parties from the disputing parties, depending upon the nature of international dispute settlement mechanisms.

The division between the treaty parties and the disputing parties raises an issue. The issue is whether the intentions of the Contracting parties are still primary to adjudicators in the interpretation and application of a treaty or not.

In general situations, international adjudication is the mechanism of settling the dispute raising out a treaty. Except for the consent of the disputing parties, the commencement of an international adjudication case must be relevant to the violation of specific treaty obligations or rules. Therefore, international adjudication has two-fold functions: treaty interpretation and dispute resolution.

According to the interpretative rules of the Vienna Convention, the primary principle of treaty interpretation is to identify the intentions of the Contracting States to a treaty. In the context of the state-state dispute settlement mechanism, the disputing parties are the Contracting States to the treaty. Because of the overlap between the treaty parties and the disputing parties, the process of identifying the intentions of the Contracting States by the adjudicators is also the process of considering the intentions of the disputing parties.

As the primary institution for the disputes between member States of the United Nations, the International Court of Justice (ICJ) has explained that interpreting an instrument must be according to the intentions of the 'parties'. It announced in several cases that the intentions of the parties are the necessary basis of evolutionary

interpretation.<sup>631</sup> While the ICJ did not clarify which party is ‘the parties’ it referred, there is no question that the parties are the States interested in the treaty at issue.

The WTO dispute settlement mechanism also only serves to the disputes raising out between the member States of the WTO. The institutional context, on one side, clarifies the function of WTO adjudicators as the management of legal interpretation of WTO provisions. On the other side, the function of WTO adjudicators is to adjust the relationship between Member States which is infringed by inconsistent trade measures. Article 3.2 of the DSU highlights that the rulings of WTO adjudicators ‘cannot add to or diminish the rights and obligations provided in the covered agreements’.

The two requirements implicate that the disputing parties of the WTO adjudication process are the treaty parties to the WTO. The primary concern of WTO adjudicators in the decision-making is how to interact with the Member States.

In the context of state-state dispute settlement, the interested parties that WTO adjudicators are required to respond is simplified to the nation-states. While WTO adjudicators primarily interact with the disputing parties, their decisions are also the response to other Member States of the WTO as a whole. The final decision is not only the balance of the interests between the disputing parties but also the balance of rights and obligations among all member States.

In the context of the private-state disputes, the parties involved in the adjudication process is not limited to the nation-states. The interested parties divide into two groups. One group is the Contracting States to the treaty; another group is the disputing parties

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<sup>631</sup> *Land and Maritime Boundary between Cameroon and Nigeria (Cameroon v Nigeria: Equatorial Guinea intervening)* (Judgment) [2002] ICJ Rep 303, 346; *Aegean Sea Continental Shelf (Greece v Turkey)* [1978] ICJ Rep 3, para 77; *Gabcikovo-Nagymaros Project (Hungary v Slovakia)* (Judgment) [1997] ICJ Rep 7, para 142; *Navigational and Related Rights (Costa Rica v Nicaragua)* (Judgment) [2009] ICJ Rep 213, para 63; *Pulp Mills on the River Uruguay (Argentina v Uruguay)* (Judgment) [2010] ICJ Rep 14, para 204.

by which one party is not the signatory States. For instance, the investor–State arbitration is about the dispute between foreign investors and the host government which is one of the treaty parties to the BIT.

The division between the treaty parties and the disputing parties raises the issue of whose intentions are decisive to adjudicative decisions.

While the nature of investor–State arbitration and the WTO dispute settlement mechanism is different, the two dispute settlement mechanisms share the function of depoliticising the influences of the Contracting States on the adjudicative proceedings. Therefore, the legitimacy of investor–State arbitration rests on the States consent to the creation of investor–State dispute settlement provisions. In this respect, the intentions of the States to the treaty are the primary concern of arbitrators’ decision–making.<sup>632</sup>

On the other hand, investor–State arbitration is learned from the model of commercial arbitration. The commencement of the arbitration proceedings must base on the consent by disputing parties. The consent of the disputing parties has a two–fold meaning. First, it means the parties have the intention of entering into a third–party adjudication procedure. Second, it means that the parties agreed to accept and be bound to the final decision. The dual meaning of the parties’ consent constitutes the underlying principle of international adjudication and arbitration, the principle of party autonomy. It means that the disputing parties enjoy the freedom to choose the law applicable to the arbitration procedure and the disputed issues. The applicable laws could be irrespective of the treaty at issue.<sup>633</sup> Because of the principle of party autonomy, the intentions of

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<sup>632</sup> Eirik Bjorge, *The Evolutionary Interpretation of Treaties* (OUP 2015) 56.

<sup>633</sup> José E. Alvarez, ‘Is Investor–State Arbitration ‘Public’?’ (2016) 7(3) *Journal of International Dispute Settlement* 534, 551.

the disputing parties are also vital to the arbitration proceedings.

Given the complexity of the subject, it is still debatable about the extent to which investor–State arbitrations is different from commercial arbitrations and applied to the public law analogy.

The debate, however, is not as severe as expected from the communication perspective. Whatever the scope of the interested parties, the adjudication process channels the communication of legal opinions between these parties and adjudicators. The course of searching the intention of parties is the process of identifying legal issues. But more importantly, it channels adjudicators to communicate their understandings with the disputing parties and with the Contracting States. In other words, the communication scenario merges the division between the treaty parties and the disputing parties. The intention of the treaty parties and the intention of the disputing parties are both of the materials that international adjudicators need to consider and respond to in the written reasoning.

On the concern of the communicative function, adjudicators are required to provide the reasoning to explain their decisions. The reasons include which elements are concerned in the decision–making, the selection of evidence to review the disputing parties’ assertions, and how they confirmed the final decisions not beyond the intentions of the Contracting States to the treaty. The reasoning is the information that disputing parties rely on to assess the rationality and quality of the decision. They can decide whether or not to challenge the result through the procedures of recognition and enforcement. The reasoning is also essential to the Contracting States. They can decide whether are they need to take political and legislative actions in response to legal interpretations by the adjudicators. This thesis will deepen the discussion of the duty of reason–giving by the adjudicators in the final part.

#### 6.3.3.3. The interaction with outsiders: judicial borrowing and *amicus curiae*

In the adjudication process, there is another relation what adjudicators involved. The last but not the least relation rests on the interaction between the adjudicators and the outsiders. The outsiders refer to the people either foreign to the dispute or outside of the community of the adjudicators in their domain.

In chapter five, the study has categorised the scope ‘third party’ to the international adjudication as two groups: non-disputing parties and non-treaty parties. The division is not necessary for international adjudication but depending upon the nature of international disputes and the structure of the adjudicative proceedings. For instance, investor-State arbitration has not been entirely opening the arbitration procedures to non-disputing parties. On the contrast, the WTO dispute settlement mechanism paves the way for the engagement of non-disputing member States and non-treaty parties in the adjudication procedure. However, WTO adjudicators enjoy the discretion to decide whether the opinions from the non-treaty parties such as civil society and NGOs will be concerned in the decision-making. This section advances the engagement of third parties in international adjudication from the communicative perspective.

Here this study argues that the procedures for the third-parties’ participation are vital to the decision-making of adjudicators. These procedures channel the communication between adjudicators with the ‘outsiders’. Two points support this argument: the *amicus curiae* procedure and judicial borrowing of experiences from other international adjudicative authorities.<sup>634</sup>

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<sup>634</sup> Laurence Boisson de Chazournes, ‘Plurality in the Fabric of International Courts and Tribunals: The Threads of A Managerial Approach’ (2017) 28(1) *European Journal of International Law* 13, 31.

*Interaction with other international courts and tribunals*

It is a common practice that international adjudicators refer to legal opinions or interpretative approaches developed by other international authorities when interpreting treaties. Commentators also argue that cross-reference of legal opinions as the trend of the proliferation of international adjudication.<sup>635</sup>

The Vienna Convention recognises the cross-reference of legal opinions as one of the interpretative approaches. It is codified by Article 31(3)(c) by ‘the relevant rules of international law applicable in the relations between the parties’. While this paragraph does not indicate that the ‘relevant rules of international law’ include the practice of international courts and tribunals, Kurtz believes that this is the ground of judicial borrowing. International tribunals and courts are encouraged to talk with each other and pay attention to juridical exchange.<sup>636</sup>

While investment treaties and WTO law share certain legal principles and interpretative approaches, the exchange of legal opinions between the two jurisprudences is not as active as expected. The study finds that the interaction between investment arbitrators and WTO adjudicators has not reached the level of judicial borrowing. The practice is instead more like a one-way direction.

The finding of the limited interaction between investment arbitrators and WTO adjudicators echoes the view of chapter five in terms of the openness of the two dispute settlement institutions. The openness of investor-State arbitrations leads investment tribunals more willing to consider experiences of other authorities. The WTO jurisprudence is one of the reference points. By contrast, WTO adjudicators are rare to

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<sup>635</sup> Benedict Kingsbury, ‘Foreword: Is the Proliferation of International Courts and Tribunals A Systemic Problem?’ (1999) 31 *International Law and Politics* 679; Chester Brown, *A Common Law of International Adjudication* (OUP 2007) 15–33.

<sup>636</sup> Jürgen Kurtz (n 640) 26.



mention or adopt the experiences of investor–State arbitration in WTO cases. The self–reference of legal interpretation within the WTO system creates the impression of a self–contained system.

The attitude of disputing parties is also the reason for the one–way–reference of legal interpretations between investment arbitrators and WTO adjudicators. In comparison to investment treaty disputes, disputing parties of WTO cases are not used to invoke legal tests or interpretations developed by other international tribunals, including investor–State arbitration, to support their assertions. As such, WTO adjudicators lack incentives to make judicial borrowings from the arbitration community. Moreover, the strict *de facto* precedent principle of the WTO jurisprudence also reduces the incentives of WTO panels on judicial borrowing. In the *US–Steel (Mexico)* case, the Appellate Body had articulated the *de facto stare decisis* of previous panels and its reports once adopted by the DSB.<sup>637</sup> The powerful and guiding effects of previous reports not only apply to the parallel relation between WTO members and WTO adjudicators but also apply to the vertical relation between panels and the Appellate Body. The heavy reliance and respect of the legal opinions of previous reports also are indicative of the conservative attitude of WTO adjudicators on communication with other communities.

Commentators suggest other explanations to the limited cross–reference between the two jurisprudences. Kurtz criticises the limited judicial borrowing of WTO jurisprudence in investor–State arbitration as the result of misuse of WTO law by arbitral tribunals.<sup>638</sup> He takes the *Occidental* and *Methanex* cases, for example, to

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<sup>637</sup> Appellate Body Report, *US–Steel* (n 370), paras 158–62.

<sup>638</sup> Jürgen Kurtz, ‘The Use and Abuse of WTO Law in Investor–State Arbitration: Competition and Its Discontents’ (2009) 20 *European Journal of International Law* 749, 751.

illustrate how inadequate knowledge of tribunals concerning WTO law and jurisprudence leads to the inconsistency of legal tests in investment treaty awards.<sup>639</sup>

Howse and Chalamish take the opposite position. They question whether Kurtz had underestimated the difference in character between the WTO law system and investment treaties. As such, they argue that interpretive methods mainly cause the inconsistency of legal tests and interpretations by arbitral tribunals.<sup>640</sup>

On the other hand, DiMascio and Pauwelyn raise caution about the size of the inherent differences between the two regimes. They instead take a moderate attitude. They acknowledge the different objectives of WTO law and investment treaties making direct judicial borrowing inappropriate.<sup>641</sup> What they argue is two regimes sharing common grounds that justify judicial borrowing by tribunals. The shared issue between the two regimes regarding national treatment is ‘to eliminate discrimination against foreigners without encroaching too far upon domestic regulatory sovereignty’.<sup>642</sup>

The discussion reveals the internal dilemma of the duality logic between similarities and divergences. While judicial borrowing is aimed to reduce differences, the differences inherent to the treaties and institutional functions would hinder its function.

Nevertheless, from the communicative perspective, judicial borrowing is not aimed to unify legal interpretations or converge the texts. Instead, it is a way to construct legal interpretations and decisions. The purpose of communicating with other adjudicative communities is to collect information to support interpretative approaches,

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<sup>639</sup> Ibid, 770.

<sup>640</sup> Robert Howse and Efraim Chalamish, ‘The Use and Abuse of WTO Law in Investor–State Arbitration: A Reply to Jürgen Kurtz’ (2010) 20 *European Journal of International Law* 1087, 1088–89.

<sup>641</sup> Nicholas DiMascio and Joost Pauwelyn, ‘Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?’ (2008) 102 *American Journal of International Law* 48, 81.

<sup>642</sup> Ibid, 89.

to justify interpretation results, and to evaluate the validity of counter-opinions. In this respect, unification of legal interpretations is one of the probabilities of the communication process rather than the end.

### *Interaction with non-disputing parties*

Another dimension of the interaction between adjudicators and the outsider is the participation of non-disputing parties.

Non-disputing parties usually participate in international adjudication for one or two reasons. They either attempt to defend the direct interests of interested parties to a dispute or to argue broader public interests influenced by a case. The two situations both aim to raise the issues that might not be asserted by the respondent States due to tactical considerations.<sup>643</sup> In some situations, submissions through the third-party or the amicus curiae procedures are against the respondent State's position and to pursue broader public interests, whereas they usually are in favour of the exercising State. In other situations, the submission from outsiders is to provide factual and legal information to bring a fresh and relevant perspective in the adjudication process.<sup>644</sup>

Whatever the motivations behind the submission, from the aspect of communication of legal opinions, these submissions channel international adjudicators to acknowledge, exchange and communicate opinions with people outside of their domains.<sup>645</sup>

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<sup>643</sup> Farouk El-Hosseny (n 453) 134.

<sup>644</sup> This is the viewpoint that the International Institute for Sustainable Development (IISD) in its amicus brief argued before the *Methanex* tribunal in light of the necessity of amicus participation. *Mexthanex v. United States*, Decision of the Tribunal on Petitions from Third Persons to Intervene as Amici Curiae, 15 January 2001, para 5.

<sup>645</sup> The concern of public interests in investor-State arbitration is one of the reasons that the *Methanex* tribunal considered the amicus submission. In its reasoning, '[t]here is an undoubtedly public interest in this arbitration.... The public interest in this arbitration arises from its subject-matter, as powerfully

The communication between adjudicators and outsiders reflects on three places: (i) the assertions by third parties respecting the dispute; (ii) adjudicators' reactions to the amicus submission; and (iii) the relevance of the amicus submission to final decisions.

The communication proceedings, however, depend upon the response of international adjudicators and disputing parties. The communication might cease because international tribunals rejected amicus submissions at the first stage or not have actual adoption in the final decisions. This situation is evidence of the WTO jurisprudence. Commentators have found that WTO adjudicators tend to restrict the relevance of amicus submissions to the factual analysis rather than the legal analysis.<sup>646</sup> It is also evidence of the recent panel report involving Australia's tobacco packing measures.<sup>647</sup> The relevance of opinions of amicus submissions on final decisions is also absent, whereas this panel received 35 additional *amicus curiae* submissions during the adjudication procedure.<sup>648</sup>

Another situation of suspension of the communication is the claimant dropping its claim or both disputing parties reaching a voluntary settlement without the involvement of the tribunal. In *Aguas del Tunari v. Bolivia*,<sup>649</sup> for example, this tribunal had no chance to examine further amicus petitions nor the merits of this case because the claimant investor dropped its claims and both disputing parties reached a voluntary

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suggested in the [amicus] Petitions. In this regard, this Tribunal's willingness to receive amicus submissions might support the process in general and this arbitration in particular'. *Mexthanex v. United States*, *ibid*, para 49.

<sup>646</sup> Theresa Squatrito, 'Amicus curiae briefs in the WTO DSM: Good or bad news for non-state actor involvement?' (2018) 17(1) *World Trade Review* 65, 83.

<sup>647</sup> Panel Report, WT/DS425, 441, 458, 467/R, *Australia—Certain Measures Concerning Trademarks, Geographical Indications and Other Plain Packaging Requirements Applicable to Tobacco Products and Packaging* ('*Australia—Plain Tobacco Packing Measures*'), issued and circulated to Members on 28 June 2018.

<sup>648</sup> *Ibid*, para 1.49.

<sup>649</sup> *Aguas del Tunari, S.A. v. Republic of Bolivia* ('*Aguas del Tunari v. Bolivia*'), ICSID Case No. ARB/02/3.

settlement.<sup>650</sup>

Despite the uncertainty of the communication process, some investor–State arbitral cases demonstrate the merit of this interactive structure on clarifying legal understandings. These legal understandings are usually related to the exercise of regulatory sovereignty for the public interest, environmental protection and human rights.

In *Sociedad General de Aguas de Barcelona v. Argentina*,<sup>651</sup> the amicus brief submitted by five civil societies raised the state’s responsibility to protect the right to water. They contended that this responsibility justified Argentina’s measures. While this tribunal did reckon that it is essential of water rights for the citizens and Argentina experienced a severe financial crisis, however, it clarified that the defence of necessity was not sufficient to legitimate the violation of Argentina’s obligations under the investment treaties in the application. Otherwise, the stability of international law and the system of international relations would be at risk.<sup>652</sup> In the case involving the US ban on the chemical MTBE, the International Institute for Sustainable Development (IISD) submitted an amicus brief to raise the attention of environmental protection and sustainable development embodied in NAFTA before the *Methanex* tribunal.<sup>653</sup> The tribunal did express its acknowledgement that there was widespread public support for a ban on MTBE in the reasoning.

Moreover, this *Sociedad General* tribunal found that this disputed measure was

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<sup>650</sup> Farouk El-Hosseny (n 453) 156.

<sup>651</sup> *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v. Argentine Republic* (‘*Sociedad General de Aguas de Barcelona v. Argentina*’), ICSID Case No. ARB/03/19.

<sup>652</sup> *Sociedad General de Aguas de Barcelona v. Argentina*, Decision on liability, 30 July 2010 (Jeswald W. Salacuse, Gabrielle Kaufmann–Kohler, Pedro Nikken) paras 257–58.

<sup>653</sup> *Methanex v. United States*, IISD amicus submission, 09 March 2004, at 23.

supported by scientific evidence, which was then followed by a series of public hearings, public testimony and peer review before the ban.<sup>654</sup> This finding proved the ban on MTBE, not an arbitrary and protectionist decision. It finally ruled that this measure did not amount to an expropriation action.

While the third-party procedure enriches the communication of legal opinions, it is still arguably the effectiveness of third-party submissions on final decisions.<sup>655</sup> After all, international adjudication primarily functions as a remedy for rights infringed.<sup>656</sup> The object of adjudicative review is the interests infringed by state practices which violated specific treaty obligations. As such, adjudicators tend to avoid the expansive intervention of non-disputing parties which turns treaty disputes into petitioners' cases.<sup>657</sup>

The practice of investor-State arbitration and the WTO dispute settlements, for instance, shows that investment arbitrators and WTO adjudicators remain the tendency of giving preference to one side of disputing parties.<sup>658</sup> Public interests of international society as a whole are also concerned by adjudicators randomly, depending upon the experiences of the individual adjudicator.<sup>659</sup>

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<sup>654</sup> *Mexthanex v. United States*, Final award on jurisdiction and merits, Part III – Chapter A, para 101.

<sup>655</sup> Farouk El-Hosseny (n 453) 178; Theresa Squatrito (n 646) 74–76.

<sup>656</sup> For instance, the ICJ in the *Barcelona Traction* case highlighted the distinction between rights and interests in response to the Belgium's request. It held that '... as the Court has indicated, evidence that damage was suffered does not ipso facto justify a diplomatic claim. ...Not a mere interest affected, but solely a right infringed involves responsibility, so that an act directed against and infringing only the company's rights does not involve responsibility towards the shareholders, even if their interests are affected'. *Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain)* (Judgement) [1970], ICJ Rep 3, para 46.

<sup>657</sup> Farouk El-Hosseny (n 453) 278–79. Judge Anzilotti in his individual opinion in the *Oscar Chinn* Case well illustrated this point. He expressed that 'international law would be merely an empty phrase if it sufficed for a State to invoke the public interest in order to evade the fulfilment of its engagements'. The *Oscar Chinn* Case (UK v. Belgium) (1934) PCIJ Rep Ser A/B No 63, 66, para 184.

<sup>658</sup> Theresa Squatrito (n 646) 74.

<sup>659</sup> This regard is illustrated by the *Mexthanex* tribunal when considering the amicus submission. In its word, 'there is an undoubtedly public interest in this arbitration. ...In this regard, the Tribunal's willingness to receive amicus submissions might support the process in general and this arbitration in particular'. *Mexthanex v. United States*, Decision of the Tribunal (n 679), para 49.

Nevertheless, the engagement of outsiders at least paves the way that adjudicators communicate with international society in terms of the governance of state practices. The communication process enables the adjudicators to respond to the contemporary demands of society through legal interpretations.

#### 6.3.4. The reciprocal interaction and the evolution of international law

The analyses above approach the relations that either the States or adjudicators involve and lead them to the communication of legal opinions. The communication involves the interaction within the insiders and between insiders and outsiders. Among these interactions, the interaction between the States and adjudicators is the most important one. The conclusion of treaty negotiation outlines the boundaries of sovereignty–restriction. The treaty text frames the discretion of adjudicators. For adjudicators, their primary duty is to identify the intentions of the Contracting States and to settle the dispute in line with the balance of rights and obligations that they agreed. The interaction between the States and adjudicators crystalises the governance of state practices.

This section advances the nature of the interaction between the States and adjudicators as a reciprocal process rather than a circular one.

While the processes of treaty making and treaty–interpreting are separate, they are correlated and connected. In the beginning, treaty–making sets up the boundaries for treaty interpretation. Adjudicators are required to implement the content of treaty rules through the process of treaty interpretation and dispute resolution. The interpretation result and the adjudicative decision might, in turn, motivate the signatory States to take legal amendments and the institutional reform. Finally, the adjustment of existing

international orders might affect policy expectations and assumptions of international society. As such, the result of the interaction does not return to the same place but moves forward in different directions. This is why the thesis argues the reciprocal process of communication of legal opinions and experiences drives the progress of international law.

The NAFTA experiences of the scope of minimum standards of treatment illustrate the reciprocal interaction between the States and adjudicators.

The story started with the interpretation of Article 1105 of NAFTA (minimum standards of treatment) by NAFTA tribunals. NAFTA arbitrators interpreted the minimum standards of treatment with evolutionary nature. The scope of minimum standards of treatment is changing in line with the development of customary law principles and international law. However, NAFTA Contracting States disagreed with the interpretation results. These States had tended to express their oppositions in the status of the respondent State and through the third-party procedure of NAFTA arbitration.

The NAFTA Contracting States did not deny the discretion of arbitrators to decide in preference of one side of opinions or to propose their interpretations beyond opposite assertions of the disputing parties. What they argued is that the interpretation choices and decisions should not go beyond their intentions. In specific, they disagreed that they had the intentions to regulate the scope of minimum standards of treatment beyond the practices of customary international law. Therefore, they questioned the interpretation result exceeded the discretion of the NAFTA tribunals.

These NAFTA States then challenged the adjudicators' decision by issuing a joint statement. The joint statement clarified the meaning of the minimum standards of



treatment.

However, the joint statement accelerated the tension between the States and adjudicators in terms of the interpretative authority. NAFTA tribunal questioned the nature of the joint statement as simply legal interpretation or legal amendment which substantively modified the treaty text. The question of the legal effects of the joint statement leads to the issue of whether arbitrators are bound to the joint statement in the interpretation and application of this provision.

As to this issue, NAFTA arbitrators at that time had not established united understandings. Some tribunals believed that the interpretation note issued on the consent of the NAFTA Contracting States is not binding on tribunals. It left to the discretion of tribunals to interpret the treaty in light of interpretive principles and their experiences, not bound to the interpretive opinions by the Contracting States. Other tribunals instead decided to interpret the provision of minimum standards of treatment in line with the joint interpretative statement.

The division of arbitrator positions reveals the relevance of normative implications of the Contracting States' actions on the behaviours of arbitrators. The Contracting States might respond to legal interpretations of arbitrators by either the issue of authoritative interpretation or legal amendments. However, the two actions implicate different degrees of binding effects. The difference in normative implications in no small extent direct the discretion that arbitrators remain reserved in the interpretation of the same principle and the rule in the future.

Given the diverse legal opinions, some NAFTA Contracting States decided to take more active methods such as modifying their model BITs or amending relevant

provisions to a treaty. The investment chapter of the *US–CAFTA* (2004), for example, adopted two textual arraignments to stipulate the connection between the provision of the minimum standard of treatment and customary international law. One place is the explicit language of ‘by customary international law’ in this provision (Article 10.4). The other one is to insert interpretation guidance to this provision through an additional agreement in Annex 10–B.

Another example of the interaction between the States and adjudicators resulting in textual adjustments is most-favoured-nation (MFN) clauses. Since the *Maffezini* decision pointed out the possibility to apply (MFN) protection standard to procedural rights in investment treaties, the scope of MFN clause becomes an arguable issue in investor–State arbitration. Accordingly, several later investment treaties controlled the scope of MFN protection by using explicit language to exclude the procedural and dispute settlement provisions from the application of the MFN provision. The investment chapter of the *US–CAFTA* (2004) is an example.<sup>660</sup>

The reciprocal interactions advance the intersubjective (social–cultural) insights of international law.<sup>661</sup> They suggest that how the change and development of international law are driven by the communication between nation–states and adjudicators, reflecting on the interaction between the text and practice, and leading the changes in international law.

6.4. The substance changed and changing along with the (re)construction of

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<sup>660</sup> Robert Howse and Efraim Chalamish (n 675) 1088.

<sup>661</sup> Tomer Broude and Yuval Shany, ‘The International Law and Policy of Multi–Sourced Equivalent Norms’ in Tomer Broude and Yuval Shany (eds), *Multi–Sourced Equivalent Norms in International Law* (Hart Publishing 2011) 1–18; Jutta Brunnee and Stephen J. Toope, ‘Constructivism and International Law’ in Jeffrey L. Dunoff and Mark A. Pollack (eds), *Interdisciplinary Perspectives on International Law and International Relations: The State of the Art* (CUP 2012) 122–25; Mark A. Pollack and Gregory Shaffer, ‘The Interaction of Formal and Informal Lawmaking’ in Joost Pauwelyn, Ramses Wessel, and Jan Wouter (eds), *Informal International Lawmaking* (OUP 2012) 241–70.

## international law

The thesis has explained the progress of international law driven by the communication of legal opinions and experiences between the participants. The next issue is what is the legal opinions and experiences concerned.

As to this question, previous analyses of this study sheds light on the answer. The thesis proposes that the ultimate concern of the decisions by the States and adjudicators is the governance of national sovereignty. The idea of regulating the boundaries of sovereignty is the issue that is concerned by the States, adjudicators and other parties when exchanging their opinions and experiences. As such, the decisions of the States and adjudicators have the joint function of defining the boundaries of sovereignty over cross-border issues.

### 6.4.1. The transformation of the conception of sovereignty in international law

International law is closely related to the concept of sovereignty. History of international law revolved with the development of the concept of sovereignty. On the one side, customary law principles identify the good governance of the States. The treaty text defines the boundaries of sovereignty—restriction over specific issues. Adjudicators assess whether the exercise of sovereignty in action is the accepted performance or a consistent measure under a treaty. As the thesis argues above, the interaction between the States and adjudicators is the exchange of opinions concerning the governance of sovereignty.

The interaction is a dynamic and reciprocal process. The adjudicators might refine the original boundaries of sovereignty agreed by the States or accepted by the community of States. The change would raise the corresponding actions by the States,

either to confirm the adjudicators' understandings or to clarify their intentions. The communication result will lead to the change in international law. This is because the opinions exchanged involve the idea of the boundaries of sovereignty to be defined. As such, the result of communication is not only the solution for a dispute but also implicates the shared understanding of the boundaries of sovereignty, which might lead to the movement of international law.

International law is closed to the conception of sovereignty. The development of international law reflects the transformation of the concept of sovereignty. The transformation of the concept of sovereignty, in turn, sheds lights on the future of international law.

The compatibility of the concept of sovereignty in contemporary international law, however, is confronting challenges. There are two leading schools of thoughts arguing the contemporary meaning of the concept of sovereignty in international law.

One school of thought is to question the States' dominant power of rulemaking to international affairs. It highlights the phenomenon that international law is frequently constructed from decentralised relations between various actors such as nation-states, international organisations, non-state enterprises and individuals.<sup>662</sup> Some commentators develop the concept of global governance to describe the reality. They argue that the decentralised or bottom-up approach of rulemaking means that international orders no longer serve for political interests of nation-states but all people. For instance, Anne-Marie Slaughter suggests that international governance rests on a complex global web of government networks.<sup>663</sup> In the governance network, national and international judges and regulators exchange information and coordinate activity to

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<sup>662</sup> Samantha Besson, 'Sovereignty, International Law and Democracy' (2011) 22(2) *European Journal of International Law* 373, 374.

<sup>663</sup> See Anne-Marie Slaughter, *A New World Order* (Princeton University Press 2005).

deal with cross-border issues. In other words, the role of government and national sovereignty are not the dominant source of the international order. Therefore, some urge to reducing or eliminating the application of the concept of sovereignty.<sup>664</sup>

Another school of thought appreciates the continuing role of sovereignty in international law. However, it argues that this concept needs to be reformulated. For instance, David Held applies the development of international human rights law, environmental law and economic law to argue that the role of sovereign states is not demised or eroded. However, the broader scope and complexity of regulatory issues go beyond the traditional conception of sovereignty, which based on territorial boundaries.<sup>665</sup> Alvarez questions that the elimination of the concept of state sovereignty ignores the reality that the implementation of international law still relies on the role of the nation-states and the exercise of sovereign powers.<sup>666</sup> Likewise, Professor Jackson also recognises the practical functions of the concept of sovereignty in the interpretation and implementation of international law. He acknowledged that sovereign states had got a notorious reputation as organised hypocrisy<sup>667</sup> due to their actions not corresponding with their commitments. However, he argued that the absolute nature of sovereignty is already a myth in modern international law. It is time to shift attention to what is changed by the allocation of power in different contexts.<sup>668</sup>

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<sup>664</sup> José E. Alvarez, 'The Return of the State' (2011) 20 Minnesota Journal of International Law 223, 225; Jan Klabbers, 'Clinching the Concept of Sovereignty: Wimbledon Redux' (1999) 3(3) Austrian Review of International and European Law 345, 346.

<sup>665</sup> David Held, 'The Changing Structure of International Law: Sovereignty Transformed?' in David Held and McGrew, Anthony (eds), *The Global Transformations Reader: An Introduction to the Globalization Debate* (Polity Press 2003) 169–70.

<sup>666</sup> José E. Alvarez (n 664) 259.

<sup>667</sup> The term 'organised hypocrisy' is developed by Professor Krasner. He uses this term to argue the arbitrary decision and actions by nation states in international relations. What they say is not that what they do. Stephen D. Krasner (n 25) 9–10.

<sup>668</sup> John H. Jackson, 'Sovereignty—modern: A new approach to an outdated concept' (2003) 97 American Journal of International Law 782, 794–95, 801–02.

It can be seen that these opinions share some understandings, while they suggest opposite directions for the concept of sovereignty. First, the state-centred conception is no longer the right description of international law. While the conventional conception still has the power to explain the textual arrangement and institutional structures framed by the allocation and delegation of sovereign power, it cannot explain why international law involves non-state actors and how nation-states interact with those non-state actors who are not under the control of the Contracting States. Second, treaties are no longer concerned with national interests of a country only. A large part of treaties is designed to protect the interests of non-state actors or for the concern of common interests of the international community.<sup>669</sup>

While there is the opposition between respecting the sovereignty and anti-sovereignty in academic discussion, as Sir Jennings rightly stated, the nature and purposes of sovereignty in international law are continuously defined and redefined to deal with contemporary problems.<sup>670</sup>

The thesis suggests that the trend of treaty negotiation of investment treaties shows the preference to the appreciation of sovereignty. Some of the investment treaties signed during the 1990s and 2000s stipulated customary law principles concerning sovereign states in the preamble. The principles include the principle of sovereign equality<sup>671</sup> and the principle of regulatory power by the State<sup>672</sup>. These principles are incorporated for the management of the treaty relationship between the Contracting States. While the

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<sup>669</sup> Ibid, 801.

<sup>670</sup> Sir Robert Jennings, 'Sovereignty and International Law' in Gerard Kreijen, Marcel Brus, Jorrijs Duursma, Elizabeth De Vos, and John Dugard (eds), *State, Sovereignty, and International Governance* (OUP 2002) 27.

<sup>671</sup> See, e.g., Australia–Poland BIT (1991), the preamble ('...that investment relations ...in accordance with the internationally accepted principles of mutual respect for sovereignty, equality, mutual benefit, non-discrimination and mutual confidence').

<sup>672</sup> See, e.g., Bolivia–Spain BIT (1990), the preamble ('Recognizing ...the right of each Contracting Party to determine that role and to define the conditions under which foreign investments may participate in the process...').

number of these treaties is small (around 3% of total BITs),<sup>673</sup> it reveals that investment treaties highlight the continuing role of sovereignty.

The trend of investment treaties, however, cannot conclude the revival of sovereignty in the absolute and state-centric sense. As chapter five mentions, international investment law has noted the issues of transparency and public participation in the arbitration process and the treaty negotiation. International institutions such as UNCTAD and ICSID also modify the arbitration rules to incorporate the procedures of public participation and access to information. These changes result in the duties imposed on the government. The changes implicate that the concept of sovereignty is different from the state-centric scenario that sovereignty is exclusive to the interests of the State. On the contrary, sovereignty is shared by the public and the government.

The ways by which international law defines the boundaries of sovereignty are also changing. It no longer focuses on how to constrain and restrict the exercise of sovereignty. Instead, it pays attention to how to appreciate the role of governmental interventions on the social and economic order.

The development of international investment law shows that the concept of sovereignty is still vital to the international law system. The international law system is concerned with the governance of sovereignty. The progress of international law rests on the (re)interpretation of the boundaries of sovereignty. Moreover, the implementation of international law relies on self-discipline and political decisions of the States. However, sovereignty has transformed from the symbolic of the dominated position of the States toward a shared concept which includes the concerns of the public and the

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<sup>673</sup> The data is reserved to this study.

government. This view echoes the mounting position of individuals in international law, as chapter one discusses.

#### 6.4.2. The function of international law as a restriction, reservation, or expansion of the boundaries of sovereignty

Under the conventional state-centred conception, international law is conceived as an instrument to avoid the misuse and abuse of sovereign powers. Either customary international law or treaties are concerned with sovereignty-restrictions. The boundaries of sovereignty-restriction are either decided by the accepted performance of the community of States or defined by the treaty text. The concern of restricting sovereignty was dominated by the initial development of international investment law and GATT/WTO law.

The conception of international governance of sovereignty is changing along with the shift of political ideologies and the progress of international society. As chapter one highlights, international society has witnessed the rise of individuals. The rising position of individuals leads international law to expand the function of international adjudication for private-public disputes. The creation of investor-State arbitration is an example.

The rising position of private parties in international society, on the other side, echoes the shift of political ideologies. About economic activities, the political ideology is shifting from suspicion of governmental intervention on the market toward an appreciation of the role of government for balancing economic interests with other social values. The sustainable development policies in specific characterise the balancing concern for the policy choices. Reading the UN Sustainable Development Goals, economic growth is not the end of the development of society. Instead, economic



development is the means of social development for public interests. Public interests are characterised by the improvement of social inequality, public health, the right to access clean water, climate change and responsibility production and consumption. The implementation of these goals requires the active engagement of the State. Therefore, the thesis argues that the rise of sustainable development policies signals the conception of the governance of sovereignty in international society is changing.

The transformation of the conception of sovereignty results in the progress of the regulatory patterns of international law. International law is no longer concerned with sovereignty–restriction. It instead pays attention to the reservation of regulatory powers and even to encourage the engagement of the government for public interests. In other words, the horizons of international law include the reservation and expansion of the boundaries of sovereignty.

Accordingly, the thesis proposes the perspective of the governance of sovereignty deepens the understanding of international law. This perspective enables us to review how international law restricts, reserves, and expands the boundaries of sovereignty.

First, the reservation of sovereignty is usually reflected by the rules which define regulatory freedom or policy space for the Contracting States. The way to reserve sovereign powers includes the exceptional provisions, reservation clauses and the definition of the scope of application. The reserved spaces created by these approaches are different, depending upon the substantive content.

However, reserving sovereignty is unlike empowering non–state actors who were not powerful or rights–holders under international law. Regulatory power and policy–making power are part of sovereignty. They are inherent to the political unity of nation–

states. As such, the notion of a right to regulate in some situations might overlap with the first dimension. The *SPS and TBT Agreements* are classic examples. At first sight, these Agreements based on the premise that member States have regulatory needs for public interests. The two agreements instead impose a series of conditions for the adoption of relevant measures. In other words, those conditions are the propositions of the use of regulatory power instead of the exceptions for States' responsibility. In this respect, the rules of the *SPS and the TBT Agreements* primarily remain under the shadow of the restrictive conception.

Second, the expansion of the boundaries of sovereignty is often reflected in the regulations that encourage the signatory States to something useful. This sort of regulations is known as 'best efforts commitments' of a treaty. A common approach for the best-efforts commitments is the preamble. In the preamble, the Contracting States expressed their joint political statements for the future. For instance, the preamble of the agreement establishing the WTO lists several objectives that Member States are encouraged to achieve. Some investment treaties also incorporated the objectives concerning sustainable-development-relevant policies, promotion of the well-being of humans and environmental protection in the preamble.

It can see that these best-effort commitments share the common feature with the reservation of sovereignty. Both of them are concerned with public interests, while the legal effects depend upon whether the Contracting States transformed the political announcements into specific rules and treaty obligations. In general, the best-effort commitments of a treaty are usually unenforceable as soft obligations.

The existence of best-efforts commitments shows that international investment law and WTO law have not incorporated a range of normative rules and treaty obligations to expand the boundaries of sovereignty substantively yet.

The practice, however, at least reflecting that international investment law and trade law is enhancing the adjustment of boundaries of sovereignty at different extents.

#### 6.4.3. The rise of balancing and the boundaries of sovereignty in international law

A factor for the movement of international law is the conception of the governance of sovereignty. While international investment law and trade law was dominated by liberal economic policies which endorsed the idea of small government in the market, the two regimes are gradually shifting to the substantive development policies which enhance the role of government. As chapter one has pointed out, the balancing concern is essential to sustainable development policies.

In chapter one, the thesis argues that the development of international law and international adjudication is parallel. Both the States and adjudicators are aware of the concept of sustainable development. The virtue of the concept of sustainable development is to require to take into concern all relevant interests and values in the policy-making and rulemaking process. The inclusive consideration is in the attempt to balance social, economic and environmental concerns in the final decision. The inclusive and balanced concern is altering the landscape of national policies and international governance. It shifts international governance of economic activities from a single-interest dimension toward an inclusive and balanced concern.

The rising inclusive and balanced concern explains new investment treaties aiming to ‘correct’ the imbalanced relations and asymmetric textual arrangements as that under the old generation of BITs.

There are two ways that treaty relations are rebalanced. One way is to highlight and reserve regulatory freedom that is inherent to the host States. For instance, some

new investment treaties and the investment chapter of trade agreements have attempted to rebalance the treaty relation by highlighting human rights and sustainable development. The Austrian Model BIT (2010) states the commitment to ‘achieving these objectives in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognised labour standard’. In the last version of the Norwegian Model BIT (2015), it expressly preserves the States’ right to regulate for a wide range of public interests such as health, safety, human rights, labour rights and resource management or environmental concerns. The right to regulate is also allowed if there is necessary to protect public morals, human, animal or plant life or health, as well as to main public order (Articles 11, 12 and 24).

Another way is to highlight the responsibility and duty of foreign investors for the development of a host State. In past BITs, investors had always been in a protected role. The protection of investors was reflected by the substantive principles imposed on host States and the right to access to international arbitration. On the contrary, in the new generation of BITs, the role of investors is shifted from the protected role to the role of performer. In some treaties, investors are required to perform specific actions. Those actions are related to corporate social responsibility (CSR).

For instance, the 2010 Austrian Model BIT stresses CSR in the preamble. It not only emphasises the importance of CSR but also directly defines responsible corporate behaviours by reference to the *OECD Guidelines for Multinational Enterprises*. While CSR provisions in the draft Norwegian Model BIT (2007) attracted public critiques and were withdrawn from the 2009 draft, the Norwegian government reintroduced CSR provisions in its 2015 version.<sup>674</sup> Norway also increases the precise level of voluntary

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<sup>674</sup> Kun Fan, ‘Rebalancing the Asymmetric Nature of International Investment Agreements?’ (Kluwer Arbitration Blog 2018), available at <http://arbitrationblog.kluwerarbitration.com/2018/04/30/rebalancing-asymmetric-nature-international-investment-agreements/> accessed 10 April 2019.

CSR provision by referring to international instruments such as the *OECD Guidelines for Multinational Enterprises*, the *UN Guiding Principles on Business and Human Rights* and the *UN Global Compact*.

Some comments separate the CSR issue from sustainable development. They argue the limited discussion of CSR in BITs due to the widespread and promotion of sustainable development policies.<sup>675</sup> However, there is no essential difference between these two issues. As the preamble of the 2010 Austrian Model BIT states, the purpose of addressing responsible corporate behaviours is for the concern of creating confidence and a balanced situation between foreign investors and host States. Although the mainstream discussion of CSR in international law is from the perspective of business conduct, the dimensional regulatory concerns of CSR reveals that this concept shares the function of the concept of sustainable development. Both of them aim to challenge a conventional singular dimension and to argue an inclusive and balanced concern. The concept of sustainable development challenges the economics-dominated conception in international economic law. Likewise, the concept of CSR challenges the singular commercial conception of business practices in the society. In this respect, the CSR issue in international law is the extension of an inclusive and balanced concern, as well as sustainable development policies.

The change is not limited to the normative rules but also found in international adjudication regarding the balancing analysis.

Chapters two and four have discussed the different modes of the balancing approach applied by the investor–State tribunals and WTO adjudicators in Chapter Four.

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<sup>675</sup> Rafael Peels, Elizabeth Echeverria M, Jonas Aissi, and Anselm Schneider, ‘Corporate Social Responsibility in International Trade and Investment Agreements: Implications for States, Business And Workers’, ILO Research Paper No. 13 (April 2016) 10.

Our findings echo Gerstetter's analysis; she divides the application of balancing into two modes. One is the deductive mode, which means balancing applied in a technical and literal way. Another is balancing in the argumentative structure, which refers to the situation where the application of balancing is in line with the substantive sense.<sup>676</sup> According to our findings, investment arbitrators tend to use substantive balancing. On the contrary, WTO adjudicators are inclined to use technical balancing.

The difference is whether the interests argued by disputing parties and the values protected by a treaty are factors that are taken into account in decision making. In investor–State arbitration, balancing is not only the interpretation result but more importantly, the guidance of treaty interpretation. By contrast, the WTO adjudicators tend to interpret WTO provisions in the technical and literal way. The Appellate Body is careful to avoid creating an impression that it formulates the balancing act in the decision–making process.<sup>677</sup>

The practices of investor–State arbitration and WTO dispute settlements show that the inclusive and balanced concern is often involved in the conflict of interests or characterised by the notion of the right to regulate. Moreover, the potential threat to state regulatory freedom by the public interest in international adjudication, especially ad hoc investment arbitration, also raises the awareness of the idea of reserving national sovereignty.<sup>678</sup> In this respect, the inclusive and balanced concern is not only the cause of the development of international law but also the consequences.

One thing needs to be cautious. The balancing concern is not the guarantee of a

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<sup>676</sup> Christine Gerstetter, 'The Appellate Body's "Response" to the Tensions and Interdependencies between Transnational Trade Governance and Social Regulation' in Christian Joerges and Ernst–Ulrich Petersmann (eds), *Constitutionalism, multilevel trade governance and social regulation* (Hart Publishing 2006) 116–17.

<sup>677</sup> Ibid, 124.

<sup>678</sup> Catherine Titi (n 141) 67–69.

balanced result for the competing interests for interested parties. The distinction between the balancing concern and the balanced result is important. That is because the virtue of the balancing concern is to ensure the quality of the decision-making process. The quality of the decision-making process could be standardised by procedural requirements such as objective assessment, the duty of reason-giving and the structural analysis. By contrast, the balanced result is hardly defined. It depends upon the subjective sense of fairness. It is interpreted differently by different actors from various perspectives. The study has discussed the confusion between the two conceptions of balancing in chapter four.

## 6.5. Conclusion

While there are similarities and divergences in the balancing analysis in investor-State arbitration and the WTO jurisprudence, one thing is shared by the two jurisdictions. The common feature is the role of international adjudication in the development of international law.

Investment arbitrators and WTO adjudicators are representative of two ways by which international adjudicators engage in the progress of international law. The two ways are: filling the gap within the texts or refining the existed provisions. Either of the ways is influenced by the textual and institutional features of a domain.

Previous chapters analyse how the textual and institutional differences result in the application of the balancing analysis in international investment law and WTO law. In this chapter, the study advances the findings from the sociological perspective and suggests that the application of balancing is the product of the interaction between the States and adjudicators.

The sociological insights lead the study to review the meaning of the treaty text and interpretative choices as the decisions by the States and the adjudicators. These decisions are concerned with the same issue, the governance of state practices.

The decision either by the States or by the adjudicators involves the interaction with other parties. The dimensional relations constitute the social context in which the States and adjudicators proceed the decision-making. Given the communicative and relational function, the thesis argues that the progress of international law is primarily driven by the communication process by the States and adjudicators and between the two parties. The essence of legal opinions being exchanged and communicated is the way of governing state practices. The opinions of the governance of state practices are in turn reflected by the treaty text or the resolution of a dispute.

Concerning the governance of sovereignty, the thesis suggests the joint function of the States and adjudicators as the decision makers of international law. Under the communicative structure of their decision-making process, they can share legal opinions and understandings within a domain or across different regimes. This view explains the parallel development of balancing between international investment law and WTO law, on one side. On the other side, this view renews the practical differences of balancing in the two regimes as crystallising the boundaries of sovereignty shaped by the States and adjudicators different in each domain.



## **Conclusion**

History shows that the development of international law is swinging between unity and fragmentation. While the present international law is fragmented into a range of regimes, there are some legal principles and experiences are converged across regimes. The emergence of the balancing approach is an example. The comparative study of international investment law and WTO law reveals that similarities and differences coexist in the treaty text and the practice.

This thesis attempted to offer a framework to rethink the conventional wisdom that weighed convergences more than divergences on the evolution of international law. For the concern of the stability and certainty of a legal system, standard practices and united principles have their merit for the systematic concern. The analyses of investment awards involving the balancing approach in chapter two seem to prove this point. The point explains the dominance of the convergence/divergence distinction in international law which promotes the unity of legal interpretations, principles and judicial experiences.

Nevertheless, the convergence/divergence distinction has instead prohibited new ways of reviewing the construction of international law. The result, which I discussed in chapter six, is against the reality of international law as a fragmented system. About the balancing approach, the pursuit of standard practices appears to be presented as a choice of the experiences of one domain against the other, rather than a discussion of how to comprehensively account for the meaning of the balancing approach within the individual domain and in the international law system.

This study reviewed the balancing approach in line with the contexts, including

the treaty interpretation, the treaty text, and the power relation. The finding of balancing in variation explains the parallel development of the balancing concern in the treaty text and the practice. The parallel development of the balancing concern leads the study to argue the balancing approach as the decisions by the States and adjudicators. These decisions are concerned with the essence of international law, the governance of state practices.

Different from the conventional state-centric scenario, the thesis focuses on the interaction between the States and adjudicators. As the analyses of chapters one and four, the similar experiences of balancing shed lights on the joint function of the States and adjudicators on international law. While the balancing approach is individual practice in either international investment law or WTO law and either by nation-states or adjudicators, the application mirrors the shared understanding in international society. The shared understanding is the governance of state practices toward the reservation of sovereignty for the Contracting States and toward an inclusive attitude.

As to the interaction between the States and adjudicators in detail, chapter six proposed a framework. The proposed framework tries to explain the nature of the interaction between the States and adjudicators as the communication of legal opinions and experiences and illustrate how the communication results in the changes in international law.

The thesis realises that different ideas could not necessarily match the research results in terms of the balancing approach and the theory of international law. They might disagree with the differentiation of the balancing approach, the joint function of adjudicators as law-creation, and the sociological aspect for the construction of international law and dispute settlements. Other criticism might question the study of complicating the meaning of the balancing approach, oversimplifying international law

as the interaction between the States and adjudicators, or exaggerating the function of balancing as the part of defining the boundaries of sovereignty.

It is not my intention to argue that the proposed framework covers every situation in international law, nor propose the final argument of the balancing approach. The thesis tends to advance existing studies to build new ideas, adjusting old ideas for the new reality. The proposed framework in chapter six aims to create a space in which we can reflect and review the existing ideas of the balancing approach and international law. The intention explains why the thesis addresses the practice of the balancing approach not only through the comparative lens but also in a whole picture of the changing political ideologies and the progress of international law.

The aim of the thesis was not limited to generalise the findings of balancing to the whole picture of international law. More importantly, the findings produce several subtleties that deepen the understandings of the balancing approach in international law. Based on the analyses of the practices of investment arbitrators and WTO adjudicators in chapters two and three respectively, the view of chapter four argues a range of meanings of the word ‘balancing’ through the discourse analysis of the text and the reasoning.

If applied the convergence/divergence distinction, the variety of balancing would be differentiated into what is right and what is wrong. The polarisation of the debate between consistent and flexible practice would also drive the discussion to the merit of centralised institutions of dispute settlement such as the WTO system. The results of the convergence/divergence distinction, as chapter five illustrated, include reference to the WTO experiences and reform the existing investor–State arbitration to the WTO–like system. However, in chapter four and five, the analyses have revealed that the situation

to a large extent is rooted in the division between international investment law and WTO law. The division is the reason for the differences in the textual arrangement, the membership, and the institutional structure of dispute settlements.

Therefore, the thesis argued that the question was not about the appearance to which the balancing approach is applied, but the reason why the balancing approach or the word ‘balancing’ is mentioned.

Changing the assumption that the balancing approach is an interpretative method allowed my departure from the argument of identifying the standard balancing approach in international law and away from the debate of whether the balancing approach is a legal principle or just an institutional notion for adjudicators. Given the separation between international investment law and trade law, as analysed in chapter one, the thesis was cautious of arguing cross-reference of experiences between the jurisprudence of investor-State arbitration and WTO dispute settlements. The analyses in chapters four and five explain the limitations to the convergence of the two authorities in terms of the balancing issue.

Given what the thesis concerned is the ‘why’ question, in the final part, it proposes a framework to explain the parallel development of the balancing concern in the text and the practice. The framework illustrates the process by which either the States or adjudicators construct their decisions by communicating with their community and with the counterparties and also influenced by international society as a whole. Among these relations, the States and adjudicators interact with each other under the institutional context in specific. The inter-subject communication, in turn, reciprocity between the text and the practice which drives the progress of international law.

This study submitted three lines of questions on which the research results were

knitted together. The first is to define the extent to which the application of the balancing approach is similar or different between investor–State arbitration and the WTO dispute settlement mechanism. The analyses of chapters two and three display that the balancing approach is applied for the same issue—conflicting interests or regulatory purposes—while there are differences in the analysis structure and considering factors. The second is to inquire about the reasons for the differences. Chapters four and five suggest the textual and institutional features as the reasons. The third was to compare the development of the text and the practice in terms of balancing, as discussed in chapter one and chapter four. The thesis raised a question, is the parallel development between the text and the practice and between international investment law and WTO law coincident or expected? If the balancing concern remarks the shared understanding between the States and adjudicators, what are the ultimate concern of international law and international adjudication? Chapter six argues that the essence of international law and dispute settlements as the boundaries of internal and external sovereignty.

After a summary of the findings, the thesis suggests three points of knitting the findings together.

First, balancing itself is a concept that has no specific meaning. Its meaning is characterised by the context in which it is applied. I suggest three contexts by which balancing has applied in international law. Balancing might be used in the normative context by which it means a requirement of considering relevant and conflicting elements in the decision making. Alternatively, balancing might refer to the relationship between the parties, including the relationship between the treaty parties and between the disputing parties. Moreover, balancing could mean the allocation of power between the interested parties. While the context varies, a common feature is usually balancing

not giving specific meaning or objective measurement. Instead, the final result depends upon the discretion of the decision maker. In other words, balancing creates a space for decision makers.

However, the flexibility of balancing leads us to rethink what the primary element for the management of a legal system, stability or flexibility is. If the answer is the former, the next question is how to characterise the substance of balancing in various contexts. If the answer is the latter, the following issue is how to ensure the quality and legitimacy of the decision. While the issue is datable, however, the contextual analysis of balancing reminds us to identify what context by which balancing is mentioned before applying the analogy of the experiences between other jurisprudence.

The second point is the implication of the parallel development of the emergence of balancing in the text and the practice. The analyses of chapters one and four reveal that both nation-states and adjudicators have noticed the importance of balancing. From the perspective of nation-states, balancing is a principle to ensure the fairness and justice embedded in the arrangement of rights and obligations for the Contracting States. From the perspective of adjudicators, the fairness between the treaty parties and between the disputing parties is also the context in which balancing is applied. The question is, why do nation-states and adjudicators share the same idea if they belong to separate communities? The issue leads us to reflect the joint function of the activities by the States and adjudicators.

While individuals have a growing position in international law, nation-states and adjudicators still are the two major actors. The processes of treaty negotiation and treaty interpretation dominated the progress of international law. While the two processes are based on different authorities, they share the same function. The function is the communication of legal opinions and experiences. Given the communicative function,

nation–states and adjudicators can construct the shared understandings. The communication, however, is not limited to the adjudicative proceedings. Political decisions on foreign policies or legislative actions of the treaty are all part of the inter–subject communication. Given the reciprocal interaction between the States and adjudicators, international law is evolutionary. Under the communicative scenario, the emergence of the balancing concern in the text and the practice remarks the shared understanding between the States and adjudicators.

The last but not the least point is the implication of balancing in the evolution of international law. While balancing is the practice of an individual domain, it reflects the trend of international law. This point relates to the viewpoint of chapter one about the essence of international law.

In chapter one, the thesis argues that the essence of international law is the governance of state practices. History reveals that the regulatory method is changing from customary law principles to treaty making. The change of regulatory methods explains the dominance of treaties in contemporary international law. International law is functional for the governance of state practices, international adjudication as the enforcement of international law shares the same function. The point of view not only echoes the argument of the joint function between the States and adjudicators. More importantly, it sheds lights on the ultimate concern of the decisions by the States and adjudicators, the governance of state practices.

The criticism could be made that the States and adjudicators are in the principle–agent relation. Given the principle–agent relation implicates a hierarchy of power, the States and adjudicators cannot be in equal relation. The thesis agrees that adjudicators cannot replace with the nation–states to modify the treaty text directly. However, it

cannot deny that the interpretation results usually trigger the adjustment of treaty text or institutional reforms. As such, from the perspective of the progress of international law, the thesis suggests that the decisions made by the States and adjudicators both influence the development of international law even though they are the result of the exercise of different authorities. The joint function is to enforce the governance of state practices.

Given the joint function, balancing marks the understandings between the States and adjudicators in terms of the governance of state practices. The thesis has analysed the correlation between international law and political ideologies in chapter one. History indicates the trend of international law toward an inclusive and balanced governance model. Sustainable development policies and general exceptions for public policies are examples. Likewise, the practice of investor–State arbitration and the WTO dispute settlement mechanism also highlights an inclusive consideration for competing interests to a dispute. The treaty text and the practice reveal the governance of state practices no longer dominated by a singular–dimensional vision. The change of political ideology indicates that the understanding of the role of government in the market is shifting from suspecting to recognising.

Provided the popularity of balancing in contemporary society, the thesis suggests that balancing implicates that the governance of state practices is shifting from sovereignty–restriction to sovereignty–reservation. The trend of sovereignty–reservation is not only reflected in the broader range of exceptions for the exercise of sovereignty which might cause distortions on trade interests and the interests of foreign investments but also reflected in the intensive controlling mechanisms of the Contracting States over international adjudication. In this respect, while the emergence of balancing is individual practice, it reflects the change of international law as a whole.



Therefore, the relevance between political ideology and international law provides the predictive function for the progress of international law.

Policy is always adapting and changing,<sup>679</sup> and so are international law. Because the interaction between the States and adjudicators is dynamic, international law is adjusting in response to the contemporary understanding of the governance of state practices. Therefore, there is a continual need to question whether existing regulations and institutions are appropriate to the policy issue at stake.

While the arguments the thesis suggests are not a definitive answer, they are at least the revisions. It realises that these ideas are subject to revised. This study at least has set out a new way to explore the connection between individual practice and the general trend of international law and to reconstruct the variety of the practice from other perspectives.

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<sup>679</sup> Justin Parkhurst (n 571) 122.

**Appendix A: The collected arbitral awards and these involving the balancing concern**

Case name	Arbitral award/decision	Key words	Involved BITs	Balancing involved or not
<i>Asian Agricultural Products (AAPL) v. Sri Lanka</i>	Final award, 27 June 1990	VCLT, Article 31–context	UK–Sri Lanka BIT (1980)	NO
<i>ADC Affiliate and ADC v. Hungary</i>	Award, 2 October 2006	VCLT, Article 31–states’ practices	Cyprus–Hungary BIT (1989)	NO
<i>CMS Gas v. Argentina,</i>	Award, 12 May 2005	Expropriation–general issues	Argentina–United States of America BIT (1991)	NO
<i>Daimler Financial Services v. Argentina</i>	Award of jurisdiction, 22 August 2012	VCLT, Article 31–general issues	Argentina–Germany (1991)	YES
<i>Genin, Eastern Credit Ltd. and A.S. Baltoil v. Estonia</i>	Award, 25 June 2001	FET	Estonia– United States of America BIT (1994)	NO
<i>LG&amp;E energy and financial corp. v.</i>	Decision on liability, 3 October	FET–states’ regulatory	Argentina–United States of America	YES

Appendix A

<i>Argentina</i>	2006	freedom	BIT (1991)	
<i>Maffezini v. Spain</i>	Award, 13 November 2000	Legitimate expectations	Argentina—Spain BIT(1991)	NO
<i>Metaclad v. Mexico</i>	Award, 30 August 2000	Expropriation—general issues	NAFTA, Chapter 11	NO
		NAFTA—minimum standards of treatment		
<i>Mondev v. U.S.</i>	Award, 11 October 2002	NAFTA—minimum standards of treatment	NAFTA, Chapter 11	NO
<i>Noble Ventures v. Romania</i>	Award, 12 October 2005	Customary international law and VCLT	United States of America—Romania BIT (1994)	NO
<i>Pope &amp; Talbot v. Canada</i>	Award on the merits of phase 2, 10 April 2001	Expropriation—general issues	NAFTA, Chapter 11	NO
		Indirect expropriation		
		National treatment		
<i>Saluka Investment BV v. Czech Republic</i>	Partial award, 27 March 2006	Expropriation—police power	Czech Republic—Netherlands BIT (1991)	YES
		FET		

<i>S.D. Myers v. Canada</i>	Partial award, 13 November 2000	NAFTA—minimum standards of treatment	NAFTA, Chapter 11	NO
		Indirect expropriation		
<i>SGS v. Philippines</i>	Decision on jurisdiction, 29 January 2004	VCLT, Article 31—the preamble	Swiss–Philippines BIT (1997)	NO
<i>Tecmed v. Mexico</i>	Award, 29 March 2003	FET	Spain–Mexico BIT (1995)	YES
<i>Waste Management v. Mexico</i>	Award, 30 April 2004	MFN	NAFTA, Chapter 11	NO
		NAFTA—minimum standards of treatment		
<i>Wintershall v. Argentina</i>	Award on jurisdiction, 8 December 2008	VCLT, Article 31—the structure of a treaty	Argentina—Germany (1991)	NO
		MFN		
Follow-up cases (during 2010 and 2015)				
<i>Abaclat v. Argentina</i>	Decision on jurisdiction and admissibility, 4 August 2011	VCLT – treaty interpretation	Argentina—Italy BIT (1990)	NO

Appendix A

<i>AWG v. Argentina</i>	Decision on liability, 30 July 2010	Expropriation	Argentina—United of Kingdom BIT (1990)	YES
<i>Burlington Resources v. Ecuador</i>	Decision on liability, 14 December 2012	Expropriation	United States of America –Ecuador BIT (1993)	NO
<i>Caratube oil v. Kazakhstan</i>	Award, 5 June 2012	FET	United States of America –Kazakhstan BIT (1992)	NO
<i>Chemtura v. Canada</i>	Award, 2 August 2010	FET—state’s regulatory freedom	NAFTA, Chapter 11	NO
<i>El Paso energy co. v. Argentina</i>	Award, 31 October 2011	FET	Argentina—United States of America BIT (1991)	YES
<i>Grand River v. U.S.</i>	Award, 12 January 2011	Expropriation	NAFTA, Chapter 11	YES
<i>Impregilo S.p.A. v. Argentina</i>	Award, 21 June 2011	Expropriation—public purpose/FET	Argentina—Italy BIT (1990)	NO
<i>Lemire v. Ukraine II</i>	Decision on jurisdiction and	FET	United States of America –Ukraine BIT	YES

	liability, 14 January 2010		(1994)	
<i>Merrill &amp; Ring v. Canada</i>	Award, 1 March 2010	Indirect expropriation	NAFTA, Chapter 11	YES
<i>Mobil Inv. Canada &amp; Murphy v. Canada</i>	Decision on liability and on principle of quantum, 22 May 2012	Indirect expropriation	NAFTA, Chapter 11	NO
<i>RosInvestor Co. v. Russia</i>	Final award, 12 September 2010	Expropriation—cumulative effect of acts/regulatory power	Denmark—Russia BIT (1993)	NO
<i>Total S.A. v. Argentina</i>	Decision on liability, 27 December 2010	Expropriation/FET	Argentina—France BIT (1993)	YES
<i>Vigotop v. Hungary</i>	Award, 1 October 2014	Expropriation/FET	Cyprus—Hungary BIT (1989)	NO

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