Gaetano Morelli Lectures Series (Vol. 3 – 2020)

Discourses on Methods in International Law: An Anthology

International Investment Proceedings: Converging Principles?

Jorge E. Viñuales*

Table of Contents: I. Introductory observations. – II. The broader context of investment proceedings. – III. The scope of jurisdictional power. – III.1. Objective vs subjective definitions of investment. – III.2. Contribution to the development of the host State. – III.3. Legality of investments. – IV. The uncertain place of admissibility. – IV.1. Illegality between jurisdiction and admissibility. – IV.2. Indirect shareholder claims. – V. (Over-)Reliance on investment treaties. – V.1. Treaty and custom in investment arbitration. – V.2. The police powers doctrine. – V.3. Countermeasures. – VI. Concluding observations.

Abstract: Several key issues relating to the conduct of international investment proceedings converge towards competing and parallel solutions. The purpose of this study is to identify such solutions and spell out their overall systemic implications when taken together.

Keywords: investment law – ISDS - definition of investment – legality of investments – indirect shareholders claims – treaty and custom in investment arbitration.

I. Introductory Observations

International arbitration proceedings have featured prominently in the literature on international law in the last two decades. This is likely a result of the surge in investment arbitration since the 1990 decision in *AAPL v. Sri Lanka*,[1] which admitted the proposition that a treaty clause may serve as a sufficient basis for a State to consent to arbitration with a foreign investor, despite the absence of privity of contract between the two.[2] Much has been written regarding the nature of investment arbitration proceedings,

* Harold Samuel Professor of Law and Environmental Policy, University of Cambridge, and Of Counsel with Lalive (Geneva), jev32@cam.ac.uk. This *Chapter* is the written text of my Gaetano Morelli Lectures delivered at the University of Rome on the 27 May 2016 at the kind invitation of Professor Enzo Cannizzaro. All views expressed are in my strict academic capacity.

[1] ICSID, final award of 27 June 1990, case no. ARB/87/3, *Asian Agricultural Products LTD (AAPL) v. Republic of Sri Lanka*.

[2] This point was emphasised by J. Paulsson, *Arbitration Without Privity*, in *ICSID Review-Foreign Investment Law Journal*, 1995, p. 232 *et seq*.

ISBN: 978-88-943616-1-2
doi: 10.15166/978-88-943616-1-2

which rely heavily but not entirely on the techniques of international commercial arbitration,[3] as well as regarding their legitimacy, to the extent that they bestow on one or, more frequently three private individuals the power to decide disputes with potentially important public dimensions.[4] Those discussions, however significant, are not the primary target of these lectures. Nor are the debates over the role of precedent in investment arbitration,[5] or the – alas too frequent – contradictory positions taken by investment tribunals on similar issues.[6]

Instead, I would like to make the case for a change of approach in the way we – as academics and practitioners – analyse investment law. The suggested change has two main aspects. *Firstly, I believe that legal analysis should focus not on treaties, rules or cases, but on certain "stances" or "positions" that are important – perhaps the most important – "micro drivers" of the dynamics of the entire investment law system. Secondly, these stances should be analysed in the light of their implications not only for investment proceedings or even the overall relation between foreign investors and host States but as one part of a larger context, involving other stakeholders, values and legal systems*. In many ways, these lectures are an attempt at bringing the analysis closer to the topography of international investment proceedings so as to identify the spectrum of positions regarding the application of certain major principles and their wider implications. This spectrum is not unlimited. As I will endeavour to show, whereas it is rare not to find fluctuation and ambiguity in the application of virtually all principles governing investment proceedings, the divergence tends to settle or crystallise around a limited number – two, perhaps three and in some cases four – approaches or ways of applying a principle. Technically, these approaches are presented as "interpretations" of the applicable rules and, sometimes, they even purport to express common positions widely adopted in the jurisprudence. But, in fairness, they are conceptual stances, broad options within a spectrum of possibilities, that I will call for present purposes "converging principles" or, to use an expression of Aldo Moro that was kindly suggested to me by Professor Enzo Cannizzaro and that is fitting for a series of lectures delivered at the University of Rome, they can be seen as *convergenze parallele*.

[3] The ambiguous foundations of the investment arbitration were analysed, in particular, by Z. DOUGLAS, *The Hybrid Foundations of Investment Treaty Arbitration*, in *British Yearbook of International Law*, 2004, p. 151 *et seq*.

[4] The first author to have fully articulated this point was G. VAN HARTEN, *Investment Treaty Arbitration and Public Law*, Oxford: Oxford University Press, 2007.

[5] For two overviews of the debate see G. KAUFMANN-KOHLER, *Arbitral Precedent: Dream, Necessity or Excuse?*, in *Arbitration International*, 2007, p. 357 *et seq*.; G. GUILLAUME, *The Use of Precedent by International Judges and Arbitrators*, in *Journal of International Dispute Settlement*, 2011, p. 5 *et seq*.

[6] For two overviews of the debate see J. E. VIÑUALES, F. SPOORENBERG, *Conflicting Decisions in International Arbitration*, in *The Law and Practice of International Courts and Tribunals*, 2009, p. 91 *et seq*.; P. MAYER, *Conflicting Decisions in International Commercial Arbitration*, in *Journal of International Dispute Settlement*, 2013, p. 407 *et seq*.

The precise legal nature of these principles is difficult to characterise. I have noted that these approaches claim to be interpretations of the applicable rules but, strictly speaking, the treaties interpreted are in most cases different, although their wording may be to some extent similar. The fact that dozens of different treaties may be at stake and that only a few "interpretations" may be derived from them raises some doubt as to the "interpretative" nature of these common positions. There is, of course, an element of interpretation involved, but this interpretation is greatly influenced by a distillation of previous cases, particularly a distillation operated by authoritative commentary, that sets bounds to the spectrum of approaches available to tribunals. This is, of course, unless the treaty at stake contains unusual clauses or wording. At the same time, such common positions cannot be considered to be, technically, jurisprudential lines. This is not only because there is no doctrine of *stare decisis* in international law (or international investment law) but also because the material from which "lines" would be derived does not even refer to the same law. Finally, such principles cannot be taken as rules agreed by the parties as applicable to their dispute. Although this may be the case with respect to some rules derived from soft-law instruments,[7] or practices,[8] the parties to a dispute have no authority to either create conventional rules applicable to other potential parties or to turn a commonly agreed principle into customary law.[9] The latter point is sometimes forgotten by investment tribunals, who may find it convenient to merely state that both parties agree on the contents of a rule or on the fact that a rule has customary nature. All in all and, in fairness, the converging principles I will be discussing are conceptual positions that can rely on some authority, broadly understood, without necessarily enjoying a clear link to a formal source of law.[10]

The roadmap for the analysis begins with a brief characterisation of the wider context of international investment proceedings (section II). This is intended to emphasise

[7] See e.g. International Bar Association (IBA), Rules on the Taking of Evidence in International Commercial Arbitration, adopted by a resolution of the IBA Council of 29 May 2010.

[8] See e.g. the common use of the so-called "Redfern Schedule" to structure the document production phase in investment procedures.

[9] This point was clearly and strongly emphasised by the International Court of Justice (ICJ) in one of the most important and influential cases in the ICJ's history. See International Court of Justice, *Military and Paramilitary Activities in and against Nicaragua* (Nicaragua v. United States of America), judgment of 27 June 1986, para. 184 ("[t]he Court notes that there is in fact evidence, to be examined below, of a considerable degree of agreement between the Parties as to the content of international customary law relating to the non-use of force and non-intervention. This concurrence of their views does not however dispense the Court from having itself to ascertain what rules of customary international law are applicable. The mere fact that States declare their recognition of certain rules is not itself sufficient for the Court to consider these as being part of customary international law, and as applicable as such to those States").

[10] See on this issue my discussion of the "distance" between treaty norms and the detailed rules derived from them by investment tribunals: J.E. Viñuales, *The Sources of International Investment Law*, in S. Besson, J. d'Aspremont (eds), *The Oxford Handbook on the Sources of International Law*, Oxford: Oxford University Press, 2017, pp. 1069 *et seq*.

both the place of the principles discussed in these lectures, as finer-grained but identifiable positions within a limited range of possible understandings of a given norm, and the dimensions that must be taken into account in determining the implications of a given stance. In other terms, this first section discusses why stances are micro drivers of the system and why the bilateral relations between foreign investors and host States must be seen as just one aspect of a wider context. I then address three broad areas where converging principles can be detected, namely in connection with jurisdiction (section III), admissibility (section IV) and the merits of a dispute (section V). These are by no means the only areas relevant for the inquiry but they do offer a wealth of striking illustrations that are of significant practical importance for investment proceedings as such. For each area, I select a limited number of examples that are sufficient, in my view, to convey the general thesis advanced in these lectures regarding the need to focus on stances, as the true micro drivers of the system, and on their implications. I conclude my lectures with some observations on the implications of this thesis for legal scholarship, teaching and practice (section VI). By and large, I have tried to preserve in the written expression of my lectures the style and cadence that characterised their oral delivery. I must therefore ask for the indulgence of the reader for what may strike her/him as a certain *liberté de parole*, which I hold so dearly.

II. The broader context of investment proceedings

Investment arbitration proceedings do not take place in a *vacuum*. They aim to settle a dispute – sometimes only a dimension of the dispute – that may have much deeper roots and that expresses one avenue among many others of reaching a goal that an economic entity has set for itself. This is the broader context that must be taken into account in assessing the implications of different stances, and it can be characterised by reference to three observations.

Firstly, investment disputes only concern one relation, that between a foreign investor and the authorities of a host State, within a wider set of relations potentially involving interactions with populations affected by the investment scheme, different levels of governmental authorities and the authorities of another State (the home State or parties to relevant multilateral instruments). These other relationships are governed primarily by different norms of domestic and international law. It is a truism to note that the relations between the foreign investor and potentially affected individuals or populations are subject to the domestic law of the host State (e.g. tort law) but also, potentially, to that of other States (e.g. if the parent company of the investor is sued before the tribunals of the State where it has its headquarters under the law of that State). It seems also obvious that the relations between the authorities of the host State and the investor are subject to domestic law and, perhaps, to contractual arrangements (that may be subject to the domestic law of host State or that of another State, through a choice-of-law clause). The interactions between the host State authorities and the po-

tentially affected populations are governed both by domestic and international law, particularly by human rights instruments. State authorities have a duty to protect individuals within their territory (or jurisdiction) from deprivation of their human rights by a third party, such as an economic operator. Last but not least, there are other international obligations undertaken by the host State which also have a bearing on the way a State organises its legal framework providing protection not only to foreign investors but also to the individuals in its territory, certain groups or the natural environment. Such other obligations may concern the fight against corruption, labour standards, environmental protection, collective rights, and many others. Thus, all in all, investment schemes often intervene in the context of a wider State-Investor-Population triangle (SIP triangle).[11] International investment law only targets one aspect of this triangle, i.e. the relationship between the foreign investor and the host State. And, in turn, investment arbitration proceedings only address one sub-component of this partial aspect, as further discussed below.

Indeed, investment proceedings are only a segment of the overall relationship between the foreign investor and the host State. When this relationship becomes conflicting, at least three main stages can be distinguished with the process of dispute settlement, moving from the pre-litigation phase (where investment law and lawyers intervene to prepare the dispute but also to assess its prospects, e.g. when a third party is considering the acquisition of the affected entity or providing finance to pursue the claim), to the litigation phase (itself with several components), to the enforcement phase (whether through judicial means or through alternative means). The litigation phase can be conceptually sub-divided into at least four main components, namely the jurisdictional, admissibility, merits and quantum phases, with some additional incidental proceedings, such as interim relief. Moreover, new proceedings can be brought to challenge the award (annulment or set aside) or seek its recognition and enforcement. All these phases are well-known but, given the fact that I will focus only on some of them, it may be useful to recall some basic distinctions: at the jurisdictional phase, a tribunal must answer the question of whether it has the power to hear the dispute; at the admissibility phase, the tribunal must assess whether it should use such power; at the merits phase the tribunal, in the exercise of such power, must make a decision on the claims and arguments advanced by each party. The law applicable to investment proceedings concerns all their phases, although the rules will normally be different for each question addressed by the tribunal, and I will analyse it transversally.

The latter point connects the second observation with the third one, namely that the system of investment arbitration as we understand it today is not the only possible

[11] On the SIP triangle see J.E. Viñuales, *International investment law and natural resource governance*, in K. Kulovesi, E. Morgera (eds), *Research Handbook on International Law and Natural Resources*, Cheltenham: Edward Elgar, 2016, pp. 26-45.

expression of the very legal architecture upon which it rests. This is important to understand why stances are important micro drivers of how the system effectively operates. Over time, the system has been structured around two main concepts: the law and judge of foreign investment.[12] Historically, the initial forms of foreign investment protection relied on the extraterritorial application of the home State's laws as well as on the extraterritorial jurisdiction of its tribunals over disputes involving nationals from capital-exporting countries. This specific expression of the two components of the system progressively gave way to internationalised or international forms of both the law and the judge through the development of mixed commissions and international minimum standards of treatment of aliens. Today, the prevailing understanding emphasises a combination of investment treaties and *ad hoc* investment arbitration tribunals. But even such an understanding leaves significant room for a more integrative – and more accurate – view where "emphasis" is not conflated with a "quasi monopoly" of either investment treaties or investment tribunals. I use the rather strong expression of "quasi monopoly" to highlight that, through a number of apparently innocuous stances or "principles" (e.g. treaty – rather than contract – arbitration, distinction between treaty and contract claims, generous interpretations of arbitration clauses), investment treaties have come to displace domestic, contractual and even customary international law, and investment tribunals have substituted themselves for domestic courts or contractual arbitration *fora*. The stances or principles that have enabled such an idiosyncratic state of affairs are by no means a necessary corollary of the existence of treaties or arbitration institutions/rules. There are alternative competing principles that, on the same legal architecture, would lead to a very different system. And this is all the more striking if one considers that, as I mentioned in the previous section, the legal foundations of all these principles are neither clear nor necessarily solid.

Combining these three contextual observations, my purpose in what follows is to shed light on the current idiosyncratic understanding of investment arbitration by reference to certain key stances or principles relating to the jurisdictional, admissibility and merits phases. In doing so, I hope to show that such understanding results from principles that have no clear legally-grounded priority (or claim to priority) over other possible principles relating to the same question, and that this state of affairs has important consequences for both the operation of investment law and for the wider SIP triangle.

[12] For a concise presentation of this evolution see J.E. VIÑUALES, *L'État face à la protection internationale de l'entreprise: Regards sur le droit international des investissements contemporain*, in A. SUPIOT (ed.), *L'état de l'entreprise dans un monde sans frontières. Perspectives économiques et juridiques*, Paris: Dalloz, 2015, pp. 103-114.

III. The scope of jurisdictional power

The scope of jurisdiction of investment tribunals is conditioned upon the dispute relating to an "investment" in the host State. The term "investment" is misleadingly simple, and it has been the object of much controversy leading to a rather volatile body of jurisprudence. For that very reason, it provides a useful field of inquiry for the identification of different stances or principles that converge towards settled, though parallel, solutions. Rather than merely describing a series of cases and noting their diverging positions, the purpose of this section is to map the conceptual problems that they raise, often implicitly, and the limited set of potential answers that may be given to them. Specifically, I will discuss three series of problems: whether the definition of "investment" is subjective or objective; in the latter case whether it contains a requirement that the transaction contributes to the development of the host State; and whether legality of the investment is a requirement of its existence or of its protection.

III.1. Objective v. subjective definitions of investment

The first question can be introduced by reference to the *Poštová Banka v. Greece* case.[13] In this case, two financial entities, one based in the Slovak Republic and the other in Cyprus, claimed to hold an investment in Greece, in the form of Greek bonds, which had been allegedly treated in breach of the treaties between, respectively, the Slovak Republic and Greece and Cyprus and Greece. The tribunal decided the case on a pragmatic basis reasoning that the Cyprus investor, as a mere shareholder of the Slovak investor, did not have legal rights over the bonds and, as regards the Slovak investor, that the bonds were not encompassed by the definition of investment of the applicable treaty. But for present purposes the interest of the decision lies elsewhere, namely in that the tribunal was prompted by the parties to embark on a mapping exercise of the different positions regarding the definition of investment.[14]

In this mapping exercise, the tribunal identified two positions followed by arbitral tribunals. The first, which can be traced back to the so-called "Salini test" holds that there are some core contents of the definition of investment.[15] The consequences of such contents vary depending on the context. For arbitration proceedings under the aegis of ICSID, the main implication is that unless the core contents are met an ICSID tribunal would have no jurisdiction over the dispute. Other tribunals have extended this implication beyond the ICSID context emphasising the need to look beyond words, even the words used in a bilateral treaty to define the term investment, and concentrate on

[13] ICSID, award of 9 April 2015, case no. ARB/13/8, *Poštová banka, a.s. and Istrokapital s.e. v. Hellenic Republic*.

[14] *Ibid*., paras 351-359.

[15] See ICSID, decision on jurisdiction of 31 July 2001, case no. ARB/00/4, *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, para. 52.

the reality of the transaction, which must involve a financial contribution, risk and certain duration.[16] The second position holds that the term investment has whatever meaning the States parties to a treaty intended to give it. Thus, even those transactions that epitomise in common language the opposite of making an investment (e.g. debt by contrast to equity, or a sale of goods by contrast to foreign direct investment)[17] would be an "investment" if included in a relevant provision of a treaty.[18] Depending on the context, this position may be limited to non-ICSID arbitration, which relies only on a treaty, or even to ICSID arbitration under the theory that Article 25 of the ICSID Convention merely mirrors the definition of investment included in the relevant treaty.[19]

Faced with these different solutions, the first impression that one may gather concerns the significant volatility of the investment case law. Yet, the two positions, even with their fluctuations depending on whether or not they cover ICSID and non-ICSID contexts, form important poles of attraction or convergence. The *Poštová Banka* case offers a good illustration of this point. Indeed, in reaching its conclusion, the tribunal noted that: "[t]he rule of interpretation of Article 31 of the Vienna Convention on the Law of Treaties must be applied to each treaty in particular, and not seeking to create general categories or classifications of treaties, depending on whether the definition is broad or closed".[20]

The majority of the tribunal later seemed to characterise its own approach of the treaty as following a subjective test,[21] but it added that it would have reached the same conclusion had it applied an objective test under Art. 25 of the ICSID Convention.[22]

In the context of these lectures, the gravity pull of these two positions is not mentioned to reassure the reader as to the innocuous character of theory (as it will become apparent in what follows, the conceptual distinction carries important practical consequences). It is noted to emphasise the need, for commentators but also for practitioners, to focus on analysing the implications of each position, rather than on this or that treaty or this or that case. It is the positions, the poles or principles towards which cases converge, even if parallel, that should be our analytical object. And our task is to identify

[16] See e.g. Permanent Court of Arbitration, award of 26 November 2009, case no. AA280, *Romak S.A. v. The Republic of Uzbekistan*, para. 180, as well as para. 207.

[17] See e.g. ICSID, award of 1 December 2010, case no. ARB/09/11, *Global Trading Resource Corp. and Globex International, Inc. v. Ukraine*, rejecting a claim based on a sale of goods as manifestly without merit under Art. 41, para. 5, of the ICSID Arbitration Rules, paras 41-59, or *Romak v. Uzbekistan*, cit., para. 242.

[18] See e.g. ICSID: award of 8 November 2010, case no. ARB/07/16, *Alpha Projektholding GmbH v. Ukraine*, para. 314; decision on jurisdiction and admissibility of 8 February 2013, case no. ARB/08/9, *Ambiente Ufficio S.P.A. and Others (formerly Giordano Alpi and Others) v. Argentine Republic*, para. 462.

[19] See e.g. ICSID, decision on the application for annulment of 16 April 2009, case no. ARB/05/10, *Malaysian Historical Salvors v. Malaysia*, para. 73.

[20] See *Poštová banka v. Greece*, cit., para. 287.

[21] *Ibid*., para. 360.

[22] *Ibid*., para. 371 (the observations of the tribunal seem to be of general application but the section under which they are offered specifically refers to the ICSID Convention).

them and then to spell out in as much detail as possible their legal and policy implications for the operation of the investment arbitration system, keeping in mind the wider context of the SIP triangle. In the next paragraphs, I provide two illustrations of the implications of siding with one or the other position.

III.2. Contribution to the development of the host State

One significant implication of retaining an objective definition of the term "investment" is that such definition involves stable components. Depending on the components that are (or not) considered to define the core of an investment scheme, many transactions or assets may (or may not) be covered. Obvious examples that may be excluded from a traditional objective definition include loans (or other money claims), bonds or other public securities, intellectual property rights, regulatory authorisations, sales transactions or short-term financial placements. In this section, I discuss one component that received much attention in a stream of cases, namely the contribution to the development of the host State. Although some commentators and tribunals have expressed doubt as to the relevance of this component on grounds of economic liberalism, no one is more ironic than history itself, with its current wave of protectionism and illiberalism in what seemed to be the least exposed quarters. Underpinning the "development" component is the other – often forgotten – objective of investment treaties, namely the promotion of prosperity through the facilitation of investment flows.

This debate can be introduced by reference to the *Malaysian Historical Salvors v. Malaysia* case.[23] The dispute concerned alleged rights derived from a contract for the location and salvage of the cargo of a British vessel that ran aground in 1817 in an area now under Malaysian waters. The sole arbitrator declined jurisdiction on the basis of an objective understanding of the term "investment" in Art. 25 of the ICSID Convention,[24] encompassing not only the usual financial contribution, duration and risk but also the need that the transaction contributes to the development of the host State, derived from the preamble of the ICSID Convention.[25] Reasonable minds may disagree, but the decision of the sole arbitrator was cautious and thoroughly argued. Yet, it was met with great scepticism by a majority of an *Ad Hoc* Committee, which annulled the award for its

[23] See ICSID, award of 17 May 2007, case no. ARB/05/10, *Malaysian Historical Salvors v. Malaysia*.

[24] The sole arbitrator discusses two stances, i.e. the typical characteristics approach and the jurisdictional approach, but both are expressions of an objective, albeit flexible and pragmatic, definition of the term investment. See *ibid*., paras 70-72.

[25] *Ibid*., para. 66 (interestingly, the decision refers here to a case where the reference to the development of the host State was used to reach the conclusion, on the basis of a subjective understanding of the term investment, that a loan constituted an investment because it contributed to the development of the host State), para. 124 (noting that when the other components are superficially met, the contribution to the development of the host country becomes more important), and paras 125-146 (rejecting the existence of an investment on grounds of lack of contribution to development).

reliance on the need for a transaction to contribute to the development of the host State.[26] The position of the majority of the *Ad Hoc* Committee is in my view debatable but, for present purposes, what must be emphasised is that to reach its conclusion the Committee had to turn the definition of investment in the ICSID Convention first into a very broad objective one (limited to the acknowledgement that "investment does not mean sale")[27] and then into a subjective definition, recognising its dependence upon the 1700 investment treaties concluded since the adoption of the ICSID Convention:

> "While it may not have been foreseen at the time of the adoption of the ICSID Convention, when the number of bilateral investment treaties in force were few, since that date some 2800 bilateral, and three important multilateral, treaties have been concluded, which characteristically define investment in broad, inclusive terms such as those illustrated by the above - quoted Article 1 of the Agreement between Malaysia and the United Kingdom. Some 1700 of those treaties are in force, and the multilateral treaties, particularly the Energy Charter Treaty, which are in force, of themselves endow ICSID with an important jurisdictional reach. *It is those bilateral and multilateral treaties which today are the engine of ICSID's effective jurisdiction. To ignore or depreciate the importance of the jurisdiction they bestow upon ICSID, and rather to embroider upon questionable interpretations of the term "investment" as found in Article 25(1) of the Convention, risks crippling the institution*".[28]

Again, reasonable minds may disagree, and one Committee member strongly disagreed, but the point that deserves to be noted is the move from one pole (the objective definition) towards the other pole (the subjective definition) in order to dismiss the importance of the development component. Curiously, the majority seems to assume that it is an unquestionably good thing to expand the scope of jurisdiction under ICSID even beyond the very limits initially envisioned at the time of the adoption of the ICSID Convention. That was the consensus prevailing in investment arbitration circles a decade ago. It is no longer so obvious but that is not the topic of my lecture. For now, it will suffice to emphasise two points. One is that, as I mentioned earlier, the policy – even ideological – cleavage underpinning the debate over the "development" requirement is deep and opposes neoliberalism to developmentalism. The other is that, despite the shifts in perception and the surge in investment cases, the principles towards which the solutions converge remain relatively stable, namely an objective versus a subjective definition.

III.3. Legality of investments

Another implication of retaining an objective or a subjective definition of investment concerns the legality of investments. Some tribunals have considered that the legality

[26] *Ibid.*, paras 62-63, 69, and 71-72.
[27] *Ibid*., para. 72.
[28] *Ibid*., para. 73.

and even the good faith of the investment are a definitional feature, rather than a condition for the protection of investments. Indeed, in *Anderson v. Costa Rica*[29] the tribunal considered that there could be no investment in a transaction that was a hoax (a so-called "Ponzi scheme") and therefore had no legal existence. In a similar vein, the tribunal in *Phoenix v. The Czech Republic* reasoned that the restructuring of an investment scheme for the purpose of gaining protection under the applicable treaty was not merely inadmissible; it meant that there was no "investment" under the treaty.[30] Although at the jurisdictional level the end result of this position may be similar to that of considering illegality as a condition for the protection of an otherwise existing investment, there are potentially important implications of retaining one or the other stance.

These implications can be understood by reference to the widely accepted distinction between initial and subsequent illegality of an investment.[31] This distinction has been used to separate jurisdictional effects (a tribunal has no jurisdiction because, in case of initial illegality, there is no protected investment) from consideration at the merits stage (a tribunal can assert jurisdiction but, in its consideration of the merits, it will take into account the illegality in the operation of the investment). Such a distinction would only be possible if legality is not a definitional component of the term "investment". Indeed, if an asset, transaction or scheme needs to be lawful in order to be an investment, then it is less relevant when it became unlawful. As soon as it became so, there is no longer an investment, which is a pre-condition for a tribunal to exercise jurisdiction. By contrast, if legality is not a definitional component, then different forms of illegality may display different effects in a procedure. Such effects may concern not only jurisdiction, but also admissibility or the merits and, hence, the distinction between initial and subsequent illegality remains fully relevant. An investment that has been made legally but subsequently becomes inconsistent with the laws of the host country (e.g. an intellectual property right that has been declared invalid, a regulated company that has continued operation without renewing a permit or without meeting important safety standards, an extractive industry scheme that has massively polluted the surrounding

[29] See ICSID, award of 10 May 2010, case no. ARB(AF)/07/3, *Alasdair Ross Anderson and others v. Costa Rica*, paras 51-61.

[30] See ICSID, award of 15 April 2009, case no. ARB/06/5, *Phoenix Action, Ltd. v. The Czech Republic*, para. 114.

[31] On this distinction see ICSID: award of 16 August 2007, case no. ARB/03/25, *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines*, para. 345; award of 29 July 2015, case no. ARB/10/15, *Bernhard von Pezold and others v. Republic of Zimbabwe*, para. 420; award of 22 August 2016, case no. ARB(AF)/12/5, *Rusoro Mining Ltd. v. Bolivarian Republic of Venezuela*, para. 289 *et seq*.. Permanent Court of Arbitration: final award of 18 July 2014, case no. AA 226, *Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, paras 1354-1356; final award of 18 July 2014, case no. AA 227, *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, paras 1354-1356; final award of 18 July 2014, case no. AA 228, *Veteran Petroleum Limited (Cyprus) v. The Russian Federation*, paras 1354-1356; award of 15 march 2016, case no. 2012-2, *Copper Mesa Mining Corporation v. Republic of Ecuador*, para. 5.54 *et seq*.

area or bullied the affected populations by means of a private military company) would exist for jurisdictional purposes but the claims may not be admissible (i.e. the tribunal may not use its adjudicative power) or the company's actions may be such that the measures taken by the host State are entirely justified on the merits of the case. Such a wider set of effects only comes into play if legality is not a definitional component but a condition to be taken into account in deciding whether or not to grant protection to an investment and to what extent.

As before, reasonable minds may disagree as to the most appropriate stance but what must be emphasised is the fact that legality has converged towards two parallel positions, one where it is viewed as a definitional component and the other – more frequent – where it is considered as a requirement conditioning the (extent of) protection of an investment. Within the latter position, a number of finer-grained positions can be identified, particularly as regards the laws that must be taken into account in defining legality or the effects of initial illegality (jurisdiction or admissibility). These more specific positions have significant implications from the perspective of the SIP triangle, as they provide different degrees of relevance to laws protecting other interests. Over time, the scope of the laws that must be taken into account to assess the initial (il)legality of an investment has been broadened. One could interpret these developments as a jurisprudential line suggesting the emergence of a general principle under which a range of laws, including not only fundamental prohibitions (e.g. corruption),[32] but also domestic investment laws,[33] as well as other relevant laws (e.g. environmental permits),[34] are relevant for the assessment of initial (il)legality. But it is also possible to interpret this body of cases as pointing to a limited set of parallel solutions, particularly because early stances have been iterated in subsequent cases.[35] Whether different stances are steps in an incremental line or parallel convergences is difficult to decide in a context as volatile as investment treaty arbitration. What can instead be asserted with some confidence is that the range of possible solutions is relatively stable, with three main stances around which cases convergence. As discussed next, there is also some variation as to the consequences to be derived from this initial illegality.

[32] See e.g. ICSID, award of 2 August 2006, case no. ARB/03/26, *Inceysa Vallisoletane, SL v. El Salvador*, paras 252, 257 and 264.

[33] See e.g. ICSID, award of 12 July 2010, case no. ARB/07/20, *Saba Fakes v. Turkey*, para. 119.

[34] See e.g. ICSID, award of 30 March 2015, case no. ARB/11/24, *Mamidoil Jetoil Greek Petroleum Products Societe Anonyme S.A. v. Republic of Albania*, paras 372 and 378.

[35] For a subsequent iteration of the approach followed in *Inceysa v. El Salvador*, cit., see Permanent Court of Arbitration, award of 19 September 2013, case no. 2010-5, *ECE Projektmanagement International GmbH and Kommanditgesellschaft PANTA Achtundsechzigste Grundstücksgesellschaft mbH & Co v. Czech Republic*, paras 3.170-3.171. For a subsequent iteration of the approach in *Saba Fakes v. Turkey*, cit., see ICSID, award of 4 October 2013, case no. ARB/10/3, *Metal-Tech Ltd. v. Republic of Uzbekistan*, para. 165.

IV. The uncertain place of admissibility

Conceptually, the difference between considerations of jurisdiction and admissibility is very clear: whereas the former relate to whether a tribunal has the power to adjudicate a dispute, the latter concern the question of whether the tribunal should use this power. Significantly, whether a matter relates to jurisdiction or admissibility has also several practical implications. One commentator notes that the scope of review applicable to a tribunal's decision on the existence of its adjudicative power is different from the one applicable to decisions in the exercise of the tribunal's jurisdiction, including admissibility.[36] It could be added that the burden and standard of proof applicable to jurisdictional and admissibility matters also differs. Whereas the claimant bears the burden of proving the facts and conditions sustaining jurisdiction, the burden of establishing reasons why a tribunal should not use its adjudicative power lies with the respondent, and the standard may for some of those reasons be more demanding.[37] In light of these and other potential differences,[38] characterising an objection as a matter of jurisdiction rather than as one of admissibility is not a purely conceptual exercise. Yet, in practice, tribunals have taken different stances that I will illustrate by reference to two main questions, namely the (il)legality of investments and indirect shareholder claims.

IV.1. Illegality between jurisdiction and admissibility

In the previous section, I referred to the role of (il)legality in assessing whether a tribunal has jurisdiction over a claim. I mentioned that two main positions have been formulated in this regard depending on whether legality is a definitional component of the term investment or a condition for its protection. As noted earlier, in the latter case, the effects of illegality may concern not only jurisdictional matters but also admissibility matters or even the merits of the case. Such a broader palette of possible effects has resulted in an additional spectrum of stances regarding what is essentially the same question, namely that the investment was initially tainted by a violation of the laws of the host State.

There are two main stances that serve as poles of attraction to the solutions envisaged by tribunals. Illegality is most often framed as defeating "consent" and therefore depriving the tribunal of its jurisdictional basis. As discussed in the previous section, there is some variability as to the types of illegality, but the end result is that States have not con-

[36] Z. Douglas, *The International Law of Investment Claims*, Cambridge: Cambridge University Press, 2009, para. 307.

[37] See e.g. Permanent Court of Arbitration, award on jurisdiction and admissibility of 17 December 2015, case no. 2012-12, *Philip Morris Asia Limited v. Commonwealth of Australia*, paras 495, as well as 509 and 536 for an application; ICSID, award of 2 March 2015, case no. ARB/10/13, *Hassan Awdi, Enterprise Business Consultants, Inc. and Alfa El Corporation v. Romania*, para. 212.

[38] See e.g. ICSID, decision on liability of 29 December 2014, case no. ARB/07/31, *HOCHTIEF Aktiengesellschaft v. Argentine Republic*, para. 149.

sented to provide protection to such assets or schemes. By way of illustration, in *Inceysa v. El Salvador*, this conclusion was reached both in connection with international public policy and, in clearer terms, as regards the prohibition of unlawful enrichment: "In conclusion, the Tribunal considers that because Inceysa's investment was made in a manner that was clearly illegal, it is not included within the scope of consent expressed by Spain and the Republic of El Salvador in the BIT and, consequently, the disputes arising from it are not subject to the jurisdiction of the Centre. Therefore, this Arbitral Tribunal declares itself incompetent to hear the dispute brought before it".[39]

The underpinning rationale is not that there is no "investment" but that, due to its illegality, States cannot have intended to afford it protection, including through the possibility to bring an investment claim before an arbitral tribunal.

The effects of illegality are, however, not always stated with such clarity. A case at the borderline between jurisdiction and admissibility is *World Duty Free v. Kenya*, where the tribunal considered that a contract secured by means of a bribe paid to the then Kenyan President could not be enforced. The tribunal seems to consider that there is no basis for jurisdiction as the contract is not valid, but it states its conclusions on language reminiscent of inadmissibility:

> "In light of domestic laws and international conventions relating to corruption, and in light of the decisions taken in this matter by courts and arbitral tribunals, this Tribunal is convinced that bribery is contrary to the international public policy of most, if not all, States or, to use another formula, to transnational public policy. Thus, claims based on contracts of corruption or on contracts obtained by corruption cannot be upheld by this Arbitral Tribunal".[40]

The stance taken by the tribunal is made complex by the fact that the instrument on which the claimant relied to assert the jurisdiction of the tribunal was the contract secured by corruption, rather than an overarching investment treaty.

A clearer stance regarding the inadmissibility implications of illegal transactions is provided by the decision in *Churchill Mining and Planet Mining v. Indonesia*. In this case, the tribunal reasoned that a claim based on rights that had been secured by fraud or forgery, even if such acts were attributable to the entity that had transferred these rights to the claimant, were inadmissible.[41] Underpinning this conclusion are some case-specific considerations, including the fact that the Claimants had been negligent in inquiring into the processes used by its local partner as well as, quite surprisingly, in presenting some of the forged documents at stake as evidence in the arbitration pro-

[39] See *Inceysa v. El Salvador*, cit., para. 257.

[40] See ICSID, award of 4 October 2006, case no. ARB/00/7, *World Duty Free Company Limited v. Republic of Kenya*, para. 157.

[41] See ICSID, award of 6 December 2016, case no. ARB/12/14, *Churchill Mining PLC and Planet Mining Pty Ltd v Republic of Indonesia*, para. 508.

ceedings. Interestingly, the tribunal expressly referred to the palette of effects that may arise from fraudulent conduct:

> "[t]he legal consequences of fraudulent conduct depend to a large extent on the circumstances of each case, which may include the applicable treaty, the seriousness of the fraud, the role of the disputing parties or third parties in relation to the fraud, the nexus between the fraud and the claims, and the time when the fraud was committed. A review of international cases shows that fraudulent conduct can affect the jurisdiction of the tribunal, or the admissibility of (all or some) claims, or the merits of a dispute".[42]

This statement is correct if one sees, as most tribunals, the (il)legality of the investment not as a definitional component but as condition for its (full) protection. At the same time, the tribunal is implying than a finer-grained inquiry is necessary to understand the implications of fraudulent conduct.

The three decisions discussed in the previous paragraphs do not illustrate three stances, but only two, with *World Duty Free v. Kenya* somewhat in the middle to further highlight that there are two main poles of attraction for the solutions offered by tribunals. If a merits dimension is added, a range of new possibilities arises but only provided that the relevant claim falls under the jurisdiction of a tribunal and is admissible. I have discussed some aspects of this question elsewhere.[43] For present purposes, the main point lies in the level of analysis suggested by these cases as one which is not merely that of a rule-by-rule (too broad) or a case-by-case (too narrow) basis but, instead, one that focuses on possible solutions, parallel stances, that serve as poles of attraction for the case law.

IV.2. Indirect shareholder claims

The question of indirect shareholder claims presents some similarities with that of the characterisation of the term investment. Indeed, for a claim brought by a shareholder of a company which is, in turn, a shareholder of a company constituted in the host State, to be possible, the claimant must qualify as a "foreign investor" holding an "investment" under the terms of the applicable treaty. Aside from the questions arising from the term "investment" itself, which I have discussed to some extent earlier, two additional points relate to whether there is a "foreign investor" under the treaty as well as to whether it is a proper claimant. These three questions (investment, foreign investor, admissibility) have offered three different avenues to address the issue of indirect shareholder claims, with diverging solutions within each avenue.

[42] *Ibid*., para. 494.

[43] See J.E. Viñuales, *Investor Diligence in Investment Arbitration: Sources and Arguments*, in *ICSID Review-Foreign Investment Law Journal*, 2017, p. 346 *et seq*.

A convenient way of organising the discussion is to proceed chronologically, starting with the position under general international law as formulated by the ICJ in the *Barcelona Traction* case.[44] The facts of the case are well-known. Belgium brought an action before the ICJ against Spain in an attempt to exercise diplomatic protection of the Belgian shareholders of a Canadian company acting in Spain, for losses sustained by the company. One of the preliminary objections submitted by Spain was that Belgium lacked *jus standi* to bring a claim on behalf of Belgian interests in a Canadian company and, therefore, the claim was inadmissible. The Court framed the question in admissibility terms inquiring whether the losses allegedly suffered by Belgian shareholders were a result of a breach of rights of which such shareholders (rather than the company itself) were the beneficiaries. Because the company had a separate legal personality and the measures challenged affected the company's rights (and not the shareholders' rights, but merely their interests),[45] Belgium had no *jus standi* to bring a claim. There is some controversy as to whether the ICJ chamber in the *ELSI* case abandoned this stance in favour of the admissibility of shareholder claims.[46] But in a more recent decision, the full court confirmed the stance taken in the *Barcelona Traction* case according to which the legal personality of companies means that a company has "rights over its own property, rights which it alone is capable of protecting".[47] But the ICJ also noted that an exception to this rule – allowing the "protection by substitution" of shareholder for the company – can be introduced by an investment treaty.[48]

The discussion of the *Barcelona Traction* case provides the fall back stance against which the investment case law has framed the question of indirect shareholder claims. Two such framings, each allowing for different stances, can be identified. Both dismiss the relevance of the *Barcelona Traction* stance, but on different grounds. On the one hand, a treaty may assimilate a local company controlled by foreign shareholders to a foreign company. Thus, an otherwise local company could bring a claim to protect its own rights as if it were a foreign investor. On the other hand, the definition of investment is often broad enough to include "shares" in local companies. The "rights" – by contrast to mere interests – of which shareholders are direct beneficiaries are thereby broadened in such a way that a shareholder bringing a claim for measures against the local company is exercising its own rights, not protection (of the company) by substitution. In both cases, questions of admissibility are thus converted (sometimes debatably)

[44] International Court of Justice, *Barcelona Traction, Light and Power Company, Limited* (Belgium v. Spain), judgment of 15 February 1970, para. 3.

[45] *Ibid*., para. 44.

[46] International Court of Justice, *Elettronica Sicula S.p.A. (ELSI)* (United States of America v. Italy), judgment of 20 July 1989, para. 15.

[47] International Court of Justice, *Ahmadou Sadio Diallo* (Republic of Guinea v. Democratic Republic of the Congo), preliminary objections, judgment of 24 May 2007, para. 61.

[48] *Ibid*., para. 88.

into questions of jurisdiction because what a tribunal must assess is whether there is an "investment" by a "foreign investor" under the applicable treaty and potentially the ICSID Convention. Thus, whereas the *Barcelona Traction* stance focuses on admissibility, these two other avenues focus on jurisdiction. Up to now, the situation is relatively simple, although it may raise questions such as those discussed in connection with the definition of investment.

The analysis becomes more complex when the shareholders' claim becomes genuinely indirect. The situation then involves at least three layers, namely the shareholders (nationals of State A) of a company incorporated either in a third State (State B) or in the host State (State C), which is itself a shareholder of a company incorporated in host State. The applicable treaty, including the arbitration clause, is between State A and State C. The equation could be much more complex if there are more than three layers of shareholding, different levels of participation (majority or minority), and several applicable treaties. The three avenues identified in the previous paragraphs arise again, but I would like to focus on two of them, namely the question of whether there is an investment (for jurisdictional purposes) or whether the indirect shareholder claim is admissible.

The first question is whether there is an "investment" under the applicable treaty or potentially the ICSID Convention as well. Investment tribunals have taken two stances in this regard. Some tribunals, relying on either specific wording of the applicable treaty or on a broad interpretation of it, have considered that indirectly held shares amount to an investment.[49] This is problematic because it means that the legal personality of the company in State B is being ignored, even if such corporate screen is useful for other purpose such as tax optimisation or other form of corporate structuring. The "suppression" of this corporate layer can rely on the "economic reality" of the transaction, although the ICJ had expressly discarded such a possibility, except in exceptional circumstances, in the *Barcelona Traction* case. The economic reality of the transaction is thus selectively taken into account. It does indeed exist for, e.g. tax purposes, but it does not exist for investment claims purposes or for the purpose of extending the obligations arising from a contract between the host State and the company to the shareholder. Moreover, selectivity is even clearer if one compares the suppression of the intermediate corporate screen with other questions where disregard of formalities would be

[49] On this question see generally D. Bentolila, *Shareholders' Action to Claim for Indirect Damages in ICSID Arbitration*, in *Trade, Law and Development*, 2010, p. 115 *et seq.*, referring to ICSID: decision on jurisdiction of 3 August 2004, case no. ARB/02/8, *Siemens A.G. v. Argentine Republic*, paras 137-142; decision on jurisdiction of 29 June 1999, case no. ARB/98/4, *Wena Hotels Limited v. Arab Republic of Egypt*, paras 45-46; decision on objections to jurisdiction of 11 May 2005, case no. ARB/02/16, *Sempra Energy International v. Argentine Republic*, para. 90/91; decision on objections to jurisdiction, case no. ARB/03/2, *Camuzzi International S.A. v. Argentine Republic*, para. 63; decision of the tribunal on preliminary objections to jurisdiction, case no. ARB/03/10, *Gas Natural SDG, S.A. v. Argentine Republic*, paras 33-35. UNCITRAL Arbitration Rules, award of 3 September 2001, *Lauder v Czech Republic*, para. 77.

much more warranted, such as the artificial distinction between treaty and contract claims, which in economic reality relate to the very same transaction. Whether disregarding the intermediate corporate screen is an explicit (through a focus on the "economic reality" of the transaction) or an implicit step (by inflating the definition of investment so as to turn any interest into a direct right), this solution greatly facilitates treaty shopping, parallel proceedings and potentially double-recovery. However, some tribunals have applied a more rigorous and, in my view, legally accurate test, stating that that shareholders in State A have no rights on the assets of either the intermediate company in State B or C (which includes the shares in the company in State C) or the end company in State C. This was the reason why the tribunal in the *Poštová Banka* case declined jurisdiction *ratione materiae* to hear the claim of the Cyprus investor, itself a shareholder of the Slovak investor, who had identified as its investment the Greek bonds owned by the Slovak investor.[50] Despite their stark difference of approach, the two stances share the fact that they analyse the "indirectness" of the claim through the prism of jurisdiction, specifically whether there is an investment.

A different way of approaching this question is through the prism of admissibility,[51] as the ICJ has done in its case law. The question would then be whether the claimants (shareholders in State A) are the proper party to bring a claim in light of the object of the claim and, more specifically, of whether they hold rights protected under the applicable treaty or mere interests. Depending on the challenged measures and the affected rights, the proper party to bring the claim may be the company in State C (if considered a "foreign investor" under the treaty or simply through domestic remedies) or the intermediate company in State B or C (if a suitable treaty is applicable). In such a case, a claim brought by the shareholders in State A would simply be inadmissible (as was the claim brought by Belgium on behalf of Belgian shareholders in the Barcelona Traction). This stance would have significant implications not only for the limitation of treaty shopping, parallel proceedings, and potentially double-recovery, but also for the proper role of economic reality in investment proceedings. It does not seem acceptable that for purposes of indirect shareholder suits, the economic reality of a transaction is taken into account (thus facilitating access to investment treaty arbitration) but, when it comes to determining whether treaty and contract claims are essentially the same, the eco-

[50] *Poštová banka v. Greece*, cit., paras 228-247. A variation of this approach, also emphasising a less expansive interpretation of the term investment, is provided by ICSID, award of 2 November 2012, case no. ARB/10/12, *Standard Chartered Bank v. United Republic of Tanzania*, paras 257-270. In this case, the tribunal considered that investment requires an active role: "protection of the UK-Tanzania BIT requires an investment made by, not simply held by, an investor [...] it would be unreasonable to read the BIT to permit a UK national with subsidiaries all around the world to claim entitlement to the UK-Tanzania BIT protection for each and every one of the investments around the world held by these daughter or granddaughter entities", para. 270.

[51] See ICSID, decision on annulment of 25 September 2007, case no. ARB/01/08, *CMS Gas Transmission Company v. Argentine Republic*, para. 75, as well as paras 89-97.

nomic reality of the transaction is disregarded (thus further facilitating access to investment treaty arbitration and even limiting the impact of a carefully negotiated contract, often required by a tender process).

As in previous sections, let me add that reasonable minds may and have disagreed on such questions, but my point is different, namely that the analytical level at which such questions should be analysed is given by these parallel solutions. These are the silent micro drivers of a system that has come under so much criticism in the last years. And the analysis of these parallel stances must take into account their systemic effects, which are far from negligible. As I will discuss in the next section, the same reasoning is applicable to stances taken by tribunals in connection with the consideration of the merits of a case.

V. (Over-)Reliance on investment treaties

International lawyers working on and writing about international investment law have tended to rely, perhaps too much, on investment treaties, whether bilateral investment treaties (BITs) or investment chapters in free trade agreements (FTAs). International investment agreements (IIAs) certainly play an important role, as they provide the most frequent basis for investment claims. However, they are far from being the only source of the law applicable to foreign investment disputes, which equally encompasses at the very least domestic law, perhaps contractual arrangements, as well as other customary and treaty-based rules of international law.

Over-reliance upon IIAs is partly the result of some confusion between jurisdiction and applicable law. The fact that an arbitration clause may be limited to claims for breach of the relevant IIA does not mean that the only applicable law is that treaty. This should be a truism for any tribunal. Arbitration clauses may be relevant to determine the scope of the law applicable to the dispute, but they are not decisive. Questions of treaty law or State responsibility, which arise from customary international law, or legal aspects on which international law says little, such as corporate structure or intellectual property rights, are regularly addressed in investment disputes. Even when the treaty contains a clause defining the applicable law as "the treaty and other rules of international law", some questions will necessarily have to rely on domestic law. This is, however, not the issue that I would like to address here.[52] Instead, I would like to focus on the relations between treaty and custom in investment disputes in order to highlight, as before, different stances taken in the jurisprudence and some of their implications.

[52] See J.E. Viñuales, *The Sources*, cit., p. 1086 *et seq*.

V.1. Treaty and custom in investment arbitration

As noted earlier, reference to customary law in investment arbitration is not a particularly controversial question.[53] Tribunals routinely make reference to the customary law of treaties, particularly to the rules on treaty interpretation, or to customary rules on State responsibility. This is rather obvious. What is more difficult to map is the exact operation of such references. Over-reliance upon IIAs as *lex specialis* may obscure the many ways in which customary norms can be articulated with provisions in an IIA: *i*) to interpret such provisions; *ii*) as governing norms superseding treaty provisions (most notably because of the hierarchy of peremptory norms, which are of customary nature); and last but absolutely not least *iii*) as governing norms supplementing treaty provisions for questions not addressed by the latter.

Keeping in mind these three forms of interaction may have significant practical implications, as can be shown by reference to the expression of State sovereignty in foreign investment disputes. The third and often neglected form of interaction between treaty and custom is perhaps the only proper avenue for the operation of customary concepts expressing the idea of sovereignty in an actionable manner. This point was emphasised by the tribunal in *AAPL v Sri Lanka*, which is the very decision that recognised arbitration without privity: "[I]t should be noted that the Bilateral Investment Treaty is not a self-contained closed legal system limited to provide for substantive material rules of direct applicability, but it has to be envisaged within a wider juridical context in which rules from other sources are integrated through implied incorporation methods, or *by direct reference to certain supplementary rules*, whether of international law character or of domestic law nature".[54]

I do not question the possibility that the wording of an IIA may displace or exclude certain customary norms (which are not of peremptory nature), including certain actionable concepts expressing the idea of sovereignty. But that is only the case when the parties have specifically intended to do so and one would expect an investment tribunal to analyse whether and to what extent a specific treaty provision (or a set of them) excludes partly or entirely an otherwise applicable customary norm. A tribunal must not avoid such a necessarily fine-grained analysis by merely stating that it is applying the treaty, because treaties are "not a self-contained closed legal system" and their application requires resort to supplementary norms.

One of the most frequent examples of such supplementary norms is provided by the customary rules on treaty interpretation and application codified in the 1969 Vienna

[53] This section relies on my previous work on the topic. See J.E. Viñuales, *Customary Law in Investment Regulation*, in *Italian Yearbook of International Law*, 2013/2014, p. 23; J.E. Viñuales, *Sovereignty in Foreign Investment Law*, in Z. Douglas, J. Pauwelyn, J.E. Viñuales (eds), *The Foundations of International Investment Law*, Oxford: Oxford University Press, 2014, pp. 317-362.

[54] *AAPL v. Sri Lanka*, cit., para. 21 (emphasis added).

Convention on the Law of Treaties (VCLT), although the supplementing role has a wider scope. As noted by the tribunal in *Accession Mezzanine v. Hungary*:

> "There are a few essential points to be made in this context. First, the interpretation and application of the BIT is governed by international law, as is any treaty, and the expropriation clause is, obviously, a key part of the BIT. Second, it may not be possible to consider the scope and content of the term 'expropriation' in the BIT without considering customary and general principles of international law, as well as any other sources of international law in this area [...] The BIT in this case, as in almost all cases, has no definition of 'expropriation' within its text, nor does it contain guidelines that would assist the Tribunal in determining whether or not there has been a compensable taking of property. Expropriation has been and is now part of international law, and the change from dispute resolution under the system of diplomatic protection to investor-state arbitration has not modified that. It is true that BITs have become the most reliable source of law in this area, as have the awards of ICSID, other investor-state tribunals acting under the UNCITRAL Arbitration Rules, and other modern-day tribunals, such as the Iran-U.S. Claims Tribunal, state practice, and writings of scholars. But that is not inconsistent with the continuing relevance of customary and general principles of international law, at least as to BIT obligations that are silent as to scope and content, as well as any other sources of international law with respect to expropriation".[55]

This quotation reflects the tendency of tribunals to look at BITs, in fact IIAs, as "the most reliable source of law in this area" but, at the same time, it highlights that even for questions that are addressed in IIAs, such as expropriation, reference to customary law may still be necessary for interpretive purposes. Thus, under this stance, even if the IIA applies as *lex specialis*, that does not mean that customary law on that very specific point becomes irrelevant. It may apply together with the treaty norm in order to clarify the contents of such norm.[56]

A fortiori, when the applicable treaty does not govern the question expressly, the supplementary role of custom should be expected to be much greater. The overall im-

[55] See ICSID, decision on respondents objection under arbitration rule 41, para. 5, of 16 January 2013, case no. ARB/12/3, *Accession Mezzanine Capital L.P. and Danubius Kereskedohaz Vagyonkezelo v. Hungary*, paras 67-68 (emphasis added).

[56] International Court of Justice, *Legality of the Threat or Use of Nuclear Weapons in Armed Conflict*, advisory opinion of 8 July 1996, para. 25 ("The Court observes that the protection of the International Covenant of Civil and Political Rights does not cease in times of war, except by operation of Article 4 of the Covenant whereby certain provisions may be derogated from in a time of national emergency. Respect for the right to life is not, however, such a provision. In principle, the right not arbitrarily to be deprived of one's life applies also in hostilities. The test of what is an arbitrary deprivation of life, however, then falls to be determined by the applicable *lex specialis*, namely, the law applicable in armed conflict which is designed to regulate the conduct of hostilities. Thus whether a particular loss of life, through the use of a certain weapon in warfare, is to be considered an arbitrary deprivation of life contrary to Article 6 of the Covenant, can only be decided by reference to the law applicable in armed conflict and not deduced from the terms of the Covenant itself").

port of a treaty may still be understood as displacing or excluding custom, but one would expect at the very least this reasoning to be sufficiently spelt out in a tribunal's decision, rather than simply assumed. Yet, as I will discuss next in the light of two examples, there is still significant room for improvement in this area. Tribunals have indeed tended to assume that treaties displace the customary concepts expressing sovereignty or, in other words, even for matters not addressed in the treaty, they have disregarded the possible combined application of treaty and custom (which, as discussed earlier, other tribunals have confidently asserted for customary norms that specifically address the same matter as the applicable treaty provision). Understanding the supplementary role of custom, and its misapplication in the investment context, is important in my view not only because IIAs rarely address the extent of a State's regulatory powers explicitly but also because, when they do so (e.g. through reservations on public emergency or environmental regulatory powers) this is not to be considered as supplanting the customary norms expressing State sovereignty.

V.2. The police powers doctrine

Different understandings of the relations between treaty and custom, with the attendant consequences for the expression of sovereignty in foreign investment disputes, can be found at the roots of parallel stances on the operation of the police powers doctrine. This concept is widely recognised in international (investment) law and it essentially emphasises the duty and power of States to regulate for the public good, even if that has adverse economic consequences for individuals and companies. Given its relevance for the disputes that arise in connection with foreign investment transactions, it has been frequently applied in investment proceedings, sometimes to dispose of a claim.[57] The customary basis of this concept is unanimously recognised in the body of cases that I have just referred to, either explicitly or implicitly (e.g. through a reference to "general international law"). One frequently quoted precedent is the award of the tri-

[57] See e.g. UNCITRAL Arbitration Proceedings, partial award of 13 September 2001, *CME Czech Republic B.V. v. Czech Republic*, para. 603; ICSID, award of 16 December 2002, case no. ARB(AF)/99/1, *Marvin Roy Feldman Karpa v. United Mexican States*, paras 103 and 112; UNCITRAL Arbitration Rules, partial award of 17 March 2006, *Saluka Investments B.V. v. The Czech Republic*, paras 253-265; UNCITRAL Arbitration Rules, award of 24 December 2007, *BG Group Plc. v. Republic of Argentina*, para. 268; UNCITRAL Arbitration Rules, decision on liability of 30 July 2010, *AWG Group Ltd. v. Argentine Republic*, paras 149-150. ICSID: decision on liability of 27 December 2010, case no. ARB/04/01, *Total S.A. v. Argentine Republic*, para. 197; ICSID, award of 7 July 2011, case no. ARB/07/6, *Tza Yap Shum v. Republic of Peru*, para. 145; ICSID, award of 31 October 2011, case no. ARB/03/15, *El Paso Energy International Company v. Argentine Republic*, paras 236-241, as well as para. 243; Permanent Court of Arbitration, award (redacted) of 14 February 2012, *Les Laboratoires Servier, S.A.S., Biofarma, S.A.S., Arts et Techniques du Progres S.A.S. v. Republic of Poland*, paras 569-570, as well as para. 584; ICSID, decision on jurisdiction and liability of 6 June 2012, case no. ARB/04/4, *SAUR International S.A. v. Argentine Republic*, paras 396-401; ICSID, award of 19 December 2013, case no. ARB/10/23, *TECO Guatemala Holdings, LLC v. Republic of* Guatemala, para. 490-493.

bunal in *Saluka v. Czech Republic*, where it is stated that: "the principle that a State does not commit an expropriation and is thus not liable to pay compensation to a dispossessed alien investor when it adopts general regulations that are 'commonly accepted as within the police powers of States' forms part of customary law today".[58]

This case is of some interest for my discussion not only because it is an oft-cited *locus* of the police powers doctrine, which was effectively applied *in casu*,[59] but also because it illustrates one stance on the interaction between treaty and custom as it relates to the operation of the police powers doctrine. Indeed, the tribunal's reasoning implies that the customary norm could only be applied if it has been incorporated into the applicable treaty:

> "The Tribunal acknowledges that Article 5 of the Treaty [an expropriation clause] in the present case is drafted very broadly and does not contain any exception for the exercise of regulatory power. However, in using the concept of deprivation, Article 5 *imports into the Treaty the customary international law notion that a deprivation can be justified if it results from the exercise of regulatory actions aimed at the maintenance of public order*".[60]

Taken out of context, this statement would be questionable. The application of the police powers doctrine, which is a customary norm, does not depend upon a clause incorporating it into the treaty, unless the treaty otherwise excludes the application of relevant customary law. Indeed, for a directly relevant and widely recognised customary norm not to apply, there must be a *lex specialis* clearly excluding its application. However, the tribunal barely addressed the *lex specialis* question. Moreover, a relevant customary norm may continue to apply to shape the content of the applicable treaty provision, as in the *Accession Mezzanine v. Hungary* case. This is what the *Saluka* tribunal suggested – thereby clarifying its reasoning – when it referred, in the same paragraph, to Art. 31, para. 3, let. c), VCLT: "[i]n interpreting a treaty, account has to be taken of 'any relevant rules of international law applicable in the relations between the parties' – a requirement which the International Court of Justice ('ICJ') has held *includes relevant rules of general customary international law*".[61]

This statement is certainly correct, but it misses four important points, namely *i*) that customary law does not require "incorporation" to be taken into account, *ii*) that it may be taken into account not only for "interpretation" purposes but also *iii*) to govern a situation which is not specifically addressed in the treaty and, above all, *iv*) that there are no legal grounds to assume – without further and specific reasoning to this effect – that a treaty not addressing a given question nevertheless acts as *lex specialis* – and in

[58] *Saluka v. Czech Republic*, cit., para. 262.
[59] *Ibid.*, para. 265.
[60] *Ibid.*, para. 254 (emphasis added).
[61] *Ibid.* (emphasis added).

the very specific form of exclusionary *lex specialis* – with respect to a customary norm that specifically addresses such a question.

This implicit stance on the relations between custom and treaty is far from innocuous because the police powers doctrine is one of the main legal expressions of sovereignty relevant for investment disputes. The stance in *Saluka* on this point can be contrasted with the position of the tribunal in *Chemtura v. Canada*. Relying on the recognition of the doctrine in *Saluka*, the tribunal in *Chemtura* simply stated that the norm applied with the result that the Canadian measure challenged by the investor was a valid exercise of Canada's police powers.[62] There is no discussion, in this context, of whether the applicable treaty incorporates the customary norm or not. The customary norm was deemed applicable and it effectively provided a ground (in addition to the absence of a substantial deprivation) to reject the expropriation claim brought by the investor.

As in previous sections, my purpose in discussing these cases is to emphasise that the analysis should be conducted at the level of these stances or positions as well as focus on their implications for the broader context of international investment proceedings. One major implication is the room left to the customary expression of sovereignty by sometimes implicit and uncritical understandings of the role of treaties or, more specifically, by an over-reliance upon them to the detriment of customary law. In the next section, I will provide another example of this difficulty by reference to two opposing stances followed by tribunals with respect to operation of countermeasures as a circumstance precluding wrongfulness.

V.3. Countermeasures

The availability and operation of countermeasures as a circumstance precluding wrongfulness recognised in customary international law provides another example of the phenomenon illustrated in the previous section. Investment tribunals have taken different stances on this question, with potentially profound implications for international investment law and, more generally, for the SIP triangle. In at least three cases,[63] the respondent State invoked the doctrine of countermeasures, as codified in Art. 22 of the

[62] See e.g. UNCITRAL Arbitration Rules, award of 2 August 2010, *Chemtura Corporation (formerly Crompton Corporation) v. Government of Canada*, para. 266 ("[T]he Tribunal considers in any event that the measures challenged by the Claimant constituted a valid exercise of the Respondent's police powers. As discussed in detail in connection with Article 1105 of NAFTA, the PMRA took measures within its mandate, in a non-discriminatory manner, motivated by the increasing awareness of the dangers presented by lindane for human health and the environment. A measure adopted under such circumstances is a valid exercise of the State's police powers and, as a result, does not constitute an expropriation").

[63] See ICSID: award of 21 November 2007, case no. ARB(AF)/04/5, *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. United Mexican States*, paras 116-180; decision on responsibility of 15 January 2008, case no. ARB(AF)/04/1, *Corn Products International Inc. v. United Mexican States,* paras 145-149 as well as paras 153-192; award of 18 September 2009, case no. ARB(AF)/05/2, *Cargill, Incorporated v. United Mexican States*, paras 379-430.

ILC Articles on State Responsibility,[64] to justify a breach of an IIA (chapter 11 of the 1994 North American Free Trade Agreement, hereinafter NAFTA). The three tribunals recognised the customary grounding of the doctrine,[65] but they followed two parallel stances on its applicability, relying in this regard on different understandings of investment protection standards.

In *ADM v. Mexico*, the claimant argued that a tax on certain soft drinks and syrups was in breach of chapter 11 of the NAFTA. As part of its defence, Mexico argued that the measure was a lawful countermeasure arising from a prior breach by the United States, the claimant's home State. The tribunal analysed the relations between treaty and custom in the specific context of whether the NAFTA was a *lex specialis* excluding the customary doctrine of countermeasures. It concluded that such was not the case and, as a result, the doctrine remained applicable:

> "Chapter Eleven neither provides nor specifically prohibits the use of countermeasures. Therefore, the question of whether the countermeasures defence is available to the Respondent is not a question of *lex specialis*, but of customary international law [.] Under customary international law, '…the wrongfulness of an act of a State not in conformity with an international obligation towards another State is precluded if and to the extent that the act constitutes a countermeasure….' (Article 22 of the ILC Articles). Countermeasures may constitute a valid defence against a breach of Chapter Eleven insofar as the Respondent State proves that the measure in question meets each of the conditions required by customary international law, as applied to the facts of the case [.] The only instance in which the NAFTA refers to countermeasures is under Article 2019. Under this provision, non-compliance with a decision rendered in a Chapter Twenty State-to-State arbitration can lead to penalties. In the event of such non-compliance, the complaining State can retaliate by taking countermeasures suspending tariff concessions or other obligations under the treaty. *Outside Article 2019, the NAFTA makes no express provision for countermeasures. Accordingly, the default regime under customary international law applies to the present situation* [.] *The Tribunal therefore agrees with Respondent that countermeasures may serve as a defence under a Chapter Eleven case, as this is a matter not specifically addressed in Chapter Eleven, but valid under customary international law if certain conditions are met*".[66]

The reasoning of the tribunal provides a clear illustration of the supplementary role of customary law with respect to matters that are not specifically regulated by the applicable treaty. Significantly, the tribunal noted that in the context of Art. 2019, the NAFTA contained a *lex specialis* regime that displaced the customary one. But no such regime was

[64] International Law Commission, Draft Articles on State Responsibility for Internationally Wrongful Acts of 3 August 2001, UN Doc. A/56/10.

[65] *ADM v. Mexico*, cit., paras 125-126; *Corn Products v. Mexico*, cit., para. 145; *Cargill v. Mexico*, cit., para. 420.

[66] *ADM v. Mexico*, cit., paras 120-123 (emphasis added).

organised by chapter 11 of the NAFTA and, therefore, there was no basis to exclude the default regime of customary international law. *In casu*, the tribunal did not consider that the requirements of the customary doctrine of countermeasures were met. But for present purposes, the main point is that this doctrine was effectively applicable.

This position contrasts with the stance taken by two other tribunals in disputes with similar factual circumstances. In these disputes, the doctrine of countermeasures was deemed to be applicable only to inter-State relations. As chapter 11 of the NAFTA organises a regime of investment protection standards specifically governing the relations between private parties and host States, countermeasures had no role to play in this context. As noted by the tribunal in *Corn Products v. Mexico*:

> "The Tribunal has concluded, however, that the doctrine of countermeasures, devised in the context of relations between States, is not applicable to claims under Chapter XI of the NAFTA. Those claims are brought by investors, not by States. A central purpose of Chapter XI of the NAFTA was to remove such claims from the inter-State plane and to ensure that investors could assert rights directly against a host State. *The Tribunal considers that, in the context of such a claim, there is no room for a defence based upon the alleged wrongdoing not of the claimant but of its State of nationality, which is not a party to the proceedings* [.] *The Tribunal therefore concludes that the investor, such as CPI, has rights of its own under Chapter XI of the NAFTA. As such, it is a third party in any dispute between its own State and another NAFTA Party and a countermeasure taken by that other State against the State of nationality of the investor cannot deprive that investor of its rights. To revert to the two different examples given by the ILC in its Commentary on Article 49(1), this is a case involving the rights of a third party and not merely its interests*. Mexico owed obligations to CPI under Chapter XI of NAFTA which were separate from the obligations it owed to the United States under the NAFTA as a whole. *Even if the doctrine of countermeasures could operate to preclude the wrongfulness of the HFCS tax vis-à-vis the United States (and, for the reasons given below, the Tribunal makes no comment on that question), they cannot do so vis-à-vis CPI".*[67]

The reason given by the tribunal is not, at least explicitly, based on the *lex specialis* principle but on the general inapplicability of the doctrine of countermeasures to relations between private parties and States. But the implications of such a position are far-reaching and, in my view, very questionable. Firstly, it amounts in practice to consider that chapter 11 is a more general type of *lex specialis*, insulating the full set of relations between investors and host States from at least part of general international law.[68] Second-

[67] *Corn Products v. Mexico*, cit., paras 161 and 176 (emphasis added).

[68] In the other decision relating to the same facts, the arbitration tribunal stated that the doctrine of countermeasures could still be opposed to the investor's home State if it sought to exercise diplomatic protection. This is correct but it amounts to considering the entire set of investor-home State relations as a separate field where inter-State customary law would be of selective application. See *Cargill v. Mexico*, cit., para. 424 ("The Tribunal agrees with Respondent that if a State, through diplomatic protection, were to espouse the claims of its nationals damaged by a legitimate countermeasure, then that countermeas-

ly, the tribunal is assuming that investors have rights of their own under an investment treaty. Yet, investment treaties have been the primary example of a synallagmatic treaty, whereby the advantages that one State confers to the investors of another State are contingent on the latter's granting similar advantages to the investors of the former. This point was made as early as in 1970 in the famous paragraph 33 of the *Barcelona Traction* case and reiterated by the Inter-American Court of Human Rights in 2006.[69] Thirdly, the tribunal further states that the "rights" of a third party (the investor) are at stake, not merely its interests. To understand the implications of using this terminology, one must recall our previous discussion of the considerable expansion that such "rights" have received in a strand of the investment jurisprudence relating to shareholder claims.

Stance by stance, whether deliberately or – perhaps more likely – unconsciously, the investment case law has pushed the protection of investors to the very limits of what the system's architecture could ever permit. This point is critical. The balloon has been inflated by the accumulation of expansive – and unconsidered – stances up to a close-to-bursting point. Critique that addresses legitimacy issues without identifying specifically the mechanisms that have to be adjusted to defuse the potential crisis of the system is useful but faces a major problem: what is to be done? This is, in my view, why the level of analysis has to be adjusted to look at stances, rather than mere cases or rules, and their implications. Stances in the investment case law are important (perhaps the most important) micro drivers of the overall dynamics of the system, with the attendant broader implications for the protection of other interests and values.

ure would preclude the wrongfulness of the act that otherwise would have entailed State responsibility and the claims would be denied. In the case of diplomatic espousal, however, the claim is owned by the espousing State and the espousing State is the named party. Moreover, the operative paragraph of the resulting award reciting the decision of the tribunal names the espousing State, and not the national".)

[69] See e.g. *Barcelona Traction,* cit., para. 33 ("When a State admits into its territory foreign investments or foreign nationals, whether natural or juristic persons, it is bound to extend to them the protection of the law and assumes obligations concerning the treatment to be afforded them. These obligations, however, are neither absolute nor unqualified. In particular, an essential distinction should be drawn between the obligations of a State towards the international community as a whole, and *those arising vis-à-vis another State in the field of diplomatic protection*" (emphasis added); Inter-American Court of Human Rights, judgment of 29 March 2006, Series C no. 146, *Sawhoyamaxa indigenous community c. Paraguay*, paras 136, 137 and 140 ("The State has put forth three arguments: [...] 3) that the owner's right 'is protected under a bilateral agreement between Paraguay and Germany[,] which [...] has become part of the law of the land' [...] Lastly, with regard to the third argument put forth by the State, the Court has not been furnished with the aforementioned treaty between Germany and Paraguay, but, according to the State, said convention allows for capital investments made by a contracting party to be condemned or nationalized for a 'public purpose or interest', which could justify land restitution to indigenous people. Moreover, the Court considers that *the enforcement of bilateral commercial treaties negates vindication of non-compliance with state obligations under the American Convention; on the contrary, their enforcement should always be compatible with the American Convention, which is a multilateral treaty on human rights that stands in a class of its own and that generates rights for individual human beings and does not depend entirely on reciprocity among States*", emphasis added).

VI. Concluding observations

To conclude these lectures, I would like to recall the main point that I have made by reference to some illustrations derived from the investment case law, namely that, as legal scholars, we should focus our efforts on identifying the parallel stances or converging principles that arise from the jurisprudence as well as on understanding, to the best of our abilities, their broader implications. This point has implications for legal scholarship, teaching and practice.

As legal scholars, we carry the main responsibility for looking at the wider body of case law, from investment tribunals but also from other international *fora*, and distilling the essential stances that arise from it. It is only once these stances have been identified that their legal and policy implications can be explored, both for other issues within the investment case law (e.g. the role of "economic reality" which is used, on the one hand, to disregard corporate structures and facilitate indirect shareholder claims while, on the other hand, it is deemed of limited relevance when it comes to distinguishing treaty and contract claims) and for the wider SIP triangle (e.g. the laws deemed to be relevant to assess the initial legality of an investment or investor diligence). If legal scholars do not perform this task, it is highly unlikely that practitioners will. By their very profession, they are expected to argue a specific stance, not to seek objectively what is the state of the law. As for arbitrators, they may to some extent identify stances, but their position is difficult because their role is not one of scholarship, despite the frequent *obiter dicta* one finds in the case law, but one of deciding specific disputes, which are much more influenced by factual and intra-tribunal considerations.

In turn, it is only through the distillation effort conducted by legal scholars that the teaching of international investment law will be made more sensitive to the impact of stances as micro drivers of the system as well as to their implications. Rather than merely discussing a limited set of representative cases advancing different solutions, our teaching could greatly benefit from understanding both the overall import of the case law and its doctrinal and policy implications. It is only by making future academics and practitioners aware of *i*) these stances, *ii*) their impact as micro drivers of the system and *iii*) their implications for other values and interests, that excessive solutions will be corrected or abandoned and the pendulum will swing towards the centre, rather than towards the opposite extreme.

Last but not least, as an arbitrator and practising lawyer, I am aware of the many constraints involved in deciding and arguing a case, but I nevertheless believe that arbitrators should make an effort to consider more critically and fully the implications of the stances they take on specific issues. What may be appropriate in the specific circumstances of one case may also give rise to a range of unintended consequences capable of driving the system off the road or of greatly undermining its legitimacy. Such implications should be anticipated as much as possible and considered in the reasoning leading to a given stance. The stance may remain the same, but more nuance in the reason-

ing may serve as a safeguard against future incoherence or abuse. For such implications to be adequately taken into account by arbitrators, the role of legal scholars is, again, of particular importance. The impact of scholarship may be subject to a diffuse, indirect and perhaps frustrating form of causality, affecting the system through distillation, turned into teaching, turned into increasingly "common" sense, and ultimately on "majority views". But this is not new. As in many other areas, sometimes we must be modest in order to be ambitious.